THE STATE OF SOUTH CAROLINA

In The Court of Appeals

APPEAL FROM GREENVILLE COUNTY
Court of Common Pleas

Letitia H. Verdin, Circuit Court Judge

Case No. 2011-CP-23-02028

Precision Walls, Inc. ..... Appellant,

v.

Liberty Mutual Fire Insurance Co. ..... Respondent.

FINAL REPLY BRIEF OF APPELLANT

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I. Liberty Mutual's arguments against coverage are premised upon misconceptions regarding the scope of coverage under Commercial General Liability policies.

Throughout its brief, Liberty Mutual intersperses misleading dicta from insurance coverage cases that Commercial General Liability ("CGL") insurance policies, such as the one issued to Precision Walls by Liberty Mutual, only cover tort liability of the insured. Liberty Mutual then follows this with the argument that to construe CGL policies otherwise would, in effect, convert them into performance bonds. For the reasons explained below, neither of these propositions is accurate and they only serve to distract courts from engaging in a proper analysis of the scope of coverage under CGL polices.

A. The CGL Policy covers more than just tort claims.

One need only read the opening language of the insuring agreement of a standard CGL policy to understand that the scope of coverage of the policy is not dependent upon any distinction between tort or contract liability of the insured. The relevant language is as follows:

> **SECTION I – COVERAGES**
>
> **COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY**
>
> **1. Insuring Agreement**
>
> a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. . . .

(Liberty Mutual Ex. 1, Section I—Coverages; R. p. 169)

Precision Walls acknowledges that South Carolina's appellate courts have, in dicta, made the statement that CGL policies are intended to cover tort liability of the insured rather than contractual liability for economic loss. *See e.g. L-J, Inc. v. Bituminous Fire and Marine Ins. Co.,* 366 S.C. 117, 122, 621 S.E.2d 33, 36 (2005). The problem with this statement is that it has caused courts to stray from a straightforward analysis of the terms of the CGL policy's insuring agreement and focus instead on the legal nature of the insured's liability (i.e. tort versus contract). It is ironic that some courts have latched on to this distinction considering the fact that the term "tort" does not even appear in the standard CGL policy. *See American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65, 76-78 (Wis. 2004). Moreover, the plain language of the insuring agreement makes it clear that the insurer will pay those sums that the insured becomes **legally obligated** to pay without any distinction as to whether the liability arises in tort or contract.

The genesis for the current misperception of the CGL policy's scope of coverage is a 1971 law review article written by Dean Roger Henderson regarding insurance coverage under a version of a standard CGL policy which has long been outdated. *See Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know,* 50 Neb. L.Rev. 415 (1971). In this article, Dean Henderson wrote that "[t]he coverage [under a CGL policy] is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained." *Id.* at 441. This quote from Dean Henderson's law review article has been misconstrued and misapplied many times over the years likely

starting with the New Jersey Supreme Court's opinion in *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979). It is important to note several things about the *Weedo* case since insurance carriers continue to rely upon and cite this case in coverage disputes as Liberty Mutual has done in its brief.[1] First, the *Weedo* court was construing the scope of coverage under the terms of the 1966 version of the standard CGL policy which have been substantially and materially revised since that time. *See Weedo*, 405 A.2d at 790 n. 1; *see also American Girl, Inc.*, 673 N.W.2d at 76-78 (discussing *Weedo* and its interpretation of pre-1986 CGL policy terms). Second, the *Weedo* court never discussed the insuring agreement's initial grant of coverage; instead, the court decided the coverage issue on the basis of the policy's **exclusions**. *See American Girl, Inc.*, 673 N.W.2d at 76-78, discussing *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979). In fact, the *Weedo* court stated that "but for the exclusions in the policy, coverage would obtain. . . ." *American Girl, Inc.*, 673 N.W.2d at 76-78, *quoting Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788, 790 n. 2 (N.J. 1979). Therefore, as the Supreme Court of Wisconsin astutely noted in *American Girl*, "*Weedo* does not hold that losses actionable as breaches of contract cannot be [covered under post-1986 CGL policies]." *American Girl, Inc.*, 673 N.W.2d at 76-77.

An examination of a recent South Carolina case on the scope of coverage for CGL policies demonstrates that our courts have recognized that the legal nature of the

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[1] Liberty Mutual cites the opinion of the South Carolina Court of Appeals in *C.D. Walters Constr. Co. v. Fireman's Ins. Co. of Newark*, 281 S.C. 593, 316 S.E.2d 709 (Ct. App. 1984) ostensibly for a "cogent explanation" of the difference between "business risks" and "insurable risks." *See* Brief of Respondent at p. 14. However, the quote set forth in Liberty Mutual's brief from the *C.D. Walters* opinion is taken directly from the *Weedo* opinion where the *Weedo* court is quoting directly from Dean Henderson's law review article. *See American Girl, Inc.*, 673 N.W.2d 65, 76-78. Moreover, *C.D. Walters* also involved the interpretation of a pre-1986 CGL policy rendering it outdated and inapplicable to the analysis of post-1986 CGL policies. *See Auto Owners Ins. Co. v. Newman*, 385 S.C. 187, 195, 684 S.E.2d 541, 545 n. 2 (2009)(noting that *C.D. Walters* was distinguishable from instant case because it was analyzing pre-1986 CGL policy).

claim against the insured is not determinative of whether coverage exists under the insuring agreement. In *Auto Owners Ins. Co. v. Newman*, 385 S.C. 187, 684 S.E.2d 541 (2009), our state Supreme Court affirmed the trial court's finding that the homebuilder's CGL policy covered the claims asserted against a homebuilder by the homeowner. The homeowner sought damages for defective construction involving the home's stucco siding based upon claims for breach of contract, breach of warranty, and negligence against the homebuilder. *Id.* The *Newman* court correctly analyzed coverage under the insuring agreement of the CGL policy without regard to whether the insured's liability to the homeowner was based in tort or contract. Moreover, the *Newman* court also recognized that the 1986 amendments to standard CGL policies provide for a broad grant of coverage under the insuring agreement which is then reduced through certain policy exclusions relating to the insured's own work product. *See Newman*, 385 S.C. at 195-196, 684 S.E.2d at 545; *see also American Girl, Inc.*, 673 N.W.2d at 74 ("[t]he CGL insuring agreement is a broad statement of coverage, and insurers limit their exposure to risk through a series of specific exclusions."). The CGL policy's exclusions are where the insured's own work product becomes an issue, not in the initial grant of coverage under the insuring agreement.

As set forth above, the sun has set on Dean Henderson's tort versus contract distinction as perpetuated by *Weedo* and its progeny. The CGL policy insuring agreement makes no such distinction and it simply does not exist. Accordingly, in this instance, the fact that Precision Walls' loss arises out of its contractual liability to

its general contractor, SYS Constructors, is simply not relevant as it relates to whether coverage exists under the CGL policy's insuring agreement.

B. Finding that the insuring agreement can cover contract claims as well as tort claims will not turn the standard CGL policy into a performance bond.

Just as with the tort versus contract distinction for covered losses under a CGL policy, courts have made comments in coverage cases to the effect that covering claims arising out of the insured's contractual liability would act to transform the CGL policy into a performance bond. *See e.g. L-J, Inc. v. Bituminous Fire and Marine Ins. Co.*, 366 S.C. 117, 621 S.E.2d 33 (2005). It is unfortunate that some courts have latched on to this argument because it is misleading and untrue.

In order to understand the fallacy in comparing CGL policies to performance bonds, it is instructive to examine the nature and purpose of a performance bond which is simply a type of surety bond. The South Carolina Supreme Court provided an excellent description of the nature of a performance bond in the case of *Masterclean, Inc. v. Star Ins. Co.*, 347 S.C. 405, 556 S.E.2d 371 (2001). The *Masterclean* court described the performance bond as follows:

> A surety bond, unlike insurance, is used to obtain a commercial advantage. 'The principal does not seek protection from the surety against calamity ... the principal seeks the commercial advantage of obtaining a contract with the obligee, which requires a performance or payment bond.' . . . . The state [South Carolina] requires performance bonds for public construction contracts to protect itself from a principal's breach. The principal obtains the bond merely for the economic advantage of competing for the contract. There is no objective economic reason why a principal would voluntarily choose to provide a bond since it still bears the burden of performing and indemnifying the surety for any default.

Masterclean, Inc., 347 S.C. at 413, 556 S.E.2d at 376 (internal citations omitted). Thus, unlike a CGL insurance policy, a performance bond is designed to protect the obligee not the principal. *See id.* Under a performance bond, it is the principal who owes the surety a duty to indemnify the surety for any payments made or losses incurred by the surety on the payment bond.

With this background in mind, there is simply no way that finding that coverage for certain losses arising from an insured's contractual obligations change the status of the CGL insurer to that of a surety on a performance bond. Under the CGL policy, it is the insurer that owes the insured a duty of indemnity for covered losses. Conversely, on a performance bond, it is the principal who owes a duty of indemnity to the surety. In fact, the very foundation of this relationship is based upon the concept that the surety will never be made to ultimately pay for the default of its principal as it will be indemnified in full by the principal for the discharge of its obligations on the bond. Moreover, as set forth in *Masterclean*, *supra*, the performance bond is primarily for the benefit of the obligee on the bond rather than the principal while a CGL policy is primarily for the benefit of protecting the insured against certain defined risks. So when courts loosely analogize coverage for losses arising out of an insured's contractual liability under CGL policies to performance bonds, they are erroneously focusing on the perceived benefit that an insured would receive by being treated like a principal on a performance bond. Yet, as discussed above, there is no benefit to being the principal on a performance bond in a default situation. To the contrary, there is only an obligation to indemnify the surety for its

discharge of its obligations under the performance bond which cannot be reasonably compared to the status of an insured on a claim covered by its CGL policy.

By examining the duties and obligations of the principal and surety under performance bonds, it is clear that they are so fundamentally different than those of the insured and insurer under a CGL policy that there can be no comparison between a performance bond and a CGL policy. To attempt to compare them only detracts from a proper coverage analysis which should be focused on applying the underlying facts to the terms of the CGL policy's insuring agreement and exclusions.

II. Liberty Mutual erroneously relies on cases dealing with diminution in value claims, CGL policy exclusions, and outdated versions of CGL policies in support of its argument that the facts of this case do not establish "property damage" under the insuring agreement.

In support of its argument that Precision Walls' claim is not for "property damage," Liberty Mutual engages in an extensive discussion of cases from various jurisdictions dealing with whether diminution in value of property alone, without any accompanying physical injury, constitutes property damage. *See* Brief of Respondent at pp. 14-16, *citing Auto-Owners Ins. Co. v. Carl Brazell Builders, Inc.,* 356 S.C. 156, 588 S.E.2d 112 (2003); *New Hampshire Ins. Co. v. Vieira,* 930 F.2d 696 (9th Cir. 1991); *Travelers Ins. Co. v. Eljer Manufacturing, Inc.*, 757 N.E.2d 481 (Ill. 2001). While these cases decided that diminution in property value without accompanying physical injury did not constitute property damage under the applicable CGL policy, that analysis is irrelevant and of no help to the Court in this instance. Precision Walls' claim is not based on diminution in value of the property. The claim is for third party property damage for which Precision Walls' was legally obligated to pay.

Liberty Mutual further erroneously relies upon a case dealing with CGL policy exclusions in support of its argument that the facts of this case did not establish "property damage" under the CGL policy's insuring agreement. Unfortunately, insurers have caused much confusion over the years, especially in coverage cases litigated in the appellate courts of this State, by advancing arguments that involve moving concepts set forth in the CGL policy exclusions to the analysis of terms such as "occurrence" and "property damage" located in the insuring agreement of the CGL policy. *See e.g. Auto Owners Ins. Co. v. Newman,* 385 S.C. 187, 684 S.E.2d 541 (2009); *Crossman Communities of North Carolina, Inc. v. Harleysville Mutual Ins. Co.,* 395 S.C. 40, 717 S.E.2d 589 (2011). So it is here as Liberty Mutual relies upon the case of *Jacob v. Russo Builders,* 592 N.W.2d 271 (Wis. 1999) in support of its argument that there is no "property damage" under the CGL's policy's insuring agreement. *See* Brief of Respondent at pp. 16-17. However, that case involved the application of certain policy exclusions to defeat coverage for certain parts of the insured's claim. *See Jacob v. Russo Builders,* 592 N.W. 2d 271. In order to get to policy exclusions, there must first be a finding that the insured's claim invokes coverage under the CGL policy's insuring agreement. Therefore, this case is simply inapplicable and of no value in analyzing whether the facts of this case establish "property damage" under the insuring agreement.

Lastly, Liberty Mutual cites the case of *Fireman's Ins. Co. of Newark v. National Union Fire Ins. Co.,* 904 A.2d 754 (N.J. Super. Ct. App. Div. 2006) for the proposition that repair or replacement of defective work that has not caused "physical injury to tangible property" aside from the repair work itself is not covered under the

standard CGL policy. *See* Brief of Respondent at pp. 16-17. However, this case is inapplicable in several key respects. First, all of the CGL policies at issue were the 1973 version of the standard CGL policy issued by the Insurance Services Office which has long been outdated. *See Fireman's Ins. Co. of Newark,* 904 A.2d at 757. Second, the court relied heavily on the outdated analysis of *Weedo v. Stone-E-Brick, Inc.,* 405 A.2d 788, 790 n. 2 (N.J. 1979), in support of its holding.[2] *See id.* at 758. Lastly, as opposed to the claim of Precision Walls which involves third-party property damage to non-defective work, the *Fireman's* court found that the claim in that matter did not involve damage to property other than to the defective work itself. *See id.* at 760. Therefore, as it relates to the coverage analysis in this case, there is no value in a New Jersey case applying a coverage analysis to pre-1986 CGL policies based upon materially different facts.

III. The South Carolina Supreme Court's recent opinion in *Auto-Owners v. Rhodes* conclusively establishes that the facts presented in this case constitute an "occurrence" under the CGL policy insuring agreement.

Liberty Mutual attempts to distinguish the South Carolina Supreme Court's holding in *Crossman Communities of North Carolina, Inc. v. Harleysville Mutual Ins. Co.,* 395 S.C. 40, 717 S.E.2d 589 (2011), regarding the definition of the policy term "occurrence" on the basis that *Crossman* involved a claim for progressive property damage while Precision Walls' claim is not one for progressive property damage. While such a distinction is strained at best, it is of no moment after the recent opinion from the South Carolina Supreme Court in *Auto-Owners Ins. Co. v. Rhodes,* Opinion No. 27316 (S.C. Sup. Ct. filed September 25, 2013). In *Rhodes*, the court was "confronted with the question of whether *Crossman's* expansive view of an

[2] See pp. 2-3, *supra.*

'occurrence' is limited to progressive property damage cases." *Id.* The plaintiff in *Rhodes* was an individual who owned several large outdoor advertising signs on his property in Fairfield County adjacent to Interstate 77. *Id.* The defendants were the company that designed and constructed the signs as well as the principal owner of the company who were insured under a CGL policy by Auto-Owners. *Id.* One of the signs fell across Interstate 77 blocking traffic. *Id.* As a result of this, the South Carolina Department of Transportation ("SCDOT") ordered Rhodes to take down the remaining two signs. *Id.* After considering the implications of *Crossman*, the *Rhodes* court found that the fallen sign constituted an "occurrence" that triggered coverage under the CGL policy even as to the remaining two signs. *Id.* In so finding, the court applied a "but for" causal analysis reasoning that were it not for the first sign falling, there would have been no SCDOT mandate to remove the remaining two signs. *Id.* Therefore, the *Rhodes* court extended the application of *Crossman* to the "occurrence" analysis in situations such as the one in this case which do not involve the traditional progressive property damage found in most construction defect cases.

Applying this same analysis to the facts of this case, there can be no doubt that there is an "occurrence." "But for" the defective tape losing its adhesion and coming loose at the insulation board joints, there would have been no need to tear down the brick veneer wall. Therefore, after the recent opinion in *Rhodes,* it is clear that the trial court's ruling as to the issue of whether there is an "occurrence" must be reversed.

IV. Liberty Mutual avoids addressing the plain language of policy Exclusion "j(6)" because it clearly renders this policy exclusion inapplicable under the facts of this case.

In support of its argument as to why Exclusion "j(6)" applies, Liberty Mutual offers no resistance to Precision Walls' argument that Exclusion "j(6)" cannot apply here because it requires that Precision Wall's defective work must have been performed **on** the property that must be repaired or restored. That means that Precision Wall's defective work (i.e. the defective joint tape) had to have been performed on the damaged property (i.e. the brick veneer wall) in order for Exclusion "j(6)" to apply. As the facts here clearly demonstrate, that was not the case as the brick veneer wall was constructed by the masonry subcontract **after** Precision Walls had taped the insulation joints. While Liberty Mutual is free to ignore this argument, this Court cannot ignore this critical requirement of Exclusion "j(6)." The trial judge erred in finding that this exclusion applied and the plain facts of this case require reversal on this ruling.

V. Exclusion "m" does not apply because the brick veneer wall does not meet the policy definition of "impaired property."

Despite not seeking a ruling on the application of Exclusion "m" to the facts of this case by way of post-trial motion, Liberty Mutual now argues as an additional sustaining ground that this policy exclusion applies to bar coverage. To the extent that this issue has been preserved for review, the facts of this case demonstrate that there is no "impaired property" rendering the exclusion inapplicable. In reviewing the application of policy exclusions, courts are bound by the fundamental principles that "[p]olicies are construed in favor of coverage, and exclusions in an insurance

policy are construed against the insurer." *M & M Corp. of S. Carolina v. Auto-Owners Ins. Co.*, 390 S.C. 255, 259, 701 S.E.2d 33, 35 (2010).

Exclusion "m" to the CGL policy at issue here, commonly known as the "impaired property exclusion," applies only to "property damage" to "impaired property." (Liberty Mutual Ex. 1 Section I—Coverages, part 2—Exclusions-subpart m; R. p. 225) The key analysis as to this exclusion is whether the brick veneer wall meets the policy definition of "impaired property." It does not. The policy defines "impaired property" as follows:

> 8. "Impaired Property" means tangible property, other than "your product" or "your work" that cannot be used or is less useful because:
>
> a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or
>
> b. You have failed to fulfill the terms of a contract or agreement;
>
> **if such property can be restored to use** by the repair, replacement, adjustment or removal of "your product" or "your work" or your fulfilling the terms of the contract or agreement.

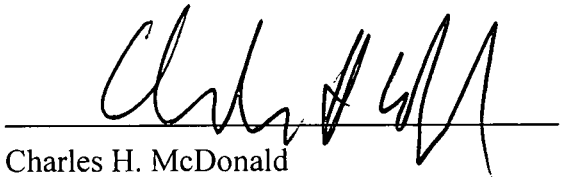
(Liberty Mutual Ex. 1 Section V—Definitions-part 8 (emphasis added); R. p. 233)

The relevant inquiry becomes whether the brick veneer wall could be restored to use by the repair of the defective tape. If so, then it could be "impaired property". If not, then it cannot be "impaired property." Clearly, the brick veneer wall could not be restored to use by Precision Walls' removing and re-applying the joint sealing tape. It had to be rebuilt after such work was done by Precision Walls. Accordingly, there is no "impaired property" under the facts of this case and this exclusion does not apply.

In its argument, Liberty Mutual erroneously states that Precision Walls contends that the usefulness of the brick veneer wall was impaired because it incorporated defective work not in compliance with Precision Walls' subcontract requirements. *See* Brief of Respondent at p. 23. Precision Walls has made no such claim with respect to the brick veneer wall. As far as Precision Walls' knew, the brick veneer wall was perfectly fine. Moreover, Precision Walls never contended that the brick veneer wall incorporated its work. For reasons that cannot be adequately explained, Liberty Mutual incorrectly thought that the Seam and Seal tape was part of the brick veneer wall. But that was Liberty Mutual's own misunderstanding, not a claim made by Precision Walls.

In similar fashion, Liberty Mutual erroneously claims that Precision Walls contends that the brick veneer wall was restored by the repair of the defective tape. *See* Brief of Respondent at p. 23. Precision Walls has made no such claim. To the contrary, Precision Walls has always maintained the obvious--that the brick veneer wall could not be restored by the removal and replacement of the tape at the insulation board joints. Because the brick veneer wall had to be torn down in order for Precision Walls to access the insulation board joints, it obviously could not be restored to use just by replacing the defective joint tape. Instead, it had to be rebuilt once Precision Walls replaced the defective joint tape.

Respectfully Submitted,



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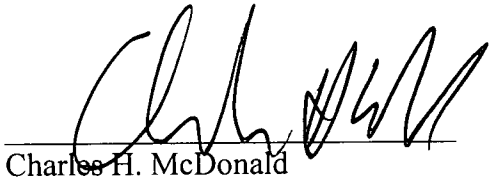
CERTIFICATE OF COUNSEL

The undersigned hereby certifies that this Final Reply Brief complies with Rule 211(b), SCACR.



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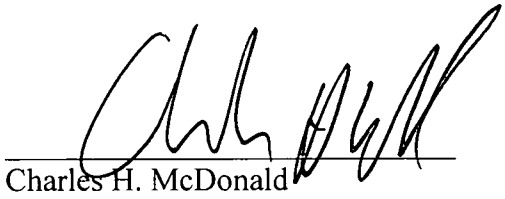
PROOF OF SERVICE

I certify that I have served the Final Reply Brief of Appellant by having a copy hand-delivered to the Respondent's attorney of record, Steven Wayne Ouzts, Turner, Padget, Graham & Laney, P.A., Bank of America Plaza, 1901 Main Street, 17th Floor, Columbia, SC, 29201.



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