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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM HORRY COUNTY
Court of Common Pleas
John M. Milling, Special Referee

Case No. 2009-CP-26-11862; Appellate Case No. 2013-001291

Harleysville Group Insurance, a Pennsylvania corporation, ... Appellant/Respondent,

v.

Heritage Communities, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar Corp., a South Carolina corporation; Riverwalk at Arrowhead Country Club Horizontal Property Regime; Riverwalk at Arrowhead Country Club Property Owners Assoc., Inc., a South Carolina Corporation; National Surety Corp.; and Tony L. Pope and Lynn Pope, individually and representing as a class all unit owners at Riverwalk at Arrowhead Country Club Horizontal Property Regime, ... Defendants,

Of whom Heritage Communities, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar Corp., a South Carolina corporation; National Surety Corp.; and Tony L. Pope and Lynn Pope, individually and representing as a class all unit owners at Riverwalk at Arrowhead Country Club Horizontal Property Regime are ..... Respondents,

And Riverwalk at Arrowhead Country Club Horizontal Property Regime and Riverwalk at Arrowhead Country Club Property Owners Assoc., Inc., are ..... Respondents/Appellants.

INITIAL REPLY BRIEF OF APPELLANT/RESPONDENT

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Harleysville Group Insurance ("Harleysville") hereby replies to the brief of the Respondents/Appellants Riverwalk at Arrowhead Country Club Horizontal Property Regime and Riverwalk at Arrowhead Country Club Property Owners Assoc., Inc. (collectively "the property owners' association" or "the association").

Argument

I. The Special Referee erred by denying Harleysville's request to allocate the underlying damages into categories of covered and non-covered damages.

As explained in Harleysville's opening brief, the Special Referee improperly denied Harleysville's request to perform the *Crossmann* analysis of dividing and categorizing the underlying verdict amount into (1) the costs of repairing the defect, which are not covered damages, and (2) the costs of repairing the damage resulting from the defective work, which may be covered. *See* Harleysville's Opening Brief at 4-14. As explained below, the counterarguments raised in the association's Response brief do not justify the Special Referee's error nor do they rebut Harleysville's arguments in favor of allocation.

A. An allocation is not a "re-litigation" of any issue.

As explained in Harleysville's opening brief, its request in this coverage action to allocate the underlying damages would not "re-litigate" the issue of damages. *See id.* at 5-8. Rather, allocation merely determines what portion of that amount should be paid by Harleysville and what portion should be paid by its insureds. Because this question—which is an issue between the insurer and the insured—was not previously litigated, its resolution now is not a "re-litigation."

The association does not dispute this. Rather, it argues that Harleysville "had a duty to its insured to seek" an allocated verdict in the underlying action. *See* Association's Response Brief at 13. The association cites no South Carolina authority establishing such a duty.[1] Even assuming *arguendo* that such a duty exists, Harleysville satisfied that duty by discussing the coverage issues with its insureds and mutually agreeing to resolve those issues in a subsequent coverage action. (Trial Tr. of Dec. 13-14, 2010 at 113, 182, 209; *see also* Association's Response Brief at 4 ("Harleysville had an agreement with its insureds that they would resolve coverage issues in a subsequent judicial proceeding.") (citing Trial Tr. of Dec. 13-14, 2010 at 185).)

Furthermore, the failure of an insurer to inform its insured of the wisdom of requesting an allocated verdict, should not result in the inability to conduct a subsequent allocation of an underlying general verdict. *See Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 618 (Minn. 2012) (noting that where the insurer fails to inform its insured of the benefits of a special verdict, the insurer may bring a subsequent coverage action where "both parties may present evidence and the district court must, as best it can, establish the allocation the arbitrator would have made if allocation had been requested").

B. At the time of the underlying trial, there was no need or possibility for Harleysville to intervene and seek an allocated verdict.

As explained in Harleysville's opening brief, under the law in force at the time of the underlying trial, Harleysville had neither the opportunity nor the incentive to

[1] The sole South Carolina case the association cites for this supposed duty—*Armitage v. Seabord Airline Ry. Co.*, 166 S.C. 21, 164 S.E.2d 169 (1932)—has nothing to do with insurance coverage or the allocation of damages into covered and non-covered amounts.

intervene and request a special verdict form.[2] *See* Harleysville's Opening Brief at 8-11. In its Response Brief, the association does not dispute this. Rather, it merely asserts that Harleysville should have foreseen a future change in the law and sought to stay the underlying cases until any change in the law occurred, or that Harleysville should have filed its declaratory judgment action sooner. *See* Association's Response Brief at 14-15.

These assertions do not alter the fact that at the time of the underlying trial, the law as pronounced was that every dollar of construction defect damages triggered indemnity obligations under a standard CGL policy and thus there was no reason for an insurer to seek an allocation in a liability trial against its insureds. Even if Harleysville had foreseen the future possible ability of an insurer to seek intervention, case law from other jurisdictions indicates that an insurer is rarely required to intervene because a subsequent coverage action is a much simpler solution. *See*, *e.g.*, *Buckley v. Orem*, 730 P.2d 1037, 1043 (Idaho Ct. App., 1986) ("We believe that requiring intervention by an insurance company in the primary action as a prerequisite to allowing the company to assert its clearly stated policy limits is a costly solution to an easily correctable problem. Intervention, with its added litigation expense, with its tendency to protract, to divert and to complicate the injury action, would certainly occur in more cases than necessary."); *id.* at 1043 n.5 ("At least one authority discourages intervention of insurance companies in the injury trial for a variety of reasons.") (citation omitted).

[2] The association claims to be confused by Harleysville's statement that there was no "opportunity" to intervene, noting that no one prevented Harleysville from filing a motion to intervene. *See* Association's Response Brief at 14. While nothing prevented Harleysville from filing a motion to intervene, there was no opportunity to *meaningfully* intervene—*i.e.*, to intervene and request a special verdict allocating the damages—because under the law then in force there was no coverage distinction between shoddy workmanship and the resulting damages, thus the allocation categories were unnecessary and meaningless. *See* Harleysville's Opening Brief at 8.

Because allocation was not known to be needed or possible at the time of the underlying Magnolia North trial, the appropriate time for allocation was in the subsequent coverage action.

C. *South Carolina precedent does not preclude allocation of an underlying general verdict.*

As explained in Harleysville's prior briefs, neither *Auto-Owners Ins. Co. v. Newman*, 385 S.C. 187, 684 S.E.2d 541 (2009) nor *Owners Ins. Co. v. Clayton*, 364 S.C. 555, 614 S.E.2d 611 (2005) prevent an insurer and insured from relying on a subsequent coverage action to allocate an underlying verdict into categories of covered and non-covered damages. *See* Harleysville's Opening Brief at 11-12; Harleysville's Response Brief at 11-12. Harleysville will not here repeat its prior arguments explaining and distinguishing *Newman* and *Clayton*. However, several of the association's other arguments warrant reply.

First, the association argues that the only evidence that may be used to allocate the underlying verdict is the record from the underlying trial and that no new evidence or analysis may be introduced in the coverage action. *See* Association's Response Brief at 10 (quoting Allan D. Windt, *Representations of Insurance Companies and Insureds* § 6:26); *id.* at 20. This is incorrect. The association cites no case law in support of this argument and quotes a treatise section that discusses a different issue.[3] Indeed, the treatise notes that in the situation presented here—where the judgment includes both

[3] The treatise excerpt quoted by the association discusses what evidence is permissible to determine whether any covered claim was submitted to the jury *See* Windt, § 6:26 ("The preceding discussion relates to the issues that are presented when there is a dispute as to whether a judgment was entered on grounds that would give rise to coverage. Such disputes can be resolved by analyzing what was proved in the underlying action. A more difficult problem is presented when the parties agree that the judgment represents both covered and noncovered items, and there is a dispute as to how to allocate the judgment between the two.").

covered and non-covered claims[4]—there is a different and "more difficult problem" in determining "how to allocate the judgment between the two." Windt, § 6:26.[5] Courts addressing this issue have held that an insurer *may* present new evidence in a coverage dispute to properly allocate an underlying general verdict. *See Duke v. Hoch*, 468 F.2d 973, 984 (5th Cir. 1972) ("[T]he court will face the issue of attempting retrospectively to allocate the damages awarded. . . . The primary source of evidence will be, of course, the transcript of the merits trial, containing the evidence on which the jury based its verdict. . . . . If it is impossible for the court to make a meaningful allocation based on only the transcript, [the judgment holder] should have the right to adduce additional evidence and [the insurer] to present evidence in rebuttal); *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 618 n.4 (Minn. 2012) (noting that in a coverage action to allocate an underlying award, "[t]he primary source of evidence will be the transcript of the arbitration proceeding and the evidence before the arbitrator, but if it is impossible for the district court to make a meaningful allocation based solely on the arbitration record, the parties should have the right to adduce additional evidence"); *Allstate Ins. Co. v. Keltner*, 842 N.E.2d 879, 883 (Ind. Ct. App. 2006) (noting that the allocation of an underlying general verdict "might be determined by examining the evidence and argument of counsel presented during the

[4] Here, all—including the Special Referee—agree the underlying verdict includes both covered and non-covered damages. (*See* Post-Trial Hearing Tr. of April 9, 2013 at 89.)

[5] In quoting from this section of the treatise, the association apparently overlooks its statement that "[i]f, as is normally the case, the insured has the burden of allocating the judgment, *there will be no coverage*." Windt, § 6:26 (emphasis added; citations omitted). Indeed, the treatise supports Harleysville's argument that allocation is an appropriate issue for a coverage dispute. *Id.* at § 6:27 ("Whether the grounds on which a judgment against the insured was entered were within the policy coverage should always be a contestable issue.") (citation omitted).

underlying trial or by the presentation of additional evidence"); *Buckley v. Orem*, 730 P.2d 1037, 1043 (Idaho Ct. App., 1986) (remanding coverage action for taking of new evidence to allocate underlying general verdict).

Second, the association claims there are no South Carolina cases in which a litigant was permitted to allocate an underlying general verdict. *See* Association's Response Brief at 11. Although South Carolina's appellate courts have not previously confronted the precise issue presented in this appeal, they have recognized a court's ability to analyze and reform a jury's general verdict to bring it into compliance with the law. *See Chastain v. AnMed Health Foundation*, 388 S.C. 170, 694 S.E.2d 541 (2010) (affirming trial court's post-verdict ruling that, because it was impossible to determine from the general verdict how many negligent occurrences the jury had found, the damages award should be reduced to the amount appropriate for one occurrence). Similarly, our courts have recognized a trial court's ability to allocate an underlying settlement between various claims. *See Smith v. Widener*, 397 S.C. 468, 473, 724 S.E.2d 188, 191 (Ct. App. 2012) (holding that where a prior settlement involves two claims, one of which is later tried to a verdict, "the circuit court must make the factual determination of how to allocate the settlement between the two claims" and thus determine how much of a setoff to apply to the verdict); *Rutland v. S.C. Dept. of Transp.*, 400 S.C. 209, 734 S.E.2d 142 (2012) (affirming trial court's allocation of underlying settlement in a different way than the settling parties had agreed the amount should be allocated). In sum, neither South Carolina precedent nor persuasive authority from other jurisdictions prevents a trial court in a coverage action from allocating an underlying general verdict on the basis of new evidence and arguments.

D. Other jurisdictions permit allocation of an underlying general verdict.

As explained in Harleysville's prior briefing, other jurisdictions permit the allocation of an underlying verdict into categories of covered and non-covered damages. *See* Harleysville's Opening Brief at 12-14; *see also Duke v. Hoch*, 468 F.2d 973 (5th Cir. 1972); *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 618 (Minn. 2012); *Allstate Ins. Co. v. Keltner*, 842 N.E.2d 879, 883 (Ind. Ct. App. 2006); *Donna C. v. Kalamaras*, 485 A.2d 222, 224 (Me. 1984).

A federal district court recently allocated an underlying amount in a coverage action strikingly similar to this one. *See Crossmann Communities of N.C., Inc. v. Harleysville Mut. Ins. Co.*, No. 4:09-CV-1379-RBH, 2013 U.S. Dist. Lexis 138941 (D.S.C. Sept. 27, 2013). In that case, the total underlying settlement between the homeowners' association and the underlying defendants included both covered and non-covered damages. *Id.* at *37 ("The total settlement paid by Beazer to True Blue was $3,336,800, which included both covered and non-covered damages."). To determine what portion of this settlement was covered by Harleysville's policies, the trial court in the coverage action accepted expert testimony from both Harleysville and the insured builder. *Id.* at *40. The builder's estimate of the cost of repair included the cost to repair defective work (*i.e.*, non-covered damages) and the resulting damage to non-defective work (*i.e.*, covered damages). *Id.* at 41-42 (noting that the insured's expert "admitted that some of his estimate includes the cost to repair defective work rather than resulting damages"). Harleysville's expert, in contrast, estimated a cost of repair that included only the "cost to repair the resulting damages," *i.e.*, the covered damages. *Id.* at 41. Based on these estimates, the trial court determined the amount for

which Harleysville was responsible—an amount that included only the covered cost to repair resulting damages, not the defective work itself. *Id.* at 42-43. Here, the Special Referee should have similarly relied on expert testimony proffered in the coverage action to allocate the underlying verdict.

Other jurisdictions permit an allocation in circumstances like those presented here, and the association fails to effectively distinguish these cases. For example, the association argues that *Duke v. Hoch* is distinguishable because in *Duke* the insurer could prove the underlying verdict included non-covered damages. *See* Association's Response Brief at 18-19. This is no distinction. There is no dispute here that the underlying verdict included non-covered damages. *See* Post-Trial Hearing Tr. of April 9, 2013 at 89; *see also* Association's Opening Brief at 11 ("Harleysville conceded at oral arguments on the motions to alter or amend that the POA verdict included covered as well as uncovered claims.") (citing Post-Trial Hearing Tr. of 4/9/13 at 11 and 77-78)).

Similarly, the association tries to distinguish other cases allocating an underlying general verdict by arguing that the facts of those cases "are vastly different." *See* Association's Response Brief at 20-21. However, the only difference the association can identify is that in those cases the insurer had moved unsuccessfully to intervene in the underlying suit. *Id.* This is a distinction without a difference. An unsuccessful motion to intervene changes none of those cases' relevant procedural facts or the courts' reasoning and holdings. This Court should follow the lead of other jurisdictions and allow a coverage action to determine an insurer's responsibility for an underlying verdict by allocating that verdict into categories of covered and non-covered damages.

This should be done in all cases where it is clear, as it is here, that the underlying verdict contains both covered and non-covered damages.

II. The "time on risk" formula applies to the underlying damages award, but the Special Referee erred in his application of that formula.

As explained in Harleysville's opening brief, the Special Referee correctly determined that *Crossmann's* "time on risk" formula applied, though he erred in several aspects of applying the formula. *See* Harleysville's Opening Brief at 14-20. The question of whether "time on risk" applies is separate from the question of allocation. *See* Harleysville's Response Brief at 8-13. The association nevertheless continues to argue that the Special Referee erred by applying "time on risk" to a general verdict because to do so would be speculative and unprecedented in any jurisdiction. *See* Association's Response Brief at 22-24. As explained below, the association is incorrect.

A. Application of "time on risk" is not speculative because all *of the underlying causes of action were premised on progressive physical damage.*

"Time on risk" applies to all covered damages here because *all* of the causes of action alleged by the association in the underlying suit were based on progressive damages. In the underlying liability action, the association brought four causes of action against the insureds, plus several claims against other entities such as subcontractors: negligence, breach of express warranties, breach of implied warranties, and breach of fiduciary duty. *See* Riverwalk Fourth Amend. Compl. at ¶¶ 24-42, 52-57. *Each* of these causes of action was expressly premised on progressive physical damages. *See id.* at ¶¶ 26, 31, 36, 41, and 56.[6] Indeed, the property owners' association concedes a

[6] Paragraph 26 asserts a claim for negligence and alleges "the buildings have been continuously and repeatedly exposed to leaks causing moisture infiltration." Paragraph 31 asserts a claim for breach of express warranties with the sole alleged damages being the same "as set forth hereinabove," *i.e.*, the

developer's breach of fiduciary duty that causes continued deterioration "is tantamount to 'progressive damages.'" *See* Association's Opening Brief at 12. Because the association's underlying claims were based on progressive damages, there is no speculation in determining that "time on risk" applies to the entire underlying verdict.

B. Other jurisdictions apply the "time on risk" formula to underlying unallocated amounts.

The association argues there is no legal authority "authorizing application of TOR to a general verdict containing numerous types of damages and causes of action." Association's Response Brief at 24. The association is incorrect. Courts of other jurisdictions have applied "time on risk" to underlying unallocated amounts that include a variety of claims and damages. *See*, *e.g.*, *Penn. Nat'l Mut. Cas. Ins. Co. v. Roberts*, 668 F.3d 106 (4th Cir. 2012) (applying "time on risk" to determine insurer's coverage responsibility for underlying verdict that included claims of unfair trade practices and negligence resulting in progressive damages from lead poisoning); *City of Sterling Heights v. United Nat'l Ins. Co.*, 319 Fed. Appx. 357 (6th Cir. 2009) (affirming use of "time on risk" formula to determine insurer's coverage liability for an underlying, unallocated settlement of claims for defamation, interference with contract, and violation of due process and equal protection rights). Because the underlying verdict

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progressive damages alleged in paragraph 26. Similarly, paragraph 36 asserts a claim for breach of express and implied warranties with the sole alleged damages being the same "as set forth hereinabove," *i.e.*, the progressive damages alleged in paragraph 26. Paragraph 41 asserts a claim for breach of implied warranties with the sole alleged damages being the same "as set forth hereinabove," *i.e.*, the progressive damages alleged in paragraph 26. Finally, paragraph 56 asserts the insureds breached their fiduciary duty by building with substandard and inappropriate materials and in turning over the buildings and common areas in deteriorated condition, alleging the damages that resulted were the same "as set forth hereinabove," *i.e.*, the progressive damages alleged in paragraph 26.

here could be entirely based on progressive damages, it is appropriate to apply "time on risk" to the entire amount.

C. The Special Referee erred by failing to apply "time on risk" on a per-building basis.

As explained in Harleysville's opening brief, the Special Referee erred in his "time on risk" calculation by using a single starting date for damages to all 19 buildings, despite the fact that many of the buildings had not yet been built on the date when the damages supposedly began to occur. *See* Harleysville's Opening Brief at 16-17. The Special Referee should instead have applied his calculation on a per-building basis. A federal district court recently applied a per-building "time on risk" calculation in a coverage action strikingly similar to this one. *See Crossmann Communities of N.C., Inc. v. Harleysville Mut. Ins. Co.*, No. 4:09-CV-1379-RBH, 2013 U.S. Dist. Lexis 138941, *57-58 (D.S.C. Sept. 27, 2013). The association does not dispute the accuracy or reasonableness of a per-building calculation. Accordingly, this Court should adopt the per-building formula set out in Harleysville's prior briefing and reduce the damages accordingly.[7]

D. The Special Referee erred by applying the wrong policy expiration date in calculating Harleysville's "time on risk."

As explained in Harleysville's opening brief, the Special Referee erred in his "time on risk" calculation by finding that Harleysville had coverage until June 18, 2001, when the undisputed testimony at trial was to the contrary. *See* Harleysville's Opening Brief at 17-18. The Special Referee compounded this error by refusing to

[7] *See also* part XI, *infra*, explaining with specificity the way in which Harleysville requests this Court correct the amount for which Harleysville is responsible.

allow Harleysville to introduce additional evidence showing that policy had been cancelled from its inception due to nonpayment. *See id.* In response, the Association argues that "[n]o testimony was given that the subject policy had been cancelled," that the introduction of additional evidence to correct the Special Referee's factual error would have been "highly prejudicial," and thus that the Special Referee did not abuse his discretion in refusing to permit the additional evidence. *See* Association's Response Brief at 25.

As an initial matter, the association's effort to paint this issue simply as a question of reopening the record to admit additional evidence is incorrect. The Special Referee's error was not solely his refusal to permit the additional evidence. Rather, the error of his calculation is discernible from the undisputed testimony at the bench trial. Specifically, Mr. Lee Wright, Harleysville's construction defect litigation manager, explained the last policy period covering Heritage Riverwalk ended on June 18, ***2000***:

> Q: Again about Heritage Riverwalk, when is the first policy and when is the last policy?
> A: 6/18/97, '98, and the last one is 6/18/99, 2000.
>
> * * *
>
> Q: What about Heritage Riverwalk after 6/18 of 2000?
> A: Uninsured.

(Trial Tr. of December 13-14, 2010 at 166-67.) Similarly, the association is somewhat misleading when it states that there was no testimony that the policy had been cancelled. Although the word "cancelled" was not used, no one disputed Mr. Wright's explicit testimony that Harleysville's coverage ended in 2000. (*See id.*) The Special

Referee's ruling contrary to the testimony was significant and prejudicial. *See* Harleysville's Opening Brief at 18-19.

Furthermore, the Special Referee compounded his error and abused his discretion by refusing to admit additional evidence regarding the cancellation of the 2000-01 policy. The introduction of this evidence would not have necessitated "further discovery and trial," *see* Association's Response Brief at 25, and the only purported "prejudice" it would have caused the association would have been to require a "time on risk" calculation that required the insureds rather than Harleysville to pay the bulk of the underlying damages.

E. The Special Referee erred by refusing to apply "time on risk" to the "loss of use" damages.

As explained in Harleysville's opening brief, the Special Referee erred by refusing to apply "time on risk" to the $1 million the jury awarded the individual homeowners for loss of use ($250,000 in actual damages and $750,000 in punitive damages). *See* Harleysville's Opening Brief at 19-20. Specifically, in light of the policies' language and the Special Referee's ruling that the underlying injuries were progressive damages, the loss of use damages are deemed to have occurred over a span of years that are only partially covered by Harleysville. *See id.*

The association's only argument in response is that the damages should be deemed to occur at the moment the first drop of water intrudes and causes damage. *See* Association's Response Brief at 26. The association's argument is contrary to the language of the applicable policies, which state that "'loss of use shall be deemed to occur at the time of the physical injury that caused it.'" Riverwalk Order at 47 (quoting

policies). Here, the physical injuries that caused the loss of use were gradual and progressive. They did not occur at the first moment of water intrusion, but occurred only gradually over a period of years as a result of repeated water intrusion. Furthermore, the sole case the association cites in support of its argument—*Walde v. Assoc. Ins. Co.*, 401 S.C. 431, 737 S.E.2d 631 (Ct. App. 2012)—does not involve progressive damages. In sum, the policy language and precedent discussed in Harleysville's opening brief demonstrates that the loss of use damages were deemed to occur over the same time period as the progressive physical damages and thus should be subject to a "time on risk" calculation.

III. The "time on risk" calculation applies to the underlying punitive damages.

In its prior briefing, Harleysville explained that, even assuming Harleysville's policies cover punitive damages, the Special Referee erred by refusing to apply the "time on risk" analysis to the underlying punitive damage award. *See* Harleysville's Opening Brief at 20-23. In response, the association seeks to analogize to contributory negligence, arguing that because a plaintiff's comparative negligence does not reduce a punitive damage award, neither should "time on risk." *See* Association's Response Brief at 27. This supposed analogy, however, fails to acknowledge the significant differences between "time on risk" and contributory negligence, such as the fact that "time on risk" does not reduce the association's punitive damages but merely determines what portion of that award Harleysville is responsible to pay.

IV. Harleysville's policies do not cover the underlying punitive damages.

As explained in Harleysville's prior briefing, Harleysville's policies cover only damages the insured is legally obligated to pay arising from bodily injury or property

damage caused by an "occurrence," *i.e.*, an *accident*. Harleysville's Opening Brief at 24-26; *see also Auto-Owners Ins. Co. v. Rhodes*, 405 S.C. 584, __, 748 S.E.2d 781, 789-90 (2013) (defining an "occurrence" in a CGL policy to be an "accident," *i.e.*, an "unexpected happening or event, which occurs by chance") (citing *Green v. United Ins. Co. of Am.*, 254 S.C. 202, 206, 174 S.E.2d 400, 402 (1970)).

Punitive damages, as a matter of law, cannot be awarded for mere accidental conduct. *See Atkinson v. Orkin Exterminating Co., Inc.*, 361 S.C. 156, 167, 604 S.E.2d 385, 391 (2004) (noting that punitive damages may be warranted where the harm is the result of "intentional malice, trickery, or deceit" but not where the wrongdoing was a "mere accident") (quoting *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 419 (2003)); *Lengel v. Tom Jenkins Realty, Inc.*, 286 S.C. 515, 519-20, 334 S.E.2d 834, 837 (Ct. App. 1985) ("A plaintiff is entitled to recover punitive damages if the act complained of is determined to be willful, wanton or reckless. . . . *Punitive damages are not awarded for mere negligence.*") (emphasis added) (quotation marks and citations omitted).

Furthermore, the association's closing argument in the underlying makes it clear that the punitive damages were not sought for merely accidental conduct:

> And what they did, they built these condominiums, they knew they were defective, they knew in 1998 the windows had significant problems. They were asking for 192 windows to be replaced. They knew the decks were leaking and they had problems with that.
>
> * * *
>
> Now, why do you award punitive damages? . . . These people unquestionably knew, if they knew anything about construction at all, that they were building defective

> condominiums and they were putting them in the stream of commerce, they were selling to innocent people these condominiums and they did it over a long period of time and you can consider that.

Underlying Riverwalk trial Tr. at 1743, 1770. Because punitive damages—as a matter of law and in light of the underlying argument—cannot be and were not awarded for mere accidental conduct, Harleysville's policies do not cover the punitive damages assessed against its insureds.

In response, the association relies on cases that are distinguishable in significant respects. *See* Association's Response Brief at 29 (citing *Carroway v. Johnson*, 245 S.C. 200, 139 S.E.2d 908 (1965) and *S.C. State Budget & Control Bd. v. Prince*, 304 S.C. 241, 403 S.E.2d 643 (1991)). *Carroway* is inapposite because it involved automobile insurance, which by statute is required to cover punitive damages. *See* S.C. Code Ann. §§ 38-77-140 (requiring coverage for "damages") and 38-77-30(4) (defining "damages" to include punitive damages). Similarly, *Prince* is inapposite because the policy expressly covered intentional torts including the underlying defamation. In addition, *Prince*, like the other case cited by the association—*State Farm Fire & Cas. Co. v. Martinez*, 995 P.2d 890 (Kan. Ct. App. 2000)—involved policies with broader language than Harleysville's policies. Specifically, the policies in *Prince* and *Martinez* covered "all sums" the insured was obligated to pay as damages. Here, in contrast, Harleysville's policies cover only those sums the insured is liable to pay arising from an *accident*. Furthermore, *Martinez* analyzed whether the policy covered a statutory fine

imposed as civil penalties on the insured, not the question of whether punitive damages were covered.[8] Thus, the cases relied upon by the association are unpersuasive.

Next, the association argues that because punitive damages may be awarded for less than intentional conduct, they must be covered by the policy. *See* Association's Response Brief at 30-31. The association's argument rests on the premise that punitive damages may be imposed not only for intentional conduct but also for reckless, willful, wanton, or grossly negligent conduct. *Id.* (citing *Penn. Thresherman & Farmers' Mut. Cas. Ins. Co. v. Thornton*, 244 F.2d 823 (4th Cir. 1957)). From this premise, however, the association leaps to the unsupported conclusion that punitive damages must be covered by Harleysville's policies. The association's argument fails for two simple reasons: (1) Harleysville's policies cover only those sums arising from accidents and (2) no authority—including *Thornton*—permits the imposition of punitive damages for merely negligent conduct.

Here, in light of the association's closing argument requesting punitive damages in the underlying case, the jury necessarily found and sought to punish Harleysville's insureds who, in the words of the argument, "unquestionably knew . . . that they were building defective condominiums." *See* Underlying Riverwalk trial Tr. at 1770; *see*

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[8] Incidentally, in contrast to the *Martinez* court's holding, most courts have held that insurance policies do *not* cover civil penalties. *See, e.g., Travelers Ins. v. Waltham Indus. Labs.*, 883 F.2d 1092 (1st Cir. 1989) (finding no coverage for civil penalties); *Township of Gloucester v. Maryland Cas. Co.*, 686 F. Supp. 394, 401-02 (D.N.J. 1987) (holding fines and civil penalties did not constitute "damages" under CGL policy); *A.Y. McDonald Industries v. INA*, 475 N.W.2d 607, 626 (Iowa 1991) ("We hold that the term 'damages' under the CGL policies does not include the civil penalty imposed."); *Drexel Group v. Vigilant Ins.*, 595 N.Y.S.2d 999, 1009 (N.Y. Supr. Ct. 1993) (finding "the sting of criminal penalties is not to be soothed by permitting its payment out of an insurance pool rather than directly by the wrongdoer"); *see also Washington Cnty. Unified Sewerage Agency v. First State Ins. Co.*, No. 94-36277, 1996 U.S. App. Lexis 8503, * 5-6 (9th Cir. March 28, 1996) (predicting that Oregon courts would follow the "sensible line of authority" holding that civil penalties are not covered by insurance policies).

also Pope v. Heritage Comms., Inc., 395 S.C. 404, 436, 717 S.E.2d 765, 782 (Ct. App. 2011) (holding that the Heritage entities had knowingly sold the condominiums with construction deficiencies) (*certiorari* pending). Because the punitive damages could not and did not arise from an "accident" as required by the express terms of the policies' insuring agreements, they are not covered.

V. The underlying damages—both actual and punitive—are excluded from coverage by the policies' "expected or intended" exclusions.

As explained in Harleysville's prior briefing, the Special Referee erred by ruling that the underlying damages are covered despite the "expected or intended" exclusions in each of the CGL policies. *See* Harleysville's Opening Brief at 26-35. In response, the association argues that Harleysville cannot prove that the insureds expected or intended their acts and the resulting damage. *See* Association's Response Brief at 31-44. As explained below, however, the association's argument fails to account for the exclusion's breadth and the evidence of the insureds' intent and expectations.

A. The actual damages were expected or intended.

The essence of the association's argument on this issue is fairly simple. It argues that because there is evidence the insureds did not intend the damages resulting from their acts, this Court cannot disturb the Special Referee's ruling that the exclusion does not apply. The association's argument, however, suffers from two fatal defects. First, contrary to the association's assertion, the evidence and testimony from the underlying trial indicated the insureds *did* expect or intend their actions and resulting damages.[9]

[9] For example, the insureds knew they were using materials and practices that had previously caused damages at their prior developments, but persisted with these practices at Riverwalk. (*See* Underlying Riverwalk Trial Tr. at 939, 957; Tr. of video dep. of Gwyn Hardister of April 15, 2009.) Indeed, the

Second, even if the evidence was unclear as to the insureds' *intent,* the evidence was clear that the insureds would have reasonably *expected* the damage that resulted from their shoddy workmanship.

Although the policy excludes *expected* or intended acts and damages, the association's argument focuses on the insureds' intent. *See* Association's Response Brief at 36,[10] 39,[11] and 40[12]; *see also* Riverwalk Order at 2023.[13] The distinction

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association's closing argument in the underlying trial argued forcefully that there was evidence of intent or expectation of damages—exactly the opposite of what it argues now:

> And what they did, they built these condominiums, they knew they were defective . . . .
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> * * *
>
> Now, why do you award punitive damages? . . . These people unquestionably knew, if they knew anything about construction at all, that they were building defective condominiums and they were putting them in the stream of commerce, they were selling to innocent people these condominiums and they did it over a long period of time and you can consider that..

Underlying Riverwalk Trial Tr. at 1743, 1770. The association has made a similar reversal by now relying on Mr. Hardister's testimony at the underlying trial to argue that the insureds were unaware of their shoddy practices and the substantial likelihood of resulting damage. *See* Association's Brief at 37.

[10] The association points to testimony in the coverage action from Lee Wright, Harleysville's construction litigation manager, who stated he had no evidence the insureds "'consciously *intended* to create a situation that water damage would occur.'" Association's Response Brief at 36 n.14 (citing hearing Tr. of December 13-14, 2010 at 191-92) (emphasis added).

[11] The association relies on the underlying testimony of Gwyn Hardister, president of the developer, who "testified that there was nothing done intentionally or maliciouisly." Association's Response Brief at 39.

[12] The association notes the Special Referee found that the insureds installation of windows it knew had moisture intrusion problems "was *unintended* by the Harleysville insureds." Association's Response Brief at 40 (citing Special Referee's Order at 10) (emphasis added).

[13] The Special Referee relied on Lee Wright's testimony "that he had no evidence that the insureds 'consciously *intended* to create a situation that water damage would occur.'" Riverwalk Order at 20 (emphasis added). Similarly, the Special Referee erroneously stated that for this exclusion to apply there must be evidence "that the insured subjectively *intended* its subcontractors to perform negligently and subjectively *intended* the resulting damages." *Id.* (emphasis added). In addition, the Special Referee relied on Mr. Hardister's testimony that "[t]here was nothing done *intentionally* or maliciously." *Id.* at 21 (emphasis added). Likewise, the Special Referee erroneously stated "[i]t is the *intent*, not the foreseeability that determines the application of exclusion 'a'" and that "there is nothing in the record

between these terms is significant. The association incorrectly states that "expected" and "intended" are synonymous. *See* Association's Response Brief at 32. The sole case the association cites involved a different exclusion, and in any event, does not hold that the two terms are synonymous. In *S.C. Farm Bureau Mut. Ins. Co. v. Dawsey*, 371 S.C. 353, 355, 638 S.E.2d 103, 104 (Ct. App. 2006), the insured had fired shots at his sons' car tires. One of the shots ricocheted and injured the son. The insurer filed a declaratory judgment action against the father and the son to determine coverage. The trial court held that the "intentional acts" exclusion, which excluded coverage for any injury caused by an intentional act, regardless of whether the resulting injury was expected or unexpected, applied and barred coverage.[14] On appeal, the son sought to distinguish between an intentional act causing an *unexpected* result and an intentional act causing an *unintentional* result, arguing that the latter should be covered. The Court of Appeals rejected this argument because under the facts of the case, the distinction made no difference and the son had admitted "that the terms "intend' and 'expect' are 'often defined synonymously.'" *Id.* at 357, 638 S.E.2d at 105.

In contrast, courts specifically considering the "expected or intended" exclusion have recognized the term "expected" is broader than the term "intended," and that an "expected or intended" exclusion is broader than the type of exclusion at issue in *Dawsey*. *See Mut. Serv. Cas. Ins. Co. v. Country Life Ins. Co.*, 859 F.2d 548, 552 (7th Cir. 1988) ("[E]ven where the damages are not accomplished by design or plan (not

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that indicates the insureds *intended* to injure the plaintiffs or *intended* its subcontractors to perform negligently." *Id.* at 22-23 (emphasis added).

[14] Specifically, the clause excluded coverage for injury "'resulting from intentional acts or directions of you or any insured. The expected or unexpected results or (sic) these acts or directions are not covered.'" *Dawsey*, 371 S.C. at 355, 638 S.E.2d at 104.

intended), they may be of such a nature that they should have been reasonably anticipated (expected) by the insured. [] This Court recently noted that an exclusion for 'intended' or 'expected' damages would be significantly broader than an exclusion for damages caused intentionally by or at the direction of the insured.") (citations and internal quotation marks omitted); *Allstate Ins. Co. v. Lahoud*, 605 S.E.2d 180, 183 (N.C. Ct. App. 2004) (noting an "expected or intended" exclusion is broader than an exclusion of only "intentional" acts); *Auto-Owners Ins. Co. v. Harrington*, 565 N.W.2d 839, 842 (Mich. 1997) ("In this case, the policy's use of the word 'expected' broadens the scope of the exclusion because 'expected' injuries are the 'natural, foreseeable, expected, and anticipated result of an intentional act.'") (citation omitted).

Here, even if it were unclear whether the insureds *intended* to cause damage, there can be no question that they *expected* the damages that occurred. *See* Underlying Riverwalk Trial Tr. at 846-49, 852-89 (evidence that a representative from Betterbilt windows met with insureds and explained the insureds' window installation practices were causing the water intrusion problems and if those installation practice continued, the windows would leak and cause damages); *id.* at 935-39 (testimony by Mr. Hardister that before constructing Riverwalk, Heritage Communities had received complaints of water intrusion and window leaks from residents of Heritage's prior condominium complexes using "the same configuration" of windows used at Riverwalk and that the insureds continued selling condominiums at Riverwalk, knowing that the complex was subject to leaks at or near the windows); *id.* at 957 (testimony that as of September, 1998, when construction of half the Riverwalk buildings was ongoing, "Heritage knew there were problems with windows at Riverwalk," yet continued to build and sell the

units). Where an insured has advance notice of an issue, the insured "necessarily anticipated or expected any damage" that subsequently occurs. *Dunes W. Residential Props. v. Essex Ins. Co.*, No. 06-2020, 2007 U.S. App. Lexis 29931 (4th Cir. Dec. 28, 2007) (applying South Carolina law).

These damages were the natural, foreseeable, expected, results of their conduct. The association argues it is irrelevant whether the wrongdoer foresaw or should have foreseen the results of his acts. *See* Association's Response Brief at 33. Although South Carolina courts have not previously considered whether a foreseen or foreseeable injury is "expected,"[15] other courts analyzing this exclusion have expressly held that it applies where the damage was foreseeable or foreseen. *See* Harleysville's Opening Brief at 30 n.29 (compiling cases); *see also Auto-Owners Ins. Co. v. Harrington*, 565 N.W.2d 839, 842 (Mich. 1997) (noting that "'expected' injuries are the 'natural, foreseeable, expected, and anticipated result of an intentional act.'") (citation omitted).

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[15] Contrary to the association's assertion, the Court in *Auto-Owners Ins. Co. v. Newman* did not reject a foreseeability test. *See* Association's Response Brief at 32-33. Rather, *Newman* simply held that in the absence of any evidence the insured expected the damages, the "expected or intended" exclusion did not apply. *Newman*, 385 S.C. 187, 197, 684 S.E.2d 541, 546 (2009). The association fails to note *Newman's* only mention of foreseeability is when it cited with approval a case from Tennessee holding that a court *should* consider foreseeability to determine coverage under a CGL policy. *Id.* at 194, 684 S.E.2d at 545 (citing *Travelers Indem. Co. of Am. v. Moore & Assocs.*, 216 S.W.3d 302, 309 (Tenn. 2007)).

Similarly, the association is incorrect when it says South Carolina courts have long rejected foreseeability as the test for determining whether an "expected or intended" exclusion applied. *See* Association's Response Brief at 33. The sole case cited by the association—*Stevenson v. Conn. Gen. Life Ins. Co.*, 265 S.C. 348, 218 S.E.2d 427 (1975)—does not involve an "expected or intended" exclusion. Rather, it involved the question of whether burns suffered by the insured were covered by the policy despite the fact that a reasonable man might have foreseen that walking barefoot on a hot surface could lead to injury. The *Stevenson* Court held that the appropriate question is not whether an objective man might have foreseen the injury, but whether *the insured* foresaw or expected the injury. *Stevenson*, 265 S.C. at 353-54, 218 S.E.2d at 430 (holding that the question of whether an injury was an accident was "not to be determined in terms of whether it was reasonably foreseeable, but in terms of whether it occurred with his intent or volition; *whether it was an event which he actually expected or anticipated* as a result of walking on the boat deck") (emphasis added).

B. The punitive damages were, by definition, awarded for conduct that was expected or intended.

As previously explained by Harleysville, the punitive damages awarded by the underlying jury—as a matter of law and in light of the underlying jury charge—were necessarily premised on the jury's finding that Harleysville's insureds engaged in conscious wrongdoing. *See* Harleysville's Opening Brief at 33-35. The association's argument in response is easily put to rest. The association argues that punitive damages may be awarded not only for intentional wrongdoing but also for reckless conduct. *See* Association's Response Brief at 42-44.[16] The association's argument, however, fails to recognize that, as a matter of law, conduct that is sufficiently reckless to warrant punitive damages necessarily contains an element of intent. *Carter v. R.L. Jordan Oil Co., Inc.*, 301 S.C. 84, 86, 390 S.E.2d 367, 368 (Ct. App. 1990) ("'Conduct is wilful, wanton, or reckless *when it is committed with a deliberate intention* under such circumstances that a person of ordinary prudence would be conscious of it as an invasion of another's rights. *It is the present consciousness of wrongdoing that justifies the assessment of punitive damages* against the tortfeasor'") (quoting *Cohen v. Allendale Coca-Cola Bottling Co.*, 291 S.C. 35, 351 S.E.2d 897 (Ct. App. 1986)) (emphasis added); *Bussey v. Charleston & W. Carolina R. Co.*, 75 S.C. 116, 129, 55 S.E. 163, 167 (1906) (noting that recklessness warranting punitive damages "*is the equivalent of willfulness or intentional wrong.*") (citation omitted; emphasis added).

[16] In addition, the association asserts that nothing in the policy excludes punitive damages and that Mr. Wright supposedly conceded that punitive damages may be covered. *See* Association's Response Brief at 43. This assertion is correct only insofar as the policy has no exclusion that expressly excludes punitive damages and insofar as Mr. Wright stated there was no such explicit exclusion.

Indeed, even the case the association cites notes that conduct warranting punitive damages must be so reckless as to take the nature of a willful act. *Anderson v. Atl. Coast Line R. Co.*, 179 S.C. 367, 184 S.E. 164, 166 (1936) ("[N]egligence may be so gross as to amount to recklessness, but, when it does, *it ceases to be mere negligence, and assumes very much the nature of willfulness.*") (emphasis added).

VI. Coverage of the underlying damages is barred by the policies' "faulty work" exclusion.

In its opening brief, Harleysville explained that the Special Referee erred when he ruled that the underlying damages are covered despite the fact that each policy contains an exclusion "j(5)" for damage to any piece of real property on which the insured or its subcontractors performed operations which resulted in damage to that property. *See* Harleysville's Opening Brief at 35-37. In response, the association cites a recent opinion in which our Supreme Court held "that the temporal limits of the exclusion are coterminous with the performance of the acts." *Bennett & Bennett Const., Inc. v. Auto Owners Ins. Co.*, 405 S.C. 1, 747 S.E.2d 426 (2013). The Supreme Court's ruling in *Bennett* largely forecloses portions of Harleysville's prior argument regarding exclusion j(5). Nevertheless, the interpretation of the exclusion adopted in *Bennett* highlights the internal inconsistency of the Special Referee's ruling in this regard.

Specifically, when discussing "time on risk," the Special Referee found that the progressive damages began to occur on *all* the buildings 30 days after the certificate of occupancy was issued on the *first* building completed by Harleysville's insureds. Riverwalk Order at 46-47. At the time of the first certificate of occupancy, however,

the vast majority of the buildings in the complex were still being built.[17] Accordingly, the Special Referee ruled that damages were occurring to buildings during the time the insureds or their subcontractors were performing work. If this is correct, then under *Bennett* the majority of the underlying damages are barred by exclusion j(5).

The association cannot have it both ways, arguing one thing when discussing "time on risk" and arguing the opposite when discussing exclusion j(5). Either all damages began on a single date before most of the buildings were built (in fact not possible), or the damages to each building began on a date specific to that building's completion. If the former is correct, then the Special Referee erred by failing to rule that exclusion j(5) excludes coverage for the majority of the damages. Alternatively, if latter is correct, then the Special Referee erred by failing to apply "time on risk" on a per building basis.

VII. The Special Referee made improper and prejudicial findings of fact.

In its opening brief, Harleysville explained that the Special Referee erred in his findings regarding Harleysville's reservation of the right to contest coverage, Harleysville's decision to forgo a needless and futile attempt to intervene in the underlying suit, and Harleysville's correct interpretation of the then existing law regarding allocation. *See* Harleysville's Opening Brief at 37-44. The only assertions raised by the association that warrant response are briefly rebutted below.

[17] The Special Referee determined that damages began to occur on Nov. 27, 1997. Riverwalk Order at 45-46. Of the 19 buildings at the Magnolia North complex, 13 were not completed until June 11, 1998. *See* "Riverwalk Data" attached to Harleysville's proposed order to the Special Referee. Accordingly, the Special Referee effectively ruled that in 13 of 19 buildings, damages were occurring during construction.

First, the association asserts that the Special Referee's erroneous findings regarding Harleysville's reservation of rights were not prejudicial. *See* Association's Response Brief at 46. The prejudice of the erroneous findings was that the Special Referee concluded "that Harleysville's actions constitute an implied waiver of Harleysville's right to contest coverage in this action." Riverwalk Order at 44 (citation omitted). In addition, the prejudice is evident by the fact that the association relies on the supposed inadequacy of Harleysville's reservations of rights to argue that the verdict is not subject to allocation. *See* Association's Response Brief at 56.

Next, the association asserts the Special Referee's finding that Harleysville failed to reserve its rights cannot be disturbed if that finding is supported by any evidence, and that Harleysville's failure to produce a letter sent to one insured constitutes such evidence. *See* Association's Response Brief at 46-48. However, the problem with the Special Referee's finding was that it was *contradicted* by the evidence and was incorrect as a matter of law. *See* Harleysville's Opening Brief at 39-41 (explaining that Harleysville repeatedly and clearly explained to its insureds Harleysville's reservation of its rights).[18]

In addition, the association asserts that the contents of Harleysville's reservation of rights letters were insufficient and that Harleysville should have intervened in the underlying suit. *See* Association's Response Brief at 48-51. The legal and factual sufficiency of Harleysville's letters is thoroughly established in Harleysville's prior

[18] Even assuming the absence of the letter indicated it never existed, Harleysville's oral reservation of rights was sufficient and effective. *See* Harleysville's Opening Brief at 50 n.36 and accompanying text (compiling cases).

briefing and need not be repeated here, *see* Harleysville's Opening Brief at 49-57, as has the futility and needlessness of intervention, *see id.* at 8-11; *see also supra* at 3-4.

VIII. The Special Referee erred by excluding relevant, admissible evidence and testimony.

Harleysville explained in its opening brief that the Special Referee made numerous evidentiary rulings. *See* Harleysville's Opening Brief at 44-48. In response the association argues the Special Referee's rulings were correct. Several of the association's arguments merit reply and are easily rebutted.

First, the association wrongly asserts "Harleysville conceded that there is no method to determine how the jury allocated damages." Association's Response Brief at 51 n.20. Harleysville made no such concession. Rather, it repeatedly argued to the Special Referee and this Court that it is possible to accurately allocate the underlying damages. *See* Harleysville's Pre-Trial Brief at 20-36; Trial Tr., December 13-14, 2010, at 235-53; Harleysville's Motion for Judgment and Directed Verdict at 3; Harleysville's proposed Order at 23-30; Harleysville's Motion to Vacate, Alter, or Amend at 5; Harleysville's Opening Brief at 5-18. The fact that a lay witness stated in a deposition that he was personally unsure how the underlying jury awarded damages is hardly a concession of this issue of law and legal theory. *See Linder v. Ins. Claims Consultants, Inc.*, 348 S.C. 477, 489, 560 S.E.2d 612, 618-19 (2002) (recognizing that lay persons like insurance employees are not expected to understand or decide issues of abstract legal principles or trial strategy) (citing *Dauphin Cnty. Bar Ass'n v. Mazzacaro*, 351 A.2d 229, 233-34 (Pa. 1976)).

Second, the association states Harleysville was not prejudiced by the Special Referee's ruling excluding testimony that Harleysville met with its insureds to discuss its coverage concerns and to reserve the right to contest coverage in a subsequent action. *See* Association's Response Brief at 53 ("Harleysville failed to point out any prejudice resulting from this ruling.") (citation omitted). The prejudice of these rulings is that in conjunction with the Special Referee's erroneous legal analysis, *see* Part IX, *infra*, they led the Special Referee to incorrectly conclude that Harleysville failed to reserve its right to contest coverage. *See* Riverwalk Order at 44.

Third, the association states that it was harmless error for the Special Referee to exclude testimony of Harleysville's discussions and agreement with its insured prior to the underlying trials to defer resolution of the coverage dispute until after trial. See Association's Response Brief at 53. Specifically, the association asserts this error was harmless because the "same testimony was allowed on cross examination." *Id.* This is incorrect because the testimony allowed on cross examination was not the same. The testimony excluded by the Special Referee described meetings that occurred *before* the underlying trial. (*See* Trial Tr. of December 13-14, 2010 at 113 (noting that in discussion with the insureds, "the idea was to go into the trials in lockstep" together and defer coverage dispute until later).) The testimony later elicited on cross-examination describes discussions *after* the lawsuit in which Harleysville reiterated its position there was no coverage. (*See id.* at 180.) This error was not harmless. As noted above, this erroneous ruling, in conjunction with the Special Referee's erroneous legal analysis, *see* Part IX, *infra*, led the Special Referee to incorrectly conclude that Harleysville failed to reserve its right to contest coverage. *See* Riverwalk Order at 44.

IX. Harleysville adequately reserved its right to contest coverage.

In its opening brief, Harleysville explained that the Special Referee incorrectly ruled that Harleysville failed to reserve its right to contest coverage. *See* Harleysville's Opening Brief at 48-59. In response, the association concedes that the "real issue" is not whether every insured received a reservation of rights letter but argues that Harleysville, in its oral or written reservations of rights, was obliged to advise its insureds of a conflict of interest and the supposed need for an allocated verdict. *See* Association's Response Brief at 55. South Carolina's courts have never mandated the contents of a reservation of rights letter or conversation, but other jurisdictions to consider this question have *not* required that an insurer's reservation of rights inform the insured of any supposed conflict of interest. *See* Harleysville's Opening Brief at 52-54 (compiling authorities). Indeed, the very existence of a reservation of rights letter implicitly notifies the insured of any conflict. *Britt v. Cambridge Mut. Fire Ins. Co.*, 717 S.W.2d 476, 481 (Tex. Ct. App. 1986). As to the allocated verdict, as explained repeatedly in Harleysville's prior briefing, there was no need for Harleysville to advise its insureds they should request an allocated verdict because, *inter alia*, at that time, under South Carolina law, *all* the underlying damages were covered.

In addition, the association argues that a stranger to the insurance contract, such as the association, may raise and rely on supposed deficiencies in the insurer's dealings with its insureds. *See* Association's Response Brief at 57-58. The association relies on a significantly distinguishable case—*Canadian Ins. Co. of Canada v. Rusty's Island Chip Co.*, 36 Cal. App. 4th 491 (Cal. Ct. App. 1995)—for the proposition that a party

injured by an insured has standing to litigate coverage issues such as an insurer's reservation of rights. The critical difference between that case and the case at bar, however, is that in *Canadian*, the court's holding was expressly premised on the fact that a California statute made the underlying injured party a third party beneficiary of the insurance contract between the insurer and the insured, and thereby permitted the injured party to enforce those promises made for his benefit. *Canadian*, 36 Cal. App. 4th at 497 (relying on Cal. Ins. Code § 11580 (b)(2)). In contrast to this California statute, South Carolina's courts have stated that an injured person is a stranger to the insurance contract and has no right to enforce it or rely on its breach. *See*, *e.g.*, *Auto-Owners Ins. Co. v. Rhodes*, 405 S.C. 584, 598, 748 S.E.2d 781, 788 (2013) (citing *Young v. Smith*, 168 S.C. 362, 167 S.E. 669 (1933) for the proposition that "no privity of contract exists between an insurance company and a third party who may benefit from indemnification unless the insurance contract specifically lists the third party as a beneficiary"); *Trancik v. USAA Ins. Co.*, 354 S.C. 594, 554-55, 581 S.E.2d 858, 861 (Ct. App. 2003) (holding an injured party "does not have a contractual relationship with the insurer and cannot maintain an action against the insurer for breach of the insurance contract"); *see also* Harleysville's Opening Brief at 57-59 (compiling cases).

X. The Special Referee erred by refusing to consider Harleysville's Motion for Judgment.

The Special Referee denied its motion for judgment based on his erroneous belief that motions for judgment are inapplicable in a non-jury setting. *See* Harleysville's Opening Brief at 58-60. In response, the Association does not dispute that Harleysville is correct regarding the applicability of motions for judgment in a

bench trial pursuant to Rule 41, SCRCP. Rather, the association merely argues that the Special Referee's erroneous denial of the motion should be excused because Harleysville's Motion for Judgment was inadvertently titled as a Rule 50 or 56 motion rather than as a motion pursuant to Rule 41. *See* Association's Response Brief at 58-59. The association's argument places form over substance and ignores the fact that courts should and do apply the proper law to an incorrectly captioned motion. *See, e.g.*, *Ducworth v. Neely*, 319 S.C. 158 n.1, 459 S.E.2d 896 n.1 (Ct. App. 1995) (noting that an incorrectly captioned motion was actually a motion pursuant to Rule 41(b), SCRCP, and therefore reviewing it as such).

XI. This Court should recompute the damages amount for which Harleysville is responsible by applying the correct law.

Assuming some of the underlying damages are covered and not excluded by the policies, this Court should apply the proper law regarding allocation and "time on risk" and should thus recompute the amount for which Harleysville is responsible. In the underlying trial, the association was awarded a verdict of $4,471,178.31.[19] Riverwalk Order at 3. According to the Special Referee, Harleysville is responsible for $3,044,499.43. *Id.* at 49.[20] After correcting the Special Referee's errors, this Court has several options for recalculating damages as explained below. The below options assume

[19] This amount includes actual damages of $4,500,000 and punitive damages of $250,000 in the association's suit, and loss of use damages of $250,000 and punitive damages of $750,000 in the individual homeowners' consolidated suit. Riverwalk Order at 3. The trial court granted a setoff from this combined total of $5.5 million, bringing the total underlying verdict to $4,471,178.31. *Id.* n.1.

[20] The Special Referee ruled that Harleysville was liable for $1,794,499.43 in actual damages, $250,000 in punitive damages, and $1,000,000 in loss of use damages (including $250,000 actual and $750,000 punitive damages), for a total liability of $3,044,499.43. *See* Riverwalk Order at 49.

the exclusion-based arguments of Harleysville are not adopted by this Court. Should they be, which Harleysville urges, this Court can easily adjust the judgment accordingly.

First, by allocating the actual damages, applying "time on risk" to the covered actual damages on a per-building basis using the correct policy date, applying "time on risk" to the loss of use damages using the correct policy date, and applying "time on risk" to the punitive damages using the correct policy date, Harleysville would be liable for **$659,600.79**. This result is calculated as follows. As explained in the bench trial, only 17.82% of the actual damages are covered, *see* Harleysville's Opening Brief at 5, bringing the covered actual damages to $575,350.48. When this amount is subject to a per-building "time on risk" using the correct policy dates, it is reduced to $161,600.79:

Bld.	"Start date" (CO + 30)[21]	Days of coverage[22]	Days of damages[23]	Multiplier[24]	Damage per building[25]	Covered damages
1	11/27/1997	935	2347	.3984	$30,281.60	$12,064.19
2	11/30/1997	932	2344	.3976	$30,281.60	$12,039.96
3	12/14/1997	918	2330	.3940	$30,281.60	$11,930.95
4	12/26/1997	906	2318	.3909	$30,281.60	$11,837.08
5	12/24/1999	178	1589	.1120	$30,281.60	$3,391.54
6	2/2/1998	868	2279	.3809	$30,281.60	$11,534.26
7	3/2/1998	840	2251	.3732	$30,281.60	$11,301.09
8	3/9/1998	833	2245	.3710	$30,281.60	$11,234.47
9	6/11/1998	739	2151	.3436	$30,281.60	$10,404.76
10	7/15/1998	705	2117	.3330	$30,281.60	$10,083.77

[21] Dates are taken from Harleysville's exhibit "Riverwalk Data," an attachment to its proposed order.

[22] The Special Referee held the policies expired on June 18, 2001 (Riverwalk Order at 46), thus each building was covered from its start date to June 18, 2001. This date, however, is wrong. See below.

[23] The Special Referee ruled the damage at Riverwalk concluded on April 30, 2004. (Riverwalk Order at 45-46.) Thus, the damages to each building occurred from its "start date" to April 30, 2004.

[24] The multiplier is calculated by dividing the days of coverage by the days of damages. It reflects the portion of time the policies were in effect during the time in which the damages were occurring.

[25] Actual damages, after set-off and not including punitive and loss of use damages, and being properly allocated are $575,350.48. Divided among the 19 buildings at Riverwalk, this amounts to $30,281.60 per building.

11	8/16/1998	673	2085	.3228	$30,281.60	$9,774.90
12	9/25/1998	633	2045	.3095	$30,281.60	$9,372.16
13	11/5/1998	592	2004	.2954	$30,281.60	$8,945.18
14	11/30/1998	567	1979	.2865	$30,281.60	$8,675.68
15	12/17/1998	550	1962	.2803	$30,281.60	$8,487.93
16	10/24/1999	239	1651	.1448	$30,281.60	$4,384.78
17	1/30/2000	141	1553	.0908	$30,281.60	$2,749.57
18	12/24/1999	178	1590	.1119	$30,281.60	$3,388.51
19	12/24/1999	178	1590	.1119	$30,281.60	$12,064.19
					Total:	**$161,600.79**

The Court would then apply "time on risk" to the loss of use damages, using the correct policy dates, which reduces the total loss of use damages to $398,400.[26] The Court would then apply "time on risk" to the underlying punitive damages, yielding a punitive damage amount of $99,600.[27] Taken together, as noted above, after allocating and properly applying "time on risk," Harleysville is responsible for $659,600.79.

If this Court declines to allocate the underlying damages, it should nevertheless recalculate Harleysville's liability based on the Court's holdings on the other issues. For example, if the Court determines to apply "time on risk" to the unallocated actual damages on a per-building basis, the actual damages are reduced to $925,871.66 if using the correct policy date, *see* Harleysville's Opening Brief at 18-19, and are reduced to $1,521,098.33 if using the incorrect policy dates used by the Special Referee, *id.* at 16-17. Next, if the Court holds that "time on risk" applies to the underlying punitive damages, that amount is reduced to $99,600 if using the correct policy dates, *see* note 27 *supra*, or is reduced to $138,950 if using the incorrect policy dates used by the Special

[26] The longest time period of Harleysville's coverage was for the first building built, where Harleysville covered 935 of the 2347 days in which damage occurred. *See* chart above. Accordingly, Harleysville's "time on risk" is calculated by multiplying the damage amount by .3984.

[27] *See* note 26, *supra*. Harleysville's "time on risk" is calculated by multiplying the damage amount by .3984.

Referee.[28] Similarly, if the Court determines to apply "time on risk" to the loss of use damages, that amount will be reduced to $398,400 if using the correct policy dates, *see* note 27 *supra*, or reduced to $555,800 if using the incorrect policy dates used by the Special Referee, *see* note 28, *supra*.

Finally, even if allocation is not warranted, if "time on risk" does not apply on a per-building basis or to the loss of use or punitive damages, and if the Special Referee did not err by using incorrect policy dates, the remaining aspects of the Special Referee's "time on risk" calculation—*i.e.*, that it applies to the covered damages and his chosen "end date" of damages—are correct, and the association is not entitled to the inflated amount it seeks in its cross-appeal. *See generally* Harleysville's Response Brief (refuting the association's arguments no appeal seeking to enlarge the amount of its recovery).

Conclusion

For the foregoing reasons, this Court should reverse the judgment of the Special Referee in the various respects noted herein and either eliminate or reduce the amount of Harleysville's liability in accordance with its holdings or alternatively remand for further proceedings consistent with such an opinion.

[*SIGNATURE PAGE ATTACHED*]

[28] The Special Referee determined that Harleysville had coverage for 1,300 of the 2,347 days in which the damage occurred, and thus used a multiplier of .5558.

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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM HORRY COUNTY
Court of Common Pleas
John M. Milling, Special Referee

Case No. 2009-CP-26-10053
Appellate Case No. 2013-001291

Harleysville Group Insurance, a Pennsylvania corporation, ... Appellant/Respondent,

v.

Heritage Communities, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar Corporation, a South Carolina corporation; Riverwalk at Arrowhead Country Club Horizontal Property Regime; Riverwalk at Arrowhead Country Club Property Owners Association, Inc., a South Carolina corporation; National Surety Corp., and Tony L. Pope and Lynn Pope, individually and representing as a class all unit owners at Riverwalk at Arrowhead Country Club Horizontal Property Regime, ... Defendants.

Of whom Heritage Communities, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar Corporation, a South Carolina corporation; National Surety Corp., and Tony L. Pope and Lynn Pope, individually and representing as a class all unit owners at Riverwalk at Arrowhead Country Club Horizontal Property Regime, ... Respondents,

And Riverwalk at Arrowhead Country Club Horizontal Property Regime; Riverwalk at Arrowhead Country Club Property Owners Association, Inc. are, ... Respondents/Appellants.

PROOF OF SERVICE

I, the undersigned Administrative Assistant of the law offices of Nelson Mullins Riley & Scarborough LLP, attorneys for Appellant/Respondent, do hereby certify that I have served all counsel in this action with a copy of the pleading(s) hereinbelow specified by mailing a copy of the same by United States Mail, postage prepaid, to the following address(es):

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