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: 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 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 are Respondents,

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

RESPONDENT'S FINAL BRIEF OF RESPONDENT/APPELLANT

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Statement of the Case

This appeal arises from a declaratory judgment action filed October 14, 2009, by Harleysville Group Insurance (hereinafter "Harleysville") seeking a determination of its duty to indemnify its insureds for two general verdicts. Harleysville asked that if the Court determined it had a duty to indemnify, to permit it to allocate the two general verdicts into covered and non-covered damages. The general verdicts arose out of construction defect cases and were secured against Heritage Communities, Inc., the overall developer of the Riverwalk Condominiums; Heritage Riverwalk, Inc., the site specific developer; and Buildstar, Inc., the general contractor. These three entities will be referred to collectively as "the Harleysville insureds". Harleysville insured each of these entities through commercial general liability policies ("CGL").

One of the general verdicts was secured against the Harleysville insureds by the Riverwalk at Arrowhead Country Club Horizontal Property Regime and Arrowhead Country Club Property Owners Association, Inc., (collectively "Riverwalk" or "POA"). The other general verdict was secured by the individual homeowners through a class action ("Pope Class Action"). The POA and Pope Class are sometimes referred to as the "claimants". The Harleysville insureds were the same in both actions. In this declaratory judgment action the Riverwalk and Pope Class Action were consolidated with a substantially similar action ("Magnolia North") and were referred to the Honorable John M. Milling as Special Referee by a Consent Order dated October 21, 2010, (R. p. 17), directing him to take testimony and evidence and to issue final orders disposing of the cases.

The Special Referee held a hearing on December 13-14, 2010. Subsequently, as a result of the Supreme Court's opinion in *Crossman Communities of North Carolina, Inc., et. al. v. Harleysville Mutual Insurance Company, et. al.*, 395 S.C. 40, 717 S.E.2d 589 (2011), the Special Referee reopened the hearing on December 9, 2011, to hear arguments and testimony regarding the application of "time on risk" as described in *Crossman*.

On February 28, 2013, the Special Referee issued his order disposing of the Riverwalk action and the Pope Class Action (R. p. 25). The Special Referee ruled that the Harleysville CGL policies covered the general verdicts in each of the underlying actions; no policy exclusions applied; the general verdicts could not be divided into covered and non-covered damages; Harleysville did not properly reserve its rights to contest coverage; and "Time-on-the-risk" applied to the actual damages awarded in the Riverwalk POA action but did not apply to punitive damages or to the Pope Class Action loss of use damages.

Both parties filed motions to vacate, alter or amend the Order. After a hearing held on April 9, 2013, the Special Referee denied these motions in an Order dated April 23, 2013 (R. p. 124). Harleysville filed its Notice of Appeal on May 20, 2013, and Riverwalk filed its Notice of Appeal on May 23, 2013. On June 14, 2013, the Court of Appeals consolidated the cross appeals.

Statement of Facts

In the underlying POA action, the Fourth Amended Complaint is the operative Complaint. (R. pp. 1098) In the Pope Class Action, the Third Amended Complaint is the operative Complaint. (R. pp. 1076) In both complaints, the POA and Pope Class alleged numerous construction deficiencies in the development and construction of the Riverwalk project and alleged that as a result of those deficiencies "numerous parts of the buildings have been continuously and repeatedly exposed to leaks causing moisture infiltration resulting in mold, rot, rust and degradation of the buildings." (R. pp. 1103-1104; R. pp. 1085-1087) In addition, the Complaint alleged that defective windows and trim board have caused the buildings to be continuously and repeatedly exposed to moisture and unconditioned air entering the buildings, walls and rooms, resulting in mold, mildew, rot and degradation of the buildings. It is not contested that all of the work was performed by subcontractors. (Wright Deposition, p. 79, line 23-p. 80, line 7; R. p. 1432) The pleadings in both the POA and Pope Class Action contained a cause of action for negligence, breach of warranty and breach of fiduciary duty. In addition to costs to repair the damages, the POA sought damages for costs they had expended prior to trial attempting to stop water from intruding and making the buildings unsafe. (R. p. 808, line 2-p. 809, line 10)

Pursuant to the terms of their policies, Harleysville employed attorneys to represent their insureds. Harleysville also provided reservation-of-rights ("ROR") letters to some of its insureds but omitted sending the general contractor, Buildstar, a reservation-of-rights letter and provided no reservation-of-rights letters to its insureds in the Pope Class Action. (R. pp. 1776-1842)

During the six (6) years that the cases were pending, Harleysville monitored the cases and was in contact with the insureds and their attorneys hired to represent their insureds, who were regular attorneys hired by Harleysville. [1] (R. p. 431, line 18-p. 432, line 6) Although Harleysville contends that they had numerous conversations with their insureds about why they did not "think" there was any coverage, Harleysville did not advise their insureds of a conflict of interest or the need for a verdict that differentiated between covered and uncovered claims. (R. p. 427, lines 10-13; R. p. 433, lines 21-25) Harleysville simply advised their insureds that they did not believe there was any coverage because these claims did not meet the level of being an "occurrence". (R. p. 428, lines 4-10)

Harleysville's ROR letters were general and were a restatement of most all, if not all, of the many exclusions in the policy. Harleysville never detailed to its insureds which exclusions they deemed applicable and strikingly in this appeal, only contended that there are two exclusions applicable.

Harleysville had an agreement with its insureds that they would resolve coverage issues in a subsequent judicial proceeding. (R. p. 430, lines 16-25) During the approximately 6 years between the filing of the underlying POA action and the verdict, Harleysville chose not to seek a judicial determination of what claims, if any, were covered so that appropriate action by their insureds could be taken to protect their interests. Harleysville attended the underlying trial with its coverage counsel (R. p. 434, lines 2-14), and conferred with the attorneys representing the insureds. However, Harleysville never brought the need for an allocated verdict to the attention of their insureds, or to attorneys

[1] In the discovery process, Harleysville refused to produce certain documents such as emails between them and the attorneys they hired based upon "attorney-client privilege". (R. p. 1701)

they hired to represent their insureds or to the Court, and made the decision neither to intervene, nor to ask the Court to file special interrogatories. Harleysville's reasoning for not intervening was that they had attempted to do so in other cases, but the lawyers would not agree to it. Thus, when the form of the verdict was being discussed, Harleysville sat silent. (R. p. 433, lines 16-25) (See also, Answers to Request to Admit and Supplemental Interrogatories dated February 4, 2010, (R. pp. 1640-1643), wherein Harleysville admits it had no discussion about the verdict form with its insureds.) Harleysville admits there is now no method to determine how the jury allocated damages. (Wright depo, p. 85, lines 4-12; R. p. 1434)[2]

The Pope Class Action and the POA action ("underlying action(s)") were consolidated for trial and a jury trial commenced on January 5, 2009, and each were concluded with a general verdict on January 15, 2009. At the trial of the underlying actions the Trial Court directed a verdict for the POA on its negligence claim and submitted the case to the jury to determine damages for negligence and breach of fiduciary duty if such breach occurred. (R. p. 2116) The jury found for the POA on breach of fiduciary duty and awarded a general verdict to the POA on both causes of action of Four Million Two Hundred Fifty Thousand and no/100 ($4,250,000.00) Dollars and punitive damages of Two Hundred Fifty Thousand and no/100 ($250,000.00) Dollars. (R. p. 2116) In the Pope Class Action, the Court also directed a verdict on the negligence claim and in addition, submitted to the jury breach of warranty of habitability and breach of fiduciary duty. The jury found for the Pope Class on all causes of action and awarded a general verdict of Two Hundred

[2] The attorneys hired by Harleysville to represent its insureds agreed to the use of a general verdict form. (R. p. 1038, line 8-p. 1041, line 22)

Fifty Thousand and no/100 ($250,000.00) Dollars actual damages and Seven Hundred Fifty Thousand and no/100 ($750,000.00) Dollars punitive damages for a total verdict in both actions of Five Million Five Hundred and no/100 ($5,500,000.00) Dollars. (R. p. 2116; R. p. 2118) At the post trial motion hearing, the Court granted an offset from the total of the two verdicts resulting in a final combined verdict of Four Million Four Hundred Seventy-One Thousand One Hundred Seventy-Eight and 31/100 ($4,471,178.31) Dollars for both actions. (R. p. 1)

The Harleysville insureds appealed the underlying actions and the Court of Appeals affirmed. *Pope v. Heritage Communities, Inc.*, 395 S.C. 404, 717 S.E.2d 765 (Ct. App. 2011) A certiorari petition was filed and is pending before the South Carolina Supreme Court. Harleysville filed this declaratory judgment after the verdicts were rendered in the underlying case.

In the Amended Answer and Counterclaim filed in this action November 6, 2009, (R. p. 148) the POA and Pope Class contended that Harleysville slumbered on their rights in re coverage of the claims, which prejudiced the Claimants and the Harleysville insureds and contended that Harleysville should be estopped from now attempting to re-litigate damages. (R. pp. 150-151) Claimants denied that any of the exclusions applied, denied that TOR applied to the general verdicts, and sought a judgment against Harleysville for their general verdicts together with costs and post judgment interest.

Argument

I. The Special Referee did not err in denying Harleysville's request to attempt an allocation of the general verdict because their attempt was in violation of South Carolina precedent.

Harleysville does not contest the fact that covered claims were submitted to the jury. (R. p. 651, lines 3-11; R. p. 676, lines 1-12; R. p. 717, line 23-p. 718, line 5) However, Harleysville asked the Special Referee to allow it to introduce a damage estimate not related to the jury's verdict and then extrapolate from the new estimate how the jury allocated damages. The issue of whether an insurance carrier should be allowed in a declaratory judgment action to attempt the allocation of a general verdict was decided in *Auto-Owners Insurance Company, Inc. v. Newman*, 385 S.C. 187, 684 S.E.2d 541 (2009) ("Newman"). Appellants are clearly in error in asserting that *Newman* does not apply in this case to foreclose Harleysville from attempting to allocate the general verdict. The *Newman* case was a declaratory judgment action to determine if Auto-Owners had to indemnify the Newmans for an arbitrator's general award arising from the negligent construction of the Newman's home. In *Newman*, the Supreme Court delineated what was covered in a construction case involving moisture related damages resulting from inadequate construction. The *Newman* Court held that defective construction was not covered under the CGL policy but the moisture damage to previously undamaged parts of the building resulting from the defective construction was covered.

In *Newman*, Auto-Owners hired attorneys to represent the general contractor (Trinity) in the arbitration proceeding. At the arbitration hearing, neither of the attorneys hired by Auto-Owners sought to secure an allocated award differentiating between covered and non-covered damages, and as a result, the arbitrator issued a general unallocated award. Although the Court held that any portion of the arbitrator's award allocated to removal and replacement of the defective stucco was not covered, the Court nevertheless held that Auto-

Owners must pay the entire award. The Court reasoned that the declaratory judgment action could not be used to re-litigate damages, ie., to litigate which damage amounts fell into the covered column and which damage amounts fell into the non-covered column. In a footnote, the Court gave the reason for this ruling:

> 5. Auto-Owners represented Trinity in binding arbitration, made mandatory by the terms of the insurance contract. Auto-Owners did so with a reservation-of-rights and an understanding that the coverage issue would be reserved for judicial consideration in a separate proceeding. When the arbitrator determined damages, Auto-Owners did not seek review of [intervene] or otherwise contest the damages award. *Id.* p. 201

Other than the underlying trial being a jury trial instead of an arbitration, the essential facts of *Newman* and this case are the same.

Important policy reasons underlie the *Newman* Court's ruling on this issue. First, insurance carriers who assume and control the defense of their insureds are held to a high standard of care to take whatever action it can to protect the insured's rights to be compensated to the fullest extent allowed by the terms of the policy and the law. *Magnum Foods, Inc. v. Continental Gas Co.*, 36 F.3d 1491 (10th Cir. Ok. 1994) (Insurer who undertakes a suit against its insured must meet a high standard of conduct. The right to control the litigation carries with it the duty not to prejudice the insured's rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages.) Second, to allow the insurance company to take no action when the issue of damages is raised in litigation and then put its insured in a position of having to go through additional litigation to re-litigate damages is unconscionable. This is especially true when the insurance carrier takes no action to seek an allocated award which puts the Court in a position of speculating how the jury allocated damages. *Moore v. Moore*, 360 S.C. 241,

599 S.E.2d 467 (S.C. App. 2004) ("since the jury returned a general verdict and the appellant did not request the Trial Court to submit a special verdict form to determine the type of damages rendered by the jury, the Court cannot speculate as to what portion of the award the jury attributed to lost profits as opposed to other tort damages") Third, the insurance carrier drafted the policy and is in the best position to know that an unallocated verdict can mean devastating consequences to its insureds. Since the insurance carrier has elected to assume and control the defense of its insured, it is the insurance companies' duty to seek an allocated verdict or to inform its insureds, the attorneys, or the Court of the consequences of an unallocated award. *Pharmacists Mutual Insurance Co. v. Mayer*, 187 Vt. 323, 993 A.2d 413 (2010) (although Pharmacists did not control the litigation, having perceived a conflict and deferred to independent counsel, it nevertheless continued to monitor the trial through its litigation specialist and remained the most informed party concerning coverage issues and the potential difficulties in parsing a general verdict between covered and non-covered damages. Therefore, it was incumbent upon Pharmacists to notify the Trial Court and the parties of the potential apportionment issue and of the need for special interrogatories allocating damages or to seek permission if necessary to attend the charge conference to propose such interrogatories or even intervene in the litigation if all else failed.)

The rule pronounced in *Newman* gives the insurance carrier the incentive to take all legal avenues including intervention, submission to the Court of special interrogatories, or in the very least, informing its insured of the need for an allocated verdict. To allow the insurance carrier to disregard those avenues the legislature has provided, such as Rule 24,

SCRCP, for intervention and Rule 79, SCRCP, for submission of special interrogatories, would create a waste of judicial resources.

Appellant contends that *Newman* does not foreclose its request to allocate damages because in *Newman* the record was not sufficient for an allocation of damages, but it is in this case because Harleysville presented evidence sufficient for an allocation of damages.[3] Harleysville's reading of *Newman* misses the mark. In *Newman*, when the Court refers to "the record", they are clearly referring to the record before the arbitrator who issued a general award from which it could not be determined how the arbitrator allocated damages. It is the Trial Court's record or in *Newman*, the arbitrator's record from which it is determined if an allocation between covered claims and non-covered claims can be made. As noted in *Allan D. Windt, Representations of Insurance Companies and Insureds, §6: 26*, it is only the Trial Court's record for determining if an allocation can be made:

> They should not, for example, be allowed to call as witnesses the people that testified at the earlier Trial unless those persons are limited to reading their testimony from the earlier Trial. To the extent those witnesses give any other testimony, such testimony is irrelevant; it will not assist in the determination of how the Court or the jury in the underlying case viewed the facts.

Newman is not without precedent. In *Owners Ins. Co. v. Clayton*, 364 S.C. 555, 614 S.E.2d 611(2005)("Owners"), Owners brought a declaratory judgment action to determine its responsibility to indemnify its insured who had been sued and against whom a general verdict had been rendered. Three causes of action had been submitted to the jury and Owners contended that all three claims were excluded. Owners had provided a CGL policy

[3] Harleysville was allowed to proffer evidence of how the damages could be allocated, not based upon the trial record, but upon a completely new estimate. The Special Referee rejected the evidence as irrelevant and speculative. (R. p. 461, line 20-p. 479, line 22)

(as Harleysville did here) and defended its insured under a full reservation of rights. Owners contended that the "Employment Related Practices Exclusion" excluded any coverage for the claims. The Court stated that "since the Clayton jury returned a general verdict, a finding that any of the three claims submitted to that jury is not excluded answers the coverage question" *Id.* p. 560. The *Owner's* Court found one of the claims was not excluded and stated that "Our holding that the exclusion does not apply to the defamation claim means that Owners must indemnify Lands Inn for the Clayton general verdict" *Id.* p. 561. The Court went on to hold that since one claim was covered, it need not address the other claims. Had there been a segregated verdict between the three claims as opposed to a general verdict, the Court would have had to examine each claim to determine if the exclusion applied to them. See also *Liquor Liability Joint Underwriting, Association v. Hermitage Insurance Company*, 419 Mass. 316, 644 N.E.2d 964, 969 (1995) (Where insurer fails to carry its burden of allocating a judgment between covered and uncovered claims, it is liable for the entire judgment.)

Newman and *Owners* are in accord with a long line of South Carolina precedent as noted by the Special Referee in his Order. (R. p. 56) Respondents/Appellants could find no case (and Appellant cites none) in South Carolina in which a litigant was allowed to attempt an allocation of a general verdict. This Court recently decided *Jenkins v. Few*, 391 S.C. 209, 705 S.E.2d 457 (Ct. App. 2010) ("Few") and addressed the request of a defendant to allocate damages when a general verdict had been rendered. In *Few*, several claims were submitted to the jury which rendered a general verdict. Few argued that the jury's award on one of the claims was excessive and should be reduced. In denying allocation of the general verdict, this Court said:

> Few contributed to drafting and agreed to use a general verdict form that did not include a separate damages award for each cause of action. Because the verdict was a general verdict, it is impossible to determine how the jury allocated damages between civil conspiracy, conversion and trespass to personal property. We will not speculate as to how the jury allocated damages. *Id.* p. 221

Every South Carolina case this writer could find on this issue was in accord with the Court's holding in *Few*. (R. p. 56) Harleysville has cited no South Carolina Case allowing the allocation of a general verdict. The Special Referee's Order on this issue should be affirmed.

A. The attempt by Harleysville to allocate the general verdict is a re-litigation of damages.

In the underlying Trial Court, Harleysville employed attorneys to defend its insureds. As part of this defense, Harleysville paid an expert to prepare a damage estimate for presentation to the jury to counter the damage estimate submitted to the jury by the Plaintiffs. In the declaratory judgment action from which this appeal arises, Harleysville attempted to introduce a completely new damage estimate unrelated to any estimates that were submitted to the jury in the underlying trial.[4] Had the judge allowed this damage estimate, Respondents/Appellants (who step into the shoes of the insured) would have had to produce another damage estimate and "re-litigate" the same damages already litigated in the Trial Court. Harleysville's assertion that this would not be a "re-litigation" has no merit. Simply because Harleysville is attempting to use the damage estimate for a different

[4] The estimate of repairs submitted to the jury by Harleysville's insureds in the underlying action was $2,391,619.00 (R. p. 1036, lines 4-6). The estimate of damages submitted by the Plaintiffs in the underlying action was $8,991,669.00 (R. p. 919, lines 18-25). The estimate of damages proffered by the Harleysville insureds in the present action was $4,741,000.00 (R. p. 488, lines 15-18).

reason (to parse the general verdict) cannot take away the fact that the same damages litigated in the liability trial are being "re-litigated".[5]

Regardless of how Harleysville tries to interpret the word "re-litigate", the reason for the Court's refusal to allow for a new litigation of damages remains the same. Harleysville controlled the defense and had a duty to its insured to seek a verdict that would protect the insured's interest and avoid putting the Court, its insureds or these claimants through more protracted and expensive litigation. *Armitage v. Seaboard Airline Ry. Co.*, 166 S.C. 21, 164 S.E.2d 169 (1932) (Courts do not approve of numerous actions regarding the same matter thereby putting the Courts and parties to additional expense and trouble. This is especially true when submissions of special issues [interrogatories] to the jury would avoid this). *McCloud v. Roy Riegels Chemicals, et. al.*, 20 Cal. App. 3d 928, 97 Cal. Rptr. 910 (Cal. App. 3d Dist. 1971) (parties should have but one chance by request for special verdict forms to have the jury's verdict pinpointed. They should not be permitted to drag out litigation by turning their backs on the safeguards provided by the legislature. Where a general verdict was rendered where a special verdict could have been used, it puts the Courts in a guessing game as to how the jury traveled to reach its verdict.); *Highway 20 Terminal Inc., v. Tri-County Agri Supply, Inc.*, 235 Neb. 207, 454 N.W.2d 671 (1990) (Insurance carrier who failed to seek an allocated verdict will not be allowed to attempt to recompute damages; this would be pure speculation since there is no method to determine why the jury returned the amount they did, their discussions and reasons inhere in the verdict and cannot be inquired into.)

[5] Harleysville wants the Court to ignore the jury's verdict and adopt Harleysville's view of the facts.

In its brief, (p. 7), Harleysville seems to imply that it discussed the need for an allocated verdict with its insureds. The record is conclusive that this did not occur. (R. pp. 1720-1724) The Special Referee's unchallenged findings of facts 48 and 49 (R. p. 37) with references to the record, conclusively show that Harleysville never discussed with its insured the need for an allocated verdict; never filed a motion to intervene and never advised the Court of the need for an allocated verdict. Harleysville should not be allowed to now benefit from its own miscalculation that nothing was covered. (See also Response to Plaintiff's Amended Responses to Defendant's First Requests for Admit and Supplemental Interrogatories dated February 17, 2010, R. pp 1668-1669, paragraphs 10-11, wherein Harleysville admits it did not discuss the form of the verdict with its insureds.)

B. Harleysville should have filed its declaratory judgment in a timely manner or should have timely intervened or sought an allocated verdict to protect its insureds.

Harleysville first says that it had neither the opportunity nor the incentive to intervene to seek an allocated verdict. Claimants are not sure what Harleysville means when it alleges that it did not have the "opportunity" to intervene. There is nothing in the record to even imply that Harleysville was in some way prevented from filing a motion to intervene under Rule 49, SCRCP. Harleysville made a conscious decision not to intervene (R. p. 433, lines 16-20)

Harleysville contends that at the time of the Riverwalk Trial *Newman I* said that all damages in a construction case were covered, thus there was no reason for it to intervene. (Brief p. 8) It should also be noted that Harleysville knew or should have known that a petition for rehearing was filed in *Newman I* and could have sought delay in the underlying cases pending a ruling by the Supreme Court. Two (2) years after the POA brought their

action, the Supreme Court decided *L.J., Inc. v. Bituminus Fire and Marine Insurance Co.*, 366 S.C. 117, 621 S.E.2d 33 (2005) in which the Court clearly enunciated the law in the final *Newman* decision that water damage resulting from defective construction could be covered under the CGL policy. Harleysville has been extremely involved in these coverage issues and had to be fully aware during the six (6) years of the pendency of these actions of the probability that some of the damages may be covered.[6]

Harleysville's position apparently assumes that they could not have intervened or sought a declaratory judgment until the trial of the case in 2009. However, the underlying case was filed in 2003 and Harleysville was fully aware of the coverage issues at that time and issued reservation-of-rights letters in January, 2004. (R. pp. 1776-1843) Yet Harleysville made no attempt to intervene during all those years the litigation was ongoing and waited some six (6) years after the case was filed and after the verdicts were rendered to file this declaratory judgment action. A declaratory judgment action is ripe and can be filed during the pendency of the underlying action for damages. *Auto-Owners Ins. Co. v. Rhodes*, 2013 W.L. 5348381; *Isle of Palms Pest Control Co. v. Monticello Ins. Co.*, 319 S.C. 12, 459 S.E.2d 318 (Ct. App. 1994).

Harleysville also contends that it could not "simply instruct" the insureds counsel to request an allocated verdict. (Brief p. 10) The basis for this is that it would violate Rule 5.4(c), RPC, Rule 407, SCACR, which prevents a person paying a lawyer to represent a third person "to direct or regulate" the lawyer's professional judgment. A letter to their insureds with a copy to defense counsel advising of the need for an allocated verdict and

[6] In fact, Harleysville at some point advised their insureds that the "grand majority" of the claims were not covered. (R. p. 356, lines 5-21)

the results of not securing one does not "direct or regulate" the lawyers professional judgment. It would not create a conflict and would be in the best interest of both the insurer and the insured. This would have been especially beneficial to the insureds if advised well before trial so that evidence could have been presented in such a manner to allow for an allocation. Harleysville's insureds or these claimants should not be prejudiced by Harleysville's failure to take appropriate action. Clearly Harleysville slumbered on its rights and now asks this Court to extricate it from its own ineptitude. Harleysville should not now be allowed to relitigate damages and extend this litigation because of its own failure to protect its interest and those of the insureds.

C. An allocation of damages contained in a general verdict is barred by not only *Auto-Owners v. Newman*, but also by South Carolina precedent and precedent from other jurisdictions.

The holding of the Court in *Newman* and numerous other South Carolina cases barring post-trial allocation of general verdicts is addressed above. Harleysville's contention that it should now be allowed to present evidence of how the jury "might have" allocated damages neither serves the best interests of its insureds, nor judicial economy, especially in light of the fact that the problem could and should have been avoided had Harleysville taken the appropriate steps available to them. As the Court said in *Magnum Foods, Inc. v. Continental Cas Co.*, 36 F.3d 1491 (10th Cir. Okla. 1994):

> As an initial matter, we note that an insurer who undertakes the defense of a suit against its insureds must meet a high standard of conduct. *Duke v. Hoch*, 468 F.2d 973, 978, (5th Cir. 1972); *Gay & Taylor, Inc. v. St. Paul Fire & Marine Ins. Co.*, 550 F. Supp. 710, 714-16 (Dist. Ct. Okla. 1981). The right to control the litigation carries with it certain duties. *Traders & General Ins. Co. v. Rudco Oil & Gas Co.*, 129 F.2d 621, 627 (10th Cir. 1942). One of these is the duty not to prejudice the insured's rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages. See *Gay & Taylor*, 550 F.Supp. at 716. The

> reason for this is that when grounds of liability are asserted, some of which are covered by insurance and some of which are not, a conflict of interest arises between the insurer and the insured. If the burden of apportioning damages between covered and non-covered were to rest on the insured, who is not in control of the defense, the insurer could obtain for itself an escape from responsibility merely by failing to request a special verdict or special interrogatories. *Duke*, 468 F.2d at 979. The insurer is in the best position to see to it that the damages are allocated; therefore, it should be given the incentive to do so. *Id.* pp. 1498-1499.

Harleysville's reliance on *Duke v. Hoch*, 468 F.2d 973, 978, (5th Cir. 1972) for the proposition that it should be allowed to allocate the jury's verdict is misplaced. In *Duke*, the facts are vastly different than the present case. Duke had secured a general verdict against accountants for various services. The Trial Court had directed a verdict of liability on a non-covered claim. Home, the insurance carrier, was able to prove (how is not explained by the Court) that the jury allocated damages to the non-covered claim that the Judge had directed a verdict on. The Court pointed out that Home would be allowed to try and separate covered and uncovered damages "only if it was first established that a portion of the verdict represented liability for uncovered acts." *Id.* p. 976 This burden was upon Home. Since Home met its burden, the Court remanded the case for the Trial Court to determine as best as it could, how the jury may have allocated damages if it had been given a chance to do so. The Duke Court said "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." *Id.* p. 894 Harleysville attempted an allocation based on totally different evidence from the "evidence on which the jury based its verdict." *Duke* not only has different facts than the present case, it is also against all South Carolina precedent as the Special Referee set out in his Order. (Order p. 32) *Pharmacists Mutual Insurance Co. v. Mayer*,187 Vt. 323, 993 A.2d 413 (2010) is fully in line with the Supreme Court's holding in *Owners v. Clayton*

and *Newman, supra*. In *Pharmacists*, there were different defamatory statements submitted to the jury, which issued an undifferentiated award. The Court held that once the insured demonstrated that a covered claim was submitted, the burden is on the carrier to then demonstrate that the entire claim is excluded from coverage. The Court went on to say that even though Pharmacists did not control the litigation:

> ...it nevertheless continued to monitor the Cooper Trial [underlying trial] through its "litigation specialist" and remained in regular contact with defense counsel. Indeed, Pharmacists remained the most informed party concerning coverage issues and the potential difficulties of parsing a general verdict as between covered and uncovered claims. Therefore, to protect its interests and meet its burden it was incumbent upon Pharmacists to notify the trial court and the parties of the potential apportionment issue and of the need for special interrogatories allocating damages, to seek permission if necessary, to attend the charge conference, to propose such interrogatories, or even to intervene in the litigation if all else failed. *Id.* p. 420 [citations omitted]

When Harleysville sought to limit its liability for the verdict, it was required to show that "it had faithfully and fully performed its responsibilities to its insured by disclosing the need for an allocated verdict." *Buckley v. Orem*, 112 Idaho 117, 123, 730 P. 2d 1037 (Idaho Ct. App. 1986). Harleysville failed to perform even a modicum of this duty and as a result, placed upon itself liability for the entire verdict.

D. Other jurisdictions as does South Carolina will not allow the Court to speculate as to how the jury allocated damages.

The distinguishing factor between the present case and *Duke* is the carrier's ability in *Duke* to prove that the general verdict included non-covered damages. This distinction has been pointed out by other Courts. For example, in *Mid-Continent Casual Company v. Clean Seas Company, Inc.*, 860 F. Supp. 1318 (M.D. Fla. 2012), the Court distinguished *Duke* by noting that because of the Trial record and instructions to the jury it could be

established that non-covered claims were included in the verdict. *Id.* p. 1324. See also *Tig Insurance Company v. Royal Insurance Company of America*, 2004 W.L. 728858 (Del. 2004) ("*Duke* clearly holds that a post-verdict allocation of damages in the coverage context should not even be considered unless and until the insurer meets its burden of showing that the general verdict included damages for non-covered acts") The *Tig* Court held that where it was impossible to determine if a lump-sum award included non-covered damages, the "so called 'duty to allocate' recognized in *Duke* is not even implicated. The Court held in *Tig* that since the Court has no basis to make a logical assessment of the jury's purpose when it awarded lump-sum damages, the Court will not engage in speculation especially "when the dilemma now confronting TIG is of its own making." *Id.* p. 8.

South Carolina, along with many other jurisdictions, follow the rule that attempting to allocate a general verdict would necessarily have to be the result of conjecture, speculation or guess. *Highway Terminal, Inc. v. Tri County Agri. Supply, Inc.*, 235 Neb. 207, 454 N.W.2d 671, 675 (1999)(what motivated a jury to reach its general verdict inhere in the verdict and cannot be inquired into); *Niles v. U.S.*, 520 F. Supp. 808 (N.D. Cal., 1981)(California Courts refuse to speculate on how the jury arrived at its verdict. Appellants' remedy was to request a special verdict at the time of the Trial.); *Ammondson v. Northewestern Corp.*; 353 Mont. 28, 220 P..3d 1, (2009) (Court will not speculate how the jury arrived at the compensatory award); *Hydent v. Highcouch*, 353 Ark. 609, 110 S.W.3d 760 (2003) (where a general verdict is used Court will not speculate what the jury found); *Collins v. Talley*, 146 N.C. App. 600, 553 S.E.2d 101 (2001) (An appellate court will not speculate as to the legal or factual basis for the jury's award of damages).

In the case at bar, such an allocation is impossible to make. Harleysville attempted to introduce by Mr. Frank Baiden an estimate of what Mr. Baiden believed would be covered damages based on his new estimate. His estimate had no relationship to the Trial record and was excluded. On cross examination, Mr. Baiden, Harleysville's expert, testified as follows:

> Q. And I want to make sure. There's no correlation between your estimate and the estimates that were given to the jury?
>
> A. No, sir. (R. p. 507, lines 4-8)

He also testified that he never even looked at the estimate of damages submitted to the jury. (R. p. 500, line 21-p. 502, line 13)

Allowing Harleysville to attempt an allocation would be speculative and arbitrary; clearly prohibited by South Carolina case law. (See Special Referee's Order, R. p. 56)

Harleysville cites *Allstate Insurance Co. v. Keltner,* 842 N.E.2d 879 (Ind. Ct. App. 2006) ("Keltner") for the proposition that other jurisdictions allow post-trial allocations. The facts in *Keltner* are vastly different than those in this case. In *Keltner*, Allstate attempted to intervene for the purpose of seeking an allocated verdict and the Keltners opposed the motion. The Trial Court denied Allstate's motion. The Court also indicated some doubt there was even a need for an allocated verdict. *Id.* p. 884, Ft. Note 4. Had Allstate followed the same course as Harleysville in this case and taken no steps to seek an allocated verdict, the outcome may have been entirely different.

The next case Harleysville cites for the proposition of allowing post-trial allocation is *Donna C. v. Kalamaras*, 485 A.2d 222 (Me. 1984). Several allegations were made against the insured, some of which may not be covered. The carrier attempted to intervene

and participate in the trial which the Trial Judge denied. Under these circumstances, the Court held the carrier could not be denied the right to subsequently raise coverage questions.

Harleysville made a decision not to intervene; not to advise its insureds of a conflict of interest; not to ask the Court to submit special interrogatories; and not to advise their insureds of the need for an allocated verdict. It is unconscionable for Harleysville to ask for the Court's aid. Harleysville and its counsel attended the trial and conferred with defense counsel before and during trial, yet took no action believing there was no coverage for any of the claims. They had an obligation to their insureds to at least attempt to intervene or to advise them and counsel of the need for an allocated verdict and the catastrophic loss of coverage or protracted litigation that may result from an unallocated verdict. *Clinkscales v. North Carolina Mutual Liability Insurance Company*, 201 S.C. 375, 23 S.E.2d 1 (1942) (Where damages could have been stated separately by the jury but no request was made and where "counsel sat silently by and permitted the jury to disburse without raising any question thereabout" an allocation could not thereafter be considered. *Id.* p. 6); *Butterfield v. Giuntoli, et. al.*, 448 Pa. Super. 1, 670 A.2d 646, 658 (1995) (holding that insurer had the opportunity and the obligation to request special interrogatories allocating damages between covered claims where insurer's attorney attended the Trial, was in contact with defense counsel and sat in on chamber conferences. While in Court, in chambers or through the defense attorneys handling the case, the insurer had the opportunity to request specific instructions on the question, specific interrogatories, or special verdict forms. 670 A.2d at 658) The Court went on to note that the insurer had the option to intervene but did not pursue any means available to them to definitively determine its duty to indemnify.

Therefore, the Court concluded that the insurer could not meet its burden of proving that the claim was excluded from coverage.

Allowing Harleysville to now attempt an allocation of damages would be speculative, arbitrary and against well settled South Carolina precedent.

II. The Special Referee erred in applying "Time-on-the-Risk" ("TOR") at all because applying TOR to a general verdict resulting from claims that would be covered and claims that would not be covered has no legal basis.

The single issue, the subject of Respondent's/appellant's cross appeal, is that the Special Referee erred in applying TOR to a general unallocated verdict.[7] Without knowing how the jury allocated damages, which is an impossibility in this case, any formula applied by the Special Referee would have no legal basis. In *Crossman*, the Court made it clear that TOR only applies to damages that occur over a period of time, ie., progressive (injury) damages.[8] In this case, since the verdict is unallocated between progressive and non-progressive damages a formula would be impossible to devise which would have any legal basis. Although this writer could find no case directly in point, *Doe v. Illinois State Medical Inter-Insurance Exchange*, 234 Ill. App 3d 129, 599 N.E.2d 983 (2000) is analogous. In *Doe*, the insurance carrier assumed the defense of its insured doctor. The insured doctor's treatment extended over two policy periods. It was clearly in the doctor's interest that his negligent acts be deemed unrelated and therefore covered under both policy periods. Otherwise, the doctor would be personally liable for any judgment corresponding

[7] As pointed out in Respondent/Appellant's cross appeal, this relief was not requested by Harleysville. Harleysville asked that the general verdict be allocated into covered and uncovered damages and TOR applied to the covered damages. (R. pp. 135-138)

[8] The Court in *Crossman* defined "progressive injuries" as "8. A progressive injury is an injury that resulted from an event or set of conditions that occurs repeatedly or continuously over time, such as long term exposure to asbestos fibers or the continual intrusion of water into a building."

to his conduct during the second policy period. The carrier, however, sought to have the doctor's conduct constitute a series of related acts so that only one policy would provide coverage. The Court stated:

> By not warning Doctor Magsaysay [insured] about this conflict, reserving its rights or filing a declaratory judgment action until after the verdict, the insurer is estopped from contesting coverage under the second policy here... Id. p. 135
> The verdict for Plaintiffs did not specify which acts of negligence were proved; stating only that the damages suffered resulted in 'the occurrence in question.' The jury may have found the defendant negligent in 'one or more' of the ways plaintiff claimed, as instructed. *Which of those ways were proved, during the policy period the negligent acts were committed, or whether no negligence was committed during the first policy period or, alternatively, during the second policy period are questions not put to the jury by either party.* Although the insurer suggests that plaintiffs should have submitted special interrogatories or an allocated verdict form to the jury, it was the insurer who was aware that such a problem existed as between itself and its insured, Dr. Magsaysay; therefore it was the insurer's obligation to ameliorate its own allocation difficulty. Id. p. 138 [Emphasis supplied]

The Special Referee without the facts of how the jury allocated damages, to what periods the jury allocated damages, or to what causes of action the jury allocated damages had no legal basis to apply TOR using any formula.

In the present case, Harleysville never reserved its rights as to this issue, never advised its insureds of this issue and never even advised the insureds that a conflict of interest existed (R. p. 427, lines 10-13), and therefore, should not be aided by the Court by applying TOR.

In the underlying POA case, in addition to the damages submitted to the jury for cost of repair, the POA submitted repair expenses incurred prior to trial that they had expended over a period of time to make the buildings safe. (R. p. 808, line 2-p. 809, line

10) If the jury awarded these damages, TOR would not apply to them. In addition, the jury found that the Harleysville insureds breached their fiduciary duty by turning common elements over to them that were in a bad state of repair. This breach occurred in September, 2002 (R. p. 805, line 1-p. 806, line 23).[9] Since the jury did not give the Plaintiffs the full measure of their claimed damages, who is to say that the jury did not cut off damages in 2002 at the time the common elements were turned over. This is not beyond the realm of possibility especially since the judge charged the jury on Plaintiffs' duty to mitigate. (R. p. 1072, line 17-p. 1073, line 10)

Because of these factors, no formula for applying TOR would be appropriate, including the one used by the Special Referee and the one proposed by Harleysville. Both of these formulas mold the jury's verdict without any legal basis. Harleysville or the Special Referee cite no legal authority, nor can they, authorizing application of TOR to a general verdict containing numerous types of damages and causes of action.

A. The Special Referee did not err in his refusal to reopen the case for Harleysville to try and prove one of its policies had been canceled.

"The decision whether to reopen a record for additional evidence is within the Trial Court's sound discretion and will not be disturbed on appeal absence an abuse of discretion." *Brenco v. South Carolina Department of Transportation*, 377 S.C. 124, 659 S.E.2d 167 (2008). After the Special Referee issued his order, Harleysville asked the Court to reopen the record to allow proof that one of the policies it introduced had been cancelled. On August 31, 2010, Claimants took the deposition of Mr. Lee Wright, Harleysville's 30(b)(6) witness in re the policies. (R. pp. 1673-1675) Harleysville's attorney had produced

[9] The Special Referee extended the TOR calculation through April 30, 2004. (R. pp. 69-70)

a notebook of all the policies the subject of the declaratory judgment action. Mr. Wright testified that these were the policies at issue in this declaratory judgment action. (Wright Depo., p. 48, lines 9-15; R. p. 1424) No testimony was given that the subject policy had been cancelled. Harleysville also responded to discovery listing the policy in question as one that was in force during the policy periods indicated on the policy. (R. p. 1736; R. p. 1759, Response 32) The notebook of Harleysville's policies was introduced at the trial of this case along with a chart showing the policies and dates of coverage. (R. pp. 1450-1638; R. p. 1844) There was no testimony at any time that the policy in question had been canceled.

The reopening of the case would have been highly prejudicial to the POA and the Pope Class. The Respondents would have been put to further discovery and trial. Harleysville's request to reopen the case was too late. The Special Referee did not abuse his discretion. In addition, this may well be inconsequential since we do not know if the jury awarded damages that occurred during this policy period.

B. TOR would not apply to loss of use damages awarded to the Pope class.

Harleysville's policies cover "property damage" which is defined as:

> Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it. (*Id.* quoting policy)

Harleysville contends that this language and the principle of progressive damages mandates application of TOR to the loss of use damages awarded to the Class.[10] Harleysville reasons that since the policy provides that loss of use is deemed to occur "at the time of the physical

[10] Harleysville's citation of *National Grange Mutual Insurance Co. v. Fireman's Insurance Company*, 310 S.C. 116, 425 S.E.2d 754 (Ct. App. 1993) is inapposite. National Grange stands for the proposition that loss of use damages are excluded from contribution under S.C. Code §38-75-20. It has no application to TOR.

injury that caused it" and since the physical injury that caused it occurred progressively, TOR should be applied. This assertion by Harleysville ignores the wording of its policy. The loss-of-use provision speaks of the time at which the loss of use will be deemed to occur, which is at the time of the physical injury that caused the loss of use. In this case, water intrusion damages.

In the recent case of *Walde v. Association Insurance Co.*, 401 S.C. 431, 737 S.E. 2d 631 (Ct. App. 2012) the Court had before it the meaning of "physical injury" in the context of the CGL policy's loss-of-use coverage. The Court noted that regardless of how long the property damage occurred, the policy deems all loss of use to have occurred "at the time of the occurrence." *Id.* p. 639 In this case, the "occurrence" occurred when water entered the buildings causing damage to previously undamaged property. *Newman* supra. (continuous moisture intrusion resulting from the subcontractor's negligence is an "occurrence" as defined by the CGL policy. *Id.* p. 544) The policy does not say that the loss of use will be deemed to occur when the physical injury that caused it progresses to an extent that loss of use results. *Cook v. State Farm Automobile Insurance Company*, 376 S.C. 426, 656 S.E.2d 784 (Ct. App. 2008) (Clauses of inclusion in an insurance policy should be broadly construed in favor of coverage). Simply stated, there is no logical argument that TOR would apply to loss-of-use damages and Harleysville cites no case which supports their position.

III. TOR cannot apply to punitive damages.

Harleysville cites no precedent nor can it, that punitive damages are progressive damages and subject to TOR. Harleysville cannot tell us upon what act(s) the jury determined to award punitive damages or when those acts occurred. The only thing that is

clear is that the acts justifying punitive damages occurred before the last policy expired. At the expiration of the last policy the Harleysville insureds were no longer involved at Riverwalk.[11]

A. TOR should not apply to either actual or punitive damages.

Harleysville attempts to reduce its liability for the punitive damage award by asking the Court to apply TOR to punitive damages.[12] Such holding would be unprecedented and in conflict with the nature and purpose of punitive damages.

Harleysville asserts that because punitive damages have a "compensatory role" TOR should be applied to reduce its liability for punitive damages. By analogy, this position is untenable. In *Clark v. Cantrell*, 339 S.C. 369, 529 S.E.2d 528 (2000) the Court considered for the first time whether under comparative negligence, punitive damages as well as actual damages were required to be reduced. The Trial Court and the Court of Appeals had both determined that punitive damages would not be reduced. As Harleysville has advanced in this case, the Appellant argued that punitive damages have a "compensatory role" and therefore should be reduced. The Supreme Court disagreed. The Court stated "while there is a compensatory aspect to punitive damages, we find unpersuasive Cantrell's [Defendant's] attempt to blur all distinctions between actual and punitive damages by unduly emphasizing that compensatory aspect." *Id.* p. 379. Reducing coverage for punitive damages would take away protection that the insureds paid for. Harleysville's failure to submit special interrogatories leaves the Court to speculate as to what actions of the defendants motivated the jury to award punitive damages and when

[11] The last policy expired on June 18, 2001 and the Harleysville insureds had completed the last building in the last of 1999 or beginning of 2000 (R. p. 822, line 11-p. 823, line 13).

[12] This relief, applying TOR to punitive damages, was not requested in the pleadings. (R. pp. 127-140)

those actions took place. Were the Court to apply TOR to punitive damages, the Court may well be reducing the punitive damages for actions that all took place within one coverage period. Application of TOR to punitive damages would be pure speculation since what acts the jury based punitive damages on and when they occurred inhere in the verdict and cannot be inquired into.

IV. The special referee did not err in finding that punitive damages are covered.

Harleysville begins its analysis of this issue by stating "Not all of the damages awarded in the underlying trial stem from an occurrence as defined by the relevant insurance policies." (Brief p. 24) It would be more accurate to state that "not all the claims submitted to the jury constitute an occurrence." Thus, Harleysville can only speculate as to what gave rise to the award of punitive damages. It could have been numerous events, some constituting an "occurrence" and some not. For example, the violation of a building code can give rise to an award of punitive damages if the jury finds that such violation constituted gross negligence. *Kennedy v. Columbia Lumber and Manufacturing Company*, 299 S.C. 335, 384 S.E.2d 730 (1989).

Harleysville's next contention is that the Special Referee uses the "all sums" language to support coverage of punitive damages when in fact the Harleysville policies use "those sums." Although Harleysville is correct, there is simply no difference in the application here. Harleysville's policy states that it "will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury" or "property damage." In *South Carolina Budget and Control Board Division of General Services, Insurance Reserve Fund v. Prince*, 304 S.C. 241, 403 S.E.2d 643 (1991), the Court

considered whether a policy covered punitive damages containing the language that the carrier would "pay on behalf of the insured "all sums" which the insured shall become legally obligated to pay as damages." *Id.* p. 249 Citing *Carroway v. Johnson*, 245 S.C. 200, 139 S.E.2d 908 (1965) the Court held that policy language "the sums which the insured is legally obligated to pay as damages" was sufficiently broad to cover a liability for punitive damages since "the sums" would encompass punitive damages. *Id.* p. 249 In the context of this issue, there is no difference between "all sums" and "those sums." In *State Farm Fire and Casualty Company v. Martinez*, 26 Kan. App. 2d 869, 995 P. 2d 890 (2000), State Farm issued a policy containing the same "those sums" language as contained in the Harleysville policies here. State Farm contended that the language in its policy covering "those sums" did not cover civil penalties asserted against its insured. The Court noted that in a previous case it held that "all sums" was unambiguous and unqualified, and would cover punitive damages; "the policy did not say all sums awarded as compensatory damages..." *Id.* p. 866 The Court then went on to hold that under this rational, civil penalties would be covered under the broad language of State Farm's policy that contains the language "those sums". The Court also noted, as Harleysville conceded here, (Wright Depo., p. 87, lines 4-22; R. p. 1434), there is no exclusion pointed to by State Farm that would eliminate coverage for civil penalties. It would have been simple for Harleysville to have inserted the word "compensatory" before the word "damages".

Harleysville next asserts that because its policy covers only an "occurrence" which is defined as an "accident" that conduct to warrant punitive damages must be the result of an intentional act or as the Trial Judge charged the jury, a "conscious failure" and a "present consciousness of wrong doing." However, it should also be noted the Trial Judge charged

the jury that "punitive damages will be allowed even when a defendant does not realize it is invading the plaintiff's rights, so long as the act is committed in such a manner that a person of ordinary prudence would conclude that it was done in reckless disregard of the rights of another." (R. p. 1074, line 23-p. 1075, line 3)

Harleysville's position was advanced by the insurance company in *Pennsylvania Thresherman & Farmer's Mutual Casualty Insurance Co. v. Thorton*, 244 F.2d 823 (C.A. 4 1957). Applying South Carolina law, the Court rejected the carriers position holding that:

> Negligent conduct may be so gross so as to merit characterization as willful and wanton in the sense of the rule for punitive damages, yet fall far short of an assault and battery which would distinguish it from an accidental event and withdraw it from the coverage of the policy... to allow the appellant's argument would lead to the illogical and indefensible result that... the more extreme the recklessness the more likely the insurer would be to escape liability. *Id.* p. 827.

The Court went on to hold that no matter how reckless the respondent's conduct, there was nothing in the record that the insured intended to injure the plaintiff. Likewise in the case at bar, there is evidence in the record to support the Special Referee's finding that the Harleysville insureds did not intend for their subcontractors to intentionally harm the insureds or to cause damages to their insureds. (discussed *infra*.) (R. pp. 32-34) It makes no sense that the insureds intended their subcontractors to perform negligently and then give the purchasers a warranty warranting the construction and repair of the buildings. (R. p. 941, line 15-p. 944, line 7)

Harleysville's statement that the jury's award of punitive damages is tantamount to a finding by the jury that the conduct of the insureds' was not accidental but was intended belies Harleysville's failure to take a modicum of action to protect itself. Harleysville's

statement (Brief p. 23) that "The builders intentional wrongful conduct most likely occurred prior to the Certificate of Occupancy" is illustrative of Harleysville's attempt to put the Court in a guessing game which the Court should reject. It is the tradition in the South Carolina Bar for insurance carriers to intervene solely for the purpose of submitting interrogatories to the jury after its verdict asking "Do you find the Defendant intended to damage the Plaintiff by his conduct?" The Special Referee's finding that punitive damages are covered should be affirmed.

V. The Special Referee committed no error in finding that Harleysville failed to meet its burden of proof that exclusion "a" "expected or intended" applied to defeat coverage for the general verdicts.

Insurance policy exclusions are construed most strongly against the insurance company which also has the burden of establishing the exclusions' applicability. *Owners Ins. Co. v. Clayton*, 364 S.C. 555, 614 S.E.2d 611 (2005) ("Owners"); *Boggs v. Aetna Cas. and Sur. Co.*, 272 S.C. 460, 252 S.E.2d 565 (1979).

Whether Harleysville's insureds expected or intended the harm and damage is a question of fact. *Rentco, a Division of Fruehauf Corporation v. Tamway Corporation*, 283 S.C. 265, 321 S.E.2d 199 (S.C. App. 1984) (intent is a matter of fact for the trier of the facts); *American Family Mutual Insurance Co. v. Pacchetti*, 808 S.W.2d 369 (Sup. Ct. Mo. 1991) (whether the insured "intended or expected" an injury is a question of fact.); *Watson v. Alabama Farm Bureau Mutual Casualty Insurance Co.*, 465 So.2d 394 (Ala. 1985) (question of whether infliction of an injury is "expected or intended" is a question of fact for the jury or Judge).

The terms "expected" and "intended" are generally defined as being synonymous. *South Carolina Farm Bureau Mutual Insurance Co. v. Dawsey*, 371 S.C. 353, 638 S.E.2d

103 (Ct. App. 2006) As Harleysville concedes, the Court applies a two pronged test to determine whether such an intentional act exclusion applies. *Miller v. Fidelity-Phoenix Insurance Co.*, 268 S.C. 72, 231 S.E.2d 701 (1977); *Vermont Mutual Insurance Company v. Singleton*, 316 S.C. 5, 8, 446 S.E.2d 417, 419 (1994). The two prongs are: 1) was the act causing the loss intentional; and 2) were the results (damages) intended. This is a subjective test. [13] This two pronged test was applied in *Newman*:

> In our opinion and in the absence of any evidence otherwise, it is unreasonable to believe that Trinity expected or intended its subcontractor to perform negligently. Therefore Trinity could not have expected or intended the resulting property damage. CF. *Lamar Homes v. Mid-Continent Casual Co.*, 242 SW3d 1, 8 (Tx. 2007) ("But a deliberate act, performed negligently, is an accident if the effect is not the intended or expected result; that is, the result would have been different had the deliberate act been performed correctly") *Id.* p. 197 [Emphasis supplied]

Harleysville contends that the test of whether the insured "expected or intended" the injury should be a foreseeability test. This same position was advanced by Auto-Owners in *Newman*. Auto-Owners contended the damages to the Newman's home were excluded because "...a construction professional would expect substantial moisture intrusion from defective stucco to result in these types of damages." *Id.* p. 197 This is a foreseeability test. The Court rejected this contention and applied the two prong *Miller* test. *Miller*, *supra*.

Our Court has long rejected the foreseeability test. In *Stevenson v. Connecticut General Life Insurance Co.*, 265 S.C. 348, 218 S.E.2d 427 (1975), the Court had before it

[13] Lee Wright, Harleysville's construction litigation manager admitted Harleysville had no evidence their insureds "consciously intended to create a situation that water damage would occur". (R. p. 436, line 13-p. 437, line 6)

the question of whether an injury resulted from an "accident". The insurer argued that there was no accident because a reasonably prudent person should have foreseen his conduct would cause an accident. The Court rejected the foreseeability test pointing out, if foreseeability were the test, the negligence of the insured would always defeat coverage.

As the Special Referee pointed out in his Order, it is the intent not the foreseeability because if the test is foreseeability this would unduly limit coverage because foreseeability is an essential element of negligence and therefore, even simple negligence would be excluded. (R. p. 46)

As explained in *Scott C. Turner, Insurance Coverage of Construction Disputes* § 9:3, Determination of Intent or Expectation:

> ... insurers often deny claims on the basis that the damage or injury caused by the policyholder was "foreseeable" by the policyholder. This construction cannot be. To establish liability for tort against the insured, the claimant must establish as a necessary element of negligence that the insured must have foreseen the injury or damage. Therefore, if the argument forwarded by the insurers is correct, then the very act which triggers liability also precludes coverage. Equating "foreseeability" with the term "expected" from the exclusion would result in little or no coverage. As one Court in an earth moving case has put it, 'The fact that the possibility of injury is foreseeable is not pertinent for that possibility is always present during the operation of heavy machinery and is indeed the reason for the issuance of the policy.'

A. Since there was a general verdict, Harleysville must prove that there is an exclusion that excludes the entire verdict.

In order for Harleysville to prevail on its contention that the "expected or intended" exclusion excludes coverage of the general verdict, Harleysville must show that the exclusion applies to the entire verdict, ie., all of the claims submitted to the jury are

excluded because each claim resulted from "expected or intended" conduct by its insureds. Harleysville cannot "cherry pick" claims submitted to the jury.

In *Owners*, *supra*., the Circuit Court determined that the carrier was required to indemnify its insureds and the judgment holder for the entire general verdict. *Owners* contended that the two defamatory statements from which the case arose were excluded by the terms of its policy. The case was submitted to the jury on three causes of action: malicious prosecution, slander and negligence. *Owners* had provided a CGL policy which excluded coverage for defamation related to employment. The Supreme Court upheld the finding of coverage although on a different ground than the Circuit Court. The Court stated that:

> Our holding that the exclusion does not apply to the defamation claim means that Owners must indemnify Lands Inn for the Clayton general verdict. *Frazier*, supra. Accordingly, we need not address whether the malicious prosecution claim is within the ERP exclusion." *Id.* p. 562 ... since the Clayton jury returned a general verdict, a finding of any of the three claims submitted to the jury is not excluded answers the coverage question. *Id.* p. 560

That is, if one claim submitted to the jury is covered, since there was a general verdict making it impossible to determine on which claim the jury based its verdict, the entire general verdict is covered. *Valley Bancorporation v. Auto-Owners Insurance Co.*, 212 Wis. 2d 609, 569 N.W.2d 345 (1997) (where covered and uncovered claims are submitted to the jury the entire claim is covered unless the insurer can show that the uncovered claim is the sole cause of the damage. If any included peril is a cause of the damage, it is assumed that the insured paid for protection and it would be unfair to the insured to deny the benefits he paid for. *Id.* p. 618)

The same result was reached in *Pharmacists Insurance Company v. Myer*, supra. ("Pharmacists") *Pharmacists* involved a number of claims of defamatory statements. The jury rendered a general verdict with no differentiation between covered defamatory statements and those that were not covered. The Trial Court granted summary judgment to *Pharmacists* saying it had no duty to indemnify or pay defense costs because there was an exclusion for defamatory statements the insured knew were false and therefore, the verdict was excluded. The Appellate Court remanded the case to the lower Court to allow a determination if any of the claims fell within the policy coverage. The Appellate Court was also asked about the allocation of damages if the lower court determined there were in fact covered defamatory statements submitted to the jury. The Court's reasoning is instructive:

> 14. For purposes of judicial economy, we also consider the corollary issue, raised and briefed by the parties, as to how-if at all- to allocate the damages award in the event of finding on remand that some of the defamatory statements were merely negligent and therefore within the policy coverage. As noted, the jury in the Cooper litigation rendered an undifferentiated award of $150,000.00 for defamation; it did not distinguish between covered and uncovered conduct. It is settled law in Vermont, however, that once an insured has demonstrated coverage under a policy, the burden falls "on the insurer to show that a third party's claim against the insured is *entirely excluded* from coverage. *Id.* p. 332 [emphasis added]

The Respondents/Appellants have clearly demonstrated that covered claims of water intrusion causing property damage to the previously undamaged parts of the building were pled and were submitted to the jury. This is not disputed. The Special Referee determined that Harleysville failed to meet its burden of proof that the general verdict was excluded from coverage. Because covered claims were submitted to the jury and a general

verdict rendered, Harleysville must indemnify its insureds for the general verdicts. *Owners*, *supra*.

B. Harleysville cannot meet its burden of proof that every claim submitted to the jury was excluded by the "expected or intended" exclusion.

The only exclusion advanced by Harleysville that would exclude the entire verdict is the "expected or intended" exclusion. Harleysville's argument on this issue is that the Special Referee's view of the facts were wrong. In order to prevail on their disagreement with the Special Referee on his findings of facts, Harleysville must show there is no evidence in the record to reasonably support the Judge's findings.[14] *Auto-Owners Insurance Co., Inc. v. Newman, supra*. ("when the purpose of the underlying dispute is to determine whether coverage exists under an insurance policy, the action is one at law. [citations omitted] In an action at law tried without a jury, the Appellate Court will not disturb the Trial Court's findings of fact unless there is no evidence to reasonably support them." *Id.* p. 191) [emphasis supplied]

Harleysville points out that its insureds were aware of problems with windows because they had complaints about windows leaking in other projects prior to installing windows (with the same configuration) at Riverwalk. The Special Referee found that "the Harleysville insureds did not expect or intend the subcontractors to install defective windows in the buildings. Harleysville insureds intended its subcontractors to install non-defective windows and changed window manufactures in an attempt to accomplish this". (R. p. 34, Finding of Fact 29)

[14] Lee Wright, Harleysville's construction litigation manager, testified he had no evidence that the Harleysville insureds intended to cause damages to the claimants. (R. p. 436, line 13-p. 437, line 6)

This is clearly indicated by the record in the underlying Trial. The Betterbuilt window representative, Mr. Graham, went to the Riverwalk project in the early stages because of a complaint about window leaks. He informed the job superintendent of his determination of improper installation. The response was from the Harleysville insureds that the problem was the defective window and not the method of installation and that a change in manufacturers would be made. (R. p. 860, line 7-p. 861, line 23) A meeting was called by the window supplier and was attended by Harleysville insureds. Harleysville insureds demanded the windows be replaced. (R. p. 862, line 2-p. 863, line 16) The Special Referee also found that the Harleysville insureds relied on the skill of their contractors and expected and intended them to perform their work in a competent manner. (Finding of Facts 14-15, R. p. 32) Qwyn Hardister, President of the Harleysville insureds testified that their warranty manual given to all the purchasers clearly stated that window leaks were not acceptable and would be repaired. (R. p. 943, line 17-p. 945, line 2) Mr. Hardister also testified that Heritage put defective condominiums in the stream of commerce but did so unknowingly. (R. p. 948, line 24-p. 949, line 4) The Special Referee also found that the Harleysville insureds expected the condominiums to meet the performance criteria of the warranty manual. (R. p. 35, finding 34) These findings are reasonably supported by evidence in the record. (R. p. 956, lines 10-24)

Notably, many of the Special Referee's findings on this issue went totally unchallenged. For example, one of the major issues in the underlying Trial Court was the problem with the Louisiana Pacific Trim that caused extensive moisture damage to the Riverwalk Condominiums. This problem was a latent defect and not discovered until a

painter discovered it after the buildings were turned over to the homeowners. (R. p. 34, Findings of Fact 23 and 25) Harleysville does not challenge this finding.

Dunes West Residential Properties, Inc. v. Essex Insurance Co., 2007 W.L. 4622916 (4th Cir. December 28, 2007), relied on by Harleysville is inapposite. In *Dunes*, Dunes owned a golf course which was managed by Scratch Golf Co. prior to *Dunes* acquiring the CGL policy. It was acknowledged that damages were occurring prior to the policy period. The Court held that no reasonable finder of fact could conclude that the damages that continued to occur after the policy's effective date would not be expected by Dunes. The damages claimed under the policy were simply a continuation of damages occurring prior to the policy being issued. These facts are far removed from those in Riverwalk and lend no merit to Harleysville's position. As noted above, some of the damages were not only unanticipated or unexpected, they were unknown to Harleysville's insureds. (R. p. 34, findings 23, 25, 26)

The policies provide that the "expected or intended" exclusion be looked at from the standpoint of the insured. The insureds did not construct the condominiums at Riverwalk; all the work was performed by subcontractors. (Wright Depo.p. 79, line 23-p. 80, line 16; R. p. 1432) Gwyn Hardister, president of Heritage, testified that Heritage had the expectation that their subcontractors would be reliable and skilled in their trade. (R. p. 959, lines 11-17) Harleysville insureds had the "expectation" that the subcontractors would meet the criteria set out in the warranty annual. (R. p. 956, lines 6-21) He also testified that there was nothing done intentionally or maliciously. (R. p. 962, lines 2-8) Lynn Anderson, President of Buildstar Corp., the general contractor, testified that Buildstar was strictly management and relied on their subcontractors. (R. p. 1008, lines 10-15) Harleysville

neither called its insureds to testify on this issue, nor does it dispute this testimony of their insureds.

In *Newman*, supra., the "expected or intended" exclusion was advanced by *Auto-Owners* contending that a construction professional would expect substantial moisture intrusion from defective stucco to result in the moisture intrusion damages for which coverage was sought and therefore the expected or intended exclusion barred coverage. The Court rejected this contention saying "In our opinion and in the absence of any evidence otherwise, it is unreasonable to believe that Trinity [contractor] expected or intended its subcontractor to perform negligently. Therefore, Trinity could not have expected or intended the resulting property damage." *Id.* p. 197 Likewise, there is evidence in the record to reasonably support the Special Referee's findings on this issue.

Harleysville tries to distinguish *Newman* by pointing to the words "and in the absence of any evidence otherwise" contending there is "evidence otherwise". However, there is evidence in the record to support the Special Referee's finding that Harleysville's insureds relied on their subcontractors and expected and intended them to perform the work in a skillful manner. (R. pp. 32-33, Findings of Fact 14 – 16; R. pp. 34-35, Findings of Fact 27 – 35) Harleysville does not contend that there is no evidence to reasonably support the Special Referee's findings.

The findings of the Special Referee on this issue are mostly unchallenged by Harleysville. Harleysville's selection of the installation of the windows as the basis of its claim of exclusion under exclusion (a) is simply only one deficiency, which the Special Referee concluded was unintended by the Harleysville insureds. (R. p. 34, Finding of Fact 29) Harleysville argues its view of the facts on this one deficiency, which, even if correct,

would not defeat coverage because there was a general verdict, and there were other covered claims submitted to the jury which Harleysville does not challenge. [15] *Owners*, supra.

C. The Court did not rely on inapplicable precedent in determining that the "expected or intended" exclusion did not defeat coverage.

Harleysville contends that the Special Referee used inapplicable precedent because the cases cited are distinguishable. The cases cited by the Special Referee are distinguishable if the facts as Harleysville sees them are correct. This is another attempt by Harleysville to argue the findings of facts. Harleysville distinguishes *City of Johnstown, N.Y. v. Bankers Standard Insurance Company*, 887 F.2d 1146 (2d Cir. 1989) by stating that the facts are different in that in the case at bar, "the insureds, at the time they engaged in the wrongful acts were aware of and expected the inevitable resulting damages." (App. Brief p. 30) These facts are contrary to the findings of facts made by the Special Referee. *Miller v. Fidelity-Phoenix Insurance Company*, 268 S.C 72, 12 S.E.2d 701 (1997) (Where Judge's findings that damages were not intentionally caused were supported by the evidence, the finding is binding on the Court of Appeals).

Harleysville also contends that the citation of the case of *Continental Western Insurance Company v. Toal*, 309 Minn. 169, 244 N.W.2d 121 (1976) is misplaced. (Brief p. 30) According to Harleysville, it is misplaced because it cites *Toal* for the proposition that the "expected or intended" exclusion turns on intent, not foreseeability. (Brief p. 30)

[15] Harleysville does not dispute that a number of claims for defective construction causing water damage that were submitted to the jury such as Louisiana Pacific trim product which was discovered to be defective; omission of flashing in areas; or the penetration of the weather membrane while putting in the railings causing moisture damage on the porches. (R. p. 35, Findings of Facts, 30, 32, 33, 34, 35)

In a footnote in Appellant's Brief, Appellant lists a number of jurisdictions that have determined that the "expected or intended" exclusion turns on foreseeably. In citing the *Toal* case, the Special Referee is addressing products that were installed in the Riverwalk Condominiums that turned out to be defective which the Heritage insureds were not aware of. (R. p. 46) If Heritage was not aware that defective products were being installed, the harm and damages could neither be intended, expected nor foreseen. As the Special Referee pointed out, there is no proof in the record that Harleysville's insureds even knew or were aware that the Louisiana Pacific Trim was defective and, therefore, could not be excluded from coverage under the "expected or intended" exclusion. This claim was clearly not excluded, was submitted to the jury, and under *Owners*, supra., since a covered claim was submitted to the jury and there was a general verdict, the entire general verdict is covered.

Harleysville cannot and did not meet its burden of proving exclusion "a" excluded the general verdict from coverage and the Special Referee should be affirmed.

D. The Special Referee did not rely on irrelevant testimony in determining the "expected or intended" exclusion did not apply.

Once again, Harleysville takes issue with the facts as found by the Special Referee. Harleysville contends that a blanket statement by Harleysville's construction litigation manager, Lee Wright, that the insureds built on the cheap, did so purposely, and they intended to build substandard buildings, is sufficient to invoke exclusion "a" "expected or intended". (R. p. 436, line 2-p. 437, line 6) As noted elsewhere, there is evidence in the record to reasonably support the Special Referee's findings that exclusion "a" does not apply.

Exclusion "a" must be viewed from the standpoint of the insureds. Officers of the insureds testified, as pointed out by the Special Referee, that they did not intend poor construction. They relied on the skill of their subcontractors. (R. p. 45) Clearly, there is evidence in the record to reasonably support the Special Referee's findings. This is true even if the Special Referee referred to proffered testimony. *Brown v. Allstate Ins. Co.*, 344 S.C. 21, 542 S.E.2d 723 (2001) (where Judge relied on incompetent evidence but could have reached the same result without relying on incompetent evidence, appellant court will affirm).

E. Punitive damages are clearly covered under the terms of the Harleysville policies.

The only policy provision which Harleysville points to as excluding punitive damages is the "expected or intended" exclusion. Under Harleysville's theory, punitive damages would always be excluded because punitive damages necessarily include an "intent to harm". This is simply not the law in South Carolina. See *Carroway v. Johnson*, supra. Harleysville's policy says that it will pay "those sums which the insured shall become legally obligated to pay as damages..." It does not limit the damages to compensatory damages. (R. p. 1867) Harleysville conceded at Trial that there is nothing in the policy excluding punitive damages. (Lee Wright depo. p. 87, lines 18-22, R. p. 1434) Harleysville's construction litigation manager, Lee Wright, also conceded that if punitive damages are insurable in a state and meet the qualifications for insurance, they can be paid. There is not an exclusion for punitive damages. (Lee Wright depo. p. 87, lines 4-22; R. p. 1434)

South Carolina precedent does not support Harleysville's position. In *Anderson v. Atlantic Coast Line R. Co.*, 179 S.C. 367, 184 S.E. 164 (1936), Appellant contended that in order to recover punitive damages, there must be proof that the defendant intended to injure the plaintiff. The Court rejected this position stating "it was not necessary for the plaintiffs to prove [to be entitled to punitive damages] that the defendant had a specific intent to injure plaintiffs..." *Id.* p. 165 The Court went on to state that the defendant's conduct to warrant punitive damages does not have to be wanton, willful and reckless, but plaintiff may be entitled to punitive damages "when the wrongdoer does not actually realize that he is invading the rights of another, provided the act is committed in such a manner that a person of ordinary reason and prudence would say that it was a reckless disregard of another's rights." *Id.* p. 166; see also, *Hicks v. McCandlish*, 221 S.C. 410, 70 S.E.2d 629 (1952) (punitive damages may be warranted when wrongdoer does not actually realize he is invading the rights of another).

Harleysville quotes a portion of the Judge's charge on punitive damages to justify its position that the jury had to find intent to harm to award punitive damages. However, Harleysville omitted this important part of the Judge's charge:

> punitive damages will be allowed even when a defendant does not realize it is invading the plaintiff's rights, so long as the act is committed in such a manner that a person of ordinary prudence would conclude that it was done in reckless disregard of the rights of another. (R. p. 1074, line 23-p. 1075, line 3)

Harleysville's position on this issue is without merit and contrary to South Carolina law.

VI. Exclusion j(5), "Faulty Workmanship" does not exclude coverage for the general verdict.

The Special Referee rejected Harleysville's position that the j(5) "faulty workmanship" exclusion excluded coverage of the general verdict.[16] The Special Referee concluded that this exclusion "only applies to the work that is being actively worked on at the instant the property damage occurs", citing cases from other jurisdictions. (R. p. 49) The Special Referee's Order is dated February 28, 2013. On July 17, 2013, the Supreme Court handed down its opinion in *Bennett & Bennett Construction Inc. v. Auto-Owners Insurance Co.*, 405 S.C. 1, 747 S.E.2d 426 (2013) ("Bennett"). In *Bennett*, the Court had before it the question of whether exclusion "j(5)" excluded stucco work done by a subcontractor which was defective and necessitated removal of the stucco and replacement with brick. In discussing "j(5)", the Court concluded that the terms of the exclusion "are performing" are in the present continuous tense indicating that the temporal limits of the exclusion are coterminous with the performance of the acts. *Id.* p. 428. The Court held that construing the "j5"exclusion narrowly in favor of the insured required a finding that only the damage which occurred while the insured worked on the property would be excluded. This is the exact holding of the Special Referee.

The Special Referee concluded that damages began to occur thirty (30) days after the certificates of occupancy were issued, i.e., after the work (operation) was completed.[17] Exclusion j(5) would not apply to these damages. These damages would be covered under

[16] Commentators refer to the "j5" exclusion as the "performing operations" exclusion as opposed to the "faulty workmanship" exclusion. Scott C. Turner, Insurance Coverage of Construction Disputes §29.2 (2013).

[17] Drew Brown testified that damages began to occur at or near the time the Certificate of Occupancy was issued for the building(s). (R. p. 581, line 11-p. 582, line 5)

the completed operations coverage for which the insureds paid a separate premium. (R. p. 1511)

Harleysville cites *Putnam v. Alea London, Ltd.*, 2011 WL 489968 (D. S.C. Feb. 4, 2011), to support its position that "j(5)" excludes coverage of claimant's general verdict. This case is inapposite because the *Putnam* Court held that the damages sought to be covered occurred while the contractor was still working on the house. The facts of *Putnam* and the present case are much different. The contractor in the present case had completed its operations and a Certificate of Occupancy had been issued. Water damages began to occur after the Certificate of Occupancy had been issued and continued long after. As the Court pointed out in *Bennett*, exclusion "j(5)" is intended to exclude damages occurring during the time the insured or his subcontractor worked on the property. *Id.* p. 428. There is no evidence in the record that damages were occurring to the buildings during construction. Even if exclusion "j5" applied it would not exclude the entire general verdict; there is no way to determine if the jury allocated any money to such damages. Harleysville failed to meet its burden of proof that exclusion "j(5)" applied to exclude the entire general verdict and therefore the Special Referee should be affirmed.

VII. The Special Referee did not err in his findings of facts applicable to Harleysville's failure to properly reserve its rights to contest coverage and even if he did err, such error did not prejudice Harleysville; the Special Referee committed no error in his findings relative to Harleysville's failure to intervene or seek an allocated verdict.

In his Order, the Special Referee after addressing issues of the ROR letters, stated "Although the Court has already concluded that Harleysville has a duty to indemnify the insureds, this issue (ROR letters) was fully litigated and the Court felt it appropriate to

address this issue." (R. p. 68) Although the ruling on this issue was adverse to Harleysville, it did not alter Harleysville's rights to contest coverage and did not affect the Special Referee's conclusion. No evidence was excluded based on the findings that the ROR letters were not sent or not adequate. Harleysville fails to show how this ruling prejudiced it. *Brown v. Stewart*, 348 S.C.33, 557 S.E.2d 676 (2001) (In order to warrant reversal, the Trial Court's ruling must be both incorrect and prejudice Appellant).

A. There is evidence in the record to reasonably support the Special Referee's findings that Harleysville did not send reservation-of-rights ("ROR") letters to some of its insureds.

Harleysville contends that the Special Referee's findings are "unsupported or contradicted by the evidence." (Brief p. 37) However, in order to prevail, Harleysville must show that the Special Referee's findings are found to be without any evidence which reasonably supports his findings. In re. *Treatment and Care of Luckabaugh*, 351 S.C 122, 568 S.E.2d 338 (2002). Harleysville posits that since Mr. Wright's testimony on the ROR letters is "unrebutted" that the Special Referee must take it as being true. Whether a trial is by judge or jury, "unrebutted" testimony is not binding on the trier of fact. *Green v. Greenville County*, 176 S.C. 433, 180 S.E. 471, 473 (1935) (The fact that testimony is not contradicted by direct evidence does not render it undisputed, as there is still the question of its inherent probability and the credibility of the witness. If there is anything to create distrust, the question is for the jury.) See also, *Black v. Hodge*, 306 S.C. 196, 410 S.E.2d 595 (Ct. App. 1991) (Trier of fact is not required to believe uncontradicted testimony). Here, the probability of the failure to send a ROR letter is in the record.

In the 30(b)(6), SCRCP, deposition of Lee Wright marked as Exhibit 11 (R. p. 1673) in the hearing before the Special Referee, Mr. Wright, Harleysville's construction

litigation manager was asked about why a ROR letter was not produced in the Pope Class Action. The response from Mr. Wright was "well they're, there" (Wright depo. p. 32, line 20-p. 33, line 9; r. pp. 1420-1421) This deposition was taken August 31, 2010. A reservation-of-rights letter was not produced at this time for the Pope Class Action. Neither was a ROR letter produced for the companion Magnolia (McCartney) Class Action.[18]

At the declaratory judgment hearing four (4) months later, Mr. Wright still had not produced ROR letters for the Pope Class Action. All Mr. Wright could say was he had no doubt they exist (R. p. 346, lines 7-14) but he had not seen these letters. (R. p. 426, line 12-p. 427, line 9) The ROR letters produced were not written by Mr. Wright and he produced no email or witness to verify their existence. Strikingly, all of the ROR letters that were sent by Harleysville to the insureds were copied to numerous individuals and attorneys. Yet Harleysville could not produce evidence of the existence of the missing ROR letters in re the Pope Class Action; no copy, no email, no witness that drafted the letter or received a copy. It is beyond happenstance that in both Class Actions, Riverwalk and (McCartney) Magnolia North, that had the same or related insureds, Harleysville could not produce the "missing" reservation-of-rights letters. The Special Referee clearly had a reasonable basis to find that a ROR letter to Buildstar was never sent. Evidence exists for the Special Referee to question the probability that a letter was ever sent to Buildstar. *State v. Floyd*, 174 S.C. 288, 177 S.E. 375 (1934) (failure to produce evidence raises the presumption that it did not exist); *State v. Smith*, 220 S.C. 224, 67 S.E.2d 82 (1951) (where primary evidence is not available and secondary evidence is available to prove a fact, the proponent of the

[18] Harleysville's coverage counsel, stated he didn't look for the class action reservation-of-rights letter "but I don't know why they wouldn't be there." (Wright depo. p. 33, lines 11-24; R. p. 1421)

secondary evidence is required to produce the best secondary evidence available). Mr. Wright's assertion that "I haven't seen it (ROR letters) but I absolutely believe it exists" (R. p. 426, line 12-p. 427, line 9) raises an inference that the missing ROR letters do not exist. Very telling is the testimony of Mr. Wright that he never even bothered to ask his insureds if they received a copy. (R. p. 427, lines 6-9)

There was evidence in the record to reasonably support the Special Referee's findings.

B. The Special Referee's findings that the ROR letters sent by Harleysville to its insureds did not properly reserve Harleysville's right to contest coverage is reasonably supported by evidence in the record.

Although South Carolina Courts have not considered the issue of what constitutes a proper ROR letter, other jurisdictions have. An analysis of the ROR letters is properly begun by considering the purpose of a ROR letter. As quoted by the Special Referee:

> [T]he purpose of reservation-of-rights letters is to enable the insureds to make informed decisions as to whether they should because of the existence of conflicts of interest between themselves and their insurers, take some action in order to protect their interests." Alan D. Windt, Insurance Claims and Disputes: Representation of Insurance Companies & Insureds. §2.14 (5th Ed. 2007)

Harleysville never by its ROR letters (R. p. 1776) or verbally advised its insureds that it had a conflict of interest. (R. p. 427, lines 10-12) Harleysville only informed its insureds that it would create a conflict if they intervened. Yet Harleysville was taking the position with its insureds there was no reason to discuss any exclusions because there had been no "occurrence" and therefore there was no coverage. (R. p. 427, line 19-p. 428, line 10) Harleysville in its ROR letters simply lists all the policy exclusions and states that one of the issues is whether any exclusion applies to exclude coverage. (R. p. 1787, paragraph

5) Harleysville in the ROR letters advises that its position is based upon "facts which have been made available to it to date." (R. p. 1788) Other than saying it had conversations with its insureds, Harleysville never revised its letters to inform its insureds of the exclusions it had determined applied. (R. p. 429, lines 1-22) Nothing in the record indicates that Harleysville's current position as to exclusions "a" and "j(5)" were ever specifically communicated to their insureds. Had they communicated that this was their position, the insureds could have made the record clear on this issue. Harleysville insisted there was no "occurrence" and thus, no exclusions came into play. (R. p. 429, lines 1-7) More importantly, it is conceded by Harleysville that it never informed its insureds that it had a conflict of interest or that there was a need for an allocated verdict.

It is not disputed that Harleysville had an understanding with its insureds that coverage would be reserved for judicial consideration in a separate proceeding. This does not ameliorate Harleysville's duty to seek a verdict that is susceptible to judicial determination of what damages are covered. This is clearly enunciated in *Newman*[19] and numerous cases in other jurisdictions. *Duke v. Hoch*, 468 F.2d 973, 979 (5th Cir. 1972) (Home's [insurance carrier] notification of defense under a reservation of rights was not sufficient notification to the insureds that they should protect their interest by requesting an appropriate verdict); *Pharmacists*, supra., (it was incumbent upon Pharmacists to notify the Trial Court and the parties of the need for an allocated verdict and to take action to seek one); *Herrera*, supra., (insurance carrier had an obligation to seek an appropriate verdict and not extend the litigation by seeking to re-litigate the amount of damages); *Highway 20*

[19] Auto-Owners defended under a reservation of rights but Auto-Owners took no action *in re* the general award by the Arbitrator to separate covered and non-covered damages. As a result, Auto-Owners was required to pay the entire award. *Id.* p. 198

Terminal Inc., v. Tri-County Agri Supply, Inc., 235 Neb. 207, 454 N.W.2d 671 (1990) (insurance carrier who fails to procure an allocated verdict where various claims were submitted to the jury must pay the entire verdict since how the jury allocated damages inhere in the verdict. This is not changed by problems facing defense counsel when the duties of such counsel become blurred.)

C. Harleysville's excuse for failing to intervene or seek an allocated verdict is meritless.

Harleysville offered 3 excuses for not seeking an allocated verdict: 1) Did not know what the law was at the time of the trial. Harleysville had approximately six (6) years to commence a declaratory judgment action, yet waited to commence it until after the unallocated verdict was rendered. Harleysville took the position that there was no "occurrence" and therefore nothing was covered and exclusions need not be considered. Their attempt to use their own miscalculation to prejudice their insureds should be rejected outright. 2) That lawyers in other cases had said they would oppose intervention. Whether Harleysville would be allowed to intervene is not decided by the lawyers, it is decided by the Trial Judge based upon the Rules of Civil Procedure. Harleysville made a conscious decision not to intervene and its reasons are irrelevant. 3) Harleysville was rebuffed in previous cases when it attempted to intervene. This excuse has no legal basis and is totally irrelevant as the Special Referee so held.

None of these excuses change the fact that Harleysville filed no motion to intervene; failed to inform its insureds of a conflict of interest; failed to inform its insureds of the need for an allocated verdict; failed to advise its insureds which exclusions would be relied on; and failed to advise the Court of the need for an allocated verdict in spite of the fact that

Harleysville was present at the Trial with coverage counsel and conferred with defense counsel. (R. p. 434, lines 2-14)

VIII. The Special Referee did not err in excluding testimony and evidence.

A. The Special Referee was correct in excluding testimony that attempted to allocate the general verdict.

At the hearing before the Special Referee, Harleysville attempted to introduce a new estimate of damages that had no relationship to the jury's verdict. (R. p. 498, line 8-p. 507, line 8) The estimate had no relevance to the estimates presented at trial and were irrelevant as the Special Referee correctly held. Even if Harleysville's estimate had been related in some way to the estimates given to the jury, they would have not been any proof of how the jury allocated damages; they would remain pure speculation and irrelevant.[20] *Jenkins v. Few, supra*. For example, in *Evans v. Medical Inter – Insurance Exchange*, 856 A.2d 609 (Dist. of Co. Ct. of App. 2004) a judgment creditor sought coverage for a malpractice general verdict. In an attempt to prove coverage, the claimant attempted to use affidavits that were not introduced at trial. The Court rejected the affidavits, holding that in such a dispute, the only relevant evidence are the pleadings, jury charges, written opinions and transcripts in the underlying matter. Therefore, no evidence that was not adduced in the underlying malpractice trial could be considered.

Duke v. Hoch, supra., a federal case, applying Florida law, did not follow this rule and indicated that additional evidence would be allowed if the record was not sufficient to allocate damages. However, because of the Trial Court rulings and the damages awarded, apparently the Court believed that an allocation could be made although not precise. But

[20] Harleysville conceded that there is no method to determine how the jury allocated damages. Since it is impossible to determine the jury's allocation, no evidence would be relevant on this issue.

see *Universal Underwriters Insurance Corporation v. Reynolds*, 129 So. 2d 689, 691 (Fla. Dist. Ct. App. 2d Dist. 1961) (allocation of general verdict between covered and uncovered damages was "impossible").

Harleysville's statement that the Special Referee ignored *Crossman* which permitted allocation is misplaced. *Crossman* only dealt with allocating stipulated progressive damages to different policy periods. It did not relate to the allocation of a general verdict which resulted from different claims and causes of action.

B. The Special Referee did not err in excluding testimony on the basis of hearsay and relevance in re conversations Harleysville had with its insureds.

A review of the testimony excluded is clearly testimony that was for some possible future "bad faith" claim and had no relevancy to any issue in this case. In fact, that is clearly demonstrated by the Special Referee's comment that he is not admitting this vis-à-vis whether or not coverage exists to the judgment holders. (R. p. 350, lines 13-18) The "affidavit" from its insured sought to be admitted was not an affidavit but was a statement made years before obviously related to bad faith.[21] The statement had no relevance, hearsay or not, as to the issues in this case. In addition, Harleysville failed to point out any prejudice resulting from this ruling. *Fields infra*.

C. The Special Referee did not error in excluding testimony of why Harleysville did not file a motion to intervene.

As discussed above, the fact that Harleysville was unaware of the law; had been denied the right to intervene in another case; and the attorneys in other cases had indicated

[21] See *Lee v. Gulf Insurance Co.*, 248 S.C. 296, 149 S.E.2d 639 (1996) (a statement procured from the insured cannot be used against the third-party claimant even though claimant derives his rights through the insured. *Id.* p. 299)

their objection to an intervention, was irrelevant and properly excluded. There would be no difference in saying: "I did not object to the testimony because I didn't understand the law", "my objection had been overruled in other cases", and "the attorneys in other cases had objected to the same testimony and were sustained". This testimony has no relevance and was properly excluded.

D. Testimony Harleysville contends was not admitted was subsequently admitted on cross examination and therefore, even if the Special Referee erred in including the testimony, which is disputed, it was harmless error.

The testimony that Harleysville complains of being excluded and then being relied on by the Trial Judge begins on R. p. 356 of the December 13-14, 2010 trial transcripts. The excluded and proffered testimony was that Harleysville met with their insureds and advised them that there was likely going to be no coverage for the grand majority of the claims because there was no "occurrence" according to the Supreme Court and thus the insured agreed to leave the coverage issue for a later time. (R. p. 356, line 1-359, line 2) This same testimony was allowed on cross examination. (R. p. 424, line 7-p. 431, line 25) Even if the evidence was improperly excluded, it was harmless error since the same testimony was allowed in on cross examination and there is no prejudice to Harleysville. *Fields v. Regional Medical Center Orangeburg*, 363 S.C. 19, 609 S.E.2d 506 (2005) (where there is improperly excluded evidence which is subsequently elicited on cross examination there is no prejudice and renders the wrongful ruling moot); *Recco Tape and Label Co., Inc. v. Barfield*, 312 S.C. 214, 439 S.E.2d 838 (1994) (for the Supreme Court to reverse the Trial Court for erroneously excluding evidence, appellant must show both error and resulting prejudice). Harleysville has shown neither.

IX. The Special Referee was correct in his findings in re the failure of Harleysville to send ROR letters or to send adequate reservation-of-rights letters to the insureds.

In the Claimants Answer and Counterclaim, the Claimants asserted that Harleysville "slumbered on its rights because it took the position that none of the claims of the Plaintiffs in the underlying action were covered and failed to take appropriate action to protect its interests." (R. p. 148-153) The pleading went on to allege prejudice to the Insureds and to the Claimants. (R. p. 151) Claimants alleged that Harleysville should now be estopped from trying to re-litigate damages and guess how the jury allocated damages. (R. p. 151) Harleysville filed a Reply to Amended Counterclaims (R. p. 167), and in paragraph 17 of this pleading, Harleysville raised the issue of the reservation-of-rights letters. (R. p. 171) In its prayer for relief, Harleysville asked the Court to dismiss "any claim by any defendant in this action... if it is inconsistent with written reservation-of-rights letters submitted more than three years prior to any legal claim and served by any defendants in this action." (R. p. 171)

In its discovery responses, Harleysville consistently maintained that it defended its insureds under reservation-of-rights and reserved all rights. R. p. 1641, Response 3) Harleysville put in issue the reservation-of-rights and the Claimants had the right and duty to respond.

A. The Special Referee's finding that Harleysville did not send any ROR letters to its insureds in the Class Action is supported by evidence in the record.

In each of the other reservation-of-rights letters sent in the Homeowners Association action, there were a total of eight (8) addressees and three (3) persons copied on the letter including attorneys which Harleysville hired to represent its insureds. (R. p.

1776) The only witness offered on this issue was Lee Wright who did not write the letters, had not seen the letters and did not ask their insureds or anyone else for a copy. (R. p. 427, lines 6-9) Mr. Wright knew these letters were missing when he gave his deposition over three (3) months before the trial. (Wright depo. p. 33, lines 3-23; R. p. 1421) This alone is sufficient for the Special Referee's findings on this issue.

B. The Special Referee's findings that the ROR letters were not adequate are also reasonably supported. Harleysville's assertion that it issued oral reservation-of-rights is of no help.

The question of whether the reservation-of-rights letters were sent or not sent or whether oral reservation-of-rights were given is really not the significant issue. The real issue is whether the written or oral reservation-of-rights given to the Harleysville insureds advised them of a conflict of interest and the need for an allocated verdict. This has significance in Harleysville's position that it should now be allowed to speculate as to how the jury allocated damages.

First, a review of the ROR letters pointedly shows them missing a key element which is important to Harleysville's position on the re-litigation of damages. Harleysville's reservation-of-rights letters are simply restatements of the policy provisions including exclusions, most of which Harleysville never raised in this litigation. Nowhere in Harleysville's reservation-of-rights letters that were sent is there any indication that there is a conflict of interest between Harleysville and its insureds. When Lee Wright was asked if he ever advised the insureds that there was a conflict of interest, he replied "never did in the underlying case." (R. p. 427, lines 10-12) Neither in their letters, nor orally, did Harleysville advise their insureds of the need for an allocated verdict or that if they got an

unallocated verdict it would be impossible to determine what part of the general verdict was covered thus leading to a catastrophic loss of coverage.

Harleysville's failure to issue proper reservation-of-rights letters or to properly protect the rights of their insureds resulted in a verdict that is not subject to allocation.[22] The Riverwalk action was initially filed in 2003. Harleysville issued reservation-of-rights letters on January 23, 2004. The verdict was rendered in January, 2009. During those approximate 6 years, Harleysville never sought a declaratory judgment action; never amended their ROR letters to inform their insureds of the precise exclusions they were relying on; decided not to ask the Court to submit special interrogatories to the jury, even though they thought about it, (Wright depo. p. 23, lines 6-12; R. p. 1418); decided not to intervene (R. p. 433, lines 16-20); and never discussed the need for an allocated verdict with their insureds. (R. p. 433, lines 21-25) At this late date, Hareysville wants to ignore the judgment issued in the underlying action and recompute what they think the verdict ought to have been and then allocate the damages as they have recomputed them. This position was rejected in *Newman* and the Court should reject it here.

C. The judgment holders have the right to raise the inadequacy of or non-existence of Harleysville's ROR letters.

Harleysville has not appealed the Special Referee's conclusion that the judgment holders step into the shoes of the insureds. *Lee v. Gulf Insurance Co.*, 248 S.C. 296, 149 S.E.2d 639 (1966) ("an injured party who brings suit against a liability carrier in order to collect on a judgment previously acquired against an insured is possessed of all rights of the insured and subject to all defenses that exist as between the insured and the insurance

[22] Lee Wright testified "I would agree we can't figure out how that jury did it." (Wright depo., p. 85, lines 4-12; R. p. 1434)

carrier." Id. p. 298) Harleysville apparently does not dispute Claimants' rights to contest the application of exclusions or other policy provisions as they might apply to the judgment. It is only the ROR letters that Harleysville contends the judgment creditors have no standing to contest. In *Canadian Insurance Company of California v. Rusty's Island Chip Company*, 36 Cal. App. 4th 491, 42 Cal. Rptr. 2d 505 (1995) this same position was taken by Canadian. The Trial Judge found the ROR letters sent to its insured by Canadian were not adequate to reserve its rights to contest coverage but that Rusty's, the judgment holder, did not have standing to raise that issue. The Appellate Court disagreed. The Court held an injured party is a proper defendant in an insurer's action for declaratory relief to determine the scope of coverage under its policy:

> Simply put, it is absurd to suggest that Canadian is free to file a coverage lawsuit against Rusty's and then in that lawsuit claim that Rusty's cannot defend itself because it lacks standing to litigate a coverage issue (e.g., whether Canadian's failure to reserve certain rights constitutes a waiver of those rights). Id. p. 496

The Court noted other cases had rejected similar arguments and held that since there was evidence to base the trial court's finding of an inadequacy of the reservation-of-rights letters, Canadian would be estopped to deny coverage.

In this case, Harleysville put the issue of the ROR letters in evidence and the claimants were not precluded from pursuing their claim of estoppel.

X. The Special Referee was correct in denying Harleysville's motion for a directed verdict.

Harleysville made a motion pursuant to Rule 56, SCRCP. (R. p. 2465) Harleysville then amended its motion on September 13, 2012, stating that the motion should have stated Rule 50, SCRCP, and not Rule 56, SCRCP. The Judge considered the motion under Rule

50, SCRCP, and held it was not applicable in a non jury trial. *Waterpoint Property Owners Association, Inc. v. Paragon, Inc.*, 342 S.C. 454, 536 S.E.2d 878 (Ct. App. 2000) (Rule 50, SCRCP, is inapplicable to non-jury trials.)

Harleysville specifically made its motion pursuant to Rule 50, SCRCP; it never requested consideration of Rule 41, SCRCP either by its original motion or motion to alter or amend. Even if the Special Referee had considered it under Rule 41, SCRCP, Rule 41(b) allows the judge as fact finder to weigh the evidence and determine the facts. *Waterpoint*, supra. In its Order denying Harleysville's motion, the Special Referee stated "all of the issues to be presented to the undersigned are set forth in the record, and have been considered by the court." In addition, a Rule 41(b), SCRCP, motion is made by the defendant after the close of the plaintiff's case on the basis that plaintiff "has shown no right to relief." Rule 41(b) SCRCP. Harleysville's motion was correctly denied.

Conclusion

The Court should uphold the Special Referee's findings as to coverage of the actual and punitive damages and loss of use damages and require Harleysville to indemnify its insureds by awarding claimants a judgment against Harleysville for the full amount of the underlying judgment with costs and post judgment interest. The Court should uphold the Special Referee's refusal to apply TOR to the loss of use damages and punitive damages.

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Conway, South Carolina

May 6, 2014

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: 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 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 are Respondents,

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

CERTIFICATE OF COUNSEL

The undersigned certifies that this Respondent's Final Brief of Respondent/Appellant complies with Rule 211(b), SCACR, except for the following: Dates changed to conform to the Record on Appeal.

May 7, 2014

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PROOF OF SERVICE

I, the undersigned legal assistant for John P. Henry of Thompson & Henry, P.A., attorneys for Respondents/Appellants, do hereby certify that I have served all counsel in this action with a copy of the documents(s) hereinbelow specified by mailing a copy of same by United States Mail, postage prepaid, to the following address(es) this 7th day of May, 2014:

Riverwalk Briefs:

- Appellant's Final Reply Brief of Respondent/Appellant;
- Respondent's Final Brief of Respondent/Appellant; and
- Appellant's Final Brief of Respondents/Appellants; and
- Certificate of Counsel for each.

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