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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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

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

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

v.

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

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

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

FINAL BRIEF OF APPELLANT/RESPONDENT

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Table of Contents

Table of Authorities iv

Statement of Issues x

Statement of the Case 1

Statement of the Facts 2

Argument 4

I. The Special Referee improperly denied Harleysville's request to perform the *Crossmann* analysis of dividing and categorizing the damages into (1) costs of repairing the defect and (2) costs of repairing the resulting damage 4

A. An allocation of damages does not "re-litigate" any issue 6

B. Harleysville should not have intervened in the underlying suit 8

C. An allocation of damages is not barred by *Auto Owners v. Newman* 11

D. Other jurisdictions permit a post-trial coverage action to allocate damages awarded by a general verdict in a previous action 13

II. The Special Referee erred in his calculation of the "time on risk" formula 15

A. The Special Referee erred by refusing to apply a per-building "time on risk" calculation 16

B. The Special Referee erred by applying the wrong policy expiration date in calculating Harleysville's "time on risk" at Riverwalk 18

C. The Special Referee erred by refusing to apply "time on risk" to the "loss of use" damages awarded in the underlying Riverwalk suit 20

D. The Special Referee improperly used an arbitrary start date of 30 days following the first certificate of occupancy 21

III. The Special Referee erred by refusing to apply the "time on risk" analysis to the punitive damages award 21

A. "Time on risk" should apply to both actual and punitive damages 21

B. South Carolina precedent and basic principles of fairness require the application of "time on risk" to punitive damages 23

IV. The Special Referee erred by ruling that the underlying punitive damage awards arise from a covered occurrence 24

V. The Special Referee erred by ruling that the underlying damages are covered despite the "expected or intended" exclusions in each of the CGL policies 27

A. Evidence and arguments presented in the underlying actions indicate that Harleysville's insureds expected or intended their acts and the resulting damage 27

B. The Special Referee relied on inapplicable precedent 30

C. The Special Referee relied on irrelevant testimony from the underlying action 32

D. At minimum, the underlying awards of punitive damages are excluded from coverage 34

VI. The Special Referee erred by ruling that the underlying damages are covered despite the "faulty workmanship" exclusion in each of the CGL policies 36

VII. The Special Referee made improper and unsupported findings of fact 39

VIII. The Special Referee erred by excluding relevant, admissible evidence and testimony 45

A. Testimony regarding allocation of damages 45

B. Testimony regarding Harleysville's reservation of the right to contest coverage 48

C. Testimony regarding Harleysville's failure to intervene 49

D. Testimony regarding Harleysville's Reservation of Rights letters 49

IX. The Special Referee incorrectly ruled that Harleysville failed to reserve its right to contest coverage 50

A. Harleysville adequately informed Buildstar that it was reserving its right to contest coverage of the damages 51

B. Harleysville's Reservation of Rights letters were sufficiently thorough and specific 52

C. Harleysville did not waive its right to contest coverage.....56

D. The judgment holders from the underlying suit may not raise or benefit from the alleged deficiencies of Harleysville's reservation of rights letters 59

X. The Special Referee erred by denying Harleysville's motion for judgment as a matter of law.....61

Conclusion 62

Table of Authorities

Cases

Aaron v. Mahl,
381 S.C. 585, 674 S.E.2d 482 (2009) 6

Allstate Ins. Co. v. Keltner,
842 N.E.2d 879 (Ind. Ct. App. 2006) 14

Alverson v. Minnesota Mut. Life Ins. Co.,
287 S.C. 432, 339 S.E.2d 140 (Ct. App. 1985) 56

Auto Owners v. Newman
2008 WL 648546 (S.C. March 10, 2008),
withdrawn 385 S.C. 187, 684 S.E.2d 541 ..... 8, 9, 44, 47

Auto Owners v. Newman,
385 S.C. 187, 684 S.E.2d 541 (2009) 12, 13, 30, 44

Branham v. Ford Motor Co.,
390 S.C. 203, 701 S.E.2d 5 (2010) 10

Britt v. Cambridge Mut. Fire Ins. Co.,
717 S.W.2d 476 (Tex. Ct. App. 1986) 55

Canadian Univ. Ins. Co. v. Northwest Hospital, Inc.,
389 F.2d 559 (7th Cir. 1968) 55

Capitol Indem. Corp. v. Fraley,
597 S.E.2d 601 (Ga. Ct. App. 2004) 60

Carter v. R.L. Jordan Oil Co., Inc.,
301 S.C. 84, 390 S.E.2d 367 (Ct. App. 1990) 35

City of Johnstown v. Bankers Standard Ins. Co.,
877 F.2d 1146 (2nd Cir. 1989) 30, 31

City of Sterling Heights v. United Nat'l Ins. Co.,
No. 03-72773, 2008 U.S. Dist. Lexis 26990
(E.D. Mich. April 3, 2008) 23

Clark v. Cantrell,
339 S.C. 369, 529 S.E.2d 528 (2000) 22

Cohen v. Allendale Coca-Cola Bottling Co.,
291 S.C. 35, 351 S.E.2d 897 (Ct. App. 1986) 35

Cole v. Raut,
378 S.C. 393, 663 S.E.2d 30 (2008) 5

Continental Western Ins. Co. v. Toal,
244 N.W.2d 121 (Minn. 1976) 31, 32

Cox v. Employers Liability Assur. Corp.,
191 S.C. 233, 196 S.E. 549 (1938) 10

Cozzens v. Bazzani Bldg. Co.,
456 F. Supp. 192 (E.D. Mich. 1978) 54

Crocker v. Weathers,
240 S.C. 412, 126 S.E.2d 335 (1962) 10

Crossmann Cmtys. of N.C. v. Harleysville Mut. Ins. Co.,
395 S.C. 40, 717 S.E.2d 589 (2011) 1, 4, 15, 16, 24, 27, 47

Cummings v. Tweed, 195 S.C. 173, 10 S.E.2d 322 (1940) 35

Davila v. Arlasky,
141 F.R.D. 68 (N.D. Ill. 1991) 14

Dobson v. Am. Indem. Co.,
227 S.C. 307, 87 S.E.2d 869 (1955) 10

Donna C. v. Kalamaras,
485 A.2d 222 (Me. 1984) 14

Ducworth v. Neely,
319 S.C. 158, 459 S.E.2d 896 (Ct. App. 1995) 61

Duke v. Hoch,
468 F.2d 973 (5th Cir. 1972) 13, 58

Duncan v. Hampton Cnty. Sch. Dist. No. 2,
335 S.C. 535, 517 S.E.2d 449 (Ct. App. 1999) 61

Dunes W. Residential Props. v. Essex Ins. Co.,
No. 06-2020, 2007 U.S. App. Lexis 29931 (4th Cir. Dec. 28, 2007) 28, 29

Emp. Ins. Of Wausau v. Lavender,
506 So.2d 1166 (Fla. Ct. App. 1987) 14

Equity Gen. Ins. Co., Inc. v. C&A Realty Co., Inc.,
715 P.2d 768 (Ariz. Ct. App. 1985) 54

Erickson v. Jones St. Publishers, LLC,
368 S.C. 444, 629 S.E.2d 653 (2006) 11

Facility Invs., LP v. Homeland Ins. Co. of N.Y.,
741 S.E.2d 228 (Ga. Ct. App. 2013) 55

Fed. Hill Homeowners Ass'n v. Cmty. Ass'n Underwriters of Am., Inc.,
384 Fed. Appx. 209 (4th Cir. 2010) 31

First Marine Ins. Co. v. Gibbs,
No. 98-6117 1999 U.S. App. Lexis 5891 (10th Cir. Mar. 31, 1999) 60

Garamendi v. Golden Eagle Ins. Co.,
116 Cal. App. 4th 694 (Cal. Ct. App. 2004) 58

Gold Kist, Inc. v. C&S Nat'l Bank,
286 S.C. 272, 333 S.E.2d 67 (Ct. App. 1985) 5

Green v. Ins. Co. of Am.,
254 S.C. 202, 174 S.E.2d 400 (1970) 25

Green v. Smith,
149 S.C. 303, 147 S.E. 333 (1929) 35

Harleysville Lake States Ins. Co. v. Granite Ridge Builders, Inc.,
2009 U.S. Dist. Lexis 27803 (N.D. Ind. 2009) 54

Holly Woods Ass'n of Residence Owners v. Hiller,
392 S.C. 172, 708 S.E.2d 787 (Ct. App. 2011) 61

Hoover v. Maxum Indem. Co.,
730 S.E.2d 413 (Ga. 2012) 55

Houston Gen. Ins. Co. v. AG Prod. Co.,
840 F. Supp. 738 (E.D. Cal. 1993) 55, 59

Hunter v. Peters,
No. 423946, 2001 Conn. Super. Lexis 3761
(Conn. Super. Ct. Dec. 13, 2001) 14

Ideal Mut. Ins. Co. v. Myers,
789 F.2d 1196 (5th Cir. 1986) 55

Irion v. Glens Falls Ins. Co.,
461 P.2d 199 (Mont. 1969) 52

Johnston-Crews Co. v. Folk,
118 S.C. 470, 111 S.E. 15 (1922) 6

Jordan v. Hudgens,
146 S.C. 209, 143 S.E. 811 (1928) 35

Laidlaw Envtl. Servs., Inc. v. Aetna Cas. & Sur. Co.,
338 S.C. 43, 524 S.E.2d 847 (Ct. App. 1999) 56

Las Palmas Assocs. v. Las Palmas Center Assocs.,
235 Cal. App. 3d 1220 (Cal. Ct. App. 1991) 23

Liberty Mut. Ins. Co. v. Westport Ins. Corp.,
664 F. Supp. 2d 587 (D.S.C. 2009) 57

Limehouse v. Hulsey,
397 S.C. 49, 723 S.E.2d 211 (Ct. App. 2011) 22

Lowenschuss v. Home Ins. Co.,
No. 90-0054, 1990 U.S. Dist. Lexis 11375
(E.D. Pa. Aug. 27, 1990) 52

Lyles v. MBI, Inc.,
292 S.C. 153, 355 S.E.2d 282 (Ct. App. 1987) 57

Manufacturers & Merchants Mut. Ins. Co. v. Harvey,
330 S.C. 152, 498 S.E.2d 222 (Ct. App. 1998) 25

Maxwell v. Hartford Union High Sch. Dist.,
814 N.W.2d 484 (Wis. 2012) 57

Medical Protective Co. v. Fragatos,
940 N.E.2d 1011 (Ohio Ct. App. 2010) 58

MedMarc v. Forest Healthcare,
199 S.W.3d 58 (Ark. 2004) 14

Mid-Continent Cas. Co. v. Bay Rock Operating Co.,
614 F.3d 105 (5th Cir. 2010) 7

Miller v. Atl. Coast Line R. Co.,
140 S.C. 123, 138 S.E. 675 (1926) 36

Miranda C. v. Nissan Motor Co., Ltd.,
402 S.C. 577, 741 S.E.2d 34 (Ct. App. 2013) 11

Mitchell v. Fortis Ins. Co.,
385 S.C. 570, 686 S.E.2d 176 (2009) 22

Moses v. Halstead,
477 F. Supp. 2d 1119 (D. Kan. 2007) 54

Mr. T. v. Ms. T.,
378 S.C. 127, 662 S.E.2d 413 (Ct. App. 2008) 8

Nat. Union Fire Ins. Co. v. Am. Motorists Ins. Co.,
504 S.E.2d 673 (Ga. 1998) 60

Nat'l Grange Mut. Ins. Co. v. Firemen's Ins. Co.,
310 S.C. 116, 425 S.E.2d 754 (Ct. App. 1993) 20

Nationwide Mut. Ins. Co. v. Gentry,
117 S.E.2d 76 (Va. 1960) 56

Nationwide Mut. Ins. Co. v. Nixon,
682 A.2d 1310 (Pa. Super. Ct. 1996) 59

New Hampshire Ins. Co. v. Vardaman,
838 F. Supp. 1132 (N.D. Miss. 1993) 31

Newby Int'l v. Nautilus Ins. Co.,
112 Fed. Appx. 397 (6th Cir. 2004) 58

Northwest Airlines v. Fed. Ins. Co.,
32 F.3d 349 (8th Cir. 1994) 58

Nutmeg Ins. Co. v. Clear Lake City Water Auth.,
229 F. Supp. 2d 668 (S.D. Tex. 2002) 54

O'Neill v. Smith,
388 S.C. 246, 695 S.E.2d 531 (2010) 22

Patrons-Oxford Mut. Ins. Co. v. Dodge,
426 A.2d 888 (Me. 1981) 31

Peak Prop. & Cas. Ins. Corp. v. Davis,
No. 3:12-1689, 2013 U.S. Dist. Lexis 39406,
*18 (D.S.C. March 21, 2013) 56

Plott v. Justin Enters.,
374 S.C. 504, 649 S.E.2d 92 (Ct. App. 2007) 6

Pope v. Heritage Comms., Inc.,
395 S.C. 404, 717 S.E.2d 765 (Ct. App. 2011) 26, 34

Putnam v. Alea London Ltd.,
No. 2:09-CV-1740, 2011 U.S. Dist. Lexis 12223 (D.S.C., Feb. 4, 2011) 37

Restor-A-Dent v. Certified Alloy,
725 F.2d 871 (2d Cir. 1984) 14

Richards Mfg. Co. v. Great Am. Ins. Co.,
773 S.W.2d 916 (Tenn. Ct. App. 1988) 54, 55

Rogers v. Florence Printing Co.,
233 S.C. 567, 106 S.E.2d 258 (1958) 22

S.C. Pub. Interest Found. v. Greenville Cnty.,
401 S.C. 377, 737 S.E.2d 502 (Ct. App. 2013) 6

Sapp v. State Farm Fire & Cas. Co.,
486 S.E.2d 71 (Ga. Ct. App. 1997) 38

Shannon v. Shannon,
442 N.W.2d 25 (Wis. 1989) 59

Sims v. Nationwide,
247 S.C. 82, 145 S.E.2d 523 (1965) 10

Smith v. Widener,
97 S.C. 468, 724 S.E.2d 188 (Ct. App. 2012) 21, 22

State Farm Fire & Cas. Co. v. Jenkins,
382 N.W.2d 796 (Mich. Ct. App. 1985) 31

State Farm Fire & Cas. Co. v. Jioras,
24 Cal. App. 4th 1619 (Cal. Ct. App. 1994) 52, 59

Trancik v. USAA Ins. Co.,
354 S.C. 549, 581 S.E.2d 858 (Ct. App. 2003) 60

U.S. Fid. & Guar. Co. v. Regis Ins. Co.,
No. 90-5180, 1991 U.S. Dist. Lexis 5671 (E.D. Pa. April 25, 1991) 60

U.S. Fid. & Guar. Co. v. Adams,
485 So. 2d 720 (Ala. 1986) 14

United States use of Hallenbeck v. Fleisher Eng. & Constr. Co.,
107 F.2d 925 (2nd Cir. 1939), aff'd 311 U.S. 15 (1940) 52

Vermont Mut. Ins. Co. v. Singleton,
316 S.C. 5, 446 S.E.2d 417 (1994) 27

Zaragoza v. Ebenroth,
770 N.E.2d 1238 (Ill. Ct. App. 2002) 48

Zeller v. Cumberland Truck Sales,
272 S.C. 558, 253 S.E.2d 111 (1979) 57

Statutes

S.C. Code Ann. § 33-41-340 52

Other Authorities

1 Allan D. Windt, *Insurance Claims and Disputes* 5th §§ 2:7 and 2:14 52

28 Am. Jur. 2d Estoppel and Waiver § 160 57

38 A.L.R.2d 1148 § 7(a) 54

44 Am. Jur. 2d Insurance § 1445 (1982) 60

Christopher Lyle McIlwain, *Clear as Mud: An Insurer's Rights and Duties Where Coverage Under a Liability Policy is Questionable*, 27 Cumb. L. Rev. 31 (1997) .. 15

Couch on Insurance, 3d ed. § 202:47 ..... 54, 55

John H. Mathias, Jr., John D. Shugrue, and Thomas A. Marrinson,
Insurance Coverage Disputes § 9.01[1] (2009) 10

Restatement (Second) of Judgments § 28 (1982) 8

Rules

Rule 401, SCRE 46

Rule 402, SCRE 46

Rule 403, SCRE 46

Rule 407, SCACR 11

Rule 41(b), SCRCP 61

Rule 411, SCRE 10, 13

Rule 5.4(c), RPC 11

Rule 50, SCRCP 61

Rule 56, SCRCP 61

Rule 801(d)(2), SCRE 48

Statement of Issues

1. Did the Special Referee err by denying Harleysville's request to perform the *Crossmann* analysis of dividing and categorizing the underlying damages into (1) costs of repairing the defect and (2) costs of repairing the resulting damage, where Harleysville should not have intervened in the underlying suit to seek allocation and where the underlying verdict does not bar a subsequent allocation?

2. Did the Special Referee err in his calculation of the "time on risk" formula by refusing to apply a per-building calculation, by relying on an incorrect policy expiration date, by refusing to apply the formula to "loss of use" damages, and by selecting an arbitrary unsupported date to represent the start of damages?

3. Did the Special Referee err by refusing to apply the "time on risk" analysis to the underlying punitive damages award?

4. Did the Special Referee err by ruling that the underlying punitive damage awards arise from a covered occurrence?

5. Did the Special Referee err by ruling that the underlying damages are covered despite the "expected or intended" exclusions in each of the CGL policies?

6. Did the Special Referee err by ruling that the underlying damages are covered despite the "faulty workmanship" exclusion in each of the CGL policies?

7. Did the Special Referee make improper and unsupported findings of fact, including making findings based on evidence he excluded?

8. Did the Special Referee err by excluding relevant, admissible evidence and testimony regarding allocation, intervention, and reservations of rights?

9. Did the Special Referee err by ruling that Harleysville failed to reserve its right to contest coverage despite evidence to the contrary, when there was no waiver of such rights, and when the judgment holders have no rights to argue, and did not argue, for a waiver of reservation of rights?

10. Did the Special Referee err by denying Harleysville's motion for judgment as a matter of law based on his conclusion that the motion was inapplicable to a non-jury proceeding?

Statement of the Case

This appeal arises from a declaratory judgment action to determine coverage under Commercial General Liability ("CGL") insurance policies issued by Harleysville Group Insurance ("Harleysville") following a jury verdict against its insureds in an underlying action. Harleysville filed this action on October 14, 2009, seeking a declaration that Harleysville has no duty to indemnify its insureds for monetary damages awarded in the underlying suit or, alternatively, seeking an allocation of those damages into covered and non-covered categories. The insured defendants made no appearance and filed no responsive pleading. The defendant property owners and property owners' associations, through a policy provision, and the excess insurance carrier each filed Answers and counterclaims.

This declaratory judgment action was consolidated with another, substantially similar action and, on October 21, 2010, was referred to the Honorable John M. Milling as Special Referee to take testimony and evidence and to issue orders disposing of the actions. The parties subsequently filed pre-trial briefs, and the Special Referee held a hearing on December 13-14, 2010, at which he heard testimony from two witnesses. After the South Carolina Supreme Court decided *Crossmann Cmtys. of N.C. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E.2d 589 (2011), the Special Referee reopened the hearing in this suit on December 9, 2011 to hear arguments and testimony regarding the application of the "time on risk" formula.

On September 12, 2012, Harleysville filed a motion for judgment as a matter of law and for a directed verdict, along with a proposed Order. The Special Referee denied the motion in an Order dated February 28, 2013. The Special Referee at the

same time issued two Orders disposing of the two actions.[1] The Special Referee ruled in the two Orders that the CGL policies covered the damages awarded in the underlying trial, that no policy exclusions applied, that the underlying damages could not be allocated into covered and non-covered damages, that a "time on risk" analysis applied to the underlying actual damages but not to punitive damages, and that Harleysville had failed to reserve its rights to contest coverage.

Both parties filed motions to vacate, alter, or amend the Orders. After a hearing held April 9, 2013, the Special Referee denied these motions in Orders dated April 22, 2013. Harleysville filed its notice of appeal on May 20, 2013. Shortly thereafter, the Respondent/Appellant property regime and homeowners' association filed their notice of appeal. On June 14, 2013, the Court of Appeals consolidated the cross appeals.

Statement of the Facts

This appeal involves insurance coverage analysis for damages relating to alleged construction defects at Riverwalk at Arrowhead Country Club Horizontal Property Regime ("Riverwalk" or "the complex"), a condominium complex in Myrtle Beach. The complex consists of 19 buildings containing a total of 228 units. (Riverwalk Order at 4; CR 28[2].) Construction began in 1997 and was completed by the end of 1999. (*Id.*)

The complex was developed, built, and sold by several entities. The overall developer was Heritage Communities, Inc., the site specific developer was Heritage Riverwalk, Inc., and the general contractor was Buildstar Corporation (collectively "the Heritage entities" or "the insureds"). (Riverwalk Order at 4; CR 28.) These corporate

[1] Both of these Orders as well as the Order denying Harleysville's prior motion for judgment were filed on March 5, 2013.

[2] The Consolidated Record on Appeal cites are referenced as "CR."

entities shared officers, directors, and office space, and Heritage Communities, Inc. was the parent company of the other two entities. Each of these entities was insured by Harleysville. (Harleysville's Riverwalk Dec. J. Compl. at ¶ 12; CR 130.)

After the buildings in the complex were completed and the condominiums were sold, the new residents became aware that water was intruding into the buildings causing rot, deterioration, and other damage on a progressive basis. (*Id.* at ¶ 14; CR 131.) On December 5, 2003, the Riverwalk Property Owners' Association sued the Heritage entities seeking to recover repair costs related to the alleged defective design and construction defects. (Riverwalk Order at 3; CR 27.) Individual Riverwalk homeowners subsequently sued the Heritage entities and were certified as a class and consolidated for trial with the prior-filed Riverwalk suit. (*Id.*)

Harleysville provided for the defense of its insureds under reservation of rights letters.[3] (*Id.* at 12; CR 36.) Jury trial in the Riverwalk liability suit commenced on January 5, 2009. (*Id.* at 3; CR 27.) Harleysville advised its insureds of the coverage issues but, based on its understanding of the law and facts, did not intervene in the suit. (*Id.* at 13; CR 37.) At the close of all evidence, the trial judge granted the plaintiffs' motion for directed verdict on the negligence claim. The trial court also ruled that the Heritage entities were "amalgamated" such that they were to be treated as a single entity and the actions of any one of them applied to the others. (*Id.* at 7; CR 31.) The trial court submitted the remaining claims and the question of damages to the jury. A

[3] The Special Referee ruled that because the record did not contain a copy of the reservation of rights letters regarding the complaint filed by the class of individual homeowners, those letters must have never existed. (Riverwalk Order at 12; CR 36.) As explained below, the uncontroverted testimony indicates these letters were sent and, in any event, Harleysville orally informed its insureds of its reservation of rights.

general verdict form was used. The jury returned a verdict in favor of the Property Owners' Association for breach of fiduciary duty. (*Id.* at 3; CR 27.) On the basis of that verdict and the directed verdict of negligence, the jury awarded $4,250,000 in actual damages and $250,000 in punitive damages. (*Id.*) The jury also returned a verdict in favor of the individual homeowners for breach of the warranty of habitability and awarded $250,000 in actual damages and $750,000 in punitive damages. (*Id.*) The trial judge granted a set-off from the total of the two verdicts, bringing the total Riverwalk verdict to $4,471,178.31. (*Id.* at n.1; CR 27.)

The Heritage entities appealed in the underlying suit. The Court of Appeals affirmed. A certiorari petition remains pending regarding that matter in the South Carolina Supreme Court. During the pendency of the appeal in the underlying suit, Harleysville filed the declaratory judgment action that gives rise to this appeal.

Argument

I. The Special Referee improperly denied Harleysville's request to perform the *Crossmann* analysis of dividing and categorizing the damages into (1) costs of repairing the defect and (2) costs of repairing the resulting damage.

The Special Referee erred by denying Harleysville's request to allocate damages into categories of covered and non-covered losses. The South Carolina Supreme Court has made clear that, in a progressive damages case, CGL policies cover only those damages categorized as "property damage," *i.e.*, those relating to the repair cost for damaged portions of the buildings. *Crossmann Cmtys. of N.C. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 49-50, 717 S.E.2d 589, 593-94 (2011). In contrast, damages to repair or replace defective work or improper workmanship are not covered. *Id.*

Accordingly, in its declaratory judgment action regarding coverage, Harleysville sought to allocate the damages awarded in the underlying action into categories to determine which portions of the damages are and are not covered. To that end, Harleysville proffered testimony of a qualified expert general contractor who analyzed the damages at Riverwalk.[4] This unrebutted expert testimony revealed that only 17.82% of the Riverwalk damages related to damaged portions of the buildings.[5] (*See* Trial Tr. of December 13-14, 2010, at 235-53; CR 480-98.) The remainder of the damages related to the cost to correct the original construction work to make it code compliant (*id.*), which are costs that are not covered.

The Special Referee recognized that the damages awarded in the underlying case contained both covered and non-covered damages. (*See* Post-Trial Hearing of April 9, 2013 at 89; CR 729.) Nevertheless, the Special Referee excluded Harleysville's proffered evidence, erroneously ruling that the "general verdict" in the underlying action precluded Harleysville from allocating damages into categories in its subsequent coverage action.[6] As explained below, this was error.

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[4] The Special Referee excluded the testimony. (*See* Trial Tr. of December 13-14, 2010, at 233-34; CR 478-79.) As discussed in Part VIII, *infra*, this was error.

[5] The total actual damage award in the Riverwalk action, after set off, was $3,228,679. After the Special Master applied the "time on risk" formula, the amount of actual damages was reduced to $1,794,499. (*See* Riverwalk Order at 47; CR 71.) Because only 17.82% of the damages relate to damaged portions of the building, the total potentially recoverable amount of damages under the insurance policies should be further reduced to $319,779.72.

[6] In fact, the "general verdict rule" is inapplicable here. Under the "general verdict" or "two issue" rule, where a jury's general verdict rests upon two or more claims, and the appellant can show error as to only one of those claims, the verdict will nonetheless stand because it is independently supported by the other claim. *See Cole v. Raut,* 378 S.C. 393, 406-07, 663 S.E.2d 30, 34 (2008) (citing *Gold Kist, Inc. v. C&S Nat'l Bank*, 286 S.C. 272, 282, 333 S.E.2d 67, 73 (Ct. App. 1985). In this appeal, Harleysville is not challenging the propriety of the claims submitted to the juries in the underlying action or the amounts awarded by that jury. Rather, Harleysville simply seeks to determine what portions, if any, of those amounts are covered by its CGL policies.

A. An allocation of damages does not "re-litigate" any issue.

The Special Referee's Order erroneously states that Harleysville's request to allocate damages was an attempt to "re-litigate" the issue of damages. (*See* Riverwalk Order at 30-31, 35; CR 54-55, 59.) This belief is incorrect for several reasons. First, Harleysville's coverage action does not challenging the availability, propriety, or amount of damages in the underlying actions. Rather, Harleysville seeks to determine what portions of those damages are covered by the policies.

Second, it is, by definition, impossible for this issue to be "*re*-litigated" because it was never litigated, *i.e.*, raised and determined, in the proceedings below. The preclusion doctrine of collateral estoppel "prevents a party from re-litigating an issue in a subsequent suit which was *actually and necessarily litigated and determined* in a prior action." *Aaron v. Mahl*, 381 S.C. 585, 592, 674 S.E.2d 482, 486 (2009) (emphasis added) (citation omitted); *Plott v. Justin Enters.*, 374 S.C. 504, 511, 649 S.E.2d 92, 95 (Ct. App. 2007) ("'[W]here the second suit is upon a different claim, the former judgment is conclusive only as to those issues *actually* determined.'") (quoting *Johnston-Crews Co. v. Folk*, 118 S.C. 470, 483, 111 S.E. 15, 19 (1922)) (emphasis added).[7] Because this coverage action is premised on a different claim than the prior suits, and because allocation of damages was not actually litigated and determined in the prior suits, Harleysville is not precluded from seeking allocation now.

[7] In contrast, the doctrine of res judicata precludes relitigation of *claims* that were or should have been determined in a prior action. *S.C. Pub. Interest Found. v. Greenville Cnty.*, 401 S.C. 377, 385-86, 737 S.E.2d 502, 507 (Ct. App. 2013). Res judicata is inapplicable here because this coverage action involves claims that are different from those that were or should have been raised in the prior, underlying actions and because the parties are not the same.

Third, because Harleysville was not a party to the proceedings below or in privity with any parties below, it is not precluded from seeking to allocate damages now. Although no South Carolina cases have considered whether an insurer is in privity with its insureds when defending them under a reservation of rights, the Fifth Circuit has provided the following test:

> An insurer in a coverage case will be barred from re-litigating a particular issue from the underlying liability case if: (1) the issue raised in the coverage suit was raised and determined in the liability suit; (2) the issue determined in the liability suit was essential to the judgment in the liability suit; and (3) the necessary requirement of privity exists between the insurer and the insured. [] The requisite degree of privity between an insurer and its insured can exist if: (1) the insurer controlled the insured's defense in the liability suit; *and* (2) the insurer and the insured *do not hold conflicting positions* with respect to the issue determined in the liability suit.

Mid-Continent Cas. Co. v. Bay Rock Operating Co., 614 F.3d 105, 110-11 (5th Cir. 2010) (emphasis added) (citations omitted). Here, there can be no question that the insurer and the insureds held conflicting positions with respect to the issue of whether damages should be allocated. Harleysville's position, as evidenced by its reservation of rights letters, its discussions with the insureds,[8] and its declaratory judgment action, was that much of the alleged damages were not covered by the CGL policies, and thus an allocated verdict would properly limit its exposure. The insureds, in contrast, stood to benefit from an unallocated general verdict by which they hoped to shift the entire

[8] *See, e.g.*, Trial Tr. of Dec. 13-14, 2010 at 103 (testimony that Harleysville met with its insureds and "let them know that we had coverage issues with some of these cases or with all of these cases"); CR 348; *id.* at 111; CR 356 (proffering testimony that Harleysville informed insureds' director "that we did have coverage issues with these" and "there was likely not going to be coverage for a grand majority of these, of these damages"); *id.* at 204 (testimony that Harleysville told insureds' personal attorney of coverage issues); CR 449.

liability payment responsibility to Harleysville. In light of these conflicting positions, Harleysville was not in privity with its insureds.

Fourth, even if the allocation of damages had been raised and decided in the prior actions, and even if Harleysville were in privity with its insureds, Harleysville's request to allocate damages is nonetheless warranted by the circumstances of this case. This Court has previously recognized that relitigation of an issue is permissible where special circumstances prevented an adequate opportunity or incentive to raise the issue in the prior action. *Mr. T. v. Ms. T.*, 378 S.C. 127, 137, 662 S.E.2d 413, 418 (Ct. App. 2008); *see also* Restatement (Second) of Judgments § 28 (1982). Harleysville was not a party in underlying action. As explained below, circumstances in that action deprived Harleysville of an adequate opportunity or incentive to intervene, which prevented a full and fair resolution of this issue.

B. Harleysville should not have intervened in the underlying suit.

The Special Referee's Orders refusing to allocate damages is premised largely on his belief that Harleysville should have intervened and requested a special verdict form addressing allocation. (*See* Riverwalk Order at 13, 31-33; CR 37, 55-57.) Harleysville, however, had neither the opportunity nor the incentive to intervene, and to do so would have been improper and prejudicial to its insureds. The law at the time of the underlying actions was established by the South Carolina Supreme Court's first opinion in *Auto Owners v. Newman,* where the Court ruled that every dollar of construction defect damages triggered indemnity obligations under a standard

commercial general liability policy.[9] In accordance with that opinion, other South Carolina trial courts had denied motions to intervene in analogous cases.[10] Accordingly, there was no possibility, much less an obligation, for Harleysville to intervene and demand a special verdict form to allocate damages into categories that, at that time, were unnecessary and meaningless.

Regardless, any attempted intervention threatened possible adverse results to Harleysville's insureds. In a similar lawsuit involving the same insured that reached trial several years before these actions, Harleysville filed a motion to intervene, which was strongly opposed by the insureds. Accordingly, in that instance, Harleysville withdrew its motion. (*See* Trial Tr. of Dec. 13-14, 2010 at 206-08; 451-53.[11])

A motion to intervene would have been problematic for other reasons. An intervention by Harleysville would have resulted in an adversarial relationship between insured and insurer. (*See id.* at 120 (testimony of Mr. Wright that it would have been improper for Harleysville to intervene in the underlying suits because doing so "would've put us in direct opposition to our insureds"); CR 365.[12]) Where an insurance

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[9] The underlying trial occurred in January 2009. The Court's initial opinion in *Auto Owners Ins. Co., Inc. v. Newman* was decided on March 10, 2008. *See* 2008 WL 648546. The Court did not withdraw that opinion and issue its new opinion until September 2009.

[10] For example, at the bench trial, Harleysville sought to introduce as an exhibit the transcript of a motion hearing from another trial similar to the underlying suit against its insureds. (Trial Tr. of December 13-14, 2010, at 140; CR 385.) In that other trial, the trial judge had denied the insurer's motion to intervene. (*Id.*)

[11] Harleysville proffered additional testimony regarding this past attempt at intervention to show that this same insured had previously refused to allow intervention and that both parties in that suit had threatened to allege bad faith if Harleysville intervened. (*See* Trial Tr. of December 13-14, 2010, at 131; CR 376.)

[12] For example, one of the witnesses who testified in the underlying Riverwalk trial, Mr. Graham, was offered to show that he informed the insureds that that they were improperly installing the windows. (*Id.* at 120-21, 125-26; CR 365-66, 370-71.) Had Harleysville been a party to that trial, it would have been forced into an awkward and adversarial stance of asserting the position it now argues in this coverage action that its insured had intentionally installed windows improperly.

carrier and insured have divergent interests, the proper place for resolution of those disputes is in a post-trial action relating to coverage. *See Sims v. Nationwide*, 247 S.C. 82, 145 S.E.2d 523 (1965).[13] The South Carolina Supreme Court has recognized that an unnecessary verdict form apportioning fault between co-defendants can confuse the jury and cause them to inflate the damage award to ensure a hearty recovery from the deep-pocketed defendant. *See Branham v. Ford Motor Co.*, 390 S.C. 203, 237, 701 S.E.2d 5, 23 (2010). Here, an irrelevant question to the jury about allocation of damages would have posed the same risks.

Furthermore, an intervention by Harleysville would have revealed the presence of liability insurance in contravention of Rule 411, SCRE. That Rule guards against a danger recognized by a long line of cases. *See Crocker v. Weathers*, 240 S.C. 412, 126 S.E.2d 335 (1962); *Dobson v. Am. Indem. Co.*, 227 S.C. 307, 87 S.E.2d 869, 870 (1955); *Cox v. Employers Liability Assur. Corp.*, 191 S.C. 233, 236, 196 S.E. 549, 550 (1938) ("The writer of this opinion, after twelve years' experience upon the trial bench, knows of no more effective method of embalming a defense than that of informing a jury in a negligence case that the defendant in the suit is protected against their verdict by liability insurance.").

In addition, Harleysville could not simply instruct the insureds' counsel to request an allocated verdict. The Rules of Professional Conduct mandate that counsel

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[13] Commentators have reached similar conclusions:

> Where the conflict between insurer and policyholder centers on the basis of the policyholder's liability to the underlying claimant, *the insurer may not be collaterally estopped from challenging those facts determined in the underlying action with respect to which the interests of policyholder and insurer diverge*.

John H. Mathias, Jr., John D. Shugrue, and Thomas A. Marrinson, *Insurance Coverage Disputes* § 9.01[1] (2009) (emphasis added).

for the insureds owes a duty of loyalty only to the insureds, not to Harleysville, if their interests diverge. *See* Rule 5.4(c), RPC, Rule 407, SCACR ("A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."). Even if Harleysville had instructed or requested its insureds to seek a special verdict to allocate the damages in terms of coverage, the insureds could not have done so because coverage was not an issue in the case. "Our supreme court has previously held that '[i]t is improper in a law case to submit factual issues to a jury in the form of non-binding "advisory interrogatories."'" *Miranda C. v. Nissan Motor Co., Ltd.*, 402 S.C. 577, 589, 741 S.E.2d 34, 40 (Ct. App. 2013) (quoting *Erickson v. Jones St. Publishers, LLC*, 368 S.C. 444, 480, 629 S.E.2d 653, 672 (2006)). In short, it was essentially impossible for Harleysville to intervene or otherwise meaningfully participate without seriously injuring the insureds and violating well-established rules.

No evidence could be offered in the underlying action by Harleysville sufficient to allow the jury to allocate on a sufficient evidentiary basis. The insureds' expert hired by Harleysville could not offer evidence to show which damages are not covered because it would be adverse to the insureds. The underlying plaintiffs' counsel would not offer evidence categorizing some damages as non-covered because it would hurt his clients' chances of recovery. Hence, the only fair method of analysis and allocation is a subsequent declaratory judgment action.

C. An allocation of damages is not barred by Auto Owners v. Newman.

The Special Referee's Orders erroneously stated that Harleysville's request to allocate damages was barred by *Auto Owners v. Newman*, 385 S.C. 187, 684 S.E.2d

541 (2009). (*See* Riverwalk Order at 30-31; CR 54-55.) That action arose from moisture damage to a home caused by improper stucco installation. *Newman*, 385 S.C. at 190, 684 S.E.2d at 542. The homeowner's suit against the contractor was referred to binding arbitration, and the arbitrator awarded itemized damages. *Id.* The contractor's insurer subsequently sought a declaratory judgment regarding coverage. *Id.* The South Carolina Supreme Court, in its second opinion considering the declaratory judgment action, held in pertinent part that damages awarded to remedy faulty workmanship were not covered under the CGL policy, but that it was not possible to determine from the Record what portion of the damages were attributable to faulty workmanship. *Id.* at 198, 684 S.E.2d at 547. The Court noted that the insurer had not intervened in the underlying arbitration to raise coverage questions. Accordingly, the Court granted the insurer an essentially pyrrhic victory, "revers[ing] the trial court's decision to the extent that it orders recovery under the policy for the removal and replacement of the defective stucco," but noting that "there is no evidence in the record indicating which damages may be attributed to the removal and replacement of the defective stucco." *Id.*

The *Newman* Court's ruling, however, does not foreclose Harleysville's request to allocate damages. First, the issue of allocation of damages was not raised in the arbitration nor raised in appeal briefs before the appellate court in *Newman*.[14] Second, the issue of whether a subsequent declaratory judgment action could be brought to allocate damages between those covered and non-covered was not before the *Newman*

[14] The allocation issue was raised in a rehearing petition related to the Court's second *Newman* opinion. However, the rehearing petition was denied without any express basis for denial.

Court.[15] Third, the underlying liability action in *Newman* was an arbitration, not a jury trial, and thus the *Newman* Court had no reason to consider the various disincentives and prohibitions—for example, Rule 411, SCRE or the potential for confusing the jury—that prevented Harleysville from intervening in the underlying actions here.

D. Other jurisdictions permit a post-trial coverage action to allocate damages awarded by a general verdict in a previous action.

Authority from other jurisdictions supports Harleysville's right in a coverage action to allocate the general verdict from prior suits into categories of covered and non-covered damages. The Fifth Circuit, for example, has held that an insurer is entitled to seek a subsequent allocation of the damages awarded by general verdict in a prior underlying action. *Duke v. Hoch*, 468 F.2d 973 (5th Cir. 1972). In *Duke*, at the underlying liability trial, the insured did not request a special verdict, and the jury rendered a general verdict against the insured. In the appeal of the subsequent action raising the question of coverage, the Fifth Circuit held that the coverage, if any,[16] should be limited to the amount determined by the lower court's allocation of damages into categories of those covered and not covered. The court noted that on remand

> [T]he court will face the issue of attempting retrospectively to allocate the damages awarded. . . . The primary source of evidence will be, of course, the

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[15] In *Newman*, the Court was faced with the absence of Record evidence upon which to make an accurate allocation of damages. *See Newman*, 385 S.C. at 198, 684 S.E.2d at 547 (noting "it is not possible from the record before this Court to determine what portion of the damages may be attributed to the removal and replacement" of defective work and "there is no evidence in the record indicating which damages may be attributed to the removal and replacement" of the defective work). Here, in contrast, there ***is*** Record evidence regarding what portion of damages relates to covered and non-covered damages. In its declaratory judgment action, Harleysville proffered the testimony of Mr. Frank Baiden, a qualified expert general contractor regarding the precise amounts necessary to repair the damages at the complex.

[16] The *Duke* court noted that if an insurer advises the insured of the wisdom of seeking a special verdict but the insured ignores the advice, the insured risks a total loss of coverage if the jury awards an unallocated verdict containing non-covered damages. *See id.* at 979 ("The consequence to the insureds of a nonallocated verdict is the catastrophic total loss of coverage."). The court also noted that the choice of whether to request a special verdict creates a conflict between the interests of the insured and insurer. *Id.*

> transcript of the merits trial, containing the evidence on which the jury based its verdict. The trial judge, as trier of fact, will be in the position of establishing as best he can the allocation which the jury would have made had it been tendered the opportunity to do so. If it is impossible for the court to make a meaningful allocation based on only the transcript, [judgment holder] should have the right to adduce additional evidence and [insurer] to present evidence in rebuttal.

Id. at 984. Other courts have reached similar conclusions. *See Allstate Ins. Co. v. Keltner*, 842 N.E.2d 879, 883 (Ind. Ct. App. 2006) ("Allstate, and also the Keltners, seem to assume that if there is a general judgment entered on a verdict against [the insured] that does not distinguish between covered and uncovered damages, there would be no later opportunity to make that distinction. We disagree. A proceedings supplemental would offer an occasion for presenting evidence and argument regarding a fair approximation of the division of damages."); *Donna C. v. Kalamaras*, 485 A.2d 222, 224 (Me. 1984) (Maine law "cannot rationally be interpreted as meaning that a general verdict will preclude the insurer from later litigating its coverage questions").

Other jurisdictions likewise acknowledge the impracticability of intervention by an insurance carrier in a liability action against its insured and have held that coverage issues are best reserved for subsequent litigation. *See Restor-A-Dent v. Certified Alloy*, 725 F.2d 871 (2d Cir. 1984); *Davila v. Arlasky*, 141 F.R.D. 68 (N.D. Ill. 1991); *Allstate Ins. Co. v. Keltner*, 842 N.E.2d 879 (Ind. Ct. App. 2006); *MedMarc v. Forest Healthcare*, 199 S.W.3d 58 (Ark. 2004); *Emp. Ins. Of Wausau v. Lavender*, 506 So.2d 1166 (Fla. Ct. App. 1987); *U.S. Fid. & Guar. Co. v. Adams*, 485 So. 2d 720 (Ala. 1986); *Donna C. v. Kalamaras*, 485 A.2d 222, 224 (Me. 1984); *Hunter v. Peters*, No. 423946, 2001 Conn. Super. Lexis 3761 (Conn. Super. Ct. Dec. 13, 2001); *see*

generally Christopher Lyle McIlwain, *Clear as Mud: An Insurer's Rights and Duties Where Coverage Under a Liability Policyis Questionable*, 27 Cumb. L. Rev. 31 (1997) (noting that attempts to intervene for the limited purpose of requesting a special verdict have generally been unsuccessful, primarily because state supreme courts have held that liability insurers have no absolute right to intervene, and because the trial court has the virtually irreversible discretion to grant or deny intervention). Hence, Harleysville should be permitted to seek to allocate the underlying damages into covered and non-covered categories. The Special Referee's refusal to allow this was error.

II. The Special Referee erred in his calculation of the "time on risk" formula.

Even assuming the construction defects leading to the underlying suits constitute a covered "occurrence" not excluded by Harleysville's CGL policies—an assumption Harleysville disputes, *see* Parts IV, V, and VI, *infra*—the Special Referee erred in calculating the portion of the underlying actual damage awards for which Harleysville is responsible. In *Crossmann*, the South Carolina Supreme Court adopted a "time on risk" analysis when calculating an insurer's coverage responsibility. *See Crossmann*, 395 S.C. at 50-52, 717 S.E.2d at 594-95. This analysis applies when progressive damages occur over a period of time, and the insurer's policy was in force for only a portion of that time. *Id.* at 64-65, 717 S.E.2d at 601-02.[17] Here, the Special Referee applied the

[17] The formula is applied as follows:

> In cases where it is impossible to know the exact measure of damages attributable to the injury that triggered each policy, courts have looked to the total loss incurred as a result of all of the property damage and then devised a formula to divide that loss in a manner that reasonably approximates the loss attributable to each policy period. The basic formula consists of a numerator representing the number of years an insurer provided coverage and a denominator representing the total number of years during which the damage progressed. This fraction is

"time on risk" calculation to the actual damages awarded in the underlying trials. (*See* Riverwalk Order at 44-47; CR 68-71.) However, he erred in several respects in doing so, the effect of which was to saddle Harleysville with a disproportionate share of the damages.

In *Crossmann*, the court left "it to the sound discretion of the trial court to determine whether it is necessary to apply the 'time on risk' formula separately to each individual building or whether, instead, it would be prudent to modify the default formula to arrive at a reasonable methodology for this case." *Crossmann*, 395 S.C. at 66, 717 S.E.2d at 602. Stated differently, the Special Referee had two choices: either apply "time on risk" to each building individually or employ some other *reasonable* method of applying "time on risk." The Special Referee abused his discretion by doing neither of these and instead employing the unreasonable method of selecting a starting date for damages to buildings that had not even been built as of at that date. In addition, he used an incorrect date when calculating the CGL coverage at Riverwalk, which substantially and wrongly increased Harleysville's coverage liability, and he wrongly refused to apply "time on risk" to the "loss of use" damages.

A. The Special Referee erred by refusing to apply a per-building "time on risk" calculation.

The "time on risk" calculation requires the court to determine the dates at which the damages to the buildings started and ended. The Special Referee erred in choosing a single starting date for all of the damages at the Riverwalk complex. In the Order, the

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> multiplied by the total amount the policyholder has become liable to pay as damages for the entire progressive injury. In this way, each triggered insurer is responsible for a share of the total loss that is proportionate to its time on the risk.

Crossmann, 395 S.C. at 64-65, 717 S.E.2d at 602 (footnotes omitted).

Special Referee determined that the progressive water damages on *all* the buildings began on a single date, namely 30 days after the certificate of occupancy was issued on the *first* building constructed. (*See* Riverwalk Order at 45; CR 69.) This determination ignores the fact that the buildings at Riverwalk were built over a period of years and effectively concludes that damages began accruing on buildings that had yet to be built.[18]

The Special Referee declined to calculate "time on risk" using a per-building approach because doing so would, in his view, "require the Court to allocate damages and would be speculative." (Riverwalk Order at 46; CR 70.) However, using a per-building approach would have been more precise than the improper method employed. At Riverwalk, for example, the per-building approach can be calculated as follows.

Bld.	**"Start date" (CO + 30)**[19]	**Days of coverage**[20]	**Days of damages**[21]	**Multiplier**[22]	**Damage per building**[23]	**Covered damages**
1	11/27/1997	1300	2347	.5538	$169,930.44	$94,107.48
2	11/30/1997	1297	2344	.5533	$169,930.44	$94,022.51
3	12/14/1997	1283	2330	.5506	$169,930.44	$93,563.70
4	12/26/1997	1271	2318	.5483	$169,930.44	$93,172.86
5	12/24/1999	543	1589	.3417	$169,930.44	$58,065.23

[18] At Riverwalk, for example, the first building's certificate of occupancy was issued on October 29, 1997. (*See* Riverwalk Data: Limited Chart; CR 2569.) The final building's certificate of occupancy was issued over two years later on November 24, 1999. (*Id.*)

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

[20] The Special Referee held the policies expired on June 18, 2001 (Riverwalk Order at 46; CR 70), thus each building was covered from its start date to June 18, 2001. This date, however, is wrong. Part II.B, *infra*.

[21] The Special Referee ruled the damage at Riverwalk concluded on April 30, 2004. (Riverwalk Order at 45-46; CR 69-70.) Thus, the damages to each building occurred from its "start date" to April 30, 2004.

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

[23] Actual damages, after set-off and not including punitive and loss of use damages, were $3,228,678.36. (*Id.* at 47; CR 71.) Divided among the 19 buildings at Riverwalk, this amounts to $169,930.44 per building.

6	2/2/1998	1233	2279	.5410	$169,930.44	$91,932.37
7	3/2/1998	1205	2251	.5353	$169,930.44	$90,963.76
8	3/9/1998	1198	2245	.5336	$169,930.44	$90,674.88
9	6/11/1998	1104	2151	.5132	$169,930.44	$87,208.30
10	7/15/1998	1070	2117	.5054	$169,930.44	$85,882.84
11	8/16/1998	1038	2085	.4978	$169,930.44	$84,591.37
12	9/25/1998	998	2045	.4880	$169,930.44	$82,926.05
13	11/5/1998	957	2004	.4775	$169,930.44	$81,141.79
14	11/30/1998	932	1979	.4709	$169,930.44	$80,020.24
15	12/17/1998	915	1962	.4663	$169,930.44	$79,238.56
16	10/24/1999	604	1651	.3658	$169,930.44	$62,160.55
17	1/30/2000	506	1553	.3258	$169,930.44	$55,363.34
18	12/24/1999	543	1590	.3415	$169,930.44	$58,031.25
19	12/24/1999	543	1590	.3415	$169,930.44	$58,031.25
					Total:	**$1,521,098.33**

Because this data was available and permitted a precise and accurate calculation of Harleysville's "time on risk," it was error to apply a speculative method and assume damages began occurring before most of the buildings had yet been constructed.

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

Additionally, the Special Referee erred in his calculation by using an incorrect policy expiration date in calculating the Riverwalk damages. Specifically, the Special Referee held that Harleysville's policies insured Heritage Riverwalk until June 18, 2001. (*See* Riverwalk Order at 46; CR 70.) The Special Referee erroneously refused to permit Harleysville to introduce evidence showing that the policy in force from June 18, 2000 to June 18, 2001 had been cancelled from its inception due to nonpayment. (*Id.*[24]) The evidence should have been admitted because it represented the true coverage period involved, and there was no legal prejudice to the underlying plaintiffs from its admission. The Special Referee's error also contradicts the express and uncontroverted testimony presented at the bench trial. Specifically, Mr. Lee Wright, Harleysville's

[24] See Harleysville's Motion to Amend at ¶ 38; CR 2566.

construction defect litigation manager, explained that the last policy period covering Heritage Riverwalk ended on June 18, ***2000***:

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

(Trial Tr. of December 13-14, 2010 at 166-67; CR 411-12.) The effect of this error is significant. When the Riverwalk policy expiration date is changed to the correct date, it alters the calculation set out in the table above as follows:

Bld.	"Start date" (CO + 30)	Days of coverage	Days of damages	Multiplier	Damage per building	Covered damages
1	11/27/1997	935	2347	.3984	$169,930.44	$67,697.04
2	11/30/1997	932	2344	.3976	$169,930.44	$67,566.20
3	12/14/1997	918	2330	.3940	$169,930.44	$66,951.13
4	12/26/1997	906	2318	.3909	$169,930.44	$66,418.02
5	12/24/1999	178	1589	.1120	$169,930.44	$19,035.63
6	2/2/1998	868	2279	.3809	$169,930.44	$64,721.20
7	3/2/1998	840	2251	.3732	$169,930.44	$63,412.51
8	3/9/1998	833	2245	.3710	$169,930.44	$63,052.14
9	6/11/1998	739	2151	.3436	$169,930.44	$58,381.49
10	7/15/1998	705	2117	.3330	$169,930.44	$56,589.97
11	8/16/1998	673	2085	.3228	$169,930.44	$54,850.45
12	9/25/1998	633	2045	.3095	$169,930.44	$52,599.50
13	11/5/1998	592	2004	.2954	$169,930.44	$50,199.01
14	11/30/1998	567	1979	.2865	$169,930.44	$48,686.49
15	12/17/1998	550	1962	.2803	$169,930.44	$47,635.95
16	10/24/1999	239	1651	.1448	$169,930.44	$24,599.26
17	1/30/2000	141	1553	.0908	$169,930.44	$15,428.33
18	12/24/1999	178	1590	.1119	$169,930.44	$19,023.66
19	12/24/1999	178	1590	.1119	$169,930.44	$19,023.66
					Total:	**$925,871.66**

C. The Special Referee erred by refusing to apply "time on risk" to the "loss of use" damages awarded in the underlying Riverwalk suit.

In the underlying Riverwalk suit, the jury awarded the individual homeowners $1 million for loss of use ($250,000 in actual damages and $750,000 in punitive damages). (Riverwalk Order at 47; CR 71.) The Special Referee refused to apply the "time on risk" calculation to these damages. (*Id.*) His ruling ignores the plain language of the insurance policies and the principle of progressive damages. Specifically, the applicable policies state that "'loss of use shall be deemed to occur at the time of the physical injury that caused it.'" (*Id.* (quoting policies).) The Special Referee determined that the progressive damages at Riverwalk occurred over a period of nearly seven years. (*Id.* at 45-46; CR 69-70.) Thus, the loss of use is deemed to have occurred over that same period of years. Because Harleysville insured the Heritage entities for only a small portion of that span of years, it should be responsible to cover only the portion of loss of use damages deemed to have occurred while the policies were in force.

South Carolina courts have previously indicated that when making a pro rata apportionment of damages between insurers, there is no distinction or special treatment for loss of use damages. *See Nat'l Grange Mut. Ins. Co. v. Firemen's Ins. Co.*, 310 S.C. 116, 120-21, 425 S.E.2d 754, 757-58 (Ct. App. 1993) (discussing coinsurer's statutorily mandated contribution under "pro rata calculation for real property and for personal property and loss of use"). Hence, because loss of use damages are deemed to have occurred at the same time as the progressive actual damages, the "time on risk" calculation applies equally to both.

D. *The Special Referee improperly used an arbitrary start date of 30 days following the first certificate of occupancy.*

No evidence was admitted of the first date on which the water intrusion was noticed in the buildings. No evidence was admitted of the first date on which any damage occurred necessitating a repair. The arbitrary selection of 30 days following certificate of occupancy is error as it was unsupported and grounded in speculation.

In sum, the Special Referee erred in performing the "time on risk" calculation by failing to apply a per-building formula, by ruling that damages began to accrue in most of the buildings before they were built, by using an incorrect policy expiration date which nearly doubles the responsibility placed on Harleysville, and by applying the "time on risk" calculation to only some of the damages. Reversal is thus required.

III. The Special Referee erred by refusing to apply the "time on risk" analysis to the punitive damages award.

Even assuming punitive damages are a covered occurrence under Harleysville's CGL policies and are not excluded by those policies' terms—issues Harleysville contests, *see* Parts IV and V, *infra*—the Special Referee erred by failing to apply a "time on risk" analysis to the amount of punitive damages awarded. (Riverwalk Order at 45; CR 69.) As explained below, this was error.

A. "Time on risk" should apply to both actual and punitive damages.

The logic supporting the "time on risk" framework applies equally to actual and punitive damages. Both types of damage arise from the same injury. *See Smith v. Widener*, 97 S.C. 468, 472, 724 S.E.2d 188, 191 (Ct. App. 2012). Here, the "injury" is in the form of progressive damage that occurred over a period of years. Accordingly,

it would be speculative and unjust to impose coverage responsibility on Harleysville for damage that may not have occurred during the time it insured the wrongdoers.

In addition, punitive damages, like actual damages, serve a compensatory role. *See Smith,* 97 S.C. at 472, 724 S.E.2d at 191 ("Our courts have long recognized that punitive damages serve to compensate a plaintiff and vindicate his rights arising out of a wrong suffered or injury sustained."); *O'Neill v. Smith*, 388 S.C. 246, 252, 695 S.E.2d 531, 534 (2010) ("[P]unitive damages . . . serve to vindicate the private rights of the plaintiff and they provide some measure of compensation to plaintiffs for the intentional violation of those rights."); *Clark v. Cantrell*, 339 S.C. 369, 379, 529 S.E.2d 528, 533 (2000) ("'Exemplary or punitive damages . . . in a measure compensate or satisfy for the willfulness with which the private right was invaded.'") (quoting *Rogers v. Florence Printing Co.*, 233 S.C. 567, 573, 106 S.E.2d 258, 261 (1958)). Where, as here, the punitive damages serve to compensate for an invasion of the plaintiffs' rights that occurred over a period of many years, Harleysville should be forced to cover only the portion of the wrongdoing that occurred while its policies were in force.

South Carolina's courts have repeatedly recognized the significance of the ratio between the amount of actual and punitive damages. *See Limehouse v. Hulsey*, 397 S.C. 49, 79, 723 S.E.2d 211, 227 (Ct. App. 2011) ("In reviewing an award of punitive damages, we consider . . . the disparity or 'ratio' between actual harm and the punitive damage award.") (citing *Mitchell v. Fortis Ins. Co.*, 385 S.C. 570, 686 S.E.2d 176 (2009)). Here, the jury in the underlying trial awarded actual-to-punitive ratios of 13-

to-1.[25] If the "time on risk" calculation is applied to only the actual damages, the jury's ratio is grossly distorted to 7-to-1.[26] So long as a jury's ratio of actual-to-punitive damages is compliant with due process limitations, a court may not lightly alter or inflate that ratio. *See Las Palmas Assocs. v. Las Palmas Center Assocs.*, 235 Cal. App. 3d 1220, 1254-56 (Cal. Ct. App. 1991) (holding a reduction of compensatory damages required a concurrent reduction of punitive damages to preserve the jury's ratio).

Although South Carolina courts have not previously had occasion to hold that the "time on risk" analysis applies to punitive damages arising from progressive damages, other courts have applied a "time on risk" approach to consequential damages. *See, e.g., City of Sterling Heights v. United Nat'l Ins. Co.*, No. 03-72773, 2008 U.S. Dist. Lexis 26990, *6 (E.D. Mich. April 3, 2008) (noting that in prior orders, "this Court applied the pro rata 'time-on-the-risk' allocation method to the Insureds' other damage elements; *i.e.*, defense costs and consequential damages"). This Court should adopt a similar rule.

B. *South Carolina precedent and basic principles of fairness require the application of "time on risk" to punitive damages.*

In any CGL coverage dispute arising from long-term progressive damages and involving punitive damages, the court has four options for allocating the punitive damages: (1) apply "time on risk" to the punitive damages, (2) apply joint and several liability, saddling one insurer with the entire punitive award but permitting it to later seek contribution from other insurers or from the insured (for periods of self-insurance

[25] The jury in the underlying Riverwalk suit awarded actual damages of $3,228,678 and punitive damages of $250,000. (*See* Riverwalk Order at 47; CR 71.)

[26] After the Special Referee applied the "time on risk" calculus, the actual damages were $1,794,499. (*See* Riverwalk Order at 47; CR 71.)

or no insurance), (3) assume that all of the intentional or reckless conduct occurred in "year one," *i.e.*, at the time the building was turned over to its new owner(s), or (4) pinpoint the exact acts being punished and try to determine when they occurred.

Of the four options enumerated above, only the first is viable. The second option—joint and several liability among the insurers—runs directly contrary to the approach recognized and adopted in *Crossmann*. The third option, which assumes that all the intentional conduct occurred in "year one," is fraught with problems and potential unfairness. For example, if there was no insurance in place on "year one," or if that carrier is insolvent or dissolved, the injured parties would recover *none* of the punitive damages awarded under such an approach. The fourth option—a judicial attempt to determine which acts were being punished and when they occurred—is similarly problematic. As *Crossmann* and both of the underlying suits here illustrate, the builder's intentional wrongful conduct most likely occurred prior to the certificate of occupancy and thus would not be covered.

In short, of the various options available in this and similar situations, application of "time on risk" to punitive damages is the only option that is consistent with South Carolina precedent and that reliably and evenhandedly protects the interest of injured parties and insurers. The Special Referee erred by holding to the contrary.

IV. The Special Referee erred by ruling that the underlying punitive damage awards arise from a covered occurrence.

Not all of the damages awarded in the underlying trials stem from an "occurrence" as defined by the relevant insurance policies. In particular, the award of punitive damages does not arise from an occurrence, and thus is not covered by the

policies. The Special Referee's ruling to the contrary was premised on his supposed quotation of language not present in Harleysville's policies and on his failure to apply relevant case law.

The Special Referee's Order incorrectly states that Harleysville's policies contained language agreeing to cover "all sums" its insureds are legally obligated to pay. (*See* Riverwalk Order at 37-40; CR 61-64.) In actuality, Harleysville's policies do *not* contain such "all sums" language. Rather, the policies only state that Harleysville "will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies" and that "[t]his insurance applies only [t]o 'bodily injury' or 'property damage'. . . [t]hat is caused by an 'occurrence.'" (Harleysville's Jan. 27, 2004 Reservation of Rights Letter to Buildstar regarding Riverwalk suit at 2-3 (quoting insuring agreement); CR 1821-22.) Under Harleysville's policies, an "occurrence" is defined as "*an accident*, including continuous or repeated exposure to substantially the same general harmful conditions." (*Id.* at 5 (emphasis added); CR 1824.)

Harleysville's policies do not define "accident." In the absence of a policy definition, "accident" is defined as an "*unexpected* happening or event, which occurs by *chance* and usually suddenly, with harmful result, not intended or designed by the person suffering the harm or hurt." *Green v. Ins. Co. of Am.*, 254 S.C. 202, 206, 174 S.E.2d 400, 402 (1970) (emphasis added). This Court has expressly held that a deliberate act does not give rise to an accident. *See Manufacturers & Merchants Mut. Ins. Co. v. Harvey*, 330 S.C. 152, 161, 498 S.E.2d 222, 226 (Ct. App. 1998).

Here, the underlying punitive damages awards were necessarily premised on a finding of the insureds' deliberate act, not on an unexpected event. In the underlying actions, plaintiffs asked the jury to award punitive damages based on the insureds' violation of the building code, the insureds' continued use of known damage-causing building practices, the sale of defective units with knowledge of the defects, and evidence of similar conduct in other, prior developments. (*See* Underlying Riverwalk Trial Tr. at 1743, 1770; CR 1052, 1061.[27]) Further, as a result of the jury charge in the underlying case regarding punitive damages, the jury necessarily found and sought to punish Harleysville's insureds for wrongdoing that, in the words of the jury charge, was a "conscious failure" and involved a "present consciousness of wrongdoing." *See* Underlying Riverwalk trial Tr. at 1821; CR 1074*; see also Pope v. Heritage Comms., Inc.*, 395 S.C. 404, 436, 717 S.E.2d 765, 782 (Ct. App. 2011) (holding the Heritage entities had knowingly sold the Riverwalk condominiums with construction deficiencies). These acts cannot be deemed "unexpected" or "chance" events, nor based on this record can the resulting harm from those acts.

In sum, the jury's award of punitive damages is unquestionably premised on their finding that the conduct of the insureds was not accidental. Therefore, the punitive damages awarded in the underlying suits are not sums Harleysville is obligated to cover under the policies.

[27] The transcript of the underlying liability trial was submitted as Exhibit 1 in the coverage trial before the Special Referee. (*See* Trial Tr. of Dec. 13-14, 2010 at 3; CR 248.)

V. The Special Referee erred by ruling that the underlying damages are covered despite the "expected or intended" exclusions in each of the CGL policies.

Even assuming the actual and punitive damages awarded in the underlying trials arose from an occurrence, all of the damages are excluded from coverage by policy exclusions. Accordingly, the Special Referee erred when he ruled that the damages are covered by Harleysville's policies despite the fact that each policy contains an exclusion for "expected or intended" injuries. (*See* Riverwalk Order at 19-24; CR 43-48.)

A. Evidence and arguments presented in the underlying actions indicate that Harleysville's insureds expected or intended their acts and the resulting damage.

The policy language at issue is found in exclusion "a" which expressly excludes coverage for "'[b]odily injury' or 'property damage' expected or intended from the standpoint of the insured." In *Crossmann*, the South Carolina Supreme Court recognized that this exclusion could preclude coverage in a case such as the one presented here. *See Crossmann*, 395 S.C. at 50, 717 S.E.2d at 594 (noting "that various exclusions may preclude coverage in some instances" similar to this one).[28] To determine whether such an exclusion applies, a court applies a two-prong analysis: "[t]he first is whether the *act* causing the loss was intentional, and the second is whether the *results* of the act were intended." *Vermont Mut. Ins. Co. v. Singleton*, 316 S.C. 5, 8, 446 S.E.2d 417, 419 (1994) (citations omitted) (emphasis added).

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[28] In *Crossmann*, the relevant policy contained an "expected or intended" exclusion. *Crossmann*, 395 S.C. at 47 n.3, 717 S.E.2d at 593 n.3. In that case, however, the parties had agreed not to argue the applicability of any policy exclusions. *Id.* at 46, 717 S.E.2d at 592. Accordingly, the *Crossmann* court noted "that various exclusions may preclude coverage in some instances" but "[b]ecause the parties in the present case stipulated not to raise the issue, we do not address any policy exclusions and exceptions." *Id.* at 50, 717 S.E.2d at 594. Thus, because Harleysville *is* relying on the exclusion, *Crossmann* does not control the outcome here.

Here, the evidence presented in the trials of the underlying actions indicates that the insureds intended or expected the actions and the eventual damages to the Riverwalk properties. For example, the underlying Riverwalk litigation included the testimony of Gwyn Hardister, the Senior Vice President and Chief Operating Officer of Heritage Communities, Inc. Mr. Hardister testified that *before* constructing Riverwalk, Heritage Communities had received complaints of water intrusion and window leaks from residents of Heritage's prior condominium complexes using "the same configuration of windows used at Riverwalk. (*See* Underlying Riverwalk Trial Tr. at 935; CR 941.) Where an insured has received complaints about an issue prior to the beginning of a policy period, the insured "necessarily anticipated or expected any damage which occurred after the policy's effective date." *Dunes W. Residential Props. v. Essex Ins. Co.*, No. 06-2020, 2007 U.S. App. Lexis 29931 (4th Cir. Dec. 28, 2007) (applying South Carolina law).

Furthermore, the insureds had almost immediate notice that their ongoing construction practices were causing problems. Evidence from the underlying trial revealed that in 1998—during the construction of Riverwalk—a representative from Betterbilt windows met with the insureds and explained that the insureds' window installation practices were causing the water intrusion problems and that if those installation practice continued, the windows would leak and cause damages. (*See* Underlying Riverwalk Trial Tr. at 846-49, 852-89; CR 852-55, 858-95.) Despite this warning, the insureds continued the same installation methods and practices. The receipt of these complaints during the construction phase means the insureds

"necessarily anticipated or expected any damage which occurred after the policy's effective date." *Dunes W. Residential Props.*, 2007 U.S. App. Lexis 29931.

In addition, the insureds supervised and approved the subcontractors' work. Mr. Hardister testified that the Heritage entities continued selling condominiums at Riverwalk, knowing that the complex was subject to leaks at or near the windows, but without informing prospective buyers of the problem. (Underlying Riverwalk Trial Tr. at 939; *id.* at 957 (testifying that as of September, 1998, when construction of half the Riverwalk buildings was ongoing, "Heritage knew there were problems with windows at Riverwalk," yet continued to build and sell the units); CR 945, 963.)

Indeed, plaintiffs' counsel in the underlying suit argued in his closing that the actual damages resulted from the insureds' knowing or intentional conduct:

> And what they did, they built these condominiums, they knew they were defective, they knew in 1998 the windows had significant problems. They were asking for 192 windows to be replaced. They knew the decks were leaking and they had problems with that.
>
> * * *
>
> Now, why do you award punitive damages? . . . These people unquestionably knew, if they knew anything about construction at all, that they were building defective condominiums and they were putting them in the stream of commerce, they were selling to innocent people these condominiums and they did it over a long period of time and you can consider that.

(Underlying Riverwalk Trial Tr. at 1743, 1770; CR 1052, 1061.)

In the subsequent declaratory judgment action to determine coverage, these facts and arguments were pointed out to the Special Referee. (*See* Harleysville's Pre-Trial Brief filed December 3, 2010, at 18; Harleysville's Proposed Order at 33;

Harleysville's Motion to Vacate, Alter, or Amend at 9; CR 2376, 2503, 2555.) The Special Referee, however, ruled that the exclusion did not apply to bar coverage of the insureds' acts.[29] In light of the underlying trial testimony and arguments, this was error.

B. The Special Referee relied on inapplicable precedent.

The Special Referee relied on cases from other jurisdictions that are distinguishable to support his ruling on this issue. For example, the Order cites *City of Johnstown v. Bankers Standard Ins. Co.*, 877 F.2d 1146 (2nd Cir. 1989) for the point that an insured that continues its conduct after being warned of potential damages does not expect or intend to cause harm. (*See* Riverwalk Order at 21-22; CR 45-46.) The facts of *Johnstown*, however, are easily distinguishable. In *Johnstown*, the city had operated a landfill for over 40 years. Around the time the city's landfill stopped receiving industrial and sewage waste, evidence had begun to emerge suggesting the landfill's waste was polluting surrounding ground waters. *Id.* at 1147. The state subsequently brought a CERCLA action against the city, prompting the city to bring an action against its insurer seeking a declaration that the insurer should defend and indemnify the city. The city's CGL policy excluded coverage for injury or damage expected or intended by the insured. The Second Circuit held that the exclusion did not apply because, although the city had intended the receipt and storage of hazardous wastes, the city had not *at that time* intended or expected the resulting pollution. The

[29] The Special Referee's reliance on *Auto Owners Ins. Co., Inc. v. Newman*, 385 S.C. 187, 684 S.E.2d 541 (2009) is misplaced. The *Newman* Court held that an "expected or intended" exclusion did not apply to damages caused by subcontractors' work. *See Newman*, 385 S.C. at 197, 684 S.E.2d at 546. However, the *Newman* Court's holding included an important caveat, namely that "*in the absence of any evidence otherwise*, it is unreasonable to believe that [a general contractor] expected or intended its subcontractor to perform negligently." *Id.* Here, as discussed above, the evidence is that Harleysville's insureds *were* aware that the subcontractors were performing improper construction and installation.

Johnstown court noted that the possibility that "damages might ensue" was not enough. *Id.* at 1150.

The case at bar, however, is distinguishable. Here, the evidence and arguments in the underlying liability actions indicate that the insureds, *at the time they engaged in the wrongful acts*, were aware of and expected the inevitable resulting damages. (Underlying Riverwalk Trial Tr. at 935, 939, 957, 1743, 1770; CR 941, 945, 1052, 1061.)

Likewise, the Special Referee's citation to *Continental Western Ins. Co. v. Toal*, 244 N.W.2d 121 (Minn. 1976) is misplaced. The Order cites *Toal* for the proposition that the "expected or intended" exclusion turns on intent, not foreseeability.[30] (*See* Riverwalk Order at 22; CR 46.) In fact, the broader holding in *Toal* indicates that the exclusion *should* apply here. In *Toal*, a group of men conspired and committed an armed robbery in which a store clerk was shot and killed. Two of the robbers were covered by homeowners' insurance policies. The insurers brought declaratory judgment actions in which they argued that the shooting was an expected or intended result of the armed robbery and thus was not covered by the policies. The jury found that the shooting was expected or intended and thus not covered, and the Minnesota Supreme

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[30] Other courts have reached the opposite conclusion. *See, e.g., Fed. Hill Homeowners Ass'n v. Cmty. Ass'n Underwriters of Am., Inc.*, 384 Fed. Appx. 209, 212 n.3 (4th Cir. 2010) (noting that the applicability of an "expected or intended" exclusion turns on foreseeability); *New Hampshire Ins. Co. v. Vardaman*, 838 F. Supp. 1132, 1136 (N.D. Miss. 1993) (holding that 'expected or intended" exclusion applied where the injuries caused by the insureds' acts were foreseeable); *State Farm Fire & Cas. Co. v. Jenkins*, 382 N.W.2d 796, 798 (Mich. Ct. App. 1985) ("We believe, where a policy excludes coverage for intended or expected injuries, a distinction should be drawn between the terms 'intentional' and 'expected'. In order to avoid liability for an expected injury, it must be shown that the injury was the natural, foreseeable, expected, and anticipatory result of an intentional act.") (citation omitted); *Patrons-Oxford Mut. Ins. Co. v. Dodge*, 426 A.2d 888, 892 (Me. 1981) (stating that "expected or intended" exclusion refers "to bodily injury that the insured in fact subjectively wanted ('intended') to be a result of his conduct or in fact *subjectively foresaw as practically certain* ('expected') to be a result of his conduct") (emphasis in original).

Court affirmed. The court held that "an injury is 'expected or intended' from the standpoint of the insured . . . 'when the character of the act is such than an intention to inflict an injury can be inferred' as a matter of law." *Id.* (citation omitted). The *Toal* court inferred such intent because the insureds were part of a "well planned operation" for which they had prepared and in light of the insureds' prior experience with similar acts. *Id.* at 126.

Here, the insureds had prior experience with similar projects which had given rise to similar problems. In short, the character of the acts was such that intent could be, and was, inferred. In sum, all of the cases relied upon by the Special Referee regarding the intentional nature of the underlying damages are inapplicable.

C. The Special Referee relied on irrelevant testimony from the underlying action.

In the course of ruling that the "expected or intended" exclusion did not apply, the Special Referee relied on selected portions of the testimony presented in the coverage action, apparently to show that Harleysville cannot prove that its insureds intended the precise types of physical damages leading to the underlying actions. (*See* Riverwalk Order at 20; CR 65.) Specifically, Harleysville presented the testimony of its construction defect litigation manager, Mr. Lee Wright. On cross-examination, Mr. Wright testified there was significant evidence that the insureds intended to build substandard buildings, though he could not prove what specific type of damage the owners and officers of the insured corporations intended to cause:

> I think there's a mountain of evidence that they got exactly what they intended to get . . . . [T]hey build on the cheap and they did this purposely.
>
> * * *

> Have I gotten inside Roger's head and said, and have evidence that he said or that he thought, "You know what? I'm going to build these so that they are, so that they get water damaged," no, I don't think anyone will ever have that.
>
> * * *
>
> I think there's plenty of evidence to say that they intended to build substandard buildings. Whether they, whether they intended, consciously intended to create a situation that water damage would occur, I don't have that.

(*See* Trial Tr. of Dec. 13-14, 2010 at 191-92; CR 436-37.) The Special Referee's Orders quote only the final sentence of the testimony quoted above and omits the witness' surrounding statements regarding the insureds' intent. In any event, Mr. Wright's testimony, even if it were relevant, touches only on the question of "intended" damage and not the question of "expected" damage.

Furthermore, the Special Referee's Orders rely on other testimony that was proffered on a different topic and which the Special Master had expressly stated he would not consider and did not admit. Harleysville requested the Special Referee permit Mr. Wright's testimony as to why Harleysville chose not to indemnify its insureds. (*See id.* at 78-82; CR 323-27.) The Special Referee permitted a proffer, but explicitly said he would not consider this testimony because it was irrelevant to the coverage dispute. (*Id.* at 81-82; CR 326-27.[31]) Mr. Wright, who is not an attorney, went on in the proffer to testify that his understanding of the "expected or intended" exclusion was that it contained a subjective element regarding the insured's expectation or intent. (*Id.* at 85; CR 330.)

[31] The Special Referee stated, "I am not considering it at all in connection with his [*i.e.*, Harleysville's] liability as determined by this court, if any." (*See* Trial Tr. of Dec. 13-14, 2010 at 81-82; CR 326-27.)

Despite the Special Referee's pledge not to consider it in his ruling, his Order nonetheless quotes at length from this portion of Mr. Wright's testimony, apparently to show Harleysville's difficulty in proving the insureds expected or intended the acts causing the damages. (*See* Riverwalk Order at 20; CR 44.) Hence, the Special Referee's ruling regarding this exclusion is erroneous.

D. At minimum, the underlying awards of punitive damages are excluded from coverage.

As explained above, *all* of the underlying damages arose from expected or intended actions and results and are thus excluded. At a bare minimum, however, the punitive damages are unquestionably excluded. In the underlying trial, the judge charged the jury that

> Punitive damages can only be awarded where the plaintiffs prove by clear and convincing evidence that defendants' actions were willful, wanton, malicious, and in reckless disregard of the plaintiffs' rights or where Defendants' actions were so grossly negligent as to imply a willfulness or wantonness. A conscious failure to exercise due care constitutes willfulness. It is the present consciousness of wrongdoing that justifies the assessment of punitive damages against the wrongdoer.

(Underlying Riverwalk Trial Tr. at 1821; CR 1074.) Therefore, by awarding punitive damages, the jury necessarily found that the defendants' (Harleysville's insureds) wrongdoing was a "conscious failure" and involved a "present consciousness of wrongdoing." *See also Pope v. Heritage Comms., Inc.*, 395 S.C. 404, 436, 717 S.E.2d 765, 782 (Ct. App. 2011) (holding that the Heritage entities had knowingly sold condominiums with construction deficiencies). The wrongdoing and its results were intended or, at minimum, expected.

The Special Referee, however, ruled that the award of punitive damages did not indicate that the actual damages or the punitive damages themselves were premised on the insureds' intentional wrongdoing. (*See* Riverwalk Order at 22-23; CR 46-47.) Most notably, the Special Referee held that a finding of intent is not required for an award of punitive damages. (*Id.* at 23; CR 47.) However, South Carolina cases have previously noted that willful or reckless conduct contains an element of intent. *See, e.g.*, *Carter v. R.L. Jordan Oil Co., Inc.*, 301 S.C. 84, 86, 390 S.E.2d 367, 368 (Ct. App. 1990) ("'Conduct is wilful, wanton, or reckless when it is committed with a deliberate intention under such circumstances that a person of ordinary prudence would be conscious of it as an invasion of another's rights.'") (quoting *Cohen v. Allendale Coca-Cola Bottling Co.*, 291 S.C. 35, 351 S.E.2d 897 (Ct. App. 1986)); *Cummings v. Tweed*, 195 S.C. 173, 10 S.E.2d 322, 326 (1940) (noting that requested jury charge was "entirely correct" that "[w]antonness is properly defined as a conscious failure to observe due care, an intentional doing of an unlawful act knowing such act to be unlawful, and recklessness is the equivalent to wilfulness or intentional wrong"); *Green v. Smith*, 149 S.C. 303, 147 S.E. 333 (1929) (affirming trial court and quoting trial judge's jury charge that "[a]n act is malicious when it is done with conscious knowledge of another's right, and with an intent knowingly and consciously to interfere therewith. It is a wanton and conscious and intentional interference with the known rights of another"); *Jordan v. Hudgens*, 146 S.C. 209, 143 S.E. 811 (1928) (affirming trial court and noting that trial judge had charged the jury that "punitive damages are awarded where a person willfully and wantonly, consciously invades the rights of another, and not simply where he does it negligently or carelessly, but where a person

consciously invades the rights of another, *intentionally does it*") (emphasis added); *Miller v. Atl. Coast Line R. Co.*, 140 S.C. 123, 138 S.E. 675 (1926) (affirming and quoting trial judge's charge that "[w]ilfulness and wantonness would be a conscious and intentional doing of an act").

In light of the jury charges in the underlying suit, the award of punitive damages unquestionably indicates the jury determined that the insureds' acts were intended or expected. Accordingly, because the actual damages arose from intended or expected acts and, at a minimum, the punitive damages were awarded for intended or expected harms, there can be no coverage for these damages under Harleysville's CGL policies.

VI. The Special Referee erred by ruling that the underlying damages are covered despite the "faulty workmanship" exclusion in each of the CGL policies.

Other exclusions likewise bar coverage of the underlying damages. Specifically, the Special Referee erred when he ruled that the damages are covered despite the fact that each policy contains an exclusion for damage to any piece of real property on which the insured or its subcontractors performed operations if the operations resulted in damage to that property. (*See* Riverwalk Order at 25; CR 49.) Specifically, exclusion j(5) bars coverage for property damage to

> The particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations.

(*See* Harleysville's Jan. 27, 2004 Reservation of Rights Letter to Buildstar regarding Riverwalk suit at 3 (quoting exclusion j(5)); CR 1822.) The Special Referee ruled that this exclusion "applies only to the work that is being actively worked on at the instant

the property damage occurs." (*See* Riverwalk Order at 25; CR 49.) Thus, since the water intrusion occurred after the insureds had completed work, the Special Referee ruled this exclusion did not apply. (*Id.*)

The Special Referee's ruling is problematic in two ways. First, it creates and imposes a condition not found in the language of the exclusion. The exclusion says nothing about the timing of the property damage nor does it require that the resulting damages be contemporaneous with the insureds' work. Rather, the exclusion expressly applies to any damage that "arises out of" the insureds' work, which necessarily contemplates damages that do not occur until after work on that particular piece of the project has been finished.

Second, the Special Referee's ruling is contrary to analogous case law applying this exclusion. For example, a recent decision by a federal district court in South Carolina considered the applicability of the same exclusion in a similar situation. In *Putnam v. Alea London Ltd.*, No. 2:09-CV-1740, 2011 U.S. Dist. Lexis 12223 (D.S.C., Feb. 4, 2011), homeowners sued a general contractor, alleging that the contractor's shoddy construction of the roof had allowed *subsequent* rainfall to enter the home and damage sheetrock and flooring and cause other problems. After obtaining a state court judgment against the general contractor, the homeowners brought a declaratory judgment action against the contractor's insurer, seeking a declaration that the insurer was liable for the judgment. The CGL policy in that case contained an exclusion identical to "j(5)." *See id.* at *11-12; CR 35-36. The district court held that this exclusion barred coverage of the underlying damages, *id.* at *13-18; CR 37-42, noting that the homeowners "seek coverage for exactly the kind of loss that is not

intended to be covered by a CGL policy—that is, loss caused by a contractor's negligent fulfillment of its contractual duties," *id.* at *16 (citation omitted); CR 40.

Similarly, in *Sapp v. State Farm Fire & Cas. Co.*, 486 S.E.2d 71 (Ga. Ct. App. 1997), the court held that this exclusion barred coverage for damages arising *after* a contractor had completed its work. In *Sapp*, the contractor had installed wood flooring without first addressing a moisture problem under the house. After the floor was installed, it began to warp. The homeowner sued to recover the cost of removing and replacing the flooring and to restore the home to its prior condition. The contractor's insurer brought a declaratory judgment suit seeking a declaration that any damages against its insured were not covered. The policy at issue contained an exclusion identical to "j(5)." *See id.* at 73-74. The court held that this exclusion was clear and unambiguous and it excluded from coverage the damages arising from the defective workmanship by the insured. *Id.*

At least some of the underlying damages fit neatly within this exclusion and thus are not covered. (*See* Trial Tr. of Dec. 13-14, 2010 at 251 (proffering testimony of Harleysville's expert witness that the underlying plaintiffs' damages estimates presumed the leaking windows would eventually cause damage to the interior of condominiums); CR 496; *id.* at 258-59 (proffering testimony of same witness that leaking windows would cause eventual damage to interior carpet, finishes, wallpaper, sheetrock, and other non-defective and well-constructed work); CR 503-04; *id.* at 261-62 (proffering testimony that the defective work would necessitate the repair or replacement of correctly installed work); CR 506-07.) The Special Referee erred in ruling the exclusion had no applicability.

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

The Special Referee erred by making many findings of fact that are unsupported or contradicted by the evidence. These erroneous findings infected various aspects of the Special Referee's analysis and rulings, and their prejudicial effects are noted elsewhere in this brief.

The Special Referee's Order contains factual errors regarding Harleysville's reservation of rights letters ("RRLs"). For example, the Special Referee found that some insureds did not receive reservation of rights letters in some or all of the Riverwalk-related suits. (Riverwalk Order at 12, ¶¶ 36-37; CR 60-61.) However, the unrebutted testimony presented before the Special Master indicates the opposite. Harleysville's construction defect litigation manager, Mr. Lee Wright, testified that although the record did not contain a copy of the RRLs sent to Buildstar or those regarding the individual property owners' suit, he was confident they had been sent:

> Q: Is there a reservation of rights letter sent to BuildStar?
> A: It's not here, no. I'm sure there is. I'm sure we sent one.
>
> * * *
>
> Q: There are reservation of rights letters that are not included in there; is that correct?
> A: That is correct.
> Q: Do those reservation of rights letters exist?
> A: Yes.
> Q: Any doubt in your mind they don't exist?
> A: No.
>
> * * *
>
> Q: So you can't sit here and testify for a fact that there is a reservation of rights letter in the Pope class action or for BuildStar and Magnolia North?
> A: Absolutely, positively, with one hundred percent, I haven't seen it, but I absolutely believe it exists.

(Trial Tr. of Dec. 13-14, 2010 at 98, 101, 181-82; CR 343, 346, 426-27.)

Similarly, the Special Referee found that Harleysville's reservation of rights letters were vague, failed to address various issues, and were never modified or supplemented. (Riverwalk Order at 12, ¶¶ 39-42; CR 63-66.) The legal conclusions contained within these supposed findings of fact are improper, *see* Part IX, *infra*, and the factual assertions contained in these findings diverge from the testimony presented or proffered before the Special Referee. At the bench trial, Harleysville proffered testimony that Harleysville's representatives had numerous meetings and conversations with the officers and directors of the Heritage entities and their private counsel to explain Harleysville's reservation of its rights and to discuss the coverage issues. (Trial Tr. of Dec. 13-14, 2010 at 101-13, 178-85; CR 346-58, 423-30.) This testimony further indicates that the insureds were aware of the coverage conflicts and agreed to defer resolution of those disputes for a later coverage action.

> A: We sat at a table with, with Dr. Green [an owner and director of the Heritage entities] and Allen Jeffcoat [who was Dr. Green's attorney] for several hours one morning, talking about the case in general . . . that we did have coverage issues with these . . . . He seemed to understand where, what our position was. . . . He just said, you know, "We'll leave that for later."
>
> * * *
>
> Q: And is it your testimony that Mr. Green and Mr. Van Wie [the president of Heritage] understood this?
> A: Yes.
> Q: Did you talk to Mr. Green or Mr. Van Wie about the handling of the trials?
> A: As far as what aspect of the handling?
> Q: What role Harleysville would play in regards to these coverage issues.

A: In regard to the coverage issues, we, we talked about that, how we would, that we would reserve the, the addressing of the coverage issues until after the, the underlying trials. . . . They understood that.

(*Id.* at 111-12; CR 356-57.)

Relatedly, the Special Referee found that Harleysville misinformed or neglected to discuss various coverage issues and potential conflicts with its insureds. (Riverwalk Order at 13, ¶¶ 44-45, 47-48; CR 37.) In actuality, the testimony from the bench trial clearly states that Harleysville explained the facts and policy terms that could affect coverage and discussed the need to avoid intervening in the suit so as to avoid an actual conflict of interest:

A: We, we made the decision with the insured that we would not intervene in the underlying case because that would create that conflict of interest.

* * *

Q: What I'm trying to find out is, did you ever detail the facts of the claims that would cause a denial of coverage?
A: Yes. We had, we had long conversations with Roger [Van Wie].

* * *

Q: You detailed [the policy exclusions] in the reservation of rights letter . . . without any explanation of why those exclusions may exclude coverage. What I'm asking you is, did you ever go back to your insureds and say, "Okay, after investigating these facts, we have determined that this exclusion applies, this exclusion applies, and this is why they apply"?
A: Yeah, we've had, again, we've had conversations with the insureds about it.

* * *

Q: Did you ever tell your insureds in a letter, correspondence, e-mail of what investigation Harleysville would do to determine whether or not

there was coverage or whether or not coverage would no be available?

A: The investigation, they were kept up to date on the handling of the cases all along. They knew what type of investigation was going on.

(*See* Trial Tr. of Dec. 13-14, 2010 at 182-85; CR 427-30.) Indeed, the Special Referee's findings of fact cite to pages of the transcript that directly refute the supposed finding. For example, the Order states that Harleysville failed to orally advise the insureds of any applicable exclusions and that "Harleysville did not detail to its insureds which exclusion if any would preclude coverage," citing particular pages from the bench trial transcript. (*See* Riverwalk Order at 12-13 ¶¶ 41, 44 (citing Trial Tr. of Dec. 13-14 at 182-84); CR 36-37, 427-29.[32]) An examination of those pages of the transcript reveals that Harleysville's witness and the cross-examining counsel both recognize that Harleysville *did* advise and "detail" to the insureds which exclusions might prevent coverage, both orally and in its reservation of rights letters:

Q: Well, let's suppose that you detailed all the exclusions that were in the policy —

A: And they're in the letters, too. They're in the reservation of rights letter.

Q: Right. That's what I'm saying. You detailed them all in the reservation of rights letter —

A: Uh-huh (affirmative response).

Q: — without any explanation of why those exclusions may exclude coverage. What I'm asking you is, did you ever go back to your insureds and say, "Okay, after investigating these facts, we have determined that this exclusion applies, this exclusion applies, and this is why they apply?"

A: Yeah. We've had, again, we've had conversations with the insureds about it.

(Trial Tr. of Dec. 13-14, 2010 at 184; CR 429.)

[32] The Special Referee's Order, which relies on a different pagination of the bench trial transcript, cites to "Rec. Hearing 12/13/10 pp.13829-31."

The Special Referee further found that in the underlying trial, Harleysville made a unilateral decision not to intervene. (Riverwalk Order at 13, ¶¶ 43, 46, 49; CR 37.) Yet again, this finding diverges from the testimony presented and proffered before the Special Referee. As noted above, Harleysville discussed the coverage issues with the insureds and explained that these issues were best reserved for a subsequent coverage action. Indeed, the testimony expressly explained there was an "agreement" between Harleysville and its insureds to defer resolution of the coverage dispute:

> Q: Was there an agreement between yourself and the insureds in this case relating to when coverage issues would be handled?
> A: Yes.
> Q: Please explain in full detail to The Court.
> A: After discussing it with, with Dr. Green, we told him that—we gave him our plan, that the idea was to go into the trials in lockstep with him, agree with everything that he has to say, make the, the numbers that came out, if there was a verdict, we both had the goal of making that verdict as low as it could possibly be, and then if there was a dispute over who paid how much of that, we should have that at that time.
>
> * * *
>
> A: [T]hat was the agreement. We, we made the, the decision with the insured that we would not intervene in the underlying case because that would create that conflict of interest.
>
> * * *
>
> A: That agreement, that agreement in this case was that neither one of us, neither Heritage or Heritage Riverwalk, BuildStar, Heritage Magnolia North, none of those entities, and Harleysville, of course, none of those entities benefitted from Harleysville being in the middle of the underlying trials, and the, and the decision was that those, all of those coverage issues involved in those cases would be decided in a subsequent action.

(Trial Tr. of Dec. 13-14, 2010 at 113, 182, 209; CR 358, 427, 454.)

In addition, the Special Referee found that during the course of the underlying suits, Harleysville was aware of the need for an allocated verdict and chose not to inform the insureds of the issue. (Riverwalk Order at 12-13, ¶¶ 40, 48; CR 36-37.) The testimony before the Special Referee, however, shows the opposite. Mr. Wright testified that at the time of the underlying trials, Harleysville's understanding of the then-current law was that *all* construction related and repair costs were covered expenses and thus an allocated verdict was not required. (Trial Tr. of Dec. 13-14, 2010 at 114; CR 359.) Mr. Wright also proffered testimony that Harleysville thought a request to allocate damages was prohibited:

> A: Under *Newman* one,[33] everything was covered.
> Q: Would we have been able to walk into the courtroom and ask the trial judge to do something directly against what the Supreme Court had just said?
> A: I don't believe so.
> Q: Explain.
> A: We would've had to, we would've had to come in and say, in essence, "Your Honor, we believe that the Supreme Court went too far in their *Newman* decision. We want to break these damages up into categories." And the response would've been something to the effect of, "What categories?" "Well, we don't have any idea, but we don't think that they're going to stay where they are."

(*Id.* at 135; CR 380.) In addition, Harleysville proffered testimony of its understanding that seeking an allocated verdict was a futile endeavor and harmful to the insured. Specifically, Mr. Wright proffered testimony that in prior lawsuits, the insureds' attorneys had opposed intervention and refused to request special interrogatories. (*See id.* at 208 ("We'd already had that discussion in Gardens, and we were told in no

[33] *Auto Owners Ins. Co., Inc. v. Newman*, 2008 WL 648546 (S.C. March 10, 2008), withdrawn and replaced by *Auto Owners v. Newman*, 385 S.C. 187, 684 S.E.2d 541 (2009).

uncertain terms, 'If you ever ask me this question, I will tell you no. If you ever ask me to support your intervention in the, in the case or if you ever ask me to submit special interrogatories or break down these damages in any way that it would hurt my client, I will tell you no.'"); CR 453; *id.* at 131-32 (proffering testimony that Harleysville's attempt to intervene in a prior, similar suit had prompted threats of bad faith); CR 376-77.)

Taken together, these numerous unsupported findings of supposed fact indicate that the Special Referee's rulings were based on an incorrect and unsubstantiated view of the evidence and testimony.

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

During the hearings and bench trial in this declaratory judgment action, the Special Referee erroneously excluded evidence and testimony. As explained below, these rulings were incorrect as a matter of law.[34]

A. Testimony regarding allocation of damages.

At the bench trial, Harleysville sought to introduce the expert testimony of a general contractor who analyzed the structural damage at Riverwalk and could explain what percentage of the underlying damages awards was to repair defective work and what percentage was to repair other resulting damages. (*See* Trial Tr. of December 13-14, 2010, at 216-17; CR 461-62.) Opposing counsel objected to this testimony (*id.* at 217-34; CR 462-79), and the Special Referee excluded it, forcing Harleysville to

[34] The prejudicial effect of these erroneous rulings is demonstrated throughout the brief. *See, e.g.*, Part I, *supra* (discussing the Special Referee's refusal to allocate the underlying damages into categories of covered and non-covered harm and noting that the proffered testimony in support of allocation was excluded for being supposedly speculative.

proffer the expert's testimony (*id.* at 233-35; CR 478-80). The bases of the objection and the ruling were (1) that the testimony "violates Rules of Evidence 401, Rule 402, and 403, in that it is not relevant" and (2) that "it is an attempt to go behind the general verdict of the jury, which is not permissible under the laws of this state." (*Id.* at 218; CR 463.) As explained elsewhere in this brief, the latter conclusion is incorrect both factually and as a matter of law. *See* Part I, *supra*. The evidentiary ruling was also incorrect.

The Special Referee explained this evidentiary ruling in his Order by stating, "Mr. Baiden's testimony would be irrelevant and speculative under Rules 401 & 402 SCRE, and therefore inadmissible." (Magnolia North Order at 29; CR 103.) The proffered testimony was undoubtedly relevant to the issue of Harleysville's coverage responsibility. Indeed, one of the four causes of action raised in Harleysville's Declaratory Judgment Complaints expressly alleged and sought an allocation of damages. (*See* Harleysville's Riverwalk Dec. J. Compl. at ¶¶ 27-35; CR 135-38.) Accordingly, one issue before the Special Referee was whether and to what extent the underlying damages awards compensated the underlying plaintiffs for damages not covered by Harleysville's policy. In light of this issue, the testimony of Harleysville's expert was unquestionably relevant, *i.e.*, likely "to make the existence of any fact that is of consequence to the determination of the action more probably or less probable than it would be without the evidence." *See* Rule 401, SCRE. Because this evidence was relevant, the Special Referee erred by excluding it.

The Special Referee's ruling was also in error to the extent it characterized Mr. Baiden's testimony as speculative. All parties recognized that Mr. Baiden's

qualifications as an expert and his extensive training and experience as a general contractor. (*See* Trial Tr. of Dec. 13-14, 2010 at 213-16; CR 458-61.) His estimate was prepared on the basis of 80-90 hours of work including "many visits" to the condominium complex, study of the complex's drawings, study of the underlying plaintiff's damages estimate and report, and examination of hundreds of photographs of the damages. (*Id.* at 236; CR 481.) The estimate was based on a thorough and well-supported examination of the costs to repair the progressive property damages. (*Id.* at 237-53; CR 482-98.)

In addition, the Special Referee's explanation of his ruling on the objection to this evidence amply demonstrates his error. Specifically, the Special Referee noted that "I think, with this case having been tried under the law that existed at that time, I'm going to grant Mr. Henry's motion [*i.e.*, objection]." (Trial Tr. of Dec. 13-14, 2010 at 234; CR 479.) As explained in Part I, *supra*, under the law that existed at the time of the underlying trials, namely the South Carolina Supreme Court's first opinion in *Newman v. Auto Owners,* every dollar of construction defect damages triggered indemnity obligations under a CGL policy, thus there was no need or obligation for Harleysville to seek allocation of damages in the underlying suits against its insureds.[35] The Special Referee's ruling, however, ignores the subsequent change brought about in *Crossmann* permitting allocation. Where an evidentiary ruling is based on a

[35] Harleysville sought to offer testimony demonstrating Harleysville's understanding of the then-current law and explaining that this understanding is why Harleysville did not seek to intervene or seek a special verdict form. (Trial Tr. of Dec. 13-14, 2010 at 134-36; CR 379-81.) Harleysville was forced to proffer this evidence after the Special Referee ruled that the testimony was not relevant. (*See id.* at 129; CR 374.)

misstatement of controlling law, that ruling is in error. Harleysville's expert testimony regarding allocation of damages should have been permitted.

B. Testimony regarding Harleysville's reservation of the right to contest coverage.

At the bench trial, Harleysville sought to introduce testimony and evidence regarding meetings and discussions with its insureds and the insureds' private counsel in which Harleysville had expressed its belief that: (1) there would be little or no coverage in the underlying actions and (2) the insureds understood and agreed that Harleysville was reserving its right to contest coverage in a subsequent action. (*See* Trial Tr. of Dec. 13-14, 2010 at 104-06, 109-10; CR 349-51, 354-55.) Opposing counsel objected to this testimony on the grounds of hearsay and relevance, and the Special Referee erroneously excluded the testimony. (*Id.* at 102, 106, 110-11; CR 347, 351, 355-56.)

Testimony is not hearsay when it is offered against a party and is the party's own statement. *See* Rule 801(d)(2), SCRE. Here, the supposedly hearsay testimony was the statements of Harleysville's insureds, who are opposing parties in this action. Accordingly, under Rule 801(d)(2), the testimony was not hearsay. The fact that the insureds had defaulted does not change the rules in these regards. *See*, *e.g.*, *Zaragoza v. Ebenroth*, 770 N.E.2d 1238, 1241 (Ill. Ct. App. 2002) (holding that for purposes of this hearsay exception, a party who failed to appear and defaulted was nonetheless a party opponent). Hence, it was error for the Special Referee to exclude the proffered affidavit of Roger Van Wie. (Trial Tr. of Dec. 13-14, 2010 at 109; CR 354.).

Furthermore, opposing counsel cross-examined Harleysville's witness at length regarding the purportedly deficient reservation of rights letters (Trial Tr. of December

13-14, 2010, at 178-86; CR 423-31.), and the Special Referee made multiple findings of fact and devoted many pages of the Order to the question of whether Harleysville had adequately reserved its rights. (*See* Riverwalk Order at 12-14, 40-44; CR 36-38, 64-68.) The relevance of Harleysville proffered testimony on this issue is clear, and the Special Referee's ruling excluding that testimony cannot stand.

C. Testimony regarding Harleysville's failure to intervene.

Harleysville sought to introduce evidence to show why it did not seek to intervene into the underlying action, namely because its past attempts at intervention in similar cases involving the same insureds had been rebuffed. (*See* Trial Tr. of December 13-14, 2010, at 126-40; CR 371-85.) The Special Referee excluded this evidence on grounds of relevance. (*Id.* at 127-29, 140; CR 372-74, 385.)

In fact, the testimony is relevant. The Special Referee's Order includes findings of fact and analysis discussing Harleysville' failure to intervene. (*See* Riverwalk Order at 12-13, 32-33; CR 36-37, 56-57.) The excluded testimony regarding why Harleysville did not intervene would have been relevant to determine whether Harleysville's choice was reasonable and whether an attempt to intervene would have been futile.

D. Testimony regarding Harleysville's Reservation of Rights letters.

The Special Referee, in finding supposed deficiencies in Harleysville's reservation of rights letters, cites to testimony that Harleysville was forced to proffer after the Special Referee sustained an objection to its admissibility. (*See* Riverwalk Order at 12-13, ¶¶ 42, 45 (citing Trial Tr. of Dec. 13-14 at 111); CR 36-37, 356.[36]) In light of the Special Referee's reliance on this excluded testimony, this Court should

[36] The Special Referee's Orders rely on a different pagination of the bench trial transcript and cite to "Rec. Hearing 12/13/10 p.13758."

reverse the Special Referee's findings of fact and conclusions of law as unsupported by the evidence. Alternatively, this Court should reverse based on the erroneous exclusion of the evidence subsequently relied upon by the Special Referee.

IX. The Special Referee incorrectly ruled that Harleysville failed to reserve its right to contest coverage.

The Special Referee erred by ruling that Harleysville's communications with its insureds were ineffective to reserve its right to contest coverage. When Harleysville became aware that the underlying suits had been filed, it sent Reservation of Rights Letters ("RRLs") to each of the Heritage entities involved in the Riverwalk development. (*See* Trial Tr. of Dec. 13-14, 2010 at 96-98, 101, 181-82; CR 341-343, 346, 426-27.) Nevertheless, the Special Referee ruled that (1) Harleysville failed to reserve its rights as to Buildstar regarding the individual Riverwalk homeowners' suit; (2) the RRLs sent to the other insureds were insufficiently specific and were thus ineffective; (3) as a result, Harleysville impliedly waived its right to contest coverage; and (4) the judgment holders were permitted to raise this issue in the insureds' stead. (*See* Riverwalk Order at 40-44; CR 64-68.) As explained below, each of these conclusions is incorrect. To start, however, it should be noted that Respondent made no argument or motion respecting this subject, with the exception of mentioning it in a footnote in Respondent's pretrial brief. (Riverwalk's Pretrial Memo. at 3 n.1; CR 2318.) Somehow, this bare mention improperly blossomed into the Special Referee's ruling on the reservation of rights issue.

A. Harleysville adequately informed Buildstar that it was reserving its right to contest coverage of the damages.

The Special Referee erred by ruling that because the record did not contain a copy of the RRLs sent to Buildstar regarding the underlying Riverwalk homeowners' suit, Harleysville therefore had failed to reserve its right to contest coverage. (*See* Riverwalk Order at 40-41; CR 64-65.) This ruling is wrong for several reasons. First, the unrebutted testimony before the Special Referee was that Harleysville *did* send RRLs to Buildstar. Harleysville's construction defect litigation manager, Mr. Lee Wright, testified that although the record did not contain copies of the RRLs sent to Buildstar, he was absolutely confident they had been sent. (*See* Trial Tr. of Dec. 13-14, 2010 at 98, 101, 181-82; CR 343, 346, 426-27.) Mr. Wright explained that Harleysville's files had been shifted back and forth between its offices in different states at least six times and were sent to Harleysville's counsel on several occasions, and at some point in the shuffle, the Buildstar RRLs had apparently been misplaced. (*See id.* at 99-101; CR 344-46.) Despite this uncontroverted testimony, the Special Referee erroneously ruled that the absence of copies of the RRLs meant they never existed. This ruling should be reversed.

Second, even assuming *arguendo* that Harleysville did not send written RRLs to Buildstar, Harleysville nonetheless reserved its rights through its oral communications with Buildstar. (*See id.* at 101-13 (proffering Mr. Wright's testimony that he had met with the officers and directors of Buildstar and the other insureds and explained Harleysville's reservation of the right to contest coverage); CR 346-58; *id.* at 106-09 (proffering affidavit of Roger Van Wie acknowledging his awareness of Harleysville's reservation of its rights); CR 351-54.) The Special Referee, however, concluded that an

oral reservation of rights "is generally frowned upon." (Riverwalk Order at 43; CR 67.) This ruling is incorrect. Although South Carolina's appellate courts have not previously addressed the issue, the courts of other jurisdictions have held that an insurer's oral reservation of rights is sufficient and effective.[37]

Third, in the underlying trials, the court found that the Heritage entities were amalgamated, and the Court of Appeals affirmed this finding. The United States Supreme Court has previously affirmed a holding that two contractors jointly building a structure are essentially partners, and thus notice to one of them is notice to both of them. *United States use of Hallenbeck v. Fleisher Eng. & Constr. Co.*, 107 F.2d 925 (2nd Cir. 1939), aff'd 311 U.S. 15 (1940). Analogous South Carolina law likewise indicates that notice given to one entity in an amalgam constitutes notice to the other amalgamated entities. For example, South Carolina law is clear that notice to one joint venturer or partner is notice to all. S.C. Code Ann. § 33-41-340.

B. Harleysville's Reservation of Rights letters were sufficiently thorough and specific.

The Special Referee further erred by ruling that Harleysville's RRLs were not sufficiently specific and thus were of no effect. (*See* Riverwalk Order at 41-43; CR 65-67.) South Carolina's courts have not previously mandated the contents of a RRL. The Special Referee, however, looked to a commentator's suggestions of what a RRL

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[37] *See, e.g., State Farm Fire & Cas. Co. v. Jioras*, 24 Cal. App. 4th 1619, 1630 n.12 (Cal. Ct. App. 1994) (holding that insurer had properly reserved its rights where it orally told two insured defendants that it would defend them under the same reservation of rights previously sent to insured co-defendants); *Irion v. Glens Falls Ins. Co.*, 461 P.2d 199 (Mont. 1969) (noting in declaratory judgment action that the insurer had asserted an oral reservation of right in the underlying action immediately prior to trial); *Lowenschuss v. Home Ins. Co.*, No. 90-0054, 1990 U.S. Dist. Lexis 11375 (E.D. Pa. Aug. 27, 1990) (holding that insurer adequately reserved right to contest coverage via an oral reservation of rights confirmed in writing two years later); *see also* 1 Allan D. Windt, *Insurance Claims and Disputes* 5th §§ 2:7 and 2:14 (noting that in the absence of a written RRL, "equivalent oral advice" is sufficient and "[a] reservation of rights need not be in writing") (citations omitted).

should contain and gave it binding force of law. Specifically, the Special Referee ruled a RRL must:

> (1) specifically identify the policy at issue,
> (2) describe the claims or allegations in the complaint,
> (3) cite and quote the policy provisions forming the basis of the insurer's coverage defenses and explain why the provisions could cause a denial of coverage,
> (4) specifically reserve the insurer's right to change its coverage position and assert policy-based coverage defenses,
> (5) explain the investigation that the insurer will undertake to determine its final coverage decision and when that decision will be made, and
> (6) advise of any potential conflict of interest between insurer and insured.

(*See* Riverwalk Order at 42; CR 66.) Here, there is no question that Harleysville's RRLs identified the relevant policies, described the complaint's claims, cited and quoted the relevant policy provisions, specifically reserved Harleysville's rights, and advised the insureds of the prudence of retaining their own attorney. (*See*, *e.g.*, January 27, 2004 RRL to Buildstar regarding Riverwalk suit; CR 1820). The only purported requirements missing from the RRLs were an explanation of (1) why the policy provisions could cause a denial of coverage, (2) the timeline for the insurer's investigation, and (3) a discussion of any issues that could cause a conflict between the insurer and insured.

As an initial matter, these issues were all communicated to the insureds in meetings and conversations regarding the underlying suits. Harleysville's construction defect litigation manager, Mr. Lee Wright, testified that Harleysville explained why various policy provisions could affect coverage, discussed the insurer's investigation,

and discussed the need to avoid intervening in the suit so as to avoid an actual conflict of interest. (*See* Trial Tr. of Dec. 13-14, 2010 at 182-85; CR 427-30.)

In addition, the supposedly required elements omitted from Harleysville's RRLs are not actually mandated by most courts.[38] *See generally Nutmeg Ins. Co. v. Clear Lake City Water Auth.*, 229 F. Supp. 2d 668, 696 (S.D. Tex. 2002) (noting that the insured "failed to provide any law demonstrating that there are specific requirements for a valid reservation of rights letter."). Rather, courts and commentators have recognized a minimal baseline for a RRL to be effective: "An insurer's notice of reservation of rights must fairly inform the insured of the insurer's position." *Couch on Insurance*, 3d ed. § 202:47; *see also Richards Mfg. Co. v. Great Am. Ins. Co.*, 773 S.W.2d 916, 919 (Tenn. Ct. App. 1988) (holding that notice of a reservation of rights is sufficient "if it fairly informs the insured of the insurer's position."); *Equity Gen. Ins. Co., Inc. v. C&A Realty Co., Inc.*, 715 P.2d 768 (Ariz. Ct. App. 1985) (holding RRL was effective because "the letter, in a straightforward manner, informed a reader of average intelligence that while the insurer was providing a defense, it was doing so without waiving any rights to contest liability under the policy"); 38 A.L.R.2d 1148 § 7(a) (RRL is sufficient "if it fairly informs the insured of the insurer's position.").

Indeed, courts have expressly stated that a RRL need *not* contain an explanation why the policy provisions quoted in the RRL could cause a denial of coverage. *See*

[38] Contra *Harleysville Lake States Ins. Co. v. Granite Ridge Builders, Inc.*, 2009 U.S. Dist. Lexis 27803, *22-24 (N.D. Ind. 2009) (applying same six requirements as the Special Referee applied here); *Cozzens v. Bazzani Bldg. Co.*, 456 F. Supp. 192, 200 (E.D. Mich. 1978) (stating that insurer's reservation of right was insufficient where it merely quoted but did not explain the effect of various policy provisions and exclusions and where it did not explain the conflict of interest foreseen by the insurer); *Moses v. Halstead*, 477 F. Supp. 2d 1119, 1127 (D. Kan. 2007) ("[U]nder Kansas law a reservation of rights notice must clearly set forth the reason for denial of coverage and inform the insured of his rights, including his right to decline the insurer's defense and the consequences if the insurer assumes the defense.") (citation omitted).

Houston Gen. Ins. Co. v. AG Prod. Co., 840 F. Supp. 738, 743 (E.D. Cal. 1993) ("[The RRL] clearly indicates that denial of the claim was because of [the insurer's] conclusion that the policy did not provide coverage. The fact that the legal theory upon which it relies in making this statement was not articulated cannot be seen as a waiver of the right to do so."); *Richards Mfg.*, 773 S.W.2d at 919 ("It is the insurer's conclusion regarding the existence or non-existence of certain coverage that must be clearly and fairly communicated to the insured, not its legal reasons therefor."); *Couch on Insurance*, 3d ed. § 202:47 (same). Similarly, courts have held that a RRL need *not* contain a discussion of any present or potential conflicts between the insurer and insured, because the RRL itself serves as notice of such. *See Britt v. Cambridge Mut. Fire Ins. Co.*, 717 S.W.2d 476, 481 (Tex. Ct. App. 1986).

Other courts have found RRLs effective that contained similar or less material than Harleysville's RRLs. *See, e.g., Ideal Mut. Ins. Co. v. Myers*, 789 F.2d 1196 (5th Cir. 1986) (holding that RRL was sufficient where it specifically identified the policy in question, informed the insured that the insurer had retained an attorney to defend insured in underlying suit, apprised insured of initial results of insurer's investigation, and expressly reserved insurer's rights); *Canadian Univ. Ins. Co. v. Northwest Hospital, Inc.*, 389 F.2d 559 (7th Cir. 1968); *Facility Invs., LP v. Homeland Ins. Co. of N.Y.*, 741 S.E.2d 228, 232 (Ga. Ct. App. 2013) ("'At a minimum, the reservation of rights must fairly inform the insured that, notwithstanding the insurer's defense of the action, it disclaims liability and does not waive the defenses available to it against the insured.'") (quoting *Hoover v. Maxum Indem. Co.*, 730 S.E.2d 413 (Ga. 2012)).

Ultimately, a RRL's "sufficiency is to be determined by the facts of the particular case." *Nationwide Mut. Ins. Co. v. Gentry*, 117 S.E.2d 76, 81 (Va. 1960) (citations omitted). Here, there is no question that Harleysville's RRLs informed the insureds of Harleysville's stance on the coverage issues, and the testimony before the Special Referee indicated that the insureds were unquestionably aware of Harleysville's position that the potential damages were not a covered "occurrence" or were excluded by the policies' exclusions. (*See* Trial Tr. of Dec. 13-14, 2010 at 103, 111-13; CR 348, 356-58.) Hence, the Special Referee erred in ruling Harleysville's RRLs are insufficient.

C. Harleysville did not waive its right to contest coverage.

Finally, the Special Referee erred in ruling that Harleysville's purportedly missing or unsatisfactory RRLs implicitly waived Harleysville's right to later contest coverage. (*See* Riverwalk Order at 44; CR 68.) Although South Carolina courts have not previously considered this precise question, they have clearly and repeatedly held in similar contexts that "'waiver cannot create coverage and cannot bring into existence something not covered in the policy.'" *Laidlaw Envtl. Servs., Inc. v. Aetna Cas. & Sur. Co.*, 338 S.C. 43, 53, 524 S.E.2d 847, 852 (Ct. App. 1999) (quoting *Alverson v. Minnesota Mut. Life Ins. Co.*, 287 S.C. 432, 434, 339 S.E.2d 140, 142 (Ct. App. 1985)). A federal district court recently applied this well-established body of South Carolina law and held that an insurer's failure to reserve its rights prior to underlying suit against its insured did not waive its ability to subsequently contest coverage. *Peak Prop. & Cas. Ins. Corp. v. Davis*, No. 3:12-1689, 2013 U.S. Dist. Lexis 39406, *18 (D.S.C. March 21, 2013) (holding that insurer's failure to send RRL to insured prior to

underlying litigation did not waive its right to deny coverage, noting that "'South Carolina courts have repeatedly and explicitly held that waiver cannot create coverage and cannot bring into existence something not covered in the policy.'") (quoting *Liberty Mut. Ins. Co. v. Westport Ins. Corp.*, 664 F. Supp. 2d 587, 594 (D.S.C. 2009)).

In addition, the definition of "implied waiver" makes clear that it is inapplicable here. The Special Referee's Order acknowledges that "[i]mplied waiver results from acts and conduct . . . from which an *intentional* relinquishment of right is reasonably inferable." (Riverwalk Order at 44 (emphasis added) (citing *Lyles v. MBI, Inc.*, 292 S.C. 153, 355 S.E.2d 282 (Ct. App. 1987)); CR 68.) South Carolina courts have made it indisputably plain that "waiver is the *voluntary* and *intentional* relinquishment of a known right, claim, or privilege" and that "we are controlled by the sound principle that 'where an implied waiver is claimed, caution must be exercised, for waiver will not be implied from doubtful acts.'" *Zeller v. Cumberland Truck Sales*, 272 S.C. 558, 562, 253 S.E.2d 111, 113 (1979) (quoting 28 Am. Jur. 2d Estoppel and Waiver § 160) (emphasis added). Here, it is simply untenable to argue that Harleysville's RRLs, which thoroughly and explicitly reserved Harleysville's right to contest coverage, constituted a knowing and voluntary relinquishment of the right to contest coverage. The Special Referee erred in so holding.

Courts in other jurisdictions have expressly held that an insurer's failure or delay to reserve its rights does not waive its ability to later contest coverage. *See, e.g.*, *Maxwell v. Hartford Union High Sch. Dist.*, 814 N.W.2d 484, 487 (Wis. 2012) ("[T]he failure to issue a reservation of rights letter cannot be used to defeat, by waiver or estoppel, a coverage clause—as distinguished from grounds for forfeiture—in an

insurance contract. We strongly urge insurers to communicate with their insureds about their potential coverage defenses, but we do not see the failure to issue a reservation of rights letter as grounds to require an insurer to provide insurance coverage that does not otherwise exist in the insurance contract."); *Medical Protective Co. v. Fragatos*, 940 N.E.2d 1011, 1015 (Ohio Ct. App. 2010) (reversing trial court and holding that insurer had not waived coverage defenses by failing to timely send RRL to insured); *Garamendi v. Golden Eagle Ins. Co.*, 116 Cal. App. 4th 694, 721 (Cal. Ct. App. 2004) ("In virtually every case discussing the waiver issue . . . the courts have found that there was no waiver if the insurer made a reservation of rights at any time, even if years after the defense was undertaken.") (citations omitted); *see also Newby Int'l v. Nautilus Ins. Co.*, 112 Fed. Appx. 397, 406 (6th Cir. 2004) ("The Michigan Supreme Court has indicated that generally the doctrine of estoppel should not be used to broaden the scope of insurance coverage, so long as the insurer provides reasonable notice that it is proceeding under a reservation of rights.") (citation omitted); *Duke v. Hoch*, 468 F.2d 973, 983 (9th Cir. 1972) ("There was no waiver arising from [insurer's] failure to secure from its insureds agreement to the reservation of rights.").

In addition, Harleysville's RRLs note that Harleysville "expressly reserves the right to rely upon *any* term or condition of the insurance contract." (*See* January 27, 2004 RRL to Buildstar regarding Riverwalk suit at 11; CR 1830). Courts of other jurisdictions have held that similar language allows an insurer to later assert any coverage defense, and that a RRL's failure to mention a particular provision does not waive the insurer's ability to later contest coverage. *See, e.g., Northwest Airlines v. Fed. Ins. Co.*, 32 F.3d 349, 356-57 (8th Cir. 1994) (noting that the RRL "could have

been far more specific," but the insurer "did reserve its right to deny coverage 'on additional and alternative bases,'" and thus the insurer "adequately preserved its policy defenses"); *Houston Gen. Ins. Co. v. AG Prod. Co.*, 840 F. Supp. 738, 743 (E.D. Cal. 1993) (holding an insurer's failure to raise a particular defense in its RRL did not waive its right to later assert that coverage defense); *Nationwide Mut. Ins. Co. v. Nixon*, 682 A.2d 1310, 1314 (Pa. Super. Ct. 1996) (holding that insurer's failure to include specific policy exclusion in RRL as a possible defense did not constitute waiver of that defense); *State Farm Fire & Cas. Co. v. Jioras*, 24 Cal. App. 4th 1619, 1628 n.7 (Cal. Ct. App. 1994) ("Waiver depends solely on the intent of the waiving party, and is not established merely by evidence the insurer failed to specify the exclusion in a letter reserving rights.") (citation omitted); *Shannon v. Shannon*, 442 N.W.2d 25, 32-34 (Wis. 1989) (holding that insurer's "nonspecific" RRL, which failed to mention the policy's family member exclusion, did not bar insurer from subsequently asserting that coverage defense).

D. The judgment holders from the underlying suit may not raise or benefit from the alleged deficiencies of Harleysville's reservation of rights letters.

The Special Referee's Orders stated, without explanation or citation to authority, that the judgment holders from the underlying suits could raise and rely on the purported shortcomings in the RRLs Harleysville sent to its insureds. (*See* Riverwalk Order at 44; CR 68.) Although South Carolina's courts have not yet addressed this precise question, they have stated that an injured person is a stranger to the insurance contract and has no right to enforce the terms of that contract or rely on its breach. This is because "'no privity [of contract exists] between an injured person and the tortfeasor's liability insurer, and the injured person has no right of action at law

against the insurer.'" *Trancik v. USAA Ins. Co.*, 354 S.C. 549, 554, 581 S.E.2d 858, 861 (Ct. App. 2003) (quoting 44 Am. Jur. 2d Insurance § 1445 (1982)) (alteration in original). In short, an injured party "does not have a contractual relationship with the insurer and cannot maintain an action against the insurer for breach of the insurance contract." *Id.* at 554-55, 581 S.E.2d at 861 (citations omitted).

The courts of other jurisdictions make clear that because an insurance policy is a contract solely between an insurer and insured, an injured third-party has no standing to raise or rely on an insurer's deficient or untimely RRL. *See, e.g., Capitol Indem. Corp. v. Fraley*, 597 S.E.2d 601, 603 (Ga. Ct. App. 2004) (holding that person injured by insured "lacks standing to assert the defense of waiver or estoppel against [insurer] for failing to provide a timely notice of reservation of rights" because an insurer's "right to deny coverage flows only to its insured and [an injured third party] may not complain about [the insurer's] failure to provide a timely reservation of rights notice"); *Nat. Union Fire Ins. Co. v. Am. Motorists Ins. Co.*, 504 S.E.2d 673, 675 (Ga. 1998) ("[Insurer's] 'right to deny coverage' flows only to [its insured]. Any reservation of that right would have to be directed to [the insured] and [a third party] may not complain about [insurer's] failure to provide such notice."); *see also First Marine Ins. Co. v. Gibbs*, No. 98-6117 1999 U.S. App. Lexis 5891 (10th Cir. Mar. 31, 1999) ("As a general rule, only the insured possesses standing to argue estoppel, and third parties may not raise the issue unless they stand in the same position of potential prejudice as the insured.") (citation omitted); *U.S. Fid. & Guar. Co. v. Regis Ins. Co.*, No. 90-5180, 1991 U.S. Dist. Lexis 5671 (E.D. Pa. April 25, 1991) ("Although USF&G assumed the defense of the underlying action without a reservation of rights, [Regis, the

insurer of a co-defendant in the underlying action,] has no standing to assert that USF&G thereby waived the exclusion or is estopped from denying [its insured] coverage. Regis is a stranger to the contract of insurance between USF&G and its insured.").

X. The Special Referee erred by denying Harleysville's motion for judgment as a matter of law.

Prior to trial before the Special Referee, Harleysville filed a motion for judgment as a matter of law and directed verdict. The Special Referee denied the motion in an Order dated February 28, 2013, indicating that motions for judgment are unnecessary or inapplicable in a non-jury trial.[39] (*See* Order on Motion for Judgment; CR 21.) This is incorrect. Motions for judgment are applicable in non-jury settings. *See* Rule 41(b), SCRCP (authorizing motion for judgment in bench trials). Motions for judgment are not only permissible; they are required to preserve an argument seeking a different judgment on appeal. *See, e.g., Holly Woods Ass'n of Residence Owners v. Hiller,* 392 S.C. 172, 189, 708 S.E.2d 787, 796 (Ct. App. 2011) (holding appellants failed to preserve an issue of law for appellate review by failing to move for a directed verdict on that basis); *Duncan v. Hampton Cnty. Sch. Dist. No. 2*, 335 S.C. 535, 545 n.6, 517 S.E.2d 449, 454 n.6 (Ct. App. 1999) (same). The Special Referee's refusal to

[39] The motion inadvertently stated in was brought pursuant to Rule 56, SCRCP. (*See* Harleysville's Motion for Judgment at 1; CR 2465.) The Special Referee incorrectly construed it as being made pursuant to Rule 50, SCRCP. (Order on Motion for Judgment; CR 21.) In fact, regardless of how the motion was captioned, it should have been treated as a motion for judgment pursuant to Rule 41(b), SCRCP. *See Ducworth v. Neely*, 319 S.C. 158, 159 n. 1, 459 S.E.2d 896, 897 n. 1 (Ct. App. 1995) (noting that motion styled directed verdict in non-jury action actually was a motion for involuntary non-suit under Rule 41(b), SCRCP, and therefore reviewing as such).

consider Harleysville's motion for judgment was premised on a misunderstanding of the law and, to the extent he declined to consider the motion, it was error.[40]

Conclusion

Based on the above, this Court should reverse the judgment of the Special Referee in the various respects noted herein and remand for further proceedings consistent with such an opinion.

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[40] The Special Referee's order alternatively provides he had considered and ruled upon all the issues raised by Harleysville's motion in his order disposing of the case.

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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

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

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

v.

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

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

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

CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Brief of Appellant/Respondent complies with Rule 211(b), SCACR.

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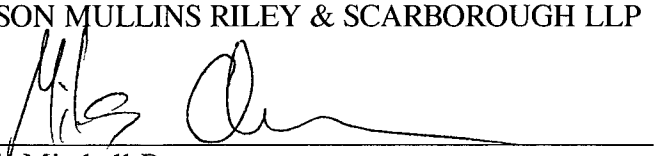
By: 

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In The Court of Appeals

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John M. Milling, Special Referee

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

PROOF OF SERVICE

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

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