

THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM AIKEN COUNTY
In the Court of Common Pleas

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Edgar W. Dickson, Circuit Court Judge

S.C. Supreme Court

ON CERTIORARI FROM THE COURT OF APPEALS

Opinion No. 5061 (S.C. Ct. App. filed December 12, 2012)
401 S.C. 431, 737 S.E. 2d 631 (Ct. App. 2012)

William and Mary Frances Walde
as assignees of Johnson Construction
Company of Aiken, Inc., Petitioners.

v.

Association Insurance Company, Respondent.

REPLY BRIEF OF PETITIONERS

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ARGUMENTS

I. Respondent Improperly Reargues Points to Which is it Bound by the Law of the Case

Respondent continually throughout its Brief states the incorrect factual predicate for its arguments that Johnson's work in advising the Board was part and parcel of its work in locating and constructing the barn, i.e., there was one continuous project. *See* Respondent's Brief, pages 9-11; 14-15; 15-16; 16-19; and 19-21. In doing so, Respondent simply restates arguments that were rejected by the Trial Court but which were not appealed by Respondent and thus became law of the case as the Court of Appeals ruled.

The Court of Appeals correctly ruled that the law of the case required it to hold that there were two separate contracts, the Permitting Contract (and thus the Permitting Work arising thereunder) and the Construction Contract (which was the actual construction of the barn), and the performances under each were separate. *See* Opinion, Appendix 2, n. 1; 13, n. 9. The Respondent cannot now change this law of the case.

Further, the Respondent's Brief for the first time since arguments before the Trial Court raises factual argument with regard to the interpretation of the Arbitration Demands and the findings of loss of use by the Court of Appeals, and some that were not so raised anyway. *See, e.g.,* Respondent's Brief, Argument I. A.(2) at pages 11-13..

Thus, this Court, as did the Court of Appeals, must consider the facts as established by the law of the case, not Respondent's arguments that while it may (or may not) have made before the Trial Court, failed to preserve on appeal. The facts which the Respondent must use are those established within the framework of the appellate rules and error preservation rules; it is not allowed by those rules to reargue points not preserved for this Court.

Respondent argues in its Brief before this Court that it did properly raise the definition of “physical injury” as defined in the Policy, citing to its repeated statements in its prior Brief before the Court of Appeals that no property damage was alleged. *See* Brief, pp. 21-23. However, Respondent mentioned the term “physical injury” once in its original appellate Brief before the Court of Appeals.¹ Respondent’s arguments on “property damage” there made no effort to define, explain, or provide any legal support for a definition of “physical injury.” The Court of Appeals clearly ventured out on its own with regard to this issue.

Correspondingly, Petitioners made no attempt in their original appellate Brief before the Court of Appeals to argue the definition of “physical injury” as there was nothing in the Respondent’s Brief before the Court of Appeals to argue against, other than mere conclusory statements. It is exactly that sort of situation for which the rule exists that the Courts do not review issues not properly raised. *See Houck v. State Farm Fire and Cas. Ins. Co.*, 366 S.E.7, 17 n.5, 620 S.E.2d 326, 332, n. 5 (2005); *Fields v. The Melrose Ltd. Partnership*, 312 S.C. 102, 439 S.E. 2d 283, 285 n. 3 (Ct. App. 1993). The first time Petitioners were on notice of such an issue and the first time they had the opportunity to brief it was in the Petition for Rehearing before the Court of Appeals. *See* Petition, Appendix pp. 17-20. The “physical injury” red herring is a textbook example of a ‘conclusory argument’ and should be rejected as such.

¹ By its own admission, Respondent stated only in its original Appellate Brief before the Court of Appeals: “nothing in this Demand sets forth any allegations that the building at issue was physically injured...” (Return to Petition for Rehearing, Appendix p. 25.) That was the extent of Respondent’s ‘argument’ on this issue.

II. Respondent Continues to Confuse the Distinction Between the Permitting Contract Work being Complete Before the Barn was Constructed under the Construction Contract; thereby ignoring that ‘Physical Injury’ did not occur to the Work from the Permitting Contract (i.e., the Permit) but rather that ‘Physical Injury’ from the Permitting Contract occurred to the Barn.

A. Respondent Wrongly Assumes There was One Course of Performance.

The key mistake made by Respondent in nearly every argument made in its Brief (and at times by the Court of Appeals as noted in the Petitioners’ Brief before this Court) was the failure to comprehend the logical coverage distinction between Johnson’s negligent performance of services, i.e., advice and representation before the BZA, and Johnson’s construction of the barn. These two separate projects resulted in an “occurrence” as defined in the Policy (the negligent representation before the BZA, and then later, the “physical damage” to the barn which was not part of the Permitting Work performed when the occurrence happened.

Again, the law of the case is that *these are two separate, unrelated acts and occurrences* and not a continuous course of action. Nothing about Johnson’s construction of the barn was defective; there is no allegation that the product Johnson constructed was improper. However, Johnson’s properly constructed barn was damaged because of Johnson’s prior negligent representation before the BZA.² The physical damage to the barn was caused by an occurrence that was not part of the construction of the barn, thus distinguishing these facts from the common construction coverage case.

For example, if the Waldes had hired “Acme Construction,” an entity wholly unrelated to Johnson, to build the barn instead of Johnson, there would be no argument that Johnson’s negligent

² As noted by Respondent in its Brief before this Court (p. 4), the Waldes specifically inquired of Johnson if they could include an accessory apartment (second floor) above the stable as part of the permitting work Johnson was doing for them and Johnson (negligently) advised the Waldes that they could. (R. 121). The negligence, and the occurrence for purposes of insurance coverage here, was this act, not where Johnson later built the building. Respondent and later the Court of Appeals repeatedly fail to recognize this point.

advice under the Permitting Contract would be an occurrence and the remedial measures to repair the barn built by “Acme Construction” would be physical injury to the barn. The negligent advice and representation arising from the Permitting Contract would result in coverage for physical damage to property. Here, Respondent and the Court of Appeals keep assuming that all the events and circumstances flow from one occurrence and one contract, but that is not the law of the case. That is not the facts the Court must follow. The Court must consider if Johnson’s negligent advice and representation resulted in physical damage to a structure and ignore that the structure was in this case built by Johnson.

Respondent claims that the property was defective from the outset because it was placed in the wrong location; however, that again misconstrues the nature of the property. Under the Construction Contract, *the work was properly performed*; it was placed where it was supposed to be (according to the Permitting Contract) and it was not defective construction. The barn was physically injured only when the BZA ordered it torn down and removed and remedial measures had to be taken. The injury occurred at least in part because of the negligent advice of Johnson that a second story accessory apartment could be built. Again, had “Acme Construction” build the barn instead of Johnson, there would be no debate that this property was physically injured.³

B. Respondent’s Initial Arguments were Properly Rejected by the Court of Appeals.

1. Physical Injury

Respondent raises essentially two alternative sustaining grounds at Argument I of its Brief (pages 8-11). The first one in Argument I. A. (1), would be resolved if the Court holds that the Court of Appeals improperly defined “physical injury” and that a “physical injury” to the barn occurred.

³ A review of the entirety of Respondent’s Brief before this Court with the proper understanding that there are two separate courses of performance, and logical analogy that a third party other than Johnson performed the Construction Contract, makes it clear that none of Respondent’s arguments make sense as all of them are predicated on the Permitting Contract work and the Construction Contract work all being one continuous performance.

Beyond that, the same distinction between the Permitting Contract and the Construction Contract control this issue, as discussed *supra*.

2. Loss of Use

(a) There Were Allegations of Loss of Use in the Arbitration Demands.

At Argument I. A. (2) of its Brief (pages 11-13), for purposes of its “loss of use” argument, Respondent attempts to by-pass the error preservation rules again by arguing that the Permitting Contract and Construction Contract were not separate contracts, notwithstanding that the Court of Appeals found that this issue was not preserved for appellate review and thus was law of the case.

Of course, the loss of use of the barn is a common sense result of the barn not being usable because it violated zoning ordinances. Regardless, the Petitioners’ Pre-Trial Brief (which is part of the Arbitration Demand to be considered for determining coverage under the duty to defend analysis as held by the Court of Appeals, Op., Appendix, p. 3, n. 2) does allege loss of use. The Pre-Trial Brief alleges in the first paragraph, page two: “[w]hat the Waldes ended up with is [not] a stable as permitted by the City, but one that is not completed *and is unusable*.” (Italics added.) (R. 118.) Thereafter, the Pre-Trial Brief alleges “the Waldes had paid Johnson \$110,500 *for the construction of the useless stable and accessory apartment*.” (Italics added) (R. 125). Thereafter, the Waldes alleged that even by that point in the arbitration “the stable is *not even now finished*” (italics in original) and listed items that prevented the stable from being usable. (R. 127-128). Clearly, there were allegations of loss of use in the pleadings.⁴

⁴ Respondent uses a comparison to a homeowner’s use of a home being delayed by the negligent failure of a contractor in obtaining a certificate of occupancy as an example of where there should not be a loss of use under a policy. Respondent’s Brief, p. 12. However, such a loss of use would actually qualify as a loss of use under the policy as there is nothing in the policy’s coverage parts (as opposed to its potentially applicable exclusions) that says such a loss of occupancy would not be a loss of use under the policy.

(b) The Standard for Alleging Loss of Use is in the Duty to Defend Context.

As the Trial Court found, the issues for the Motion for Partial Summary Judgment were confined within the context of the broad reading of the Complaint (or in this case, the Arbitration Demand) for the purposes of determining if the insurer had a duty to defend. The Arbitration Demand and Pre-Trial Brief clearly allege loss of use. Respondent's arguments must be rejected in the context of the liberal standard granted an insured in the context of a duty to defend case: the Respondent cannot ignore allegations in the Complaint that even just "create a possibility of coverage..." *Spartan Petroleum Co., Inc. v. Federated Mut. Ins. Co.*, 162 F.3d 805, 808, n. 2 (4th Cir. 1998) (R. 7). Thus, for purposes of the Court's analysis in a duty to defend case, the Pre-Trial Brief's allegations must be read, **even if ambiguous, to create coverage if the stated liability arguably covered by the policy.** *Donnelly v. Transportation Ins. Co.*, 589 F.2d 761, 767 (4th Cir. 1979); *Isle of Palms Pest Control Co. v. Monticello Ins. Co.*, 459 S.E.2d 318, 319 (S.C. App. 1995). See Trial Court Order, R. 6-7. Clearly, the allegations of lack of use by the Waldes sufficiently alleged loss of use for purposes of a duty to defend.

III. The PCOH "Exclusion" Does Not Apply.

Respondent raises the PCOH "Exclusion" as a separate reason for the Court of Appeals to be affirmed. (Respondent's Brief, Argument II. A., pages 16-19). The Trial Court rejected the applicability of this "exclusion." If Johnson's negligent representations as part of his work associated with the Permitting Contract could not subsequently result in covered property damage, then, for example, there would also be no insurance coverage for a defect in Johnson's services that later resulted in a personal injury to a third party once the work under the Permitting Contract was completed. This would result in only liability insurance during the course of a project, and no coverage afterwards. No court in this State has suggested that the PCOH can be so broadly read.

The Trial Court's Order in this case stated with reference to the PCOH argument by

Respondent:

AIC attempts to apply the Products-Completed Operations Hazard Exclusion ("PCOH") to the claims in the Complaint. However, as noted by the South Carolina Court of Appeals, the products-completed operations hazard exclusion "cannot serve as a broadly written catch-all exclusion that would prohibit recovery no matter what consequences 'arise out of' the product of the insured." *Auto Owners Ins. Co. v. Rhodes*, 682 S.E.2d 857, 870 (S.C. App. 2009). The policy actually covers products-completed operations hazards if not expressly excluded, as that was a separate coverage purchased by Johnson as reflected in the Policy Declarations. However, through the definition of certain "property damage" at Exclusion j, much of the products-completed operations hazard coverage is likewise excluded. The PCOH, however, is really not an exclusion; rather, it is an exception to an exclusion. The PCOH has been described as follows:

Before proceeding to our analysis of whether there was coverage, we think it would be helpful to explain how the PCOH provision fits into a CGL policy. A CGL policy, like every other insurance policy, has an insuring clause under which the insurer agrees to pay sums that the insured becomes legally obligated to pay because of property damages caused by an occurrence. The CGL policy also has exclusions that take away some of this coverage. The PCOH provision is an exception to these exclusions. Or, stated another way, the PCOH provision is simply a category of losses that are covered even though these losses might otherwise be excluded. Viewed in this light, the PCOH provision does not create a separate category of coverage. Rather, any loss falling within the PCOH provision must still meet all the requirements of the policy, like any other loss, except the exclusion from which the losses are excepted.

Pursell Const. Inc. v. Hawkeye-Security Ins. Co., 596 N.W.2d 67, 69 (Iowa 1999). The PCOH exception is to the Exclusion j which excludes certain types of defined "property damage" from coverage. (See pages 5-6 of Policy.) As an initial matter, Exclusion j does not apply to this situation as the negligence advice/negligent misrepresentation by Johnson does not fit into any of the exclusion's categories of excluded property damage. Thus, AIC cannot show (as is its burden) that the exclusions would apply.

Second, AIC confuses the claims in the Arbitration Demands as one for defective design or construction. The Arbitration Demands arose out of *defective advice* before a BZA, not for defective design or construction. There was no negligence in the design or construction of the building; the loss that occurred to the building was due to the negligent misrepresentations by Johnson involving the BZA. As long as the damages sought are not for the "work" itself, but are for damage to other property, the PCOH does not apply. *Gaylord Chemical Corp. v. ProPump, Inc.*, 753 So.2d 349, 354-55 (La. App. 2000)(Interpreting identical policy provision and holding there was coverage for negligent misrepresentation claim.)

Finally, the Products-Completed Hazard Exclusion by its terms states that it does not apply to *uncompleted work*. Section V, 16. a. (2). AIC states that because the barn

was not completed, then the exclusion applies. See Complaint, Exhibit C, page 7. However, Johnson's work before the BZA was completed before the construction contract was signed or work began on the barn. Thus, this exclusion does not apply.

Record, p. 17-18.

The Trial Court as an additional reason that the PCOH was not applicable in a footnote that:

The exclusion as applied to these facts is also ambiguous as it does not contemplate the work of the insured damaging other product of the insured. The Supreme Court of Florida held that a "Products-Completed Operations" exclusion was ambiguous as it referred to a contractor as opposed to a manufacturer, and thus an a duty to defend existed. *Nixon v. USF&G*, 290 So. 2d 26 (Fla. 1973). The PCOH provision here at best is similarly ambiguous when applied to these facts.

Record. p. 18, fn. 7. Clearly, the PCOH argument by Respondent is without merit.

IV. The "Your Work" Exclusion Cannot by Definition Apply.

Further, the "Your Work" exclusion does not apply because the "Work" performed under the Permitting Contract was different and separate work from that provided under the Construction Contract.⁵ Again, had "Acme Construction" built the barn, the barn would obviously not be "Your Work" for purposes of the "Your Work" exclusion arising out of the "occurrence" from the Permitting Contract. The "Your Work" exclusion simply does not extend endlessly to all structures built by one contractor for an owner under separate contracts, which is the theoretical underpinning of Respondent's argument. Petitioner cannot better put the rejection of that argument than did the trial court:

It is clear from the Arbitration Demand and then the Pre-Trial Brief that the negligent misrepresentations by Johnson and its breach of duty were related to what variances and special exceptions were needed from the BZA and were related to its misrepresentations that the Waldes could build an accessory apartment as part of a barn without BZA approval. The resulting and ensuing damage that occurred was the partial demolition of the barn Johnson built. Thus, the actions complained of in the

⁵ Respondent again fails to recognize the distinction between the Permitting Contract and the Construction Contract by its citation to *Century Indem. Co. v. Golden Hills Builders, Inc.*, 348 S.C. 559, 561 S.E. 2d 355 (2002) *overruled by Crossman Communities of N. Carolina, Inc. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E. 2d 589 (2011) for the proposition that the "your work" exclusion applies to the construction of the barn. However, the "property damage" at issue in *Century Indem. Co.* arose from the construction of one building, not separate projects or buildings.

Arbitration Demands were separate and apart from the actual construction of the barn itself. The two events (Johnson's representation of the Waldes vs. Johnson's building of the barn) are separate. They could have been performed by different companies; for example, an attorney could have represented the Waldes before the BZA. Further, as alleged in the Arbitration Demands, they were separately paid for. Thus, Johnson's work before the BZA was different from its work of building the barn. The Waldes had no complaint about the quality of the barn; their complaint was over Johnson's negligence in procuring the special exceptions or variances.

For example, had Johnson not built the barn, but had he only breached a duty of care in representing the Waldes before the BZA, there is little doubt but that the insurer would have covered the property damage to a barn built by another contractor at the wrong location and wrong height due to Johnson's negligence.

Also, by way of another example, if Johnson had improperly built a house, and after completion that house had caught on fire because Johnson negligently installed a light fixture, and then the fire spread to burn down a second house that Johnson was building, the insurer unquestionably would pay for the damage to the second house being built by Johnson. This is because Johnson's negligent conduct arose not with respect to the structure, the second house that he was building, but rather arose out of the first house it built that damaged the second house. Thus, the "your work" referred to in the Policy is the not the "your work" that was damaged.

Order, pp. 14-15. (Record, 15-16.)

Also, the Trial Court found the "Your Work" exclusion ambiguous as applied to the set of facts alleged in the Arbitration Demands:

Finally, the "Your Work" exclusion is ambiguous as applied to these facts since nowhere does the exclusion appear to contemplate the facts that occurred here: a service provided by an insured that later damaged a structure provided separately by the insured. In other words, the exclusion is inherently contradictory when the "work" of an insured damages distinct and separate "work" of same insured. In such a case, the Court must adopt the interpretation favoring the insured, which in this case would be that the two "your work" situations are separate.

Order, p. 15 (Record, p. 16), *citing Brooklyn Bridge, Inc. v. South Carolina Insurance Company*, 420 S.E.2d 511, 512 (S.C. App. 1993). Thus, for the same reasons that the PCOH's "exclusion" was properly rejected by the Trial Court, this Court should reject application of the "Your Work" Exclusion.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that this Court should reverse, correct the mistakes of the Court of Appeals, and affirm the Trial Court's Order.

Respectfully submitted,

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PROOF OF SERVICE

I, Ann Shuler, an employee of the McNair Law Firm, hereby certify that I have this day served a copy of the Reply Brief of Petitioners on counsel for Respondent by depositing a copy of same in the United States Mail, sufficient postage pre-paid as follows:

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This 2 day of September, 2014.


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