

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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APPEAL FROM HORRY COUNTY
JOHN M. MILLING, SPECIAL REFEREE

S.C. SUPREME COURT

Case No. 2017WL105021

Appellate Case No.: 2013-001281
And 2013-001291

Harleysville Group Insurance, a Pennsylvania
Corporation, Appellant/Respondent

v.

Magnolia North Horizontal Property Regime, and
Magnolia North Property Owners Association, Inc.,
a South Carolina Corporation are Respondents/Appellants

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

RETURN TO PETITION FOR REHEARING
OF APPELLANTS/RESPONDENTS

John P. Henry
Philip C. Thompson
Thompson & Henry, P.A.
1300 Second Avenue, 3rd Floor
Post Office Box 1740 (zip: 29528)
Conway, South Carolina 29526
(843)248-5741
Attorneys for Respondents/Appellants

At the request of the Supreme Court, and pursuant to Rule 240(e), *SCRAC*, Respondents/Appellants address Appellant's/Respondent's ("Harleysville's") Petition for Rehearing relative to issues regarding the Reservation of Rights letters (hereinafter "RORL"). The issues will be addressed with the heading and in the order presented by the Appellants/Respondents (Harleysville) in their Petition for Rehearing.

I. The Court Misapprehended the Applicable Rules Governing Reservation of Rights Letters and Incorrectly Determined that Harleysville's Letters were Insufficient.

a. Respondents/Appellants lacked standing to contest the adequacy of the Reservation of Rights letters.

The premise upon which Harleysville bases its contention, and the cases cited to support the contention, that Respondents/Appellants have no standing to contest the adequacy of the RORLs is that the Respondents/Appellants are third party plaintiffs and therefore, cannot sue the insurer's liability carrier, Harleysville, in a direct action, citing *Klechley v. Northeastern Nat. Cas. Co.*, 330 S.C. 277, 498 S.E.2d 669 (1998). *Klechley* stands for the proposition that in South Carolina an injured party cannot bring an action against the wrongdoer's insurer, but must first obtain a judgment and then proceed against the insurer. Respondents/Appellants take no issue with this proposition of law. What Harleysville overlooks is that the Respondents/Appellants are judgment holders and seek in this action to collect on the judgments. The Respondents/Appellants filed counterclaims seeking to collect on their judgments. (R. pp. 225-226; 152-153) In response to those counterclaims, Harleysville filed replies and in each reply set up the RORLs as a defense. (R. p. 171, 244-245)

Under Harleysville's policies, they consent to a judgment holder, with a judgment against their insured to bring a direct action against it. (R. p. 1893- typical of all policies)

The Special Referee concluded that the Respondents/Appellants [judgment holders] stepped into the shoes of the insured. *Lee v. Golf Insurance Co.*, 248 S.C. 296, 149 S.E.2d 639 (1996)

“An insured party who brings suit against a liability carrier in order to collect on a judgment previously acquired against an insured is possessed of all rights of the insured and subject to all defenses that exist as between the insured and the insurance carrier.” Id.

In *Cooke v. State Farm Mut. Auto Ins. Co.*, 231 S.C. 257, 98 S.E.2d 427 (1957) the Court held that holds a judgment against the insured occupies the same status of the insured. Harleysville cites numerous cases holding that an injured party cannot sue an insurance company of the insured and has no standing to contest policy defenses. These cases are inapposite because in this case, judgment holders are suing Harleysville as provided in Harleysville’s policy. Harleysville’s contention that it can raise the RORLs as a defense to a suit on the judgments against their insureds and the judgment holders have no standing to contest the adequacy of the RORLs, has no basis in the law.

b. Opinion No. 27698 improperly creates coverage via waiver.

1. Coverage may not be created via waiver.

Harleysville first argues that the deficient RORLs somehow created coverage by waiver. In spite of the inadequacy of the RORLs the Special Referee allowed Harleysville to advance every policy defense they wanted to advance.¹ Every exclusion was fully dealt with at trial and thoroughly explored by the Special Referee in his Order. The Special Referee also allowed Harleysville to fully present their case on coverage. It was determined

¹ The Special Referee, at the conclusion of discussing the RORLs, stated: “Although the Court has already concluded that Harleysville has a duty to indemnify the insureds, this issue [RORLs] was fully litigated and the Court felt it appropriate to address the issue.” (R. pp. 68, 115)

by the Special Referee that covered claims were submitted to the jury and Harleysville conceded this to the Court. Counsel for Harleysville stated to the Court:

“From a physical standpoint, you can look at the estimates that were presented to the jury which is part of the record in the underlying action. And those estimates included vast numbers of damages that were not covered, and vast numbers of damages that according to current law in the Supreme Court are covered. And so you have that mixture of damages which necessitates further action by the Court.” (R. p. 651)

Since Harleysville conceded there were covered damages submitted to the jury (otherwise there would be no reason to parse the general verdict) the entire general verdict is covered. *Owners v. Clayton*, 364 S.C. 555, 614 S.E.2d 611 (2005) (when the jury returns a general verdict, a finding that a covered claim was submitted to the jury, answers the coverage question. The entire general verdict is covered.) This is simply a recognition of the rule that jury verdicts cannot be looked into. It would invade the province of the jury and would lead to unguided speculation. (R. p. 56)² No waiver or RORL was ever used to deny Harleysville the right to fully litigate its claims. Waiver created or limited nothing.

Harleysville states on page 12 of its return that “The Courts’ decision will be argued to have fundamentally altered the way insurance companies handle reservations of rights going forward.” There is absolutely no basis for this statement. Harleysville has not cited one case in which a Court has approved of an insurance carrier’s reservation of rights letter that includes virtually every policy provision contained in the policy with a concluding statement that Harleysville reserves its rights to determine: “5) Whether or not any exclusion applies to preclude coverage under any policy or policies; and 6) Any additional coverage defenses which may arise during the investigation.” (R. p. 1801) Harleysville should have just sent them the entire policy and said “We reserve any defenses we have in

² See detailed analysis by the Special Referee of vast S.C. authorities not allowing inquiry into the general verdict. (R. pp. 28-34)

the policies or any other defenses that may arise.” Such chicanery gives the insurance carrier, as was done here, the latitude to deny coverage on one basis (here, no “occurrence”) and if the insured, as here, gets a big verdict against them, raise in a coverage action after the verdict, as Harleysville did here, any exclusions that meet their fancy. It was a method used by Harleysville to gain a distinct advantage over their insureds who were insolvent.³ And if this Court sanctions such claims practices, the only thing it will fundamentally change is how some carriers take advantage of their insureds. A case that perfectly describes the danger with sanctioning a “throw everything on the wall and see what eventually sticks” RORL is *Merithew v. Last*, 376 Mich. 33, 135 N.W.2d 353 (1965), in which the carrier sent its insured a RORL with the following language:

...but the company in undertaking your defense, does so under a reservation of rights, and without prejudice, and subject to the conditions, limitations, exclusions and agreement of said policy, and subject to the express understanding that by doing so the company does not waive any of its rights to rely upon the provisions of said policy, and does not waive any defense it may have to a claimed liability under said policy. *Id.* p. 355

In holding the RORL insufficient, the Court stated:

...The notice was vague and uncertain. It smacks of bad faith for want of specific reference to that clause of the policy the garnishee [insurer] has pleaded. In no field of law is legal duty more rigidly enforced than in instances at bar. The insurer must fulfill its policy-contracted obligations with utmost loyalty to its insured; not for the purpose of developing, secretly or otherwise, a policy defense. *Id.* p. 355

The insurer’s notice failed the ‘reasonable test’ because it left Last [insured] in the dark as to the nature of the policy defense or defenses the insurer had in mind; if indeed it had any in mind save such as might be conceived later as the principal case proceeded. *Id.* p. 355

By sending very general RORLs, Harleysville was able to pick and choose whatever exclusions they wanted when the coverage action began after the judgments were

³ Harleysville’s CGL Policy provided: “Bankruptcy or insolvency of the insured’s estate will not relieve us of our obligations under this coverage part.”

already rendered and the insured, or counsel for the insured, had tried the case without having a clue as to which exclusions, if any, applied. Harleysville's litigation specialist, as noted above, told the insureds that no exclusions applied because they could not get past the insuring agreement. They maintained this position until the D.J. actions were filed, over six years after the underlying cases were filed in 2003. They never changed their RORLs and the common law of good faith and fair dealing they owed to their insureds never changed. And then, in the D.J. action, as the Court stated in Merithew, Harleysville conceived defenses it had never told their insureds existed. They pled 16 exclusions and set forth numerous types of damages that were not covered. (R. pp. 133-134; 179-180) And Harleysville asks the Court to sanction this type of action by an insurer. The Court should decline sanctioning these types of RORLs which open the door to this type of untoward conduct.

2. Numerous Courts from other jurisdictions have held that a reservation of rights need not detail each policy defense upon which an insurer may rely.

It is true that sometimes an insurer may need additional time to analyze the existence of coverage and may send a general reservation of rights letter. However, the insurer must then supplement the RORL as soon as it learns of specific defenses. *Alan D. Windt, Insurance Claims Disputes: Representation of Insurance Companies and Insureds* §2.14 (5th ed. 2007) The RORL must at some point, make specific reference to the policy defense which may ultimately be asserted and to a conflict of interest that may exist. Cowan v. Insurance Co. of North America, 22 Ill. App. 3d 883, 318 N.E.2d 315 (1974)

Harleysville assumed the defense of the underlying cases in 2003 and sent RORLs from December, 2003 – February, 2004. This means Harleysville had approximately 3 years before the trials in 2006 to detail to the insureds which of the policy provisions they

would rely on. If Harleysville, was not sure they could have commenced a D.J. action long before the underlying trials began so as to avoid what happened here. But Harleysville was happy to leave their letters in place, "as is", and then they were free to pick and choose from the array of exclusions and policy provisions set out in their RORLs.

Harleysville misperceives the problem with its RORLs when it says that they are not required to detail every policy defense. The problem lies not in that the RORLs did not detail each policy defense upon which it relied. The problem with Harleysville's RORLs was that they detailed the entire policy without ever explaining to the insureds which policy provision(s) they may rely on to deny coverage. And there is a good explanation why Harleysville prepared such cut and paste RORLs. Harleysville took the position with its insureds that there was no coverage because there was not an "occurrence", and therefore, no insurance coverage for any claim in the construction litigation arena as stated in their discovery responses. (R. pp. 1656, 1670, 1682-83) These answers to discovery requests were never amended. In addition, Lee Wright, Harleysville's construction litigation specialist testified he told the insureds the Supreme Court has said that faulty workmanship in and of itself cannot be considered an occurrence. (R. pp. 356-57) And, that they became more and more convinced that there was no accident here during the pendency of these cases. (R. p. 423) And they told the insureds there was no coverage under the policies- "We communicated that to them several times." (R. p. 425, ll. 8-24) We told them the Supreme Court said there was no accident (R. p. 426, ll. 2-4) Thus, as Mr. Wright testified, if there was no "occurrence", there was no reason to explain why each policy provision may exclude coverage. And so, we have a RORL detailing all the policy exclusions coupled with Harleysville telling the insureds there was no "occurrence" and so, there was no need to discuss any of the policy provisions and such belies the problem with the RORLs.

Harleysville is correct that other jurisdictions have held that a RORL need not detail each policy defense upon which an insurer may rely. However, Harleysville has not cited one case, nor can they, where the Court sanctioned giving a RORL that contained every policy provision which allows the insurer unfettered leeway to pick and choose policy defenses in a D.J. action after verdicts are rendered. These RORLs were unusual and way out of the norm.

3. The authorities cited in Op. No. 27698 do not support the Court's conclusions on RRLs.

I have reviewed the authorities cited by the Court and find them applicable and appropriate to support the Court's findings. Most of the cases cited by the Court were contained in the Special Referee's Order or the Respondent's/Appellant's Brief. Most, if not all of Harleysville's contentions about the cases point out a distinction without a difference. Interestingly, Harleysville points to no case that found a RORL sufficient if it simply detailed every policy provision with no explanation of what the carrier was relying on. The RORL should inform the insured of the specific basis for the reservations that may deny coverage. *World Harvest Church, Inc. v. Guide One Mut. Ins. Co.*, 287 G.A. 149, 695 S.E.2d 6 (2010); *Sauer v. Home Indem. Co.*, 841 P. 2d 176 (1992) (RORL must provide a reasonable explanation of the basis in the insurance policy in relation to the facts and applicable law for denial of a claim)

4. Harleysville's Reservation of Rights letters were sufficient.

Harleysville's RORLs fall far short of being sufficient. First, Harleysville never notified the insureds of a conflict of interest, either in their RORLs or verbally. Lee Wright, when asked if he ever advised the insureds that you [Harleysville] had a conflict of interest with them [insureds]. His response was, "We never did in the underlying case." (R. p. 427, ll. 10 - 12) And it is undisputed that the RORLs set by Harleysville had nothing concerning

possible conflicts. This is particularly egregious in light of the fact that Harleysville subsequently raised, in this action, the intentional conduct exclusion which creates a significant conflict of interest and deprived the insureds of refuting this in the underlying trial. Stonebridge Dev. Co., Inc. v. Essex Ins. Co., 382 Ill. App. 3d 737, 888 N.E.2d 632 (2008) (If an insurer defends an insured without disclosing a conflict of interest in its reservation of rights letter, the insurer will be estopped from raising coverage defenses. RORLs are not sufficient if they do not disclose a conflict of interest.) Harleysville only told their insureds that it was denying coverage because "... the Supreme Court of South Carolina has said that this is not an occurrence..." (R. p. 427, ll. 19-25)

Harleysville never informed the insureds verbally or by RORL that there was a need for an allocated verdict. Their claim that they were unaware of the need for an allocated verdict because Newman was decided after the verdicts were reached in the underlying cases makes one question their veracity. Harleysville was keenly aware of the need for an allocated verdict. Harleysville discussed the need for an allocated verdict several times with defense counsel. (R. p. 1433, Depo. p. 83, ll. 1-3) Harleysville discussed it with defense counsel in both Riverwalk and Magnolia North. (R. p. 1433, Depo. 83-85) Harleysville made a conscious decision not to intervene in these cases. (R. p. 433, ll. 16-20) It is clear that Harleysville knew of the need for an allocated verdict, defense counsel hired by Harleysville knew of the need for an allocated verdict, but no one informed the insureds or the Court of this coverage issue. Magnum Foods, Inc. v. Continental Cas. Co., 36 F. 3d 1491, 1498 (10 Cir. Oak 1994) (explaining the need by the insurer to seek an allocated verdict is part of its duty of good faith) It is interesting that Harleysville asked permission from the insureds defense counsel to permit intervention and they refused, and rightly so. Defense counsel represents the insured and does not decide if intervention is appropriate. That is the Court's function.

No one with just elemental knowledge could read L-J, Inc. v. Bituminous Fire and Marine Co., 366 S.C. 117, 621 S.E.2d 33 (2005) citing High Country Assoc. v. New Hampshire Ins. Co., 139 N.H. 39, 648 A.2d 474 (1994) which has facts identical to the underlying cases (and wherein the Court held that damage from water intrusion was covered) and conclude there was no occurrence and no coverage for damages in the underlying cases. Harleysville was clearly aware of the need for an allocated verdict but they were happy with continuing to represent to their insureds that nothing was covered. A simple amendment to their RORLs would have alleviated the problem.

Intervention would not be the only method of securing an allocated verdict. Another method of seeking an allocated verdict would be to ask the Court to submit Special Interrogatories. This method was also discussed by Harleysville with defense counsel in another case. The reason it was discussed is that “the concern came up that if we didn’t there would be no way to break down the damages.” (Lee Wright Depo., R. p. 1418, Depo. pp. 21-24)⁴ This should have been done long before the trials so that planning could be done by the insureds and damages could be presented to the jury to allow for an allocation. Buckley v. Orem, 112 Idaho 117, 123, 730 P.2d 137 (1986) (Holding, it is the responsibility of the insurer to disclose the need for an allocated verdict. This has application in the secondary action because the third party pursues the insurance proceeds and stands in the shoes of the insured.)

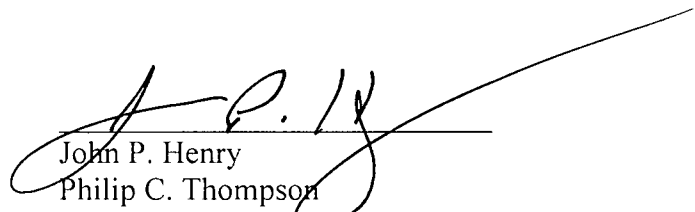
Harleysville’s statements on page 23 of their Brief is yet another example of Harleysville not understanding the problem with their RORLs. Harleysville states “Harleysville’s Reservation of Rights letters put the insured on clear notice that coverage

⁴ It is interesting that at the same time Mr. Wright was discussing the need to “break down the damages”, Harleysville was maintaining with their insureds there was no coverage. The RORLs were never amended to reflect this need for allocation.

may ultimately not exist. They also explicitly noted that Harleysville may rely on any term of the insurance contract to contest coverage.” Under this reasoning, an insurance carrier may send a RORL that simply states: “This letter is to put you on notice that coverage may ultimately not exist. We may rely on any term in your policy to deny coverage.” Then as Harleysville has done, the insurance company is free to raise anything contained in the policy in a subsequent D.J. action to deny coverage. Harleysville did worse, they told their insureds no exclusions applied and then raised numerous exclusions in this action. Harleysville’s RORLs, after setting out all the policy provisions listed 5 items under the title “RESERVATION OF RIGHTS”. These were set out in the dissent. Harleysville told the insureds only Item 1 (no “occurrence”) applied. As soon as the verdicts were rendered and Harleysville brought this D.J. action, Harleysville, as if by some mystical revelation decided fourteen exclusions applied. There should be and is a penalty for such action. Pueblo Santé Fe Townhomes Owner’s Assn. v. Transcontinental Ins. Co., 218 Ariz. 13, 19, 178 p. 3d 495, 491 (2008) (An insurer with a potential coverage defense loses its right to later litigate coverage if it defends its insured without a properly communicated Reservation of Rights.)

Harleysville’s Petition for Rehearing should be denied.

March 2, 2017



John P. Henry
Philip C. Thompson
Thompson & Henry, P.A.
1300 Second Avenue, 3rd Floor
Post Office Box 1740 (zip: 29528)
Conway, South Carolina 29526
(843)248-5741
Attorneys for Respondents/Appellants

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PROOF OF SERVICE

I, Stephanie Hall, an employee for Thompson & Henry, P.A., attorneys for the Respondent,
Magnolia North Property Owners' Association, Inc., in the above-captioned action and/or actions,
certify that I have this 2nd day of March, 2017, mailed a copy and/or copies of the following:

1. Return to Petition for Rehearing of Appellants/Respondents

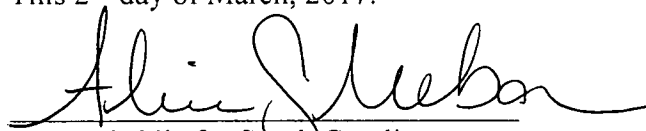
to the undersigned at his/her/their address(es) of record, with sufficient postage attached thereto,
as follows:

C. Mitchell Brown
Nelson Mullins Riley & Scarborough, LLP
1320 Main Street, 17th Floor
Columbia, SC 29201

Stephen L. Brown, Esquire
Jeffery J. Wiseman, Esquire
Young Clement Rivers, LLP
Post Office Box 993
Charleston, SC 29402


Stephanie Hall

SWORN AND SUBSCRIBED before me,
This 2nd day of March, 2017.



Notary Public for South Carolina

My Commission Expires: June 6, 2024