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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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

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

v.

Heritage Communities, Inc., a South Carolina corporation; Heritage Magnolia North, Inc., a South Carolina corporation; Buildstar Corporation, a South Carolina corporation; Magnolia North Horizontal Property Regime; Magnolia North Property Owners Association, Inc., a South Carolina corporation, and National Surety Corp., ... Defendants,

Of whom Heritage Communities, Inc., a South Carolina corporation; Heritage Magnolia North, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar Corporation, a South Carolina corporation; National Surety Corp., are ..... Respondents,

and Magnolia North Horizontal Property Regime and Magnolia North Property Owners Association, Inc., are ..... Respondents/Appellants.

Appellate Case No. 2013-001281

AND

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

v.

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

Defendants,

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

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

Appellate Case No. 2013-001291

Appellant/Respondent's Reply in Support of Petition for Rehearing

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Pursuant to Rules 221(a) and 240(f) of the South Carolina Appellate Court Rules, Appellant/Respondent Harleysville Group Insurance ("Harleysville") hereby files this Reply in Support of its Petition for Rehearing.

Harleysville respectfully requests a rehearing of Opinion No. 27698, (S.C. Sup. Ct. filed Jan.11, 2017) (Shearouse Adv. Sh. No. 2 at 21-54) ("Op. No. 27698") and/or the issuance of a new opinion based upon the issues outlined in Harleysville's Petition for Rehearing. On February 27, 2017, the deadline for filing a return to the petition, Respondents/Appellants filed a letter explaining that they would not file a return unless requested by the Court. Harleysville's counsel has been informed by the Deputy Clerk of Court that the Supreme Court requested that a formal Return be filed by Respondents/Appellants. On March 2, 2017, Respondents/Appellants filed a formal Return.

Rehearing should be granted for all of the reasons set forth in Harleysville's Petition for Rehearing and the points made in Respondents/Appellants' Return should be rejected. First, as to the reservation of rights letters ("RRLs"), Respondents/Appellants lack standing to contest the sufficiency of the reservation of rights letters since they were not parties to the insurance contract. Additionally, by determining that Harleysville's letters were insufficient, the opinion authorizes creation of coverage through waiver, and changes established South Carolina law in this regard. Second, where allocation is necessary between covered and non-covered damages, Opinion No. 27698 effectively will require insurers to intervene in underlying actions, which will likely result in extensive trial and appellate court litigation to the detriment of all parties involved in construction defect litigation. Finally, Opinion No. 27698 overlooked that the general verdicts in the underlying construction defect actions necessarily require application of time-on-the-risk to the punitive damages award. Each of these grounds justifies rehearing and/or the issuance of a new opinion.

Argument

A. The Cases Relied on by Respondents/Appellants do not Establish that they have Standing to Contest the Sufficiency of the Letters.

Respondents/Appellants incorrectly state that Harleysville contended that they lack standing to contest the sufficiency of the RLLs because they are "third-party plaintiffs." Rather, Harleysville argued that Respondents/Appellants lacked standing **in their capacity as judgment creditors** to raise issues related to Harleysville's duty to defend its insured. Because of their lack of standing, the Special Referee should not have permitted them to argue that the RRLs were insufficient.

Two critical matters are important to highlight. First, Respondents/Appellants are merely judgment creditors, they are not assignees of the insureds. Therefore, this situation differs from the typical scenario where third-party sues an insurer pursuant to an assignment. Those actions generally arise where an insured settles a liability action and assigns his or her rights to bring a bad faith claim against the insurance company to the injured party. South Carolina courts "have repeatedly denied actions for bad faith refusal to pay claims to third parties who are not named insureds" because such third parties do not have standing to sue. *Kleckley v. Nw. Nat'l Cas. Co.*, 338 S.C. 131, 135, 526 S.E.2d 218, 219 (2000).

Respondents/Appellants' rights are solely those obtained as a result of their status as judgment creditors of the insureds. Harleysville's policies permit a person or organization to sue Harleysville "to recover on an agreed settlement or on a final judgment against an insured obtained after an actual trial," but explicitly note that Harleysville will not be liable for damages not payable under the policy terms or that are in excess of the applicable policy limits. (CR 1893, 1910, 1923.) Therefore, the policies only grant a judgment creditor the limited right to

bring a collection action to recover the amount of a judgment or agreed settlement. They do not grant judgment creditors the right to sue for a breach of other contractual duties owed by Harleysville **to the insured** under the policy. Thus, as the case law cited in Harleysville's petition details, Respondents/Appellants lacked standing to contest the sufficiency of the RRLs in their capacity as judgment creditors. Pet. for Reh'g at 5-9.

The cases relied on by Respondents/Appellants in their Return do not change this conclusion. First, contrary to Respondents/Appellants' claim, *Kleckley* **does not** stand for the proposition that "an injured party cannot bring an action against the wrongdoer's insured, but must first obtain a judgment and then proceed against the insurer." Rather, *Kleckley* merely confirmed that South Carolina law does not recognize a third-party claim for bad faith. *See Kleckley v. Nw. Nat. Cas. Co.*, 330 S.C. 277, 498 S.E.2d 669 (Ct. App. 1998), *aff'd*, 338 S.C. 131, 526 S.E.2d 218 (2000).

The other two cases relied on by Respondents/Appellants are also distinguishable. *Crook v. State Farm Mut. Auto. Ins. Co.*, 231 S.C. 257, 98 S.E.2d 427 (1957) presented the situation precisely anticipated by Harleysville's policies—a judgment creditor suing to recover on a judgment obtained against the insured. As the *Crook* court explained, in such a circumstance the creditor "is, therefore, subject to any proper defense by the Insurance Company under the terms of its contract." *Id.* at 265, 98 S.E.2d at 431. Harleysville's policies explicitly reflect this principle, providing that the judgment creditor may bring suit, but that Harleysville will not be liable for damages that are not payable under the terms of the policy (*i.e.*, that are subject to any valid policy defenses) or that are in excess to the policy limits. *Crook* does not stand for the proposition that the insured "occupies the same status as the insured" **for purposes of**

challenging the sufficiency of an RRL or the insurer's compliance with its duty to defend as Respondents/Appellants suggest.

The other case relied on by Respondents/Appellants, *Lee v. Gulf Ins. Co.*, 248 S.C. 296, 149 S.E.2d 639 (1966), mischaracterized the proposition from *Crook* quoted above. *Lee* purported to cite to *Cook* to support the statement that a creditor who obtains a judgment against an insured "is possessed of all rights of the insured and subject to all defenses that exist." *Id.* at 298, 149 S.E.2d at 640-41. *Crook*, however, simply does not support such a broad proclamation. Rather, that decision only contains the language quoted above about the creditor being subject to any defenses that the insurer may raise. It is clear that status as a judgment creditor does not provide **all** rights held by the insured. The clearest example is the insured's right to bring a bad faith claim. This right does not vest to a judgment creditor simply by virtue of obtaining the judgment. Rather, it must be assigned.

Lee involved a judgment creditor seeking to collect the judgment directly from an insurer. The judgment creditor sought to admit into evidence hearsay statements of the insured under the theory that because the creditor "stepped into the shoes" of the insured, they were not hearsay. *Lee*, 248 S.C. at 297-98, 149 S.E.2d at 640. The court rejected this argument, holding that the judgment creditor merely had the same substantive rights and was subject to the same defenses as the insured for the purpose of collecting on a judgment. *Id.*, at 298, 149 S.E.2d 640-41. Tellingly, no subsequent cases have cited to this language in *Lee*.

The cases cited by Respondents/Appellants merely reaffirm that the judgment creditor has the same rights, and is subject to the same defenses, that would exist between the insured and the insurance carrier **in a collection action to obtain payment of the judgment**. Just as a judgment creditor does not obtain the ability to assert a bad faith claim absent an assignment, a

judgment creditor also does not acquire the rights to challenge the sufficiency of a reservation of rights. An insurer's reservation relates to the insurer's compliance with its duty to defend, which is separate and apart from the insurer's obligation to pay a covered judgment. *See, e.g.*, *Long v. Century Indem. Co.*, 78 Cal. Rptr. 3d 483, 491 (Ct. App. 2008) ("An insurer may satisfy its duty to defend its insured in a third-party action without waiving its right to assert it is not obligated to indemnify the insured against any judgment on the ground the claim is not covered under the policy by properly notifying the insured it is providing the defense under a reservation of rights."); *Nautilus Ins. Co. v. Lexington Ins. Co.*, 321 P.3d 634, 644 (Haw. 2014) ("[D]efending under a non-waiver agreement or reservation of rights, permits an insured to 'satisfy its duty to defend the policyholder while simultaneously preserving its ability to rely later on any available policy defenses that might have vitiated the duty.'" (quoting 22 Appleman, I*nsurance Law and Practice* § 136.7, at 50 (2003)). Therefore, Harleysville properly relied on the various cases cited in its Petition supporting that a stranger to the insurance contract has no standing to contest the adequacy of an RRL.

Additionally, another critical issue that should not be overlooked is that the **insureds** never raised any issues with the RRLs. To the contrary, Roger Van Wie—shareholder and officer of Heritage Communities, Inc., Buildstar Corporation, and the various entities formed for the condominium construction projects—affirmed that Harleysville "provided a defense under a full reservation of rights." (CR 1993.) As Van Wie noted, Harleysville informed him that it "believe[d] the policy terms and supporting case law indicate[d] that it d[id] not owe a duty of defense and indemnity for the claims and damages alleged" in the liability matters. (*Id.*) Therefore, the RRLs specifically informed the insured of Harleysville's position regarding coverage. Van Wie did not identify any issues with the RRLs, and noted that he believed

Harlesyville provided a defense and acted in good faith. (*See id.* at 1993-94.) Finally, he explained that he opposed any assignment of rights to the Respondents/Appellants to permit them to bring bad faith lawsuits against Harleysville. (*See id.* at 1994.) It would be inequitable for the Court to permit a stranger to the insurance contract to contend that Harleysville failed to sufficiently reserve its rights or comply with its duty to defend where the insured filed an affidavit stating that Harleysville met its obligations.

Therefore, because Respondents/Appellants lack standing to contest the sufficiency of the RRLs, the Court should grant rehearing.

B. Harleysville's Reservation of Rights Letters were Sufficient.

Assuming Respondents/Appellants do have standing, their arguments still fail to establish that Harleysville's RRLs were inadequate. Throughout their Return, Respondents/Appellants continue to mischaracterize and misconstrue the content of Harleysville's reservation of rights letters. Specifically, they incorrectly assert that that the RRLs "include[ed] virtually every policy provision contained in the policy" and "detailed the entire policy without ever explaining to the insureds which policy provision(s) they may rely on to deny coverage." Ret. to Pet. for Reh'g at 4, 7. This assertion was incorrectly adopted in Opinion No. 27698's characterization of the RRLs as being "generic denials of coverage coupled with furnishing the insured with a verbatim recitation of all or most of the policy provisions." Op. No. 27698 at 31. Respondents/Appellants and Opinion No. 27698 are simply wrong about the actual content of the RRLs.

The RRLs provide all of the necessary information to fairly inform the insured of the Harleysville's position with regard to its reservation of rights. At the outset of the RRLs, the insured is informed that Harleysville will provide a defense "under a full reservation of rights as explained below." (CR 1776, 1790, 1804, 1820, 1832.) The RRLs then summarize the

allegations of the complaint and identify the potentially applicable policies, coverage amounts, and policy periods. (CR 1777, 1790-91, 1805, 1821, 1832-33.) The RRLs then identify the "pertinent portions" of the CGL policies. The first "pertinent portion" identified is the "insuring agreement," which explains that the insurance applies to property damage that is caused by an occurrence and that occurs during the policy period. (CR 1777-78, 1791-92, 1806, 1821-22, 1833-34.) The next "pertinent portion" identified are seven specifically identified exclusions. (CR 1778-80, 1792-93, 1806-08, 1822-23, 1834-36.) The RRLs then provide nine definitions for key terms used in the insuring agreement and the cited exclusions. (CR 1780-82, 1794-96, 1808-10, 1823-26, 1836-38.) This process is then repeated for the excess coverage policy. (CR 1782-87, 1796-1801, 1811-15, 1826-30, 1838-42.) Finally, the RRLs conclude with sections titled "RESERVATION OF RIGHTS" and "UNINSURED EXPOSURE/EXCESS POTENTIAL." The first explains that Harleysville is reserving its rights as to the following issues: whether the property damage was caused by an occurrence, whether the property damage occurred within a policy period, and whether exclusions apply to preclude coverage. (CR 1787-88, 1801-02, 1815-16, 1830-31.) Additionally, this section specifically advises the insured that Harleysville was reserving the right to disclaim coverage for punitive damages. The last section advises the insured that it may want to employ personal counsel because of the possibility of "uninsured exposure" in general, **as well as** "uninsured exposure" if damages exceed the policy limits. (CR 1788, 1802, 1816, 1831.)

Contrary to Opinion No. 27698's statement that the RRL was a "generic denial" and a "verbatim recitation" of the policy, and contrary to Respondents/Appellants' assertion that this was the equivalent of sending the insured the entire policy and reserving everything, the RRLs establish that Harleysville specifically identified the "occurrence" issue and the possibility that

damages occurred outside its policy periods. Additionally, Harleysville pinpointed **seven** specific policy exclusions that might exclude coverage and provided the specific definitions necessary to fully comprehend the language of the exclusions. The policies actually have approximately **twenty-five exclusions** that potentially apply to property damage. Thus, rather than list all of the exclusions contained in the policy, Harleysville identified only the specific exclusions it believed were potentially applicable based on the information available to it at that time.

Opinion No. 27698 and Respondents/Appellants incorrectly conclude that the use of the actual policy language for the insuring agreement and the identified exclusions was inadequate to explain Harleysville's position. However, these provisions are self-explanatory and there is no better method of identifying what is potentially excluded than the actual language of the policy. If insurers are forced to paraphrase the policy's language, such a requirement would ultimately lead to confusion rather than clarity. Opinion No. 27698 points to the RRLs' inclusion of detail with regard to non-coverage for punitive damages, suggesting that the additional detail on this issue was required for all other identified exclusions. Op. No. 27698 at 34. This, however, overlooks the fact that there was no policy provision explicitly excluding punitive damages by name. Thus, Harleysville provided an additional explanation of its position on that point. This is not the case for the other exclusions, all of which have express provisions laid out in the policy.

The "Uninsured Exposure/Excess Potential" sections of the RRLs also provided the insured with an adequate explanation of the possibility of non-covered claims or damages. This section first advises of the possibility of "uninsured exposure" in general. Then it **separately** advises of the possibility of "uninsured exposure" based solely on damages possibly exceeding the coverage limits. Read together, the first part naturally addresses non-covered claims and

damages, as that is the only possible source of "uninsured exposure" other than from an excess judgment.

The RRLs issued by Harleysville in this matter fairly and reasonably informed the insured of Harleysville's position with regard to its reservation of rights. Opinion No. 27698 misapprehends the RRLs and their content. For these reasons, the Court should grant rehearing.

C. Opinion No. 27698 Improperly Creates Coverage Via Waiver.

1. Respondents/Appellants mischaracterize Harleysville's waiver argument.

Respondents/Appellants incorrectly describe Harleysville's waiver argument. In the Petition, Harleysville contended that the Special Referee committed a critical error by refusing to permit allocation between covered and non-covered damages. Opinion No. 27698 affirmed the Special Referee's finding that the RRLs sent by Harleysville to its insureds were "not sufficiently specific to put Heritage on notice of Harleysville's specific defenses, particularly as to the need for an allocated verdict." Op. No. 27698 at 35. By the Special Referee's own admission, however, the underlying jury verdicts related to **both** covered and non-covered damages. Op. No. 27698 at 26. Finding that Harleysville must pay the entire amount, consisting of both covered and non-covered damages due to the supposed inadequacies of the RRLs, necessarily creates coverage via waiver. Thus, regardless of the sufficiency of the RRLs, this finding was inconsistent with South Carolina law.

In any event, Op. No. 27698 ignores two crucial points. First, as detailed above, Harleysville's RRLs **did** put its insureds on notice of the specific policy defenses on which Harleysville intended to rely, including the fact that the verdict may contain uncovered damages. Again, the RRLs conclude with sections titled "RESERVATION OF RIGHTS" and "UNINSURED EXPOSURE/EXCESS POTENTIAL." The first explains that Harleysville is

reserving its rights as to the issues of whether the property damage was caused by an occurrence, whether the property damage occurred within a policy period, and whether exclusions apply to preclude coverage. (CR 1787-88, 1801-02, 1815-16, 1830-31.) Additionally, this section specifically advised the insured that Harleysville was reserving the right to disclaim coverage for punitive damages. The last section advises the insured that it may want to employ personal counsel because of the possibility of "uninsured exposure" in general, as well as "uninsured exposure" if damages exceed the policy limits. (CR 1788, 1802, 1816, 1831.)

Second, and more importantly, Harleysville **had an agreement with its insureds** to resolve coverage issues in a subsequent action. (CR 453-455, 1434.) Op. No. 27698 does not mention this agreement.

The Harleysville policies place an initial duty to inform as to the nature of damages on the insureds. The policies require that the insureds notify Harleysville as soon as practicable of an "occurrence" which may result in a claim under the policy, including "[t]he **nature** and location of any injury or damages arising" from the occurrence. (CR 1585, 1613 (emphasis added).) Thus, the insureds are supposed to provide notice of the type of damage to Harleysville in the first instance under the insurance contract. Regardless, because the RRLs were sufficient, Op. No. 27698 is wrong in its finding that Harleysville could not contest coverage.

Additionally, Respondents/Appellants mischaracterize Harleysville's arguments before the Special Referee, contending that Harleysville "conceded" that both covered and uncovered claims were submitted to the jury. This is again wrong. Because the underlying verdicts were general verdicts, they argue that the entire amount is covered and thus Harleysville could not contest coverage at all. Harleysville's **primary** position was that **none** of the damages were covered. Harleysville consistently asserted in the proceedings before the Special Referee that

there was no occurrence under the policy, and thus no damages were covered. The supposed "admission" referenced by Respondents/Appellants was Harleysville's alternative position—that in the event the Special Referee disagreed and found covered damages were included in the verdict, uncovered claims were also necessarily present and thus allocation was necessary.

Finally, Respondents/Appellants' position demonstrates a problem resulting from the holdings in Opinion No. 27698. Respondents/Appellants do not dispute that the general verdicts related to both covered and non-covered damages. Therefore, they implicitly acknowledge the advantage they received by obtaining a general verdict in the underlying liability matters and obtaining coverage for damages even they admit are not supposed to be covered by the insurance contract. If not changed on rehearing, this result will encourage continued use of general verdicts by plaintiffs and insureds in liability actions due to the potential for obtaining coverage of otherwise non-covered damages. As detailed below, it is unclear how an insurer may even go about protecting its rights to obtain an allocated verdict. However, the result of Opinion No. 27698 supports that the underlying plaintiffs and insureds will almost certainly object to any attempts by the insurer to obtain a determination regarding allocation of damages.

As Harleysville detailed in the petition, Opinion No. 27698 improperly creates coverage via waiver, which is improper under prior South Carolina precedent. The Court overlooked this result, and therefore rehearing is warranted.

2. Respondents/Appellants incorrectly assert that Harleysville's RRLs were inadequate.

Respondents/Appellants have asserted throughout these proceedings, and continue to assert, that Harleysville's RRLs essentially cut and pasted **all** of the policy provisions and then provided a "generic" denial of coverage. *See* Op. No. 27698 at 31. As Harleysville detailed

above, however, the RRLs highlighted only seven of the approximately twenty-five policy exclusions as possible grounds on which Harleysville may rely. Harleysville did not "take advantage" of its insureds by pursuing a "throw everything on a wall and see what sticks" strategy. The RRLs fairly informed the insureds regarding Harleysville's position, and noted the specific policy defenses on which Harleysville contemplated that it may rely. Respondents/Appellants' repeated assertions that the RRLs kept the insureds in the dark and failed to specify which exclusions Harleysville intended to rely on are simply not supported by the facts.

Respondents/Appellants cite to *Meirthew v. Last*, 135 N.W.2d 353, 355 (Mich. 1965), in support of their arguments. The RRL at issue in *Meirthew* was manifestly different than the Harleysville RRLs. In *Meirthew*, the reservation of rights letter only contained the following: (1) a general description of the policy, (2) notice that the insured had been sued for damages arising out of an accident, (3) a very general statement saying that the insurer was undertaking the defense subject to "subject to the conditions, limitations, exclusions and agreements" of the policy, and (4) notice that the insured may desire to employ its own counsel. *Id.* at 355. The court found that this RRL was legally insufficient due to vagueness, as it failed to identify any of the defenses that the insurer had in mind. *See id.* Additionally, the court noted that the letter came too late to avoid prejudice, as it was not issued until several years after the accident. *See id.* Therefore, *Meirthew* fails to support Respondents/Appellants argument that the Harleysville RRLs were deficient.

3. Law from other jurisdictions supports that Harleysville's RRLs were sufficient.

Respondents/Appellants cite to one Illinois case to support their argument that an RRL must make reference to any policy defense(s) which may ultimately be asserted to disclaim

coverage, and must point to any conflict of interest that may exist. *See Cowan v. Ins. Co. of N. Am.*, 318 N.E.2d 315 (Ill. 1974). Respondents/Appellants then challenge Harleysville to cite a case where a court found an RRL sufficient that contained "every" policy provision.

Even if Harleysville's RRLs cut and pasted all of the policy exclusions, which they did not, many states would uphold such a reservation of rights. Courts from a number of states have found that even a general or broad reservation of rights, such as the one addressed in *Meirthew*, is sufficient. *See, e.g.*, *Scottsdale Ins. Co. v. Al. Mun. Ins. Corp.*, No. 2:11-cv-668-MEF, 2013 WL 5231928, at *6 (M.D. Ala. 2013) (finding that general statement in letter that insurer reserves all rights under the policy was sufficient under Alabama law); *Marentes v. State Farm Mut. Auto. Ins. Co.*, No. 15-CV-05616-LHK, 2016 WL 7013449, at *15 (N.D. Cal. 2016) ("[Insurer's] statement that the defense would be subject to a 'full reservation of rights' is sufficient under *Jioras* and *Poppy Ridge* to reserve [insurer's] rights under the policy."); *Humane Soc. of the U.S. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, Pa., No. CIV.A. DKC 13-1822, 2015 WL 4616818, at *6 (D. Md. July 30, 2015) (finding that a general reservation of rights stating that the insurer "expressly reserves all of its rights under the policy, including the right to assert additional defenses" was sufficient); *Southworth v. Arbella Mut. Ins. Co.*, No. 02-158A, 2004 WL 1836277, at *1 (Mass. Super. Aug. 10, 2004) (concluding that broad reservation of rights stating that insurer does not waive any policy defenses was acceptable for insurer to protect its rights to disclaim coverage); *Allstate Indem. Co. v. Oetter*, No. 4:14-CV-00090-BR, 2015 WL 12600170, at *5 (E.D.N.C. June 9, 2015), *aff'd sub nom. Allstate Indem. Co. v. Bryant*, 637 F. App'x 106 (4th Cir. 2016) (finding general reservation noting that the insurer "reserves all rights and defenses" and did not waive any rights or obligations was a sufficient reservation of rights); *Daniel F. Young, Inc. v. Seneca Ins. Co.*, No. CIV.A. 13-02431, 2014 WL 5480810, at *7 (E.D.

Pa. Oct. 30, 2014) (finding catch-all reservation of rights sufficient under Pennsylvania law); *Nutmeg Ins. Co. v. Clear Lake City Water Auth.*, 229 F. Supp. 2d 668, 696 (S.D. Tex. 2002) (noting that there are no specific requirements for RRLs under Texas law, and finding that a general statement that insurer reserves right to disclaim coverage was sufficient); *Norman v. Ins. Co. of N. Am.*, 239 S.E.2d 902, 904, 906–07 (Va. 1978) (holding that a general reservation of rights stating that the insurer is handling the claim "under a full reservation of rights because the allegations claimed in this suit do not appear to fall within the coverage of your policy," was sufficient under Virginia law). Therefore, many courts have upheld RRLs that are much less specific than the Harleysville RRLs.

Likewise, other courts have upheld RRLs that were similar in nature to Harleysville's. These courts note that the letters should identify the exclusions or defenses that the insurer may rely on, but do not impose additional "explanation" requirements such as those imposed by Opinion No. 27698. *See, e.g.*, *Gallegos v. Safeco Ins. Co. of Am.*, 646 F. App'x 689 (10th Cir. 2016) (noting that under Colorado an insurer should disclose all defenses or exclusions on which the insurer may rely in an RRL); *Wellons, Inc. v. Lexington Ins. Co.*, 566 F. App'x 813, 821–22 (11th Cir. 2014) (noting that Georgia law recognizes that an insurer "should" inform the insured of the specific basis of the reservation of coverage, but that and RRL need not specify each and every potential basis for denying coverage so long as the insured is fairly informed that the insurer is not waiving coverage defenses); *Sosebee v. Steadfast Ins. Co.*, 701 F.3d 1012 (5th Cir. 2012) (finding that under Louisiana law recognizes a "functional approach to the reservation of rights"); *Barnard Pipeline, Inc. v. Travelers Prop. Cas. Co. of Am.*, 3 F. Supp. 3d 865, 875 (D. Mont. 2014) (noting that although the Montana code requires that insurers "promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable

law for denial of a claim," an insurer does not waive all policy defenses that are not included in an RRL); *Cust-O-Fab Serv. Co., LLC v. Admiral Ins. Co.*, 158 F. App'x 123, 129 (10th Cir. 2005) (under Oklahoma law, insurer must "disclose the rationale for coverage denial within a reasonable time"); *Doctors' Co. v. The Ins. Corp. of Am.*, 864 P.2d 1018, 1030 (Wyo. 1993) (holding that an RRL must "make specific reference to the policy defense which the insurer may assert").

The law of these states encourages insurers to identify all of the possible policy defenses or exclusions that it may rely on to disclaim coverage. Otherwise, insurers may lose the right to assert those defenses or exclusions. The cautious insurer, therefore, will make every effort to ensure all remotely relevant defenses or exclusions are identified. Hence, the result could be a cut-and-paste version of many of the policy provisions. This would be perfectly acceptable and, in fact, encouraged by these jurisdictions. In any event, the fact is that Harleysville's RRLs were **not** cut-and-paste versions of the policies, but rather were narrowly tailored to the specific defenses on which Harleysville anticipated it may rely.

Harleysville has researched the reservation of rights law of all 50 states, the District of Columbia, Puerto Rico, Guam/Northern Mariana Islands, and the Virgin Islands. It appears from review that the Harleysville RRLs would be sufficient under a clear majority of jurisdictions reviewing RRLs, and in fact, in many of these jurisdictions, the Harleysville RRLs would go well beyond what is required. A full briefing and presentation by the parties on this important point is justified, and rehearing is warranted[1].

[1] It appears only a few jurisdictions located have explicitly adopted the requirement that the insurer both identify the policy defense(s) and explain its applicability to the facts of the case. *See, e.g., Sauer v. Home Indem. Co.*, 841 P.2d 176 (Alaska 1992) (noting that a reservation of rights must provide a "reasonable explanation of the basis in the insurance policy in relation to

4. Respondents/Appellants ignore the issues raised by Harleysville regarding the authorities cited in Opinion No. 27698.

Respondents/Appellants simply contend that they have reviewed the authorities cited by the Court and find them applicable and appropriate. They also repeat the same meritless argument that the Harleysville RRLs "detailed every policy provision with no explanation." For the reasons stated above, this argument fails.

5. The RRLs did not need to specify that a conflict of interest was present or that the insured should obtain an allocated verdict.

Respondents/Appellants' final argument regarding the sufficiency of the RRLs first contends that they were inadequate because they did not explicitly inform the insured that a conflict of interest was present. Prior to Opinion No. 27698, however, no South Carolina courts had ever imposed such a requirement. Therefore, it is unreasonable to fault Harleysville for failing to do something that was not required. In any event, the RRLs clearly informed the insured that the Harleysville would provide a defense, but that Harleysville believed defenses existed to coverage, and that the insured may need to retain personal counsel because of potential uninsured exposure. The specific words "conflict of interest" may not have been present, but this undoubtedly informed the sophisticated insureds that the insurer's interests are in conflict regarding the existence of coverage.

Additionally, Respondents/Appellants contend that the RRLs were insufficient because Harleysville never informed the insureds of the need to obtain an allocated verdict. As set forth above, however, it was not necessary to specifically inform the insureds of the need to obtain an

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the facts or applicable law"); *Royal Ins. Co. v. Process Design Assoc., Inc.*, 582 N.E.2d 1234 (Ct. App. Ill. 1991) (holding that a reservation of rights must reference the specific policy provision(s) the carrier intends to rely on, and inform the insured why the provisions may apply).

allocated verdict, as Harleysville and the insureds discussed allocation and agreed that coverage matters would be resolved in a subsequent coverage action.

In addition to the issues regarding the RRLs, Harleysville's other grounds for rehearing also raise critical concerns with Opinion No. 27698. As the Petition explained, the Special Referee concluded that Harleysville should have tried to intervene to seek an allocated verdict in the underlying actions, or sought to submit special interrogatories. (CT 0037, 0056, 0058, 0086, 0105, and 0107.) The Special Referee refused to allocate between uncovered and covered damages in the declaratory judgment matters as a result, finding that it would "prejudice" the rights of Respondents/Appellants. Opinion No. 27698 affirmed these rulings.

As Harleysville detailed in the Petition, however, the majority did not address the inherent problems created by these conclusions, particularly regarding the lack of procedural mechanisms for Harleysville to intervene or submit special interrogatories without creating an impermissible conflict of interest. Opinion No. 27698 has created confusion as to how an insurer may protect its rights to obtain an allocation, or even whether it has the ability to do so at all. It is unclear whether the Court is imposing an obligation on insurers to attempt to intervene in every matter. If the trial court refuses intervention, does an insurer then nevertheless have to request special interrogatories, and if so, how? Must the insurer then appeal one or both of these denials? Is allocation between covered and uncovered damages in a declaratory judgment action only permitted when an insurer has attempted all of these procedures? Opinion No. 27698 does not provide an answer to any of these questions.

In *Sims v. Nationwide Mut. Ins. Co.*, 247 S.C. 82, 145 S.E.2d 523 (1965), this Court acknowledged that if an insurer were to defend the underlying tort action and assert defenses to coverage in that action, "a clear conflict of interests between insurer and insured" would be

presented. *Id.* at 85, 145 S.E.2d at 524. The insurer cannot "have undertaken to assert its defense and at the same time defend the insured against a charge of simple negligence." *Id.* Intervention would also reveal the presence of liability insurance in contravention of Rule 411, SCRE, which guards against the long recognized danger of disclosing this information to the jury. *See Crocker v. Weathers*, 240 S.C. 412, 424, 126 S.E.2d 335, 340-41 (1962); *Dobson v. Am. Indemn. Co.*, 227 S.C. 307, 309, 87 S.E.2d 869, 870 (1955). Therefore, trial courts are likely to refuse to allow insurers to intervene to contest coverage issues in liability matters, as impermissible conflicts of interest may arise. Additionally, this Court has also recognized that it is improper to submit special verdict questions to the jury on issues not properly before it. *See Branham v. Ford Motor Co.*, 390 S.C. 203, 207, 701 S.E.2d 5, 23 (2010). Thus, trial courts are also likely to refuse to allow insurers to submit special interrogatories relating to coverage issues having no bearing on liability.

As detailed above, Opinion No. 27698 generates more questions than answers regarding the steps an insurer should take to protect its rights. Even if an insurer attempts to intervene in the underlying liability action in order to preserve allocation of damages issues, there is a high likelihood that the trial court will refuse to allow intervention in light of the conflict of interest between the insurer and insured that could result.[2]

Opinion No. 27698 does not set forth what happens in a scenario where an **insured** objects to the insurer's attempts to intervene or submit special interrogatories. In such an instance, it seems the insurer would have a viable argument that such an objection would violate

[2] As Harleysville detailed in the Petition, this is precisely what has already occurred on several occasions after the issuance of Opinion No. 27698. On multiple occasions, insurers have sought to intervene in a liability action to protect their interests, but the trial courts refused to allow intervention.

the insured's duty to cooperate under the terms of the policy. South Carolina law is clear that a "liability insurer may successfully defend upon the ground that the insured has violated the cooperation clause of the policy only when the breach has been material and has resulted in substantial prejudice to the insurer," provided the insurer has been "reasonable in its demands and diligent in its efforts to secure the co-operation of the insured." *Evans v. Am. Home Assur. Co.*, 252 S.C. 417, 420, 166 S.E.2d 811, 813 (1969). If insurers are only able to obtain allocation of damages via intervention or special interrogatories, they will have a persuasive argument that insureds who object violate the duty to cooperate, or have otherwise frustrated any ability to have an allocation. Insurers will suffer substantial prejudice and the breach would be material if the insured objects to intervention, as it would potentially obligate insurers for damages far beyond those owed under the terms of the policy. In such a situation, perhaps the majority in Opinion No. 27698, should they not wish to change their opinion, would say there is no coverage at all. It would be helpful to the bench and bar for the majority to explain this. Further, it seems inefficient and fraught with uncertainty to burden the insurer with a duty to seek intervention and an allocated verdict, when such requests can be denied by the trial judge in the underlying construction defect litigation, prompting immediate appeals, stays, etc. Yet another problem would arise if the underlying trial judge permits intervention but declines to permit some of the insurer's proposed special interrogatories. This will lead to still more litigation.

Other jurisdictions have recognized procedures enabling an insurer to protect its interests, such as permitting allocation of damages awarded by a general verdict in an underlying liability action in a post-trial coverage action. *See, e.g., Duke v. Hoch*, 468 F.2d 973, 984 (5th Cir. 1972) (holding that coverage, if any, should be limited to the trial court's allocation of damages from the underlying action into categories of those covered and non-covered but permitting new

evidence if necessary in subsequent proceeding); *Allstate Ins. Co. v. Kellner*, 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").

Further, courts have acknowledged the impracticability of intervention of an insurance carrier in a liability matter against its insured and have held that coverage issues are best reserved for subsequent litigation. *See, e.g.*, *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 WL 34093937 (Conn. Super. Ct. Dec. 13, 2001).

Hence, the Court should grant rehearing and detail the proper mechanism by which an insurer may protect its right to have damages allocated between covered and non-covered amounts. If the Court rules that apportionment may be decided in a subsequent coverage action as Harleysville has requested, Harleysville predicts the parties may often be able to reach an agreement on the percentage allocation, as the parties did in the *Crossmann* litigation. If not, then the parties would look to the existing record, see if, in a subsequent proceeding, an allocation ruling can be obtained, and if not, the parties would produce additional evidence

through experts to permit the judge in the subsequent proceeding to rule on allocation. This is not an onerous procedure to adopt, and has in fact been adopted by other courts. Hence, Harleysville also requests rehearing and/or the issuance of a new opinion detailing the proper procedure for obtaining allocation of covered and non-covered damages.

For the foregoing reasons and for the reasons detailed in Harleysville's Petition, the RRLs issued in this matter were sufficient and the measures taken by Harleysville to obtain a subsequent allocation of damages with the full agreement of its insured were proper, and actually better serve judicial efficiencies. Therefore, the Court should grant rehearing.

Conclusion

For the reasons set forth herein, in the Petition for Rehearing, and in Harleysville's appellate briefs, the Court should grant rehearing. Alternatively, this Court should reverse the trial court and find that exclusions on the policies at issue preclude any coverage. Failing that, this Court should issue a new opinion that applies time-on-the-risk to both actual and punitive damages, and reverse and remand to the trial court to hold proceedings and consider arguments and evidence to enable it to decide how much of the general verdicts at issue are covered property damages under the policies and how much are not, within the time on risk.

Signature Page Attached

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March 9, 2017

Columbia, South Carolina

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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

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

v.

Heritage Communities, Inc., a South Carolina corporation; Heritage Magnolia North, Inc., a South Carolina corporation; Buildstar Corporation, a South Carolina corporation; Magnolia North Horizontal Property Regime; Magnolia North Property Owners Association, Inc., a South Carolina corporation, and National Surety Corp., ... Defendants,

Of whom Heritage Communities, Inc., a South Carolina corporation; Heritage Magnolia North, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar Corporation, a South Carolina corporation; National Surety Corp., are ..... Respondents,

and Magnolia North Horizontal Property Regime and Magnolia North Property Owners Association, Inc., are ..... Respondents/Appellants.

Appellate Case No. 2013-001281

And

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

v.

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

Of whom Heritage Communities, Inc., a South Carolina corporation; Heritage Riverwalk, a South Carolina corporation; Buildstar

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

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

Appellate Case No. 2013-001291

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):

Pleadings:

Appellant/Respondent's Reply in Support of Petition for Rehearing

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March 9, 2017