THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM YORK COUNTY
Court of Common Pleas

The Honorable S. Jackson Kimball
Special Circuit Court Judge

2011-CP-46-01090
2012-211939

Brian Pulliam, Deborah C. Pulliam, Monica Bradshaw, Helen K. Cook, Kala Craig, Victor E. Dirienzo, Cynthia Ditursi, J. Scott Drexel, Kathleen Kramer, Robert Loebe, Melanie McDaniel, David Osborne, Celeste Arrowwood, Vincent Dionna, Mikel Marcuse, James P. Wheaton, Jr., Joseph Manfredini, Elena Manfredini, David Cox, Jonathan B. Dillard, Eric Wilson, Don and Debbie Neff, and Marianna Junda, ...Respondents,

v.

Travelers Indemnity Company, M.U.I. Carolina Corporation, Kensington Place Owners Association, Inc., Regent Carolina Corporation and Regent Corporation,. . . . . Defendants,

Of whom Travelers Indemnity Company is the . . . . . Appellant.

FINAL BRIEF OF APPELLANT

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STATEMENT OF THE CASE

This declaratory judgment action was commenced by Respondents, unit owners of Kensington Place Horizontal Property Regime (hereinafter "Kensington Place"), against Appellant Travelers Indemnity Company (hereinafter "Travelers") and Defendants M.U.I. Carolina Corporation, Regent Carolina Corporation, Regent Corporation (collectively "Developers") and Kensington Place Owners' Association, Inc. (hereinafter "KPOA"), by the filing of a summons and complaint on March 21, 2011 and timely service thereof on Travelers. Travelers timely served and filed its answer. The Developers did not appear.

Respondents alleged that, as owners of Kensington Place, they brought an action against KPOA seeking damages for losses sustained as a result of KPOA's alleged negligence and breach of fiduciary duty in failing to maintain the common elements of the property in reasonably good repair; transferring ownership of the common elements

to them in substandard condition with no replacement reserve fund account; placing the interests of the developer ahead of the owners (thereby placing the financial burden of deferred maintenance upon the owners); failing to perform adequate inspections and retain experts to assess the condition of the building; failing to establish an adequate depreciation schedule; and failing to advise the owners of the conflicts of interest inherent in a developer-controlled property owners' association. (R. pp. 14-15, ¶¶ 7 – 8). They further alleged that these acts constitute "wrongful acts" covered under KPOA's Directors and Officers coverage with Travelers, and seek a judicial declaration to that effect. *Id.*, pp. 16-17, ¶¶ 9 – 11.

In its answer and counterclaim, Travelers denied that the allegations in Respondents' Fifth Amended Complaint in the underlying action are covered under the Travelers' policy and asserted a counterclaim alleging, *inter alia*, that it is defending KPOA in the underlying action under a reservation of rights; that the policy excludes coverage for "property damage" and "punitive damages"; and that the gravamen of the Fifth Amended Complaint is that, as a result of KPOA's alleged negligence and breach of fiduciary duties, the common elements of the building were not adequately maintained, resulting in property damage, which is excluded under the policy. (R. pp. 42-44, ¶¶ 10, 15-20).

In their Reply, Respondents denied that their allegations fall within any of the policy's exclusions and reiterated their prior allegations. (R. pp. 45-46, ¶¶ 1 – 3).

Respondents filed a motion for summary judgment and memorandum in support on November 17, 2011, arguing, *inter alia,* that their Fifth Amended Complaint in the underlying action (hereinafter "Fifth AC") seeks only economic loss, not "property

damage," making the "property damage" exclusion inapplicable. (R. p. 52, end of ¶ 1). Travelers filed its motion for summary judgment on November 15, 2011 arguing, *inter alia*, that there is no reasonable interpretation of Plaintiffs' claims other than that they are for "property damage" and punitive damages, both of which are excluded by the policy. (R. pp. 83-87). Both motions were heard by The Honorable S. Jackson Kimball on November 22, 2011. By Order entered January 30, 2012, Judge Kimball granted Respondents' motion and denied Travelers' motion, concluding that "it is inferable from the allegations of the Complaint, as well as from the arguments of counsel at the hearing, that the failure to repair and failure to inspect pertains to defective design and construction of the common elements of the condominium that has resulted in other damages as well." (R. p. 5, last ¶). He ruled that "damages for correction of initial defective construction are covered . . . [and that] [o]ther property damage caused by such defective construction is not." (R. p. 8, lines 1-2).

Travelers received notice of the entry of the order on February 1, 2012. On February 10, 2012, Travelers timely served its Motion for Reconsideration and to Alter or Amend Judgment and Memorandum in Support thereof on the grounds that:

(1) the court's reliance on *Crossmann Communities of North Carolina, Inc. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E.2d 589 (2011) was misplaced, in that *Crossmann* is distinguishable in several important respects;

(2) the pertinent policy language may not be reasonably construed to provide coverage for KPOA for liability arising out of defective construction;

(3) the Fifth AC in the underlying action does not allege that KPOA is liable for defective construction, nor can such a claim be inferred;

(4) public policy is not served by inferring that the alleged damages relate to the correction of defective construction, which the Directors and Officers Liability Endorsement was never intended to cover;

(5) the order did not address Travelers' argument that special damages, such as those inferably the result of defective construction, must be specifically pled; and

(6) the order did not address Travelers' arguments regarding various other exclusions or that Plaintiffs are inferably seeking damages for alleged diminution in value, which falls within the policy's definition of "property damage."

Travelers' Motion for Reconsideration and to Alter or Amend Judgment and Memorandum in Support. (R. pp. 95-110).

Judge Kimball denied Travelers' motion by order entered on April 9, 2012, of which Travelers received written notice on April 12, 2012. (R. pp. 9-10). Judge Kimball ruled that the Court could "find no matter presented that was not addressed by the Court expressly or by clear implication in the prior order" and found "no basis for reconsideration or amendment of the Court's ruling in the prior order." Travelers timely served and filed its Notice of Appeal on May 4, 2012.

STATEMENT OF FACTS

In their Fifth AC against KPOA, MUI and Regent, Respondents alleged that MUI purchased the property from the PTL bankruptcy estate in December 1990, completed construction and made repairs in 1994 and 1995, and then began marketing condominium units. (R. p. 67, ¶ 6). Respondents also alleged that MUI created the condominium regime on September 24, 1996 and that the Master Deed to the property provides that the unit owners have an undivided interest in the common elements. (R. p. 68, ¶ 10).

Respondents also alleged in their Fifth AC that Developers MUI and Regent combined to develop the property, and transferred the common elements to the unit owners on April 24, 2007. (R. pp. 68-69, ¶¶ 8, 11 and 14). They further alleged that, at the time of said transfer, the common elements were, and continue to be, "in substandard

condition requiring a substantial upfit of all major building elements and systems, and remediation of mold and other unsanitary conditions. . . .", the common elements "were turned over with no replacement reserve fund account" and that the developers "had a duty to insure that the common elements were in good repair, or in the alternative to provide the owners with sufficient funds to bring the common areas up to standard as of the date of the transfer." *Id.*, ¶¶ 13 - 14. Finally, as to KPOA they alleged that KPOA, "having a duty to maintain and repair the property, had and has a fiduciary duty to accomplish these duties for the benefit of the individual owners, including these Plaintiffs." (R. p. 69, ¶ 15).

These allegations are repeated in Count One ("Breach of Fiduciary Duty") and Count Three ("Negligence"). (R. pp. 69-72, ¶¶ 16-20; 24-27) (Count Two is directed solely against MUI and Regent).

KPOA's policy contains a Directors and Officers Endorsement which contains the following exclusions:

> The insurance provided by this endorsement does not apply to:
>
> (1) "Bodily injury," "property damage," "personal injury," or "advertising injury."
>
> (2) Punitive or exemplary damages.
>
> (3) Damages resulting from:
>
> * * *
>
> (b) Any dishonest, fraudulent, criminal or malicious act, error or omission committed by or with the knowledge of any insured.
>
> * * *

(e) Operations (including but not limited to construction, design, survey and engineering services) performed by or on behalf of the builder, sponsor or developer of the property designated in the Declarations.

(f) The failure of any insured to enforce the rights of the Named Insured against the builder, sponsor or developer of the property designated in the Declarations.

* * *

(h) The "wrongful act" of any developer/sponsor who is an officer or member of the condominium, or other community association, board of directors.

(i) any claim or "suit" made by any insured against another insured.

Policy No. I-680-3467M656-IND-08, Directors and Officers Liability Endorsement, p. 2 of 5 at D. (1)-(3). (R. p. 34).

ARGUMENT

In South Carolina, when "reviewing the grant of a motion for summary judgment, the appellate court applies the same standard of review as the trial court under Rule 56, SCRCP." *Grinnell Corp. v. Wood*, 378 S.C. 458, 465, 663 S.E.2d 61, 64 (S.C. Ct. App. 2008) (citations omitted), *rev'd on other grounds* 389 S.C. 350, 698 S.E.2d 796 (2010).

A suit to determine coverage under an insurance policy is an action at law. *See id.* (citing *State Farm Mut. Auto. Ins. Co. v. James*, 337 S.C. 86, 93, 522 S.E.2d 345, 348 (S.C. Ct. App. 1999)); *see also B.L.G. Enters., Inc. v. First Fin. Ins. Co.,* 328 S.C. 374, 377, 491 S.E.2d 695, 697 (S.C. Ct. App. 1997) and *Travelers Indem. Co. v. Auto World of Orangeburg, Inc.,* 334 S.C. 137, 140-41, 511 S.E.2d 692, 694 (S.C. Ct. App. 1999). Questions of coverage are determined by the allegations of the third party's complaint.

See City of Hartsville v. S.C. Mun. Ins. & Risk Fin. Fund, 382 S.C. 535, 543, 677 S.E.2d 574, 578 (2009) (citing *C.D. Walters Constr. Co., Inc. v. Fireman's Ins. Co. of Newark, N.J.*, 281 S.C. 593, 316 S.E.2d 709 (S.C. Ct. App. 1984)).

In an action for declaratory judgment, the obligation of a liability insurer to indemnify is determined by the allegations in the complaint in the underlying lawsuit against the insured. *See Collins Holding Corp. v. Wausau Underwriters Ins. Co.*, 379 S.C. 573, 577, 666 S.E.2d 897, 899 (2008). The duty to defend and the duty to indemnify are interrelated, and the duty to defend may be determined by facts outside of the complaint that are known by the insurer. *See City of Hartsville*, 382 S.C. at 544, 677 S.E.2d at 578 (citing *USAA Prop. & Cas. Ins. Co. v. Clegg*, 377 S.C. 643, 657, 661 S.E.2d 791, 798 (2008)).

Because "undisputed facts leave only a question of law for the trial court, on appeal . . . [the appellate court] reviews 'whether the trial court properly applied the law to those facts.'" *Antley v. Nobel Ins. Co.*, 350 S.C. 621, 625, 567 S.E.2d 872, 874 (S.C. Ct. App. 2002) (citing *WDW Props. v. City of Sumter*, 342 S.C. 6, 10, 535 S.E.2d 631, 632 (2000)), *rev'd on other grounds by Sweetser v. S.C. Dep't of Ins. Reserve Fund*, 390 S.C. 632, 703 S.E.2d 509 (2010). When an action, such as a declaratory judgment action, presents a question of law, the appellate court's review is plenary and without deference to the trial court. *See Crossmann Communities of N.C., Inc. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E.2d 589 (2011).

An insurance policy is a contract between the insured and the insurance company, and its terms are to be construed according to contract law. *See Coakley v. Horace Mann Ins. Co.*, 376 S.C. 2, 5-6, 656 S.E.2d 17, 19 (2007); *Cook v. State Farm Auto. Ins. Co.*,

376 S.C. 426, 429, 656 S.E.2d 784, 786 (S.C. Ct. App. 2008); *Estate of Revis by Revis v. Revis*, 326 S.C. 470, 476, 484 S.E.2d 112, 115 (S.C. Ct. App. 1997). If the language of the policy is clear and unambiguous, the language alone determines the contract's force and effect. *See Sphere Drake Ins. Co. v. Litchfield*, 313 S.C. 471, 473, 438 S.E.2d 275, 277 (S.C. Ct. App. 1993). That is, "the declarations of the parties as to what they intended by the language used are inadmissible . . . [and the] writing must speak for itself, by its terms alone, without the aid of extrinsic evidence." *Montalbano v. Auto. Ins. Co. of Hartford, Conn.*, 217 S.C. 157, 160, 60 S.E.2d 77, 78 (1950); *see also Spencer v. Republic Nat'l Life Ins. Co.*, 243 S.C. 317, 133 S.E.2d 826 (1963); *Grayson v. Aetna Ins. Co.*, 308 F. Supp. 922 (D.S.C. 1970).

Parties to a contract of insurance have the right to make their own contract, and it is not the function of the courts to rewrite or torture it. *See Sphere Drake*, 313 S.C. at 473, 438 S.E.2d at 277. "When the contract is unambiguous, clear and explicit, it must be construed according to the terms the parties have used, to be taken and understood in their plain, ordinary and popular sense." *Id.* The fact that a policy purports to afford coverage in its insuring agreement, then excludes it in an exclusion, does not create an ambiguity. *See Owners Ins. Co. v. Clayton*, 364 S.C. 555, 614 S.E.2d 611 (2005).

I. THE LOWER COURT ERRED IN CONCLUDING THAT DAMAGES FOR CORRECTING DEFECTIVE DESIGN AND CONSTRUCTION ARE NOT EXCLUDED FROM COVERAGE BY THE DIRECTORS AND OFFICERS LIABILITY ENDORSEMENT IN THE KPOA POLICY.

A. The complaint in the underlying action alleges that KPOA failed to inspect, maintain, and repair the common elements of the property and breached its fiduciary duties to the owners, but does not allege that KPOA is liable for correcting the defective construction.

The Fifth AC alleges that KPOA "had the duties . . . to provide for the **care** and **upkeep** of the property and Common Elements, and to **maintain** and **make repairs** to the property, and had the additional duty to create and fund a reserve fund **for common element repairs and replacement**." (R. pp. 67-68, ¶ 7) (emphasis added). The complaint also alleges that KPOA "**failed to adequately maintain** the common elements of the Property and failed to maintain all of the elements and common elements of the Property **in reasonably good repair**." (R. pp. 68-69, ¶ 13) (emphasis added). In addition, it alleges that KPOA "having a duty to **maintain and repair the property**, had and has a fiduciary duty to accomplish these duties for the benefit of the individual owners, including these Plaintiffs." (R. p. 69, ¶ 15) (emphasis added).

In Count One, Respondents also allege that:

> 19. The Defendant POA had the legal duty, as a fiduciary from 1996 until April 24, 2007, to ensure that the Common Elements were properly **inspected, repaired, and maintained**, yet the POA, Inc., being controlled by the developer, failed in these duties, placed the interests of the developer ahead of the owners, including these Plaintiffs, and therefore breached its fiduciary duties. Additionally, the Defendant POA had the duty to create and fund an adequate fund for reserves **for the normal replacement of the components of the Common Elements**, yet, in placing the interests of the Defendant Developers ahead of the owners, the POA failed to develop and fund an adequate reserve fund.
>
> 20. As a result of the aforesaid breaches of fiduciary duty, the Defendants are liable to the homeowners for all damages proximately flowing from the breach, including damages for the continued deterioration of the common elements.

(R. p. 70, ¶¶ 19-20) (emphasis added).

Count Three[1] for negligence contains the following allegations against KPOA:

> 26. That the actions of the POA were negligent, reckless, willful, and wanton, in one or more of the following . . . particulars, to wit:
>
> a. In failing to perform **adequate inspections** of the Common Elements from 1996-2007;
>
> b. In failing to retain experts to **assess the conditions of the building** from 1996-2007;
>
> c. In **failing to maintain** the Common Elements to an **adequate state of repair** from 1996-2007;
>
> d. In **failing to repair** the Common Elements of the building from 1996-2007;
>
> e. In negligently placing the Developers' interests ahead of those of the individual property owners, so as to place the entire **financial burden of deferred maintenance** upon the property owners, including these Plaintiffs, while acting in the capacity of a fiduciary;
>
> f. In failing to establish and fund **adequate reserve funds;**
>
> g. In failing to establish an adequate **depreciation schedule** and adequately fund known **building component repair and replacement**; and
>
> h. In failing to advise the homeowners of the various **conflicts of interest inherent in a developer-controlled POA**, and in failing to provide for independent representation of non-developer homeowners both with respect to POA actions, and also regarding property management and maintenance.
>
> 27. As a direct and proximate result of the negligence, recklessness, willfulness and wantonness of the Defendants as set forth above, the Plaintiffs

[1] Respondents' second count is directed solely against other defendants.

> Homeowners will be required to expend considerable sums for the repair and refit of this property, all to their damage.

(R. p. 72, ¶¶ 26-27) (emphasis added).

It is clear from the allegations against KPOA (especially those emphasized above) that Respondents allege that KPOA was negligent and breached its fiduciary duties by failing to adequately maintain the property, which caused the unit owners to sustain property damage, i.e., the costs of necessary repairs.[2] They seek actual and punitive damages. However, Travelers' policy excludes coverage for both "property damage" and punitive damages:

> The insurance provided by this endorsement does not apply to:
>
> (1) "Bodily injury," "property damage," "personal injury," or "advertising injury."
>
> (2) Punitive or exemplary damages.
>
> * * *

Policy No. I-680-3467M656-IND-08, Directors and Officers Endorsement, p. 2 of 5 at D. (1), (2). (R. p. 34).

The policy defines "property damage" as follows:

> F. "Property damage" means:
>
> 1. Physical injury to tangible property, including all resulting loss of use of that property;
>
> 2. Loss of use of tangible property that is not physically injured; or

[2] It may be inferred that they also seek damages for the alleged diminution in the value of their individual units, in that they seek "all damages proximately flowing from the breach" of said fiduciary duties.

3. Diminution of property value.

(R. p. 37 at F).

The allegations in the Fifth AC relate to failure to care for and keep up the property, maintain and make repairs to the property, and maintain a fund for common element repairs and replacement. There can be no dispute that the damages sought by Respondents in the underlying action are for "property damage" – which is unambiguously excluded by the policy.

B. <u>There is no evidence from which the lower court could reasonably have inferred that, in the underlying action, Respondents seek damages from KPOA for correcting defective construction.</u>

It is noteworthy that, in their declaratory judgment complaint, Respondents quoted extensively from their Fifth AC, repeating their allegations of failure to inspect, maintain, repair and establish an adequate reserve fund for same. (R. pp. 14-16, ¶ 8). However, neither complaint contains any allegation that KPOA is liable for the defective design or construction. Rather, the Fifth AC alleges that MUI completed construction of the building and made repairs in 1994 and 1995 and that the condominium regime was not created until years later in September 1996. (R. p. 67, ¶ 6). It alleges that the developers "breached the implied warranty of habitability, in that condominium units purchased by the Plaintiffs contained construction, design, and material defects, were defective, so that Plaintiffs will be and are required to spend significant sums for the repair, replacement, reengineering, redesign of the common elements all to their damage." (R. p. 71, ¶ 23). The Fifth AC contains no such allegations against KPOA. From these allegations as to the developers, the lower court inferred (unreasonably) that Respondents seek damages from KPOA – not merely for the failure to inspect, maintain,

repair and create a reserve fund as alleged in the Fifth AC – but also for defective design and construction:

> Applying the requisite standard of review for summary judgment, it is inferable from the allegations of the Complaint, as well as from the arguments of counsel at the hearing[3], that the failure to repair and failure to inspect pertains to defective design and construction of the common elements of the condominium that has resulted in other damage as well. Likewise, the allegations of failure to maintain adequate funds and establish adequate reserves for repair and maintenance pertain to the alleged defective design and construction. (*See* Complaint at ¶ 23.) Thus, inferably, the damages sustained relate to both the correction of initially defective construction, and repair of other components of the condominium damaged as a result of the defective construction.

(R. pp. 5-6) (fn. added).

The only materials submitted to the Court for consideration in connection with the motions for summary judgment were the motions and memoranda in support and opposition (with exhibits), copies of some of the cases cited therein, the Fifth AC, excerpts from the policy, including the Directors and Officers Liability Endorsement, and the pleadings. Since the only issue framed by Respondents' Motion for Summary Judgment was whether the claims asserted in the underlying action are covered under KPOA's policy, the lower court was required to view the allegations of the Fifth AC and the provisions of the subject policy in the light most favorable to Travelers, and limit any inferences to those which could reasonably be drawn therefrom. *See Stewart v. State Farm Mut. Auto. Ins. Co.*, 341 S.C. 143, 149, 533 S.E.2d 597, 600 (S.C. Ct. App. 2000). ("All ambiguities, conclusions, and inferences arising from the evidence must be

[3] No inferences can be drawn from arguments of counsel. Arguments of counsel are not evidence. *See Bowers v. Bowers*, 304 S.C. 65, 68, 403 S.E.2d 127, 129 (S.C.Ct.App.1991). Factual statements of counsel, whether made during oral argument or in written briefs or memoranda, ordinarily may not be considered. *See Gilmore v. Ivey*, 290 S.C. 53, 58, 348 S.E. 2d 180, 183 (S.C. Ct. App. 1986). Moreover, no record of the oral argument was even made.

construed most strongly against the moving party."). "On cross-motions for summary judgment, 'the court must evaluate each party's motion on its own merits, taking care in each instance to draw all reasonable inferences against the party whose motion is under consideration.'" *See B.F. Goodrich Co. v. United States Filter Corp.*, 245 F.3d 587, 592 (6th Cir. 2001) (citing *Taft Broadcasting Co. v. United States*, 429 F.2d 240, 248 (6th Cir. 1991)).

It is respectfully submitted that it is not reasonable to infer from the Fifth AC that the allegations of "the failure to repair and failure to inspect pertains to defective design and construction of the common elements of the condominium that has resulted in other damage as well". The Fifth AC contains no allegations whatsoever against KPOA relating to defective design or construction. Nor would any such allegations be expected, since the developers were also named as defendants and it is alleged in count two – which is only against the developers - that the developers:

> 23. . . .breached the implied warranty of habitability, in that condominium units purchased by the Plaintiffs contained construction, design, and material defects, were defective, so that Plaintiffs will be and are required to spend significant sums for the repair, replacement, reengineering, redesign of the common elements all to their damage.

(R. p. 71, ¶ 23).

The lower court relied on paragraph 23 from the Fifth AC in concluding that:

> . . ., the allegations of failure to maintain adequate funds and establish adequate reserves for repair and maintenance pertain to the alleged defective design and construction.

(R. pp. 5-6).

It is not reasonable to infer that, because **the developers** were alleged to have breached the implied warranty of habitability in that the property contained construction

and design defects, the damages being sought **from KPOA** pertain to the alleged defective design and construction – especially when viewing the allegations in the light most favorable to Travelers. None of the allegations against KPOA involved the construction phase of the property. The allegations against KPOA all relate to its duties to repair and maintain the property[4]. A grant of summary judgment must be made based on the record the parties have actually presented, not on one potentially possible. *See Spencer v. Miller*, 259 S.C. 453, 456, 192 S.E.2d 863, 865 (1972). Based on the record before the Court, there is nothing from which it can reasonably be inferred that the allegations against KPOA relate to design and construction.

C. Even if it is reasonable to conclude that the underlying complaint alleges that KPOA is liable for defective design and construction, the policy does not provide coverage for the remediation thereof.

Having inferred that "the damages sustained relate to both the correction of initially defective construction, and repair of other components of the condominium damaged as a result of the defective construction," the lower court concluded that "damages for correction of initial defective construction are covered . . . [and that] [o]ther property damage caused by such defective construction is not." (R. tops of pp. 6, 8).

Even if it is conceded for the sake of argument that, in the underlying action, Respondents are seeking damages from KPOA to correct defective design and construction, the policy (contrary to the findings of the lower court) still does not cover these damages. As set forth above, the court properly concluded that damages to the common elements that were the result of defective design and construction constitute

[4] It is noteworthy that the allegations in the Fifth AC against KPOA are entirely different from the allegations against the developers, perhaps indicating that Plaintiffs recognized the potential for a double recovery and sought to avoid it.

"property damage" and are excluded from coverage under the policy. ("[R]emediation of damage to other components caused by . . . defective construction would not [be covered]." (R. p. 7, end of ¶ 2). Despite this finding, the court also concluded that "remediation of defective construction would be covered by Travelers' policy . . . ." *Id.* This assumes not only that the Fifth AC actually alleges that KPOA is liable for remediation of the allegedly defective construction, but that KPOA is in fact liable for the remediation – neither of which is true.

First, the Fifth AC alleges that MUI completed construction and made repairs during 1994 and 1995, while KPOA was not even created until 1996. (R. pp. 67-68, ¶¶ 6, 9). Second, while it alleges that the developers breached the implied warranty of habitability because the units contained construction, design, and material defects requiring "repair, replacement, reengineering, redesign of the common elements . . .", there are no such allegations against KPOA. The only damages for which KPOA could conceivably be liable pursuant to the allegations of the Fifth AC would be those caused by the developers' defective design and construction, which clearly constitute "property damage" and would be excluded – and the lower court so held. The lower court correctly concluded that the allegations of damage to the common elements necessitating repair and replacement – whether caused by defective design or construction or by the failure to inspect, maintain and repair – constitute "property damage" and were therefore excluded from coverage. (R. p. 7, end of ¶ 2, p. 8 at top).

There is no support, in the record or in logic, for the Court's conclusion that "damages for correction of initial defective construction are covered." (R. p. 8). For there to be coverage for KPOA for correcting the initial defective construction, there

must be an allegation that KPOA is liable for the remediation of the initial defective construction. Not only does the Fifth AC not contain any such allegation, it actually alleges that the developers completed the construction before KPOA ever came into existence.

The lower court inferred that the damages claimed "relate to both the correction of initially defective construction, and repair of other components of the condominium damaged as a result of the defective construction." (R. p. 6). This is certainly reasonable, in that the Fifth AC alleges that the developers are liable for the initially defective construction and that the developers and KPOA are liable for the repairs to other components damaged as a result of the defective construction. However, the court then incorrectly concluded:

> However construed, the allegations of the Complaint must be fairly read to seek to require Travelers to cover the costs of remediation of damage to components of the condominium, namely, damage to individual condominium units. Liability for remediation of such damage would be premised upon the POA's negligence or breach of fiduciary duty, as alleged in the Complaint.

(R. p. 7, ¶ 2).

It is not clear which "Complaint" to which the Court was referring. If it references the Fifth AC, the Court's analysis is incorrect. The court is required to consider whether the allegations in the underlying action against KPOA bring its potential liability within the policy's coverage – not whether those allegations "seek to require Travelers to cover the costs of remediation of damage to components of the condominium . . . ." *Id.* On the other hand, if the Court was referring to the complaint in this declaratory judgment action, it was analyzing the wrong complaint for the purposes

of determining coverage, since questions of coverage are determined by the allegations of the third party's complaint. *See City of Hartsville*, 382 S.C. at 543, 677 S.E.2d at 578.

As set forth above, the Fifth AC contains no allegations that KPOA is liable for remediating the alleged defective design and construction, nor is there any reasonable basis to infer such allegations. The allegations regarding remediation are solely against the developers. It therefore is not the case that "[l]iability for remediation of such damage would be premised upon the POA's negligence or breach of fiduciary duty, as alleged in the Complaint." (R. p. 7, ¶ 2).

The lower court then concluded that "damages for correction of initial defective construction are covered" and that "[o]ther property damage caused by such defective construction is not." (R. p. 8). Even if correction of defective design and construction does not fall within the "property damage" exclusion (which it does), the damages associated with such correction of defective design and construction are not automatically covered under the Travelers policy, since there are no allegations that KPOA is liable for such damages. Those allegations are against the developers. (R. p. 67, ¶ 6; p. 68, ¶ 12; p. 71, ¶¶ 23, 25). Nor is it reasonable to infer any such allegations in the complaint. A property owners' association that did not even exist at the time of design and construction cannot be liable for that very defective design and construction. If the property owners' association is liable for damage caused by any failure on its part to discover such defective design and construction, it would be "property damage" and excluded under the policy – and the lower court so held. (R. p. 7, end of ¶ 2, p. 8 at top). It could not be liable for remediation of the defective design and construction itself, since, according to the Fifth AC, KPOA did not even exist at the time of the alleged defective design and

construction. Thus, there is no reasonable scenario whereby there would be coverage under the policy for remediation of negligent design and construction.

D. The lower court's reliance on *Crossmann Communities of N.C., Inc. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E.2d 589 (2011) is misplaced.

The lower court's conclusion that the policy provides coverage for correcting defective design and construction was largely based on *Crossmann Communities of N.C., Inc. v. Harleysville Mut. Ins. Co.,* 395 S.C. 40, 717 S.E.2d 589 (2011), which involved a commercial general liability (CGL) policy issued to a condominium developer. KPOA's policy involves Directors and Officers liability coverage for a condominium homeowners' association. The nature and purposes of the coverage available under CGL policies and policies that provide Directors and Officers coverage is very different:

> Corporations, whether for-profit or non-profit organizations, universally purchase general liability coverage. Such policies commonly cover bodily injury, property damage and personal and advertising injuries. D&O policies do not afford coverage for such claims and in fact, specifically exclude coverage for bodily injury, property damage, and personal injury.

Joseph P. Monteleone and Carrie E. Cope, Directors' and Officers' (D&O) Liability: Exposures, Risk Management and Insurance Coverage 4 (The Nat'l Underwriter Co. 2008).

Moreover, the issue in *Crossmann* was whether water intrusion due to negligent construction constituted an "occurrence", not whether the water intrusion constituted "property damage", as the parties stipulated that the water intrusion did constitute "property damage". *See Crossman*, 395 S.C. at 47, 717 S.E.2d at 592-93. The Supreme Court addressed the meaning of the term "property damage" in the context of whether the damage stipulated to be "property damage" was caused by an "occurrence." *Id.* at 48-50, 717 S.E.2d at 593-94. In that context, the Court concluded that, "negligent or defective

construction resulting in damage to otherwise non-defective components may constitute 'property damage,' but the defective construction would not." *Id.* at 50, 717 S.E.2d at 594. Here, the question is not whether there was an "occurrence" under a CGL policy, but whether the damages claimed in the underlying litigation are "property damage" as defined in the Directors and Officers Liability Endorsement.

Moreover, in contrast to the present situation, the insured in *Crossmann* was the developer – not a homeowners' association. The underlying complaint in *Crossmann* alleged that the developer-insureds were liable for damages allegedly resulting from negligent construction, while the Fifth AC contains no such allegation against KPOA. It does, of course, include such allegations against the Developers (e.g., they were negligent "[i]n taking over an existing building, completing its construction, and developing it . . . while failing and omitting to perform adequate inspections, quality control, and materials inspections to prevent building defects.") (R. p. 71, ¶ 25 a).

Another important distinction is that, in *Crossmann*, the parties stipulated that they would not argue the applicability of any exclusions, and the Court even noted that "various exclusions may preclude coverage in some instances." *Crossman*, 395 S.C. at 46, 50, 717 S.E.2d at 592, 594. Thus, *Crossmann* is limited to the question of whether there had been an "occurrence" within the meaning of the policy. As the Court observed, "it is only after 'property damage' has been alleged that the question of 'occurrence' is reached." *Id.* at 49, 717 S.E.2d at 594. Thus, if "property damage" was alleged to have been caused by an "occurrence", coverage would be available under the CGL policy. The allegations against the developers were that they negligently constructed the

condominiums, which resulted in water penetration and damage. *Id.* at 44, 717 S.E.2d at 591-92. The "property damage" exclusion was not an issue.

As in *Crossmann*, the developers here are alleged to have negligently constructed the condominiums, necessitating significant expenditures for "the repair, replacement, reengineering, redesign of the common elements . . . ." (R. p. 71, ¶ 23). The homeowners' association, KPOA, is not alleged to be liable for the negligent construction, but for the failure to inspect, maintain and repair damage to the common elements caused by the developers' negligent design and construction and for failure to create a reserve fund, thereby breaching their fiduciary duties to the owners.

The *Crossmann* Court's analysis of the "property damage" issue was specifically limited to the nature of the case presented:

> We believe a more complete understanding of the coverage issue **in this kind of progressive property damage case** should involve the policy term "property damage."

Crossmann, 395 S.C. at 48, 717 S.E.2d at 593 (emphasis added).

The lower court correctly concluded that property damage caused by defective construction is not covered. *See infra* discussion of *Eastpointe Condo. I Ass'n, Inc. v. Travelers Cas. & Sur. Co. of Am.,* 379 Fed. Appx. 906 (11th Cir. 2010)). However, the lower court erred in concluding that damages for correcting defective construction are covered. This conclusion was based on the Supreme Court's analysis of a coverage issue in a very different situation, involving developers – not a homeowners' association. More importantly, in *Crossmann,* the developer-insureds were alleged to be liable for negligent construction, while the Fifth AC contains no such allegations against Travelers' insured (and alleges that the negligent construction occurred before KPOA even existed).

Cases interpreting the property damage exclusion in Directors and Officers liability coverage are few and far between. However, *Eastpointe Condo. I Ass'n, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 379 Fed. Appx. 906 (11th Cir. 2010) is instructive. In *Eastpointe*, an owner of a condominium unit sued the Association for failing to adequately maintain and repair the roof and air conditioning system before, between, and after two hurricanes struck the area, causing water intrusion that allegedly caused mold and other damage to her unit. *Eastpointe Condo.*, 379 Fed. Appx. at 907. The unit owner sued alleging negligence, breach of fiduciary duty, and breach of contract. *Id.* Eastpointe had a Directors and Officers policy with Travelers that "contained a 'property damage' exclusion . . . for loss in connection with any claim made 'for or arising out of any damage, destruction, loss of use or deterioration of any tangible property including . . . mold, toxic mold, spores, mildew, fungus, or wet or dry rot.'" *Id.* Travelers denied coverage based on this exclusion, after which, having obtained a defense verdict in the underlying action, Eastpointe sued Travelers for declaratory judgment and breach of contract, seeking to recover attorneys' fees paid in defending the underlying suit. *Id.* The district court granted summary judgment in Travelers' favor holding that the underlying claim arose out of damage or destruction to tangible property, which fell within the "property damage" exclusion. *Id.* The United States Court of Appeals for the Eleventh Circuit affirmed, explaining its reasoning as follows:

> First, we are not persuaded by Eastpointe's attempt to differentiate between losses originating from property damage, and losses originating from breaches of fiduciary duty that ultimately result in property damage. The plain language of the D & O policy excludes coverage for any claim made "for or arising out of any damage, destruction, loss of use or deterioration of any tangible property.". . .

> . . . The premise of Bursten's breach of fiduciary duty claim was that Eastpointe failed in its duty to properly maintain, repair, and replace the building's roof and air conditioning units, and that, as a result, water infiltrated the building and caused extensive damage to Bursten's unit. Bursten's claim thus depended upon the existence of the property damage . . . In light of the broad interpretation given to the phrase "arising out of," we agree with the district court that the property damage exclusion applies to Bursten's breach of fiduciary duty claim.
>
> Second, we are not convinced that the policy language is ambiguous. . . .
>
> . . .
>
> As for Eastpointe's third argument, we do not agree that enforcing the property damage exclusion would render the D & O policy illusory. The fact that Eastpointe's primary responsibilities relate to the operation and maintenance of tangible property does not mean that the property damage exclusion bars coverage for all claims that might be asserted against Eastpointe. The claims at issue here are excluded because they arise out of damage to Bursten's property. But there are other claims that could be asserted against Eastpointe that would not fall within the property damage exclusion and might therefore be covered by the D & O policy. *See, e.g., Lime Tree Vill. Cmty. Club Ass'n v. State Farm Gen. Ins. Co.,* 980 F.2d 1402, 1405-06 (11th Cir.1993) (finding that D & O insurer had duty to defend homeowners' association against claims of slander or disparagement of title, breach of residential development's declaration of covenants and restrictions, and restraint of trade).

Id. at 909.

Similarly, notwithstanding Respondents' allegations of breach of fiduciary duty (like the allegations in *Eastpointe*), the plain language of the Directors and Officers endorsement in question clearly excludes coverage for both property damage and punitive damages. As in *Eastpointe*, the premise of Respondents' claims was that KPOA (the Association) failed in its duty to properly maintain, repair, and replace certain portions of the common elements, as a result of which their claims depend upon the existence of property damage.

Moreover, the exclusions are not ambiguous, nor would enforcing them render the directors and officers endorsement illusory, as explained in *Eastpointe*:

> The fact that Eastpointe's primary responsibilities relate to the operation and maintenance of tangible property does not mean that the property damage exclusion bars coverage for all claims that might be asserted against Eastpointe. The claims at issue here are excluded because they arise out of damage to Bursten's property. But there are other claims that could be asserted against Eastpointe that would not fall within the property damage exclusion and might therefore be covered by the D & O policy. *See, e.g., Lime Tree Vill. Cmty. Club Ass'n v. State Farm Gen. Ins. Co.,* 980 F.2d 1402, 1405–06 (11th Cir. 1993) (finding that D & O insurer had duty to defend homeowners' association against claims of slander or disparagement of title, breach of residential development's declaration of covenants and restrictions, and restraint of trade).

Id. at 909; *see also Resource Bank v. Progressive Cas. Ins. Co.*, 503 F.Supp.2d 789,797 (E.D. Va. 2007) ("Because the harms alleged in the TCPA Class Actions are invasion of privacy and property damage, Resource seeks coverage of claims 'for invasion of privacy' and 'for property damage' that Exclusion A [the "Bodily Injury and Property Damage Exclusion" of the Directors & Officers policy in question] expressly identifies.").

In short, *Eastpointe* is persuasive authority involving a similar situation and directors and officers coverage, which supports many of Travelers' arguments.

E. <u>The parties to the insurance contract could not have intended that liability arising out of construction defects would be covered</u>.

Because the exclusions at issue are unambiguous, clear and explicit, their language alone must determine the policy's force and effect. *See Sphere Drake*, 313 S.C.at 473, 438 S.E.2d at 277. It is not necessary to ascertain the parties' intent.

As our Supreme Court explained:

> [I]n cases where there is no ambiguity, contracts of insurance, like other contracts, must be construed according to the terms which

> the parties have used, to be taken and understood in their plain, ordinary and popular sense. If the intention of the parties is clear, the Courts have no authority to change the contract in any particular and have no power to interpolate into the agreement between the insurer and the insured, a condition or stipulation not contemplated either by the law or by the contract between the parties.

Carroway v. Johnson, 245 S.C. 200, 203, 139 S.E.2d 908, 909-10 (1965); *see also Blanton v. Nationwide Mut. Ins. Co.,* 247 S.C. 148, 151-52, 146 S.E.2d 156, 157-58 (1966). Even if the parties' intent is considered, the only reasonable conclusion is that the damages sought from KPOA constitute "property damage" and are excluded from coverage. "As with contracts generally, the cardinal principle in construing insurance contracts is that the intention of the parties controls." *Poston v. Nat'l Fid. Ins. Co.*, 303 S.C. 182, 185, 399 S.E.2d 770, 772 (1990).

To ascertain the parties' intent, the type of policy at issue should be considered:

> In construing an insurance policy, the determinative question is the intent of the parties – that is, what coverage the insured **expected to receive and** what the insurer **was to provide,** as disclosed by the provisions of the policy. An insurance policy is enforced in accordance with the **real intent of the parties** as expressed in the language employed in the policy. To ascertain the meaning of an insurance policy's language and the parties' intent, the court must construe the policy as a whole and **take into account the type of insurance purchased, the nature of the risks involved, and the overall purpose of the contract.** If the intention of the parties can be clearly discovered, the court will **give effect to that intention** within the sphere of its proper and legal operation and will construe accordingly the terms used in the policy, no matter how inept, ungrammatical, or inaccurate they may appear when viewed strictly or legally. The rule is that once the intention of the parties is clearly ascertained, a policy of insurance is to be **liberally construed in order to carry out that intention, especially where a liberal construction is the reasonable one** and a literal construction would lead to manifest injustice.

> Where an insurance contract is clear and unambiguous, court inquiry into the intent of the parties is limited to the four corners of the document.

43 AM. JUR.2d *Insurance* § 295 (2012) (emphasis added).

Not only does the Fifth AC not allege that KPOA is liable for construction defects, it stands to reason that the parties to a policy with a Directors and Officers endorsement would not have intended that the policy would provide coverage for such conduct. It is reasonable to conclude that a contractor or developer, as in *Crossmann,* however, might need and expect such coverage. A Directors and Officers Liability Endorsement would not be expected to provide coverage for liability for remediation of construction defects, particularly in light of the fact that the policy specifically excludes coverage for "property damage."

It could not have been the parties' intent that damage claimed for remediation of the developers' or contractors' defective construction would be covered, when damage flowing indirectly from the same defective construction would not. "It is not the function of the courts to rewrite or torture the meaning of the policy to extend coverage." *Sphere Drake*, 313 S.C. at 473, 438 S.E.2d at 277.

F. The Court's construction of the policy not only could not have been intended by the parties but, if adopted, would have consequences that are against public policy.

Another reason that the parties could not have intended that the Directors and Officers endorsement would provide coverage for defective construction, or even for negligent failure to maintain the common areas, is that such coverage would encourage collusion and would be against public policy. Travelers is not alleging collusion in this case. However, if Directors and Officers Liability Endorsements are deemed to provide

coverage for homeowners associations' purported failure to maintain the property, such associations could avoid assessments for maintenance and repairs by failing to impose them and awaiting a suit by their members, thereby making their liability coverage available to cover the expense. The association and its members would have the benefit of upgrades to the property without the necessity of an assessment. Such a result is against public policy.

The United States Court of Appeals for the Seventh Circuit recognized a similar problem in *Miller v. St. Paul Mercury Ins. Co.,* Nos. 10-3839, 10-3884, 10-3856, 10-3883, 2012 WL 2479552 (7th Cir. June 29, 2012):

> [Exclusions of coverage for losses for claims brought by one insured against another insured] are "standard" in D & O policies. They control the cost of D & O insurance by removing from coverage both "collusive suits – such as suits in which a corporation sues its officers or directors in an effort to recoup the consequences of their business mistakes, thus turning liability insurance into business-loss insurance" – as well as "suits arising out of those particularly bitter disputes that erupt when members of a corporate, as of a personal, family have a falling out and fall to quarreling."

Id. at *3 (internal citations omitted); *see also* the discussion of *Miller* at III. C. below.

II. THE LOWER COURT ERRED IN NOT ADDRESSING TRAVELERS' ARGUMENT THAT THE DAMAGES FOR WHICH COVERAGE IS SOUGHT ARE SPECIAL DAMAGES, NOT SPECIFICALLY PLED IN THE UNDERLYING ACTION.

A related issue raised below is Respondents' failure to allege any special damages in the underlying action. The Fifth AC alleges that KPOA failed to maintain and repair the property and maintain a reserve fund for maintenance of the common elements. (R. pp. 67-70, p. 72 ¶¶ 7, 13, 19, 20, 26 and 27). It alleges that KPOA is liable for all damages proximately flowing from an alleged breach of its fiduciary duty "to insure that

the Common Elements were properly inspected, repaired, and maintained" and to "create and fund an adequate fund for reserves for the normal replacement of the components of the Common Elements"." (R. p. 70, ¶¶ 19, 20). It also alleges that, "[a]s a direct and proximate result of the negligence, recklessness, willfulness and wantonness of the Defendants as set out above, the Plaintiffs Homeowners will be required to expend considerable sums for the repair and refit of this property, all to their damage." (R. p. 72, ¶ 27).

Special damages are those that "naturally and proximately, but not necessarily, accrue from the unlawful acts alleged, and are not recoverable unless specifically alleged." *Epstin v. Berman*, 78 S.C. 327, 58 S.E. 1013, 1015 (1907); *see also Crozier v. Charleston & W. C. Ry. Co.*, 222 S.C. 121, 130, 71 S.E.2d 800, 805 (1952); *Preferred Sav. Bank, Inc. v. Elkholy,* 303 S.C. 95, 99, 399 S.E.2d 19, 21 (S.C. Ct. App. 1990); *see also* Rule 9, SCRCP ("When items of special damage are claimed, they shall be specifically stated.").

If Respondents seek to recover damages for remediation of defective construction from KPOA, rather than from the developers, in the underlying action, they were required to specify the damages claimed. Not only does the Fifth AC not specify any damages allegedly arising out of defective construction, it does not even allege that KPOA is liable for any damages for remediation of negligent construction. In other words, as to KPOA, there are no allegations of liability for the damages that the Order indicates are covered. Such damages have not been specifically pled, and may not be inferred.

III. THE LOWER COURT ERRED IN FAILING TO ADDRESS THE OTHER POLICY EXCLUSIONS THAT PRECLUDE COVERAGE.

A. Allegations in the Fifth AC fall within exclusion (3)(b).

> **The insurance provided by this endorsement does not apply to:**
>
> * * *
>
> **(3) Damages resulting from:**
>
> * * *
>
> **(b) Any dishonest, fraudulent, criminal or malicious act, error or omission committed by or with the knowledge of any insured.**

Policy No. I-680-3467M656-IND-08, Directors and Officers Endorsement, p. 2 of 5 at D. (3)(b). (R. p. 34).

While the Fifth AC never uses the words, "dishonest, fraudulent, criminal or malicious" it cannot be disputed that the essence of the allegations against KPOA are that it acted in reckless disregard to the interests of the unit owners in a dishonest manner. Paragraph 26 alleges that KPOA's actions were "negligent, reckless, willful, and wanton" in any one of the following eight ways: failing to perform adequate inspections; failing to retain experts to assess the conditions of the building; failing to maintain the Common Elements to an adequate state of repair; failing to repair the Common Elements; placing the Developers' interests ahead of those of the individual property owners, failing to establish and fund adequate reserve funds; failing to establish an adequate depreciation schedule and adequately fund known building component repair and replacement; failing to advise the homeowners of the conflicts of interest inherent in a developer-controlled POA, and failing to provide for independent representation of non-developer homeowners with respect to POA actions and property management and maintenance. *See* Fifth AC, p. 7, ¶ 26. (R. p. 72). It also alleges that "from its inception in 1996 until

April 24, 2007, the POA was wholly controlled by the Defendant Developers, pursuant to provisions in the By Laws, and was operated by a three-member Board constituted of Defendant Developers' employees or designates." (R. p. 68, ¶ 9).

There can be no dispute that the conduct alleged in the Fifth AC clearly constitutes at the very least a dishonest, fraudulent, or malicious act of an insured. These allegations are of dishonest and fraudulent conduct, allegedly committed with KPOA's knowledge, and clearly fall within exclusion (3)(b).

B. <u>Allegations in the Fifth AC fall within exclusion (3)(f)</u>.

> **The insurance provided by this endorsement does not apply to:**
>
> * * *
>
> **(3) Damages resulting from:**
>
> * * *
>
> **(f) The failure of any insured to enforce the rights of the Named Insured against the builder, sponsor or developer of the property designated in the Declarations.**

Policy No. I-680-3467M656-IND-08, Directors and Officers Endorsement, p. 2 of 5 at D. (3)(f). (R. p. 34).

Respondents alleged that KPOA negligently, recklessly, willfully, and wantonly (1) failed to advise the homeowners of conflicts of interest; (2) placed developers' interests ahead of the owners' interests; (3) failed to maintain the property; and (4) failed to provide for independent representation of the owners. *See* Fifth AC, ¶ 26. (R. p. 72). In other words, the Fifth AC alleges that KPOA, due to a conflict of interest, failed to enforce the owners' rights against the developers. Accordingly, exclusion (3)(f) applies.

C. **Allegations in the Fifth AC fall within exclusion (3)(i).**

> **The insurance provided by this endorsement does not apply to:**
>
> * * *
>
> **(3) Damages resulting from:**
>
> * * *
>
> **(i) any claim or "suit" made by any insured against another insured.**

Policy No. I-680-3467M656-IND-08, Directors and Officers Endorsement, p. 2 of 5 at D. (3)(i). (R. p. 34).

The Respondents in this action are identical to the Plaintiffs in the underlying action. (R. pp. 11-18; pp. 66-73). Of the twenty-four plaintiffs, seven (Pulliam, Dionna, Manferdini, Cook, Kramer, Marcuse and Osborne) served on the KPOA Board. (R. pp. 111-124). They therefore fall within the policy's definition of "insured":

> **WHO IS AN INSURED**
>
> * * *
>
> B. Your directors, trustees or officers are also insureds, but only while acting within the scope of their duties for you. This includes:
>
> 1. Those who currently are directors, trustees or officers;
>
> 2. Those who were directors, trustees or officers when the "wrongful act" took place;
>
> 3. Those who become directors, trustees or officers after the effective date of the insurance, but only for subsequent "wrongful acts."
>
> C. Your employees and members are insureds, but only while acting at your direction and within the scope of their duties for you.

Policy No. I-680-3467M656-IND-08, Directors and Officers Liability Endorsement, p. 3 of 5 at II, B., C. (R. p. 35).

A similar exclusion was at issue in *Miller v. St. Paul Mercury Ins. Co.*, 2012 WL 2479552. In that case, the United States Court of Appeals for the Seventh Circuit observed that:

> Without such an exclusion, a D & O policy could require the insurer to pay for the business mistakes of insured directors and officers if the corporation (also an insured) or if former officers or directors brought suit, collusive or otherwise, against them.

Miller, 2012 WL 2479552, at *1.

In *Miller*, the exclusion applied to "Loss on account of any Claim made against any Insured . . . brought or maintained by or on behalf of any Insured or Company in any capacity . . . ." *Id.* Only three of the five plaintiffs were "insureds", and the main issue was whether the exclusion applied to all the plaintiffs, to none of the plaintiffs, or to only those plaintiffs who qualified as "insureds." *Id.* at *1-3. The court adopted the last option:

> We AFFIRM the district court's decision in part, to the extent it held that St. Paul is not required to defend against or indemnify the claims by the insured plaintiffs, Miller and Anderson, or by the Lane Trust, which acts on behalf of an insured.

Id., at *9.

In this case, Travelers does not seek to apply the exclusion to any of the plaintiffs but those who served on the KPOA board and therefore fall within the exclusion. Thus, the claims of these seven Plaintiffs are excluded under (3)(i), as they are "insureds" who have asserted claims against the named insured, KPOA.

IV. THE LOWER COURT ERRED IN FAILING TO ADDRESS TRAVELERS' CONTENTION THAT PUNITIVE DAMAGES ARE EXCLUDED BY THE POLICY.

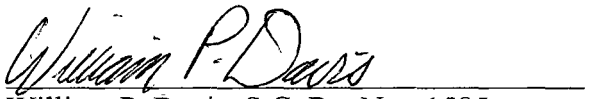
The lower court's order did not address Travelers' contention that punitive damages are not covered. The Fifth AC clearly seeks such damages, and such damages are clearly excluded by the policy. (R. p. 73 and p. 34 at D (2)). As stated at page 2 of the Directors and Officers Liability Endorsement, the coverage provided by the endorsement does not apply to "Punitive or exemplary damages." Policy No. I-680-3467M656-IND-08, Directors and Officers Endorsement, p. 2 of 5 at D. (1)-(3). (R. p. 34).

When an insurance contract is "unambiguous, clear and explicit, it must be construed according to the terms the parties have used, to be taken and understood in their plain, ordinary and popular sense." *Sphere Drake,* 313 S.C. at 473, 438 S.E.2d at 277. If the language in the exclusion is clear and unambiguous, that language alone must determine the policy's force and effect. *Id.* The fact that a policy purports to afford coverage in its insuring agreement, then excludes it in an exclusion, does not create an ambiguity. *See Owners Ins. Co. v. Clayton*, 364 S.C. 555, 614 S.E.2d 611 (2005).

CONCLUSION

Based on the argument and authorities set forth above, Travelers submits that the order of the court below should be reversed and that judgment should be entered in its favor to the effect that Respondents' allegations against KPOA in the underlying action are excluded from coverage by the Directors and Officers Liability Endorsement in the Travelers policy.

Respectfully Submitted,



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Columbia, South Carolina
November 20, 2012

THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM YORK COUNTY
Court of Common Pleas

The Honorable S. Jackson Kimball
Special Circuit Court Judge

2011-CP-46-01090
2012-211939

Brian Pulliam, Deborah C. Pulliam, Monica Bradshaw, Helen K. Cook, Kala Craig, Victor E. Dirienzo, Cynthia Ditursi, J. Scott Drexel, Kathleen Kramer, Robert Loebe, Melanie McDaniel, David Osborne, Celeste Arrowwood, Vincent Dionna, Mikel Marcuse, James P. Wheaton, Jr., Joseph Manfredini, Elena Manfredini, David Cox, Jonathan B. Dillard, Eric Wilson, Don and Debbie Neff, and Marianna Junda, ...Respondents,

v.

Travelers Indemnity Company, M.U.I. Carolina Corporation, Kensington Place Owners Association, Inc., Regent Carolina Corporation and Regent Corporation,. . . . . .Defendants,

Of whom Travelers Indemnity Company is the . . . .Appellant.

CERTIFICATE OF COUNSEL

The undersigned hereby certifies that the Final Brief of Appellant complies with Rule 211(b), SCACR and the August 13, 2007 order from the South Carolina Supreme Court entitled "Interim Guidance Regarding Personal Data Identifiers and Other Sensitive Information in Appellate Court Filings".

(Signature on following page)

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Brian Pulliam, Deborah C. Pulliam, Monica Bradshaw, Helen K. Cook, Kala Craig, Victor E. Dirienzo, Cynthia Ditursi, J. Scott Drexel, Kathleen Kramer, Robert Loebe, Melanie McDaniel, David Osborne, Celeste Arrowwood, Vincent Dionna, Mikel Marcuse, James P. Wheaton, Jr., Joseph Manfredini, Elena Manfredini, David Cox, Jonathan B. Dillard, Eric Wilson, Don and Debbie Neff, and Marianna Junda, ...Respondents,

v.

Travelers Indemnity Company, M.U.I. Carolina Corporation, Kensington Place Owners Association, Inc., Regent Carolina Corporation and Regent Corporation,. . . . . .Defendants,

Of whom Travelers Indemnity Company is the . . . .Appellant.

PROOF OF SERVICE

I, Susan Drake DuBose, attorney of Baker, Ravenel & Bender, L.L.P., attorneys for Appellant, do hereby certify that on the 21st day of November 2012, I have served the following named attorneys with the Final Reply Brief of Appellant, Final Reply Brief of Appellant, and Certificate of Compliance by mailing copies of same by United States Mail, postage prepaid, to the following at the address shown below:

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