

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas

Jennifer B. McCoy, Circuit Court Judge

Trial Court Case No. 2015-CP-10-00955
Appellate Case No. 2019-000238

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S.C. SUPREME COURT

Ex Parte:

Builders Mutual Insurance Company, Nationwide Mutual Fire Insurance Company, Nationwide Mutual Insurance Company, and Nautilus Insurance Company, Appellants,

In Re:

Palmetto Pointe at Peas Island Condominium Property Owners Association, Inc., and Jack Love, Individually, and on behalf of all others similarly situated, Plaintiffs,

v.

Island Pointe, LLC; Leonard T. Brown; Complete Building Corporation; Tri-County Roofing, Inc.; Creekside, Inc.; American Residential Services, LLC d/b/a Rescue Rooter Charleston; Andersen Windows, Inc.; Atlantic Building Construction Services, Inc. n/k/a Atlantic Construction Services, Inc.; Christopher N. Union; Builder Services Group, Inc. d/b/a Gale Contractor Services; Novus Architects, Inc. f/k/a SGM Architects, Inc.; Tallent and Sons, Inc.; W C Services, Inc., CRG Engineering, Inc.; Certainteed Corporation; Kelly Flooring Products, Inc. d/b/a Carpet Baggers and John Doe 1-60, Defendants,

Tri-County Roofing, Inc., Third-Party Plaintiff,

v.

Cornerstone Construction and Mark Malloy d/b/a Cornerstone Construction; Gutter Works, Inc. and Michael L. Segars d/b/a Gutter Works; Mr. Gutter; Litchfield Seamless Gutters & Windows, LLC and Thomas Litchfield d/b/a Litchfield Seamless Gutter; Miracle Siding, LLC and Wilson Lucas Sales d/b/a Miracle Siding, LLC; Mark Palpoint a/k/a Micah Palpoint; Elroy Alonzo Vasquez; and Chris a/k/a John Doe 61, Third-Party Defendants.

And

Complete Building Corporation, Inc., Third-Party Plaintiff,

v.

Alderman Construction; Stanley's Vinyl Fence Designs; Cohen's Drywall; and Mosley Concrete,
Third-Party Defendants,

Of Whom Palmetto Pointe at Peas Island Condominium Property Owners Association, Inc. and
Jack Love, Individually, and on behalf of all others similarly situated, Tri-County Roofing, Inc.,
Stanley's Vinyl Fence Designs, and W C Services, Inc. are the Respondents.

**AMICUS CURIAE BRIEF OF HARTFORD FIRE INSURANCE COMPANY,
HARTFORD CASUALTY INSURANCE COMPANY, AND HARTFORD
UNDERWRITERS INSURANCE COMPANY**

Steven M. Klepper, Esquire
(*pro hac vice* motion pending)
KRAMON & GRAHAM, P.A.
One South Street
Suite 2600
Baltimore, Maryland 21202

Mark S. Barrow, Esquire
Christy E. Mahon, Esquire
SWEENEY, WINGATE & BARROW, P.A.
151 Lady Street
Post Office Box 12129
Columbia, South Carolina 29211

*Attorneys for Amici Curiae Hartford Fire Insurance Company, Hartford Casualty Insurance
Company, and Hartford Underwriters Insurance Company*

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INTEREST OF AMICI CURIAE

Hartford Fire Insurance Company, Hartford Casualty Insurance Company, and Hartford Underwriters Insurance Company (collectively, “Hartford” or “*Amici*”) have issued commercial general liability insurance policies to businesses that are defendants in numerous cases over alleged construction defects (“CD litigation” or “CD actions”) in South Carolina. By virtue of their prior experience and involvement in South Carolina construction and insurance, *Amici* have perspectives and information that will serve as a useful supplement to the issues presented to the Court.

SUMMARY OF THE ARGUMENT

Some litigants interpret this Court’s decisions in *Harleysville Group Ins. v. Heritage Communities, Inc.*, 420 S.C. 321, 803 S.E.2d 288 (2017), and *Auto Owners Ins. Co. v. Newman*, 385 S.C. 187, 198, 684 S.E.2d 541, 546 (2009), as requiring insurers to intervene in CD litigation involving their insureds to request allocated verdicts for the insurers to preserve their right to allocate between covered and uncovered damages. Hartford does not believe this “mandatory intervention” reading of *Harleysville* and *Newman* to be correct. But the “mandatory intervention” reading is sufficiently plausible that many insurers, including Builders Mutual in the instant case, and Hartford in other cases, have filed intervention motions in several CD actions and have appealed orders denying those motions.

The Honorable Clifton Newman has entered orders (“Barefoot Orders”),¹ for the Horry County Circuit Court, denying Hartford’s motions to intervene in four CD actions. *See* Appendix

¹ The Barefoot Orders were entered in Horry County Circuit Court Nos. 2014-CP-2606573 (*Beach Villas*), 2014-CP-26-7634 (*Harbour Cove*), 2015-CP-26-00279 (*River Crossing*), and 2015-CP-26-2718 (*Tanglewood*). Three of the four involved the Barefoot Resort, and Hartford therefore uses Barefoot Orders as a shorthand. The Charleston County Circuit Court (Hon. Roger M. Young, Sr.) denied Hartford’s motion to intervene for the same reasons in No. 2012-CP-10-3857(*Shipwatch*). The Court can take judicial notice of such judicial records. For ease of reference, Hartford has included one of the Barefoot Orders, along with the *Lauderdale Bay* order discussed below, in an appendix bound with this brief. *See* Appendix 1–13.

1–6. But a true conflict of authority has arisen, with the Honorable William H. Seals, Jr. granting intervention in Horry County Circuit Court No. 2017-CP-26-2854 (*Lauderdale Bay*), finding that *Harleysville* and *Newman* require an insurer to seek an allocation of damages for coverage purposes in the underlying CD action. Appendix 7–13.

Amici's interest is in resolving the uncertainty regarding what the law requires of insurers to preserve their right to allocate between covered and uncovered damages. Mandatory intervention would create significant obstacles for construction companies, litigants, trial courts, defense counsel, and insurers in South Carolina. *Amici* ask the Court to clarify the holding of *Harleysville* to confirm that it does not require insurers to intervene in CD actions involving their insureds in order to request allocated verdicts for the insurers as the method to preserve their right to allocate between covered and uncovered damages. *Amici* request the Court clarify that all such issues may be preserved and may be litigated in a declaratory judgment action that is either pending or subsequently filed.

ARGUMENTS

I. MANDATORY INTERVENTION IS NOT IN ANY PARTIES' INTEREST AND SHOULD NOT BE THE LAW OF SOUTH CAROLINA TO PRESERVE COVERAGE ISSUES.

Certain insurers—including Builders Mutual in the instant case and Hartford in other cases in which their insureds are involved—have been moving to intervene in CD actions because litigants have argued that *Harleysville* and *Newman* require insurers to intervene to request special verdicts or special interrogatories that allocate between covered and uncovered damages. At least one trial court has granted intervention on this theory. *See* Appendix 7–13. Arguably, under this judicial scenario, failure to intervene may result in serious potential consequences for insurers, namely in the insurers bearing responsibility for the uncovered portions of verdicts. However, the Barefoot Orders concluded that intervention is not mandatory or even permissible, and that a

separate declaratory judgment action adequately protected the carriers' rights to dispute coverage. This tension between the courts in South Carolina creates additional motion practice, delay, and expense for all parties. *Amici* file this brief to request the Court to clarify *Harleysville* and confirm that an insurer is not obligated to intervene in CD actions involving their insureds to request allocated verdicts for the insurers as the method to preserve their right to allocate between covered and uncovered damages.

A. The Court Did Not Explicitly Decide the Intervention Question in *Harleysville*.

The Court in *Harleysville* addressed coverage in a CD action that concerned both the cost to repair faulty workmanship (which is uncovered) and the cost to repair resulting damage to otherwise non-defective components (which may qualify as covered "property damage"). *Id.* at 335, 803 S.E.2d at 296; see *Auto Owners Ins. Co. v. Newman*, 385 S.C. 187, 198, 684 S.E.2d 541, 546 (2009). In requiring the insurer to pay for both types of repair costs, *Harleysville* agreed with the Special Referee that the insurer's reservation of rights "letters were not sufficiently specific to put [its insured] on notice of [the insurer's] specific defenses, particularly as to the need for an allocated verdict." *Harleysville*, 420 S.C. at 342, 803 S.E.2d at 299.

The Court further stated that the "right to control the litigation carries with it certain duties,' including 'the duty not to prejudice the insured's rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages.'" *Id.* at S.C. at 341, 803 S.E.2d at 299 (quoting *Magnum Foods, Inc. v. Cont'l Cas. Co.*, 36 F.3d 1491, 1498 (10th Cir. 1994)). In Footnote 11, the Court stated:

In addition to finding [the insurer's] attempted reservation of rights to be insufficient, the Special Referee also found 'the Court has no basis upon which to make a logical assessment of the jury's purpose when it awarded the general verdict' as to the negligent construction, breach of warranty, and breach of fiduciary duty claims, and the Special Referee refused to 'engage in unguided speculation with respect to this issue of [allocating losses], particularly when the dilemma now confronting *Harleysville* is of its own making.' See *Newman*, 385 S.C. at 198, 684

S.E.2d at 547 (finding that even though arbitrator's award improperly included amounts for replacing and repairing faulty workmanship itself, there was insufficient evidence in the record to allow the Court to determine which costs were solely attributable to the non-covered faulty workmanship and finding that the insurer's duty to indemnify therefore covered the entire award).

Harleysville, 420 S.C. at 343 n.11, 803 S.E.2d at 300 n.11.

The Court made no express reference to the intervention issue, and cited to *Newman*, without explanation. *Newman*, which involved an arbitration of a defective-stucco claim, held that the policy's terms "prohibit[ed] recovery for the cost of removing and replacing the defective stucco—even when the replacement of the defective work may be incidental to the repair of property damage covered by the policy," and that "any amount in the arbitrator's allowance allotted to the removal and replacement of the defective stucco is not covered under the CGL policy." 385 S.C. at 198, 684 S.E.2d at 546. However, *Newman* found it was "not possible from the record before this Court to determine what portion of the arbitrator's itemized list of damages may be attributed to the removal and replacement of the defective stucco, and it is not the purpose of this declaratory judgment action to relitigate the issue of damages." *Id.* at 198, 684 S.E.2d at 547. The insurer "had an opportunity to raise this matter when the issue of damages was litigated before the arbitrator, who issued a final, binding award on the merits." *Id.* Although recognizing that the insurer defended its insured "with a reservation of rights and an understanding that the coverage issue would be reserved for judicial consideration in a separate proceeding," the Court held the insurer responsible for the entire award because when "the arbitrator determined damages, [the insurer] did not seek review of or otherwise contest the damages award." *Id.* at 198 n.5, 684 S.E.2d at 547 n.5. Thus, the arbitrator in *Newman* suggested that the insurer could have taken some action—perhaps intervention—to obtain an allocated award, and failure to do so obligated the insurer to pay all damages, even those which were expressly not covered under the policy. Indeed, the Special Referee in *Harleysville* in its decision concluded that, under *Newman*, one of the

reasons the insurer could not “relitigate” the allocation of damages was its “decision not to file a motion to intervene or otherwise seek an allocated verdict as it could have done under Rules 24 and 49, SCRCP.”² *Harleysville v. Heritage*, S.C. Sup. Ct. No. 2013-001281, Consolidated Record on Appeal, p.56. However, because Footnote 11 in *Harleysville* did not expressly approve or disapprove the Special Referee’s interpretation of *Newman*, tension has arisen over the Court’s intent in its citation.

Responding to *Harleysville*’s citation to *Newman*, the dissent wrote that “there is no suggestion how *Harleysville* could have intervened in these lawsuits and asserted a defense against coverage without creating an impermissible conflict of interest in violation of established South Carolina law.” *Harleysville*, 420 S.C. at 363, 803 S.E.2d at 311 (Pleicones, Acting Justice, dissenting) (citing *Sims v. Nationwide Mut. Ins. Co.*, 247 S.C. 82, 145 S.E.2d 523 (1965)).

Footnote 11 in *Harleysville*, when read in conjunction with *Newman* and with the *Harleysville* dissent, has led some litigants to conclude that insurers must intervene to request a special verdict. As noted above, at least one trial court has agreed with this reading of *Harleysville*. See Appendix 7–13. Hartford has moved to intervene in CD cases in an abundance of caution. *Amici* request clarification from the Court that it did not intend for *Newman* and *Harleysville* to create new South Carolina law requiring insurers to intervene for purposes of allocating between covered and uncovered damages in lieu of preserving those issues for coverage litigation.

² Available at <http://ctrack.sccourts.org/public/document/view.do?documentID=195246>. Hartford cites the docket materials not for the truth of any statement in those materials, but to examine what was (and was not) reviewed, argued, and decided by this Court in *Harleysville*.

B. The Barefoot Orders Cited Compelling Reasons Why Intervention Is Neither Necessary Nor Desirable.

In denying a number of insurers' motions for intervention, Judge Newman's Barefoot Orders found that *Harleysville* "does not mandate that the Insurers have a right to intervene to ask special interrogatories or request special verdict forms." Appendix 5. Judge Newman cited four other reasons why, in his judgment, South Carolina law generally prohibits and does not require intervention for allocation of covered versus uncovered damages pursuant to an insurance policy: (1) an insurer lacks standing to intervene under Rule 24, SCRPC; (2) a declaratory judgment proceeding is better-equipped to make a post-verdict allocation; (3) injecting coverage-related allocation issues into the CD trial puts defense counsel in a difficult position; and (4) there is too great a potential for jury confusion or unfair prejudice to the parties. *Amici* urge the Court to clarify *Harleysville* in accordance with the reasons identified in the Barefoot Orders.

1. Rule 24, SCRPC and *Ex parte GEICO* Conclude an Insurer has No Standing to Intervene in an Underlying Case.

The Barefoot Orders, in denying intervention motions filed by Hartford and other insurers, began by focusing on this Court's decision in *Ex parte Gov't Employee's Ins. Co.*, 373 S.C. 132, 644 S.E.2d 699 (2007) ("*Ex parte GEICO*"). See Appendix 4. There, GEICO moved to intervene in a proceeding to validate a common law marriage between its named insured and an individual making a claim under GEICO's policy. *Id.* at 134–135, 644 S.E.2d at 700. GEICO had denied coverage because the claimant was not its insured's spouse, and it sought to intervene because "the family court's decision on the parties' common law marriage would impact GEICO's ability to protect its interests under the insurance policy." *Id.* This Court found no standing to intervene under Rule 24, SCRPC, because "GEICO's interest is in the financial implications of the family court's decision, which is peripheral to the subject matter before the [family] court." *Id.* at 138–39, 644 S.E.2d at 702 (applying *Bailey v. Bailey*, 312 S.C. 454, 458, 441 S.E.2d 325, 327 (1994)).

Drawing an analogy to *Ex parte GEICO*, the Barefoot Orders held that Hartford's "interest arises solely out of its contract of insurance with its insured and those interests are not appropriate to be litigated or interjected into this construction defect action. Intervention is not appropriate simply because a non-party only has a monetary interest in the outcome of the case." Appendix 4-5. That analogy on this issue, however, is not perfect because *Harleysville* suggests the insurer's interest is more than financial.

It is true that these actions are CD actions, not insurance coverage actions. But *Newman* faulted the insurer for *not* raising the allocation issue "when the issue of damages was litigated before the arbitrator." 385 S.C. at 198, 684 S.E.2d at 547. *Harleysville* cited authority stating that an insurer has a "duty not to prejudice the insured's rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages." 420 S.C. at 341, 803 S.E.2d at 299 (quoting *Magnum*, 36 F.3d at 1498). It is unclear if this passage suggests that an insurer's interest in an allocated verdict is not merely a financial interest, but part of a duty to protect its insured from prejudice.

The mandatory-intervention reading of *Harleysville* and *Newman* is in tension with *Ex parte GEICO*'s interpretation of Rule 24, SCRCF. *Newman* involved an arbitration, not a jury trial. And in *Harleysville*, the Court did not mention intervention or opine as to how the insurer could have intervened under that rule. As the Court did not expressly address *Ex parte GEICO* in *Harleysville* or *Newman*, it stands to reason that insurers do not have clear standing to intervene under Rule 24, SCRCF or at least that is how the lower courts are interpreting the cases. Furthermore, for the other reasons discussed below, an insurer does not need to intervene in the underlying CD action to preserve their coverage defenses for subsequent coverage litigation.

2. Reservation of Issues for Separate Coverage Actions Are to the Benefit of All Parties, and Mechanisms Exist to Protect All Parties' Rights, Including Declaratory Judgment Actions.

In the Barefoot Orders, Judge Newman further reasoned that the insurers “can satisfactorily protect any purported interests they may have in a separate declaratory judgment action,” and that “to avoid impermissible conflict determining coverage issues, this state requires a separate action.” Appendix 5 (citing *Sims v. Nationwide Mut. Ins. Co.*, 247 S.C. 82, 145 S.E.2d 523 (1965)).

Sims addressed coverage under an automobile liability policy. 247 S.C. at 83, 145 S.E.2d at 523. The judge in the tort action held that “the defendant was negligent in passing [the automobile in which the plaintiff was riding] and colliding with same, but the defendant was not willful.” *Id.* at 84, 145 S.E.2d at 524. The insurer, which had declined to defend its insured based on an intentional-injury exclusion, introduced evidence in the subsequent coverage action that the insured intentionally ran the automobile off the road and shot the driver. *Id.* This Court held that the insurer could introduce the evidence to disprove coverage. Although recognizing the general principle that “where an indemnitor has notice of and opportunity to defend an action against the indemnitee, he is bound by material facts established against the indemnitee,” the Court adopted the “unassailable” logic of an exception for conflicts of interest:

In accord is Restatement of the Law of Judgment, Section 107(a), where the rights of indemnitee and indemnitor inter se after judgment against one of them are set out, and it is stated that if the third person has obtained a valid judgment against the indemnitee, both indemnitor and indemnitee are bound as to the existence and extent of the liability if the indemnitor has been given reasonable notice of the action and requested to defend; but in Comment (g) it is stated that this rule is binding only as to issues relevant to the proceeding; and that the judgment against the indemnitee does not decide issues as to the existence and extent of the duty to indemnify, and that in a subsequent action the indemnitor may show that the circumstances under which he was required to give indemnity do not exist.

Id. at 86–87, 145 S.E.2d at 525 (quoting *Farm Bur. Mut. Auto. Ins. Co. v. Hammer*, 177 F.2d 793 (4th Cir. 1949)). *Sims* has been the law of this state for five decades, and it seems unlikely that the Court intended to abrogate it *sub silentio* in *Harleysville*.

In addition, the Restatement (Second) of Judgments offers a potential means of reconciling *Harleysville* with *Sims*.³ The section that replaced § 107 of the first Restatement (cited in *Sims*) states that an “indemnitor is precluded from relitigating those issues determined in the action against the indemnitee as to which there was no conflict of interest between the indemnitor and the indemnitee.” Restatement (Second) of Judgments § 58(1)(b). Such a “conflict of interest” arises “when the injured person’s claim against the indemnitee is such that it could be sustained on different grounds, one of which is within the indemnitor’s obligation to indemnify and another of which is not.” *Id.* § 58(2). The accompanying commentary notes that a reservation of rights may be necessary. *Id.* § 58 cmt. a. Under this persuasive authority, so long as an insurer has advised its insured of the distinction between covered and uncovered damages in a reservation-of-rights letter, the final judgment rule does not bar subsequent litigation over the scope of the insurer’s indemnity obligation.

The *Amici* request the Court to confirm that the determination of coverage and the allocation of covered versus noncovered damages should be addressed in a separate declaratory judgment action.

3. Mandatory Intervention Creates Unnecessary Tension between Underlying Liability Issues and Coverage Issues.

Judge Newman’s Barefoot Orders further held, in denying the insurer motions, that “the deep injection of insurance coverage issues into this construction defect action would place counsel

³ This Court has looked to other provisions of the Restatement (Second) of Judgments regarding a judgment’s preclusive effect. *See Catawba Indian Nation v. State*, 407 S.C. 526, 536, 756 S.E.2d 900, 906 (2014); *Judy v. Judy*, 393 S.C. 160, 168, 712 S.E.2d 408, 412 (2011).

defending an insured in an irreconcilable conflict created by the diametrically opposed goals.” Appendix 5. It reasoned that “on the one hand, counsel must try to minimize its insured’s liability by showing lack of consequential damages and, on the other hand, counsel would likely be faced with the necessity of proving consequential damages in order to trigger and maximize coverage for its insured.” *Id.*

Sims and the Restatement favor separate resolution of coverage questions where a conflict of interest exists between insurer and insured. *Supra* § I.B.2. If a plaintiff puts on evidence unreasonably weighted toward consequential damages, with an eye to maximize coverage, defense counsel’s paramount loyalty to the insured would restrict or prevent a challenge to the plaintiff’s allocation. *See High Plains Co-op. Ass’n v. Mel Jarvis Constr. Co.*, 137 F.R.D. 285, 290–291 (D. Neb. 1991) (denying intervention, based in part on concerns regarding a conflict of interest for defense counsel).

There are other reasons, apart from coverage, that may persuade defense counsel, in the best interests of their client (the insured), not to challenge an unreasonable allocation. “One of the hardest decisions defendants in civil cases have to make, in both personal injury and commercial cases, is whether to argue liability only, or to argue both liability and damages.” Thomas A. Mauet, *TRIALS: STRATEGY, SKILLS, AND THE NEW POWER OF PERSUASION* 480 (Aspen 2015). “Views differ. Some defense lawyers believe that you cannot credibly argue both liability and damages, and that if you do, you essentially concede liability.” *Id.* Defense counsel should be able to make that strategic decision whether to argue damages, without fear of potential consequences for coverage.

4. There is Significant Potential for Confusion and Prejudice Before a Jury.

Finally, the Barefoot Orders found that an allocated verdict “will likely be confusing to the jury and may unfairly prejudice the parties participating in the trial due to the interjection of

extraneous insurance coverage issues into an already complex construction defect case, particularly given that there may not be any evidence in the record to support the special interrogatories and/or special verdict forms.” Appendix 5.

These findings suggest that allocated verdicts will not be workable in the typical CD trial. The decision whether to allow the submission of a special verdict form or interrogatories to a jury is committed to a Circuit Court’s discretion. *See* Rule 49, SCRCPP; *S.C. Dep’t of Transp. v. First Carolina Corp. of S.C.*, 372 S.C. 295, 301, 641 S.E.2d 903, 906 (2007). Evidence of insurance should not come in as evidence of a defendant’s liability insurance is highly prejudicial and inadmissible. *See* Rule 411, SCRE; *Todd v. Joyner*, 385 S.C. 509, 514, 685 S.E.2d 613, 616 (Ct. App. 2008), *aff’d*, 385 S.C. 421, 685 S.E.2d 595 (2009). In addition, the Barefoot Orders noted the potential for confusion if the jury does not have the evidence to make an allocation which would likely be the case, since there may be very little to no evidence presented for an allocation. Furthermore, the evidence necessary for an allocation between covered and uncovered damages under an insurance policy, requires a different analysis than a jury may conduct in terms of allocating liability amongst defendants. Particularly because the final judgment rule does not bar a subsequent allocation, *supra* § I.B.2, asking the jury to opine on issues and allocations that may not be part of the evidence presented could unnecessarily complicate the jury’s task and could even impede their final resolution.

II. IF THIS CASE SETTLES BEFORE A DECISION ISSUES, THE COURT SHOULD DECIDE THIS APPEAL UNDER EXCEPTIONS TO THE MOOTNESS DOCTRINE.

The docket in this appeal reflects that some insurers have settled on behalf of their insureds and moved to dismiss their appeals as moot. Hartford does not know if the remaining claims will settle before the Court has a chance to resolve these important recurring questions. Regardless, the Court may issue a decision in a moot appeal if the issues are “capable of repetition but generally

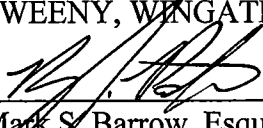
will evade review,” or if there is an “imperative and manifest urgency to establish a rule for future conduct in matters of important public interest.” *S.C. Public Interest Found. v. S.C. Dept. of Transp.*, 421 S.C. 110, 121–22, 804 S.E.2d 854, 860–61 (2017). Hartford urges the Court to exercise its discretion to decide this appeal in the event that the remaining appeals settle.

CONCLUSION

Amici ask the Court to conclude that intervention in an underlying construction defect action is not mandatory, and that a reservation of rights letter issued in accordance with *Harleysville* is sufficient to preserve the right to allocate between covered and uncovered damages in a separate declaratory judgment action.

September 6, 2019

SWEENEY, WINGATE & BARROW, P.A.


for Mark S. Barrow, Esquire
Christy E. Mahon, Esquire
1515 Lady Street
Post Office Box 12129
Columbia, South Carolina 29211
803-256-2233

Steven M. Klepper, Esquire
(*pro hac vice* motion pending)
KRAMON & GRAHAM, P.A.
One South Street, Suite 2600
Baltimore, Maryland 21202
410-752-6030

Attorneys for Amici Curiae Hartford Fire Insurance Company, Hartford Casualty Insurance Company, and Hartford Underwriters Insurance Company