IN THE STATE OF SOUTH CAROLINA

In the Supreme Court

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S.C. SUPREME COURT

APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas

Jennifer B. McCoy, Circuit Court Judge

Case No. 2015-CP-10-00955

Appellate Case No. 2019-000238

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 Lowe, 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 Building 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 Does 1-60,.....Defendants,

And

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 Lowe, individually, and on behalf of all others similarly situated, Tri-County Roofing, Inc., Stanley's Vinyl Fence Designs, WC Services, Inc., Elroy Alonzo Vasquez, and Miracle Siding, LLC and Wilson Lucas Sales d/b/a Miracle Siding, LLC, are ..... Respondents,

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I. Insurers have a right to allocate between covered and non-covered damages.

Some of the briefs filed in this appeal appear to argue that it is unreasonable for insurers to allocate between covered and non-covered damages. None of the cited authority supports such a position.

Standard Commercial General Liability (CGL) policies are drafted to grant broad liability coverage for property damage and bodily injury claims, and to narrow this coverage through policy exclusions. Precision Walls, Inc. v. Liberty Mut. Fire Ins. Co., 410 S.C. 175, 180, 763 S.E.2d 598, 600 (Ct. App. 2014). There is nothing unusual about this method—statutes are often drafted in the same manner. For example, the South Carolina Tort Claims Act broadly waives sovereign immunity, but subjects that broad waiver to various exceptions. S.C. Code Ann. §§ 15-78-40 and -60. Like statutes, insurance contracts are to be read as a whole. Reeves v. S.C. Mun. Ins. and Risk Fin. Fund, 832 S.E.2d 312, 317 (Ct. App. 2019).

CGL policies typically do not promise categorical coverage for the full amount of all property damage claims. The policy language extends coverage for such claims "to which this insurance applies." (Nationwide Policy attached to its Mot. to Intervene, Form ACP-0007 (6-05), ¶ A.1.a.) Various policy provisions clarify the types of property damage claims to which the insurance applies. The "property damage" (as defined in the policy) must be caused by an "occurrence." (Id., ¶ A.1.b.(1)(a).) The "property damage" must occur during the policy period. (Id., ¶ A.1.b.(1)(b).) Claims that are excluded are those to which the insurance does not apply. (Id., ¶ B.1.)

Under South Carolina law, insurers have a right to define the scope of their obligations through policy exclusions as long as those limitations do not contravene public

policy. B.L.G. Enters., Inc. v. First Fin. Ins. Co., 334 S.C. 529, 335-36, 514 S.E.2d 327, 330 (1999). Public policy does not prohibit liability carriers from excluding coverage for defective work performed by their insureds. In fact, courts generally recognize that building contractors should not be able to pass off their responsibility for repairing defective work to liability insurers. C.D. Walters Constr. Co., Inc. v. Fireman's Ins. Co. of Newark, N.J., 281 S.C. 593, 596, 316 S.E.2d 709, 711 (Ct. App. 1984) (distinguishing between defective work and accidental resulting damage); S.C. Code Ann. § 38-61-70(B)(2) (defining "occurrence" to exclude faulty workmanship).

At the risk of stating the obvious, liability insurers are not building contractors. They do not contract to build houses, nor are they licensed to perform such work. Insurers become involved in construction defect litigation only through the CGL policies they issue, which function as indemnity agreements. Town of Winnsboro v. Wiedeman-Singleton, Inc., 303 S.C. 52, 56, 398 S.E.2d 500, 502 (Ct. App. 1990) (citing third party liability insurance policies as an example of contractual indemnity). "Contractual indemnity involves a transfer of risk for consideration, and the contract itself establishes the relationship between the parties." Rock Hill Tel. Co., Inc. v. Globe Communications, Inc., 363 S.C. 385, 389, 611 S.E.2d 235, 237 (2005).

Liability carriers are not responsible for defective construction. Instead, they contract to assume liability of their insureds, subject to the terms of their CGL policies. The scope of liability insurers' assumed liability is not defined by the damages awarded against their insureds, but rather by the terms of their indemnity contracts—the policies.

The insuring agreement in the policy, read in isolation, does not define the scope of coverage. Precision Walls, 410 S.C. at 180, 763 S.E.2d at 600. Insurer's duties are not

defined by extracontractual, parol notions about what an insurance policy should cover. It is the contract, read as a whole, that establishes the relationship between the parties. Rock Hill Telephone, 363 S.C. at 389, 611 S.E.2d at 237; Reeves, 832 S.E.2d at 317.

The Tyger River doctrine does not stand for the proposition that policy provisions are to be ignored. The court in that case addressed liability insurers' handling of claims. The liability carrier had the opportunity to settle the case for an amount within the policy limit. Tyger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346, 347 (1933). Instead, the insurer took the case to trial, and the jury returned a verdict against the insured in excess of the policy limit. Id. The insurer then paid its policy limit, leaving the insured to pay the remainder. The carrier relied upon a Kentucky case in support of its position. Id. at 348 (citing Georgia Cas. Co. v. Mann, 242 Ky. 447, 46 S.W.2d 777 (Ct. App. 1932)). The Kentucky court had noted a split of opinions and adopted the rule that an insurer is not liable for an excess verdict in the absence of bad faith. Georgia Cas., 46 S.W.2d at 779-80. This Court disagreed with the Kentucky court and held that an insurer may be liable for an excess verdict based upon negligence. Tyger River, 170 S.E.at 348. In so holding, this Court opined that insurers may not look to their own interests; they must sacrifice their own interests to those of their insureds. Id. However, from the context it is apparent that this statement is addressed to an insurer's conduct of the defense and settlement negotiations. See Harleysville Group Ins. v. Heritage Cmties., Inc., 420 S.C. 321, 338, 803 S.E.2d 288, 298 (2017) (citing Tyger River for the proposition that an insurer may not use its right to control the defense to the detriment of the insured).

Subsequent case law has not read Tyger River to apply to the determination as to which claims are covered under an insurance policy. B.L.G., 334 S.C. at 535, 514 S.E.2d

at 330 (recognizing that insurance policies are construed as contracts). If this Court's statement in Tyger River is read broadly, there would be no limit to liability insurers' liability. A rule that insurers must always sacrifice their own interest to those of their insureds would circumvent the policy terms and conform them to the subjective notions of the insureds. This Court has not adopted such a rule. See Bell v. Progressive Direct Ins. Co., 407 S.C. 565, 581, 757 S.E.2d 399, 407 (2014) (holding that the reasonable expectations doctrine may be used as an interpretive tool, but it cannot be used to alter the plain terms of an insurance policy).

A ruling that requires insurers to pay more than what the terms of their policies require has long-term consequences. Insurers are essentially businesses that pool resources for the payment of covered claims. S.C. Code Ann. § 38-1-20(25), (28), and (33) (defining "insurance" and "insurer"); 1 Couch on Ins. §§ 1:6 and 1:9 (June 2019 Update). Insurers do not simply absorb the losses that occur when they are required to pay amounts that are not covered. Courts have recognized that these losses are passed to the public at large in the form of higher insurance premiums. Magnum Foods, Inc. v. Continental Cas. Co., 36 F. 3d 1491, 1498 (10th Cir. 1994) (holding that punitive damages should not be covered because "Society would then be punishing itself rather than the actual author of the wrong"). Higher CGL premiums mean higher housing costs. Moreover, forcing CGL carriers to pay for defective work does nothing to alleviate the root cause of the problem—it merely enables contractors to continue performing substandard work without consequences.

Courts in other jurisdictions, in cases this Court has cited, recognize that a damages award against an insured may include sums that are not covered under applicable liability

coverage. Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co., 819 N.W.2d 602, 617 (Minn. 2012). When that occurs, "it is not the purpose of [] declaratory judgment actions[s] to relitigate the issue of damages." Auto Owners v. Newman, 385 S.C. 187, 198, 684 S.E.2d 541, 547 (2009). However, it is a purpose of such actions to determine, as a matter of contract, which portions of the damages award are covered.

When a liability carrier receives notice of a claim, its options are limited. If the insurer believes all or part of the claim is not covered, its only option (other than categorically denying coverage and facing the consequences) is to file a declaratory judgment action. 14 Couch on Ins. § 202:1 (June 2019 Update). Under the law of many states, the preferred course of action is for an insurer to file a declaratory judgment. See, e.g., Richmond v. Georgia Farm Bureau Mut. Ins. Co., 140 Ga. App. 215, 217, 231 S.E.2d 245, 247 (Ct. App. 1976) ("A proper and safe course of action for an insurer in this position is to enter upon a defense under a reservation of rights and then proceed to seek a declaratory judgment in its favor.").

The purpose of a legal action is specified by the complaint. Rule 8(a), SCRCP. The South Carolina Constitution confers general jurisdiction upon the circuit courts. S.C. Const. Art. V, § 11; Jones v. S.C. Republican Party, 425 S.C. 339, 344, 822 S.E.2d 333, 335 (2018). Moreover, many coverage actions are heard in federal courts, which may not be affected by a state court ruling as to the "purpose" of a declaratory judgment action. The authority of courts to issue declaratory judgments is created by statute. S.C. Code Ann. § 15-53-20. Thus, courts have authority to allocate between covered and non-covered damages payable under a contract.

The problem that occurs in attempting to allocate between covered and non-covered damages is evidentiary in nature. The Court of Appeals of Minnesota described the issue in this way:

> Sometimes the bases of liability may be unstated or stated in vague or ambiguous terms; in that situation, both an insurer and an insured face problems of proof. If liability arises from a settlement but there is no definitive statement of the legal bases of the insured's liability, the indemnification question may depend on circumstantial evidence. For example, the evidence presented to the jury constitutes the claim of a party such that it supersedes the party's description of the claim as well as the party's discovery responses and trial memorandum.

Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co., 806 N.W.2d 82, 93-94 (Minn. Ct. App. 2011) (citations omitted), rev'd on other grounds, 819 N.W.2d 206 (2012). It may be difficult to ascertain the bases for a damages award in a subsequent coverage action. However, this does not mean that allocating is impossible as a matter of law.

II. The type of allocation necessary in cases involving coverage for construction defect is best addressed in separate declaratory judgment actions.

Nationwide disagrees with the position that intervention by insurers to submit special interrogatories or a special verdict form to the jury is a workable procedure. The basic reason such a procedure is unworkable is that it would require juries to render verdicts upon questions that were not submitted to them for trial.

"A 'verdict' is a formal decision or finding made by a jury, impaneled and sworn for the trial of a cause, reported to the court and accepted by it, upon matters or questions duly submitted to the jury upon a trial." 89 C.J.S. Trial § 981 (Sept. 2019 Update). "A verdict is the jury's answer to the questions of fact contained in the issue formed by the pleadings of the parties." Id. Thus, a jury determination qualifies as a "verdict" only if it is based upon matters or questions pled and submitted upon a trial. State v. Jernigan, 122 S.E.2d 711, 714, 255 N.C. 732, 736 (1961).

It is questionable whether a "special verdict" or a jury's answers to "special interrogatories" upon matters or questions that were not pled and tried before it would have any preclusive effect in a separate action. The doctrine of collateral estoppel only applies to issues that were actually litigated and directly determined in a prior action. Carolina Renewal, Inc. v. S.C. Dep't of Transp., 385 S.C. 550, 554, 684 S.E.2d 779, 782 (Ct. App. 2009).

However, Nationwide is mindful of the fact that the need for allocation may arise in a variety of different circumstances. Some questions that may affect coverage may be appropriate for submission to a jury in the trial against the insured. The proper procedure may depend upon the policy language at issue and the procedural posture in which the need for allocation arises.

Some insurance coverage is written to cover only specified types of claims. For example, CGL policies contain a separate coverage for "personal and advertising injury." See Owners Ins. Co. v. Clayton, 364 S.C. 555, 559, 614 S.E.2d 611, 613 (2005). This coverage ("Coverage B") applies only to certain enumerated offenses. Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Distribs., Inc., 839 F. Supp. 376, 381 (D.S.C. 1993). Since Coverage B operates on a per-claim basis, this Court has held that coverage exists when a general verdict is rendered in the underlying case and at least one of the causes of action submitted to the jury is covered. Owners, 364 S.C. at 557, 614 S.E.2d at 613. [1]

In contrast, Coverage A does not insure against theories of liability, but rather against types of covered events. Botany Bay Marina, Inc. v. Great American Ins. Co., Civ.

[1] In Owners, the insurer agreed to the general verdict form. Order Granting Land Inn's Mot. for Summ. J., pp. 6-7, Civil Action No. 2001-CP-10-03629 (Charleston County Ct. Comm. Pl. filed Mar. 10, 2004), available at https://www.sccourts.org.

A. No. 2:90-501-18, 1992 WL 356773 at *5 (D.S.C. July 29, 1992). Coverage A broadly insures against claims for accidental bodily injury or property damage. Consequently, courts analyzing claims under Coverage A have "looked behind the labels" to the underlying facts upon which the claims against the insured are based. Collins Holding Corp. v. Wausau Underwriters Ins. Co., 379 S.C. 573, 578, 666 S.E.2d 897, 900 (2008). Due to the policy language, the existence of coverage under Coverage A depends upon the nature of the defendant's conduct, as opposed to the plaintiff's theories of liability.

Some factual circumstances may call for allocation in the underlying case against the insured. In Duke v. Hoch, 468 F.2d 973, 377 (1972), one of the causes of action had a separate and independent factual basis. Most of the plaintiff's claims were for professional negligence. Id. at 975. However, one of the causes of action, the "trust account claim," was based upon misappropriation of funds. Id. at 975-76. The court ruled that the trust account claim was not covered. Id. at 976. The issue in Duke was how to allocate between the damages awarded on the non-covered trust account claim, as opposed to the covered professional negligence claims.

The court's resolution in Duke makes perfect sense given the factual circumstances of that case. The determination as to how much damages should be awarded on particular causes of action is within the province of a jury to which a case has been tried. The Duke court held, under the circumstances of that case, that the insurer must notify the insured via a reservation of rights letter to seek an allocated verdict. 468 F.2d at 979.

Under the circumstances before the court in Duke, it may be necessary for the allocation to occur in the underlying case. This creates a conflict of interest between the insured defendant (and the plaintiff), who desire full coverage, as opposed to the insurer,

who desires to enforce the contract. Duke 468 F.2d at 979. However, intervention by an insurer may not be necessary to resolve this conflict.

While the insured and the plaintiff may desire full coverage, they are only contractually entitled to what the policy provides under governing law. Insurance policies impose a duty of cooperation upon insureds that can void coverage when violated. Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C., 433 F.3d 365, 376 (4th Cir. 2005). Moreover, a duty of good faith and fair dealing is implied in every contract. Butler Contracting, Inc., v. Court St., LLC, 369 S.C. 121, 132, 631 S.E.2d 252, 258 (2006). The duty of good faith applies not only to insurers, but to insureds also. Sec. Mut. Life Ins. Co. of N.Y. v. DePasquale, 302 A.D.2d 267, 267 (N.Y. App. Div. 2003); 14 Couch on Ins. § 199:3 (June 2019 Update). Courts have held that collusive settlements to the detriment of insurers are invalid. St. Paul Travelers v. Payne, 444 F. Supp. 2d 519, 521-22 (D.S.C. 2006). Moreover, ethical obligations require lawyers to zealously advocate for their clients, "but that responsibility does not imply that a lawyer may disregard the rights of third persons." Rule 4.4(a) cmt.[1], SCRPC, Rule 407, SCACR.

The duty of zealous advocacy should not be read so broadly as to prohibit the lawyers in the underlying case from requesting an allocated verdict when they know it will be necessary for ascertaining liability coverage. If a general verdict is rendered over the liability carrier's objections, after proper notice in a reservation of rights letter, then the carrier should not be prohibited from allocating in a separate coverage action.

However, Duke is distinguishable from the present case. The applicable policy provisions and South Carolina law both require an allocation (at a minimum) between damages awarded for defective work, as opposed to damages awarded for resulting

"property damage." Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co., 395 S.C. 40, 50, 717 S.E.2d 589, 594 (2011). This determination is typically not tried to a jury in the underlying case. (See Initial Br. of Resp'ts, p. 1.)

Nationwide is not aware of any case other than Newman that would appear to categorically prohibit an insurer from allocating between covered and non-covered damages in a separate coverage action. Prior to Newman, the extent of an insurer's duty to indemnify was ascertained based upon the record from the underlying case. See e.g., Botany Bay Marina, 1992 WL 356773at *5 ("The parties have agreed that this court should determine, based on the parties' legal memoranda and the underlying trial transcript, whether the loss for which Mr. Browder was awarded judgment in the underlying action was a covered loss."). In other jurisdictions, insurers have sometimes attempted to use the lack of an allocated verdict as a shield to avoid paying claims. See Remodeling Dimensions, 819 N.W.2d at 609-10. Nationwide has made no such argument in this case.

The Court of Appeals ruled in this case that the trial should go forward, and a general verdict was awarded over the insurers' objections. Because the evidence and arguments necessary for allocation for coverage purposes were not tried to the jury in the underlying case, the insurers should not be prevented from seeking declaratory relief as to how the damages awarded (or that may be awarded) should be allocated for coverage purposes in separate coverage actions.

III. Nationwide has standing to intervene if this Court rules that such action is necessary to support an allocation between covered and non-covered damages.

Nationwide recognizes that applications for intervention by insurers may not fit the mold as to what intervention typically entails. However, the Respondents' characterization of Rule 24, SCRCP is unduly narrow. Rule 24(a) does not require an intervenor to "have

an interest in the actual subject matter of this action." (See Initial Br. of Resp'ts at p. 12.) Intervention as of right must be permitted when "the applicant claims an interest *relating to* the property or transaction which is the subject of the action." If the applicant is "so situated that the disposition of the action *may as a practical matter* impair or impede his ability to protect that interest," intervention must be allowed. Rule 24(a), SCRCP.

Respondents define "the subject of the action" narrowly so as to only include what was pled by the parties. Respondents overlook the fact that this Court specifically stated that it is not the purpose of a separate coverage action to "relitigate the issue of damages" and that allocation is not possible if the supporting record is not created in the underlying construction defect action. Newman, 385 S.C. at 198, 684 S.E.2d at 547. Nationwide did not seek to inject coverage issues into this action; in fact, it is seeking declaratory relief as to coverage in a separate action. After this Court issued its opinion in Ex Parte Gov't Employee's Ins. Co., 373 S.C. 132, 644 S.E.2d 699 (2007), in which it held that liability insurers lack standing to intervene, this Court subsequently ruled in Newman that certain coverage determinations must be made in the underlying case. If insurers' rights are adjudicated in underlying construction defect actions, then insurers have an interest relating to the property or transaction which is the subject of the action. Rule 24(a), SCRCP. Permissive intervention pursuant to Rule 24(b) should be permitted for the same reasons.

Seeking intervention was Nationwide's only means of obtaining relief given the current state of South Carolina law. The South Carolina Constitution provides that no person shall be deprived of property without due process of law. S.C. Const. Art. I, § 3. Minimal procedural due process affords a litigant notice and the opportunity to be heard. Garris v. Governing Bd. of S.C. Reinsurance Facility, 333 S.C. 432, 444, 511 S.E.2d 48,

54 (1998). The courts of this State are established and open to the public for the speedy remedy for wrongs sustained. S.C. Const. Art. I, § 9. Furthermore, equity will not suffer a wrong to go without a remedy. Lane v. N.Y. Life Ins. Co., 147 S.C. 333, 145 S.E. 196, 207 (1928). If Newman is held to prevent allocation in a separate action, then Nationwide must be allowed to intervene in this action to appear and litigate questions of allocation to whatever extent Newman requires and to the fullest extent necessary to protect Nationwide's due process rights.

CONCLUSION

If this proceeding is held to be the only forum for obtaining factual findings necessary for allocating between covered and non-covered damages, then Nationwide's motion to intervene should not have been denied. However, Nationwide's preferred relief is a ruling that liability insurers may contest allocation in a separate declaratory judgment action under Sims v. Nationwide Mutual Insurance Co., 247 S.C. 82, 145 S.E.2d 523 (1965).

Nationwide recognizes that the immediate issue on appeal only concerns its request to intervene. However, both carriers have filed parallel declaratory judgment actions which are pending at this time. If this Court rules only that the motions to intervene were properly denied, the question of Newman's impact on Sims will most likely be brought back before this Court, possibly via certification. Since the key question in this appeal is whether Newman and its progeny were intended to overrule Sims, Nationwide requests a ruling that Sims remains good law. Respondents do not appear to dispute Nationwide's position on that critical issue. (See Initial Br. of Resp'ts, p. 14.)

Respectfully submitted,

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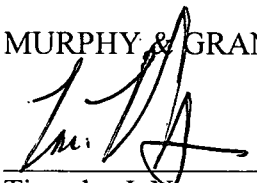

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I certify that I have served Appellant, Nationwide Mutual Insurance Company's Initial Reply Brief, via regular and/or electronic mail, on October 21, 2019, to the following attorneys of record:

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