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Post by Logan Wells

Jessco, Inc. v. Builders Mutual Insurance Co: Part 1 - “Your Work,” Late Notice, and the Duty to Indemnify

A recent opinion of the United State Court of Appeals for the Fourth Circuit addressed a multitude of issues presented in litigation involving commercial general liability policies – the “your work” exclusion, late notice, and the duty to indemnify.

On March 29, 2012, in *Jessco, Inc. v. Builders Mutual Insurance Co.*, the Fourth Circuit affirmed in part, reversed in part, and remanded by unpublished per curiam opinion the judgment of the United States District Court for the District of South Carolina, thereby finding that Builders Mutual Insurance Co. (“BMIC”) had a duty to defend Jessco, Inc. (“Jessco”) in the underlying construction-defect action, but BMIC was not obligated to indemnify Jessco for the re-grading allowance it paid to the underlying plaintiff homeowners.

In *Jessco, Inc.*, the Mazycks hired Jessco to build a house in a North Charleston subdivision. After moving into the house in 2004, they provided Jessco with a punch list of items to be completed or repaired. These items were not resolved to the Mazycks’ liking, and in 2005, they filed the underlying suit against Jessco, alleging, among other things, that their lot flooded due to improper grading. In 2006, the action was stayed so the claims could be arbitrated. In the fall of 2007, experts for the Mazycks identified water damage to the house caused by the flooding of the property.

In October 2007, after the escalation in the Mazycks' demands, Jessco finally notified BMIC of the underlying claims. BMIC concluded the claims were not covered by the Policy and Jessco failed to promptly notify BMIC of the lawsuit. Accordingly, BMIC refused to defend or indemnify Jessco with regard to the underlying suit. Jessco thereafter filed a declaratory judgment action seeking a declaration that the claims in the underlying action were covered by the Policy. BMIC counterclaimed, seeking a declaration that it was not obligated to defend or indemnify Jessco.

The arbitration hearing on the Mazycks' claims was conducted in late 2008. The arbitrator issued his award in April 2009, ordering Jessco to pay almost $55,000 in damages. As to the flooding issue, the arbitrator concluded the flooding was proximately caused by "the overcapacitation of the wetlands, caused by the overall design and development of the surrounding neighborhood." Although the arbitrator found that Jessco's work was "not the legal proximate cause of the flooding of [the Mazycks'] property," the award included a $10,000 allowance for re-grading of the lot. BMIC appealed, challenging the district court’s determination that (1) BMIC had a duty to defend Jessco in the underlying action; and (2) BMIC had a duty to indemnify Jessco for the re-grading allowance.

Duty to Defend

In asserting it had no duty to defend, BMIC argued (1) coverage for the Mazycks' claims was excluded by the Policy's "your work" exclusion; and (2) Jessco failed to notify BMIC of the underlying lawsuit "as soon as practicable" as required by the Policy.

BMIC did not dispute on appeal that the allegations of the underlying complaint raised the possibility of "property damage" caused by an "occurrence," but instead contended it had no duty to defend because coverage for the claims was excluded under the "your work" exclusion, which excluded coverage for any claims of "'[p]roperty damage' to 'your work' arising out of it or any part of it." "Your work" was defined as "[w]ork or operations performed by you or on your behalf," a definition broad enough to encompass and preclude coverage for work done by the insured's subcontractors. Although the Policy included an exception restoring coverage for damage to work performed by a subcontractor, it also contained an endorsement removing the subcontractor exception.

BMIC argued all the work on the property was done by subcontractors on Jessco's behalf, and therefore, the "your work" exclusion barred coverage for all underlying claims. The court disagreed, noting "the exclusion does not withdraw coverage for any and all work done <u>by</u> the insured or its subcontractors; it withdraws coverage in cases where the insured causes property damage <u>to</u> work done by the insured or its subcontractors... 'It does not exclude coverage for a third party's work.'" (Emphasis in original) (quoting *Limbach Co. v. Zurich Am. Ins. Co.*, 396 F.3d 358, 365 (4th Cir. 2005) (per curiam)). Thus, the court concluded, "the Policy's elimination of the subcontractor's exception means that Jessco's subcontractors will not be viewed as third-parties for purposes of determining whose 'work' was damaged, but the elimination of the exception does not, as BMIC contends, preclude coverage if Jessco's work in fact damages the work of a third party."

The court determined the Mazycks' claims against Jessco created a possibility that a third-party's work or property was damaged by the faulty workmanship of Jessco or its subcontractors, noting the contract between Jessco and the Mazycks specifically contemplated that Mr. Mazyck would perform some of the work, and that Mr. Mazyck himself installed (or hired a subcontractor to install) the flooring and landscaping. Accordingly, the court found the "your work" exclusion did not bar coverage for the underlying claims.

With regard to "late notice," BMIC argued even if the Policy otherwise provided coverage, Jessco lost its right to coverage by waiting more than two years to give notice of the underlying suit. Assuming for purposes of the opinion that notice was untimely, the court noted that under South Carolina law, "recovery under the Policy is barred only if BMIC proves that it was substantially prejudiced by the late notice." *See* *Vermont Mut. Ins. Co. v. Singleton*, 446 S.E.2d 417, 421 (S.C. 1994) ("Where the rights of innocent parties are jeopardized by a failure of the insured to comply with the notice requirements of an insurance policy, the insurer must show substantial prejudice to the insurer's rights."); *Squires v. National Grange Mut. Ins. Co.*, 145 S.E.2d 673, 677 (S.C. 1965) ("The burden of proof is upon the insurer to show not only that the insured has failed to perform the terms and conditions invoked upon him by the policy contract but in addition that it was substantially prejudiced thereby.") Therefore, because BMIC failed to present any evidence of prejudice and "prejudice to the insurer may not be presumed," the court rejected BMIC's assertion that Jessco's delay in notification precluded recovery under the Policy.

BMIC also challenged the attorney fee award; however, it failed to substantively address the issue in its brief. Accordingly, the court found BMIC had abandoned the issue. *See* *Wahi v. Charleston Area Med. Ctr., Inc.*, 562 F.3d 599, 607 (4th Cir. 2009) ("Federal Rule of Appellate Procedure 28(a)(9)(A) requires that the argument section of an appellant's opening brief must contain the 'appellant's contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies.' Because Wahi has failed to comply with the specific dictates of Rule 28(a)(9)(A), we conclude that he has waived his claims . . . .").

<u>Duty to Indemnify</u>

BMIC also contended that the $10,000 re-grading allowance was not compensation for loss caused by a covered risk. Recognizing the Mazycks asserted contract and negligence based claims against Jessco in the underlying action, the Court determined that if the re-grading allowance was awarded by the arbitrator as compensation for negligence by Jessco in grading the property, Jessco's negligence would constitute an "occurrence," and the policy would provide coverage. Thus, the court first determined the legal basis for the re-grading allowance ordered by the arbitrator:

Although the arbitrator stated that Jessco and the Mazycks both "b[ore] some responsibility for the flooding," the arbitrator ultimately determined that the flooding was caused by "the overcapacitation of the wetlands, caused by the overall design and development of the surrounding neighborhood." The arbitrator concluded that the development and overcapacitation was "an unforeseen intervening cause," and Jessco's work was "not the legal proximate cause of the flooding of [the] property."
The arbitrator's determination that Jessco's work was not the proximate cause of the flooding necessarily amounted to a rejection of any negligence-based claim asserted against Jessco. *See, e.g.,* *Hurd v. Williamsburg Cnty.*, 579

S.E.2d 136, 144 (S.C. Ct. App. 2003) ("It is apodictic that a plaintiff may only recover for injuries proximately caused by the defendant's negligence."). While there may have been some negligent conduct by Jessco, the proximate-cause determination means that Jessco could not have been held accountable to a third-party for that negligence. *See, e.g., Howard v. Riddle*, 221 S.E.2d 865, 866 (S.C. 1976) ("Plaintiff must show, as a matter of law, not only that defendant was negligent but also that his negligence was a contributing or proximate cause of the injury . . . ." (internal quotation marks omitted)).
Having established the arbitrator determined there was no actionable negligence on the part of Jessco, the court reasoned the re-grading allowance could only have been awarded as compensation for a breach of contract. Therefore, because the Policy unambiguously excluded coverage for breach of contract damages, the court found BMIC had no obligation to indemnify Jessco for the re-grading allowance paid to the Mazycks.

Having determined that BMIC owed a duty to defend Jessco in the underlying action, but did not owe a duty to indemnify Jessco for the re-grading allowance, the court vacated the district court's judgment and remanded for further proceedings consistent with the opinion.

On May 3, 2012, in *Jessco, Inc. v. Builders Mutual Insurance Co.*, upon remand by the Fourth Circuit, the United States District Court for the District of South Carolina amended its previous Judgmentand deducted $10,000.00 from the total amount previously awarded, $78,695.20, finding Jessco, Inc. ("Jessco") was entitled to a judgment in the amount of $68,695.20 plus post-judgment interest. In the same order, upon Jessco's Amended Motion for Award of Fees and Costs After Remand, addressing an issue of first impression, the court held that Builders Mutual Insurance Co. ("BMIC") was obligated to pay Jessco's attorney's fees and costs incurred on appeal.

Citing *Hegler v. Gulf Insurance Co.*, 270 S.C. 548, 550-51, 243 S.E.2d 443, 443 (1978), the court noted South Carolina courts have found an insured may be entitled to reasonable attorney fees and costs incurred in successfully defending a declaratory judgment action brought by the insurer in an effort to relieve itself of coverage under an insurance policy, reasoning that:

[A]n insured must employ counsel to defend — in the first instance in the damage action and in the second in the declaratory judgment action to force the insurer to provide the defense. In both, the counsel fees are incurred because of the insurer's disclaimer of any obligation to defend.

If the insurer ***can force [the insured] into a declaratory judgment proceeding*** and, even though it loses in such action, compel him to bear the expense of such litigation, the insured is actually no better off financially than if he had never had the contract right mentioned above.

(Alteration and emphasis in original). However, whether an insured is also entitled to recover attorney fees and costs incurred *on appeal* when (1) the insurer appeals the trial court's ruling for the insured in a declaratory judgment action, and (2) the appellate court affirms the lower court's judgment with regard to the insurer's duty to defend, had never been addressed by the South Carolina courts.

In support of its motion for attorney fees and costs, Jessco argued that whether the fees and costs arose in the context of a declaratory judgment action or in its appeal makes no difference; because in either case, the insured is doing nothing more than attempting to protect its contractual right to a defense. Thus, Jessco argued, the rationale in *Hegler* for providing relief to an insured that is "forced" into a declaratory judgment action and wins should apply equally when the insured is forced to defend its rights in the appeal of that action and wins. In opposition, BMIC argued the reversal by the Fourth Circuit as to BMIC's duty to indemnify Jessco for the re-grading allowance necessitated a finding in favor of BMIC on Jessco's motion. The court rejected BMIC's argument, noting that South Carolina courts have established the duty to defend is separate and distinct from the duty to indemnify, and Jessco's motion sought payment for fees and costs as damages suffered by Jessco for BMIC's breach of its duty to defend, ***not*** its duty to indemnify. *See USAA Prop. & Cas. Ins. Co. v. Clegg*, 377 S.C. 643, 654, 661 S.E.2d 791 (2008) (quoting *Sloan Constr. Co. v. Cent. Nat'l Ins. Co. of Omaha*, 269 S.C. 183, 186-87, 236 S.E.2d 818 (1977)).

BMIC also argued there was "simply no legal authority" supporting an award of appellate fees and costs. However, BMIC failed to produce any authority demonstrating that *Hegler* did not apply to support such an award. In response, Jessco acknowledged that the motion presented a novel legal issue, but argued there was no logical reason why *Hegler* did not apply to fees and costs incurred on appeal. The court agreed with Jessco's reasoning, finding as follows:

When BMIC appealed the declaratory judgment action, it was still seeking to avoid its obligation to defend, just as it sought to avoid its' duty to defend at the trial level. Thus, after prevailing at the trial level, Jessco was forced into the appellate process by BMIC, thereby bearing the expense, just as it was forced to bring the initial declaratory action to protect and enforce its rights. Jessco prevailed at the trial level, and on appeal, the Fourth Circuit found BMIC had a

duty to defend and affirmed this Court's judgment and damages award on that issue. *Hegler* held that an insured is entitled to recover attorney's fees and costs following a successful defense of a declaratory judgment ***action****. See Hegler*, 270 S.C. at 548 (emphasis added). The holding in *Hegler* necessarily encompasses fees and costs incurred at the appellate level of that action. The appellate expenses, like the trial level expenses, are damages arising directly out of the insurer's breach of its duty to defend. Therefore, the Court finds that Jessco is entitled to recover reasonable attorney fees and costs of defending this action on appeal from BMIC, just as it was at the trial level. *See Hegler*, 270 S.C. at 551 ("After all, the insurer had contracted to defend the insured, and it failed to do so. It guessed wrong as to its duty, and should be compelled to bear the consequences thereof.").

The court also found that Rule 222, SCACR did not prohibit an award pursuant to *Hegler*, and further, did not divest the court of authority to make such an award:

Sections (a) and (b) of Rule 222 state: "When an appeal is affirmed or reversed in part or is vacated, costs shall be allowed only as ordered by the appellate court." "In addition, the party shall be entitled to recover an attorney's fee in an amount which shall be set by order of the Supreme Court." Rule 222(b). However, the Rule "`does not preempt an award of attorney's fees to which one is otherwise entitled.'" *Muller v. Myrtle Beach Golf & Yacht Club*, 313 S.C. 412, 416, 438 S.E.2d 248 (1993) (citing *McDowell v. S.C.D.S.S.*, 304 S.C. 539, 543, 405 S.E.2d 830 (1991)). Thus, the Court may grant an award pursuant to *Hegler* because the authority pursuant to *Hegler* and the authority vested in the court of appeals pursuant to Rule 222 are not mutually exclusive.

Noting that, upon remand, the district court had jurisdiction to enforce the judgment and take any actions consistent with the Fourth Circuit’s ruling, and the *Hegler* rule did not limit the collection of attorney fees to a specific court or level of courts, the court found it could properly award appellate attorney fees and costs to an insured as damages flowing from an insurer’s breach of its duty to defend. Accordingly, the court granted Jessco’s Motion for Award of Fees and Costs After Remand.

About Logan Wells

Logan Wells is an associate practicing in the areas of premises liability, retail / hospitality / entertainment and insurance coverage. She received her undergraduate degree in history and political science from Furman University and earned her juris doctor from the University of South Carolina School of Law. During her undergraduate career, she worked for a law firm in Spartanburg as a legal assistant. While in law school, she worked as a summer associate for Collins & Lacy, before joining the firm as an attorney in the fall of 2009.

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