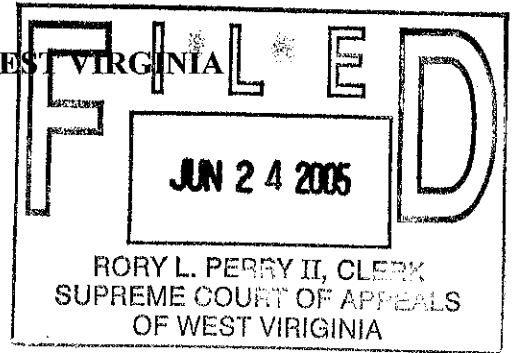


NO. 32702
IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

CHARLESTON



**FIREMAN'S FUND INSURANCE
COMPANY,**

Petitioner,

v.

**BOARD OF EDUCATION OF
THE COUNTY OF KANAWHA,**
a statutory corporation, and **PAUL
R. SKAFF, JR.,**

Respondents.

From the Circuit Court of
Kanawha County, West Virginia
Civil Action No. 02-C-1958
Judge: James C. Stucky

**FIREMAN'S FUND INSURANCE COMPANY'S
APPEAL BRIEF**

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I. KIND OF PROCEEDING AND NATURE OF RULING IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

This Appeal arises from a November 18, 2004 *Final Order* entered by the Honorable James C. Stucky, Judge of the Circuit Court of Kanawha County, as the result of cross motions for summary judgment filed by Fireman's Fund Insurance Company (hereinafter "FFIC") and the Board of Education of the County of Kanawha (hereinafter "KCBE") in a declaratory judgment action.¹ In the *Final Order*, the Circuit Court made several conclusions of law which FFIC believes are incorrect, contrary to West Virginia law, against the great weight of the majority of jurisdictions considering similar issues, and therefore, must be vacated, reversed and/or remanded.

The declaratory judgment portion of this civil action arises from a contractual dispute between the KCBE and Multi-cap. In January, 2000 the KCBE and Multi-cap entered into a contract, otherwise known as a Delegate Agreement, whereby the KCBE agreed to provide certain activities and services for the Head Start Program in Kanawha County for the period from June 1, 2000, through May 31, 2001. In return for running the Head Start Program, the contract required Multi-cap to reimburse the KCBE for their expenditures related to providing the services. After the KCBE fulfilled its portion of the Delegate Agreement, Multi-cap failed to reimburse it for its expenditures.

Multi-cap was insured by FFIC by a Non-Profit Organization Liability Insurance Policy, which contained various exclusions, including a breach of contract exclusion excluding coverage for damages arising from an actual or alleged breach of contract. Because of this exclusion, which would have clearly excluded coverage for any claim brought by the KCBE against Multi-cap related to the breach of the Delegate Agreement, the KCBE filed suit directly against Multi-cap's Executive

¹ The Amended and Supplemental Complaint filed in this matter also contains extra-contractual claims against FFIC which are not at issue on this appeal.

Director, Paul Skaff (hereinafter "Skaff"), thereby attempting to avoid the breach of contract exclusion. In its initial Complaint, the KCBE asserted that it was Skaff's negligence/conduct that led to Multi-cap being unable to reimburse the KCBE pursuant to its obligations under the Delegate Agreement. Thus, ultimately, the damages asserted by the KCBE arise from Multi-cap's failure to fulfill its obligations pursuant to the Delegate Agreement.

Based upon the breach of contract exclusion, FFIC denied both a defense and indemnity to Skaff. Thereafter, the KCBE obtained a default judgment against Skaff and entered into a consent judgement with him whereby Skaff assigned any claims he possessed against FFIC to the KCBE and the KCBE agreed not to execute on the judgment voluntarily entered into by Skaff. The KCBE then amended its Complaint to assert a declaratory judgment action against FFIC, asserting that FFIC breached its duty to defend and indemnify Skaff. Thus, the issues which were before the Circuit Court, and which are now present before this Court, involve whether FFIC was required to defend and indemnify Skaff.

On July 21, 2004, the parties filed cross motions for summary judgment solely on the declaratory judgment portion of the civil action, arguing their respective positions as to whether or not FFIC had an obligation to defend and indemnify Skaff. FFIC took the position that while the KCBE's complaint was couched in terms of negligence, the relief requested in the Complaint was solely concerned with the monies the KCBE was owed due to Multi-cap's inability to reimburse it pursuant to the Delegate Agreement and that as the damages were caused by a breach of contract, there was no coverage for the damages claimed by the KCBE. FFIC further opined that the KCBE had likely only asserted a tort claim as a means of attempting to avoid the effect of the breach of contract exclusion. Accordingly, FFIC advocated that the Complaint filed against Skaff did not

assert a claim for any damages separate and apart from those for the breach of the Delegate Agreement, and therefore, the damages were not covered under the policy. FFIC further argued that because there was no coverage for the damages asserted by the KCBE, FFIC had no duty to defend Skaff pursuant to the terms of the policy. Alternatively, and to the extent that the Circuit Court believed FFIC had breached its duty to defend Skaff, FFIC asserted that any damages resulting from its breach of its duty to defend Skaff were outlined by this Court in Aetna Cas. & Sure. Co. v. Pitrolo, 176 W.Va. 190, 342 S.E.2d 156 (1986), and did not include FFIC being estopped from asserting or raising coverage defenses pursuant to the terms of the policy.

However, the Circuit Court disagreed with FFIC and on November 18, 2003, it adopted the positions advanced by the KCBE. The Circuit Court ultimately reached the following conclusions:

- (1) That FFIC breached its duty to defend Skaff as the breach of contract exclusion could not be relied upon by FFIC based upon the exclusionary language set forth in the FFIC policy;
- (2) That because FFIC breached its duty to defend Skaff in the underlying action, it was therefore estopped from asserting any coverage defenses pursuant to the provisions of the policy;
- (3) That FFIC was bound by the default judgment entered against Skaff, which established that Skaff was liable to the plaintiff in tort, thereby foreclosing any argument by FFIC that the breach of contract exclusion set forth in the FFIC policy should be applicable to exclude coverage; and,
- (4) That FFIC was required to pay the stipulated/confessed judgment agreed to by Skaff in the amount of \$710,947.85, plus pre and post judgment interest and damages for annoyance and inconvenience.

The Circuit Court's rulings with regard to the consequences for this breach, and the relief which was ultimately granted to the KCBE, has in essence created new law, or at the very least, greatly expanded existing West Virginia law, and involves issues which are of first impression for this Court's consideration. Specifically, after determining that FFIC had breached its duty to defend

Skaff, the Circuit Court held that due to the breach, FFIC was estopped from raising any coverage defenses available under the policy issued to Multi-cap. The Court reasoned that once the insurance policy had been breached by FFIC (failure to defend Skaff), FFIC was thereafter precluded from relying upon provisions of the same policy to its benefit. In other words, the Circuit Court essentially found that the duty to defend and duty to indemnify were not separate duties.

In reaching this conclusion, the Circuit Court ignored the fact that this position has been rejected by the overwhelming majority of States which have addressed the issue. The Circuit Court also ignored the fact that this Court has not issued any decision which even remotely indicates that a breach of the duty to defend would impact an insurer's duty to indemnify, especially in light of the fact that this Court has repeatedly held that the duty to indemnify and duty to defend are separate duties and that estoppel is generally inoperable to extend insurance coverage beyond the terms of an insurance contract.

Similarly, or possibly in the alternative, the Circuit Court held that FFIC was bound by the default judgment entered against Skaff in the underlying civil action, thereby acting to collaterally estop FFIC from disputing coverage under the policy based upon grounds which challenged the facts and issues "decided" by the default judgment. However, in reaching this conclusion, the Circuit Court failed to analyze how collateral estoppel applied to prevent FFIC, who was not a party in the underlying action, from attacking a judgment entered against Skaff. More importantly, however, the Circuit Court failed to appreciate that the damages, as plead by the KCBE in its Complaint, arose from the breach of the Delegate Agreement. By entry of the default judgment, the Circuit Court determined that the KCBE was entitled to damages because of Multi-cap's failure to reimburse the KCBE pursuant to the terms of the Delegate Agreement. Therefore, the breach of contract exclusion

was not irrelevant as determined by the Circuit Court as it squarely excludes the damages plead by the KCBE and established by the default judgment.

FFIC filed a Motion for Relief pursuant to Rule 60(b), which was heard and denied by the Circuit Judge on February 7, 2005. In that motion, FFIC further demonstrated that the positions adopted by the Circuit Judge were contrary to existing West Virginia law, were contrary to the positions adopted by the majority of jurisdictions which had addressed similar, or identical, issues and acted as nothing more than a punishment to FFIC for failing to defend Skaff.

Subsequently, the Court issued a supplemental Opinion Order on February 22, 2005, which modified its November 18, 2004 *Final Order*, and held pursuant to Rule 54(b) of the West Virginia Rules of Civil Procedure that “there is no just reason for delay and that the plaintiff should be permitted to take a direct appeal” There are no remaining issues to be addressed with regard to the coverage issues which were presented to the Circuit Court and the Orders of November 18, 2004 and February 22, 2005 are final orders with regard to the declaratory judgment portion of this litigation.

II. STATEMENT OF FACTS OF THE CASE

1. On or about May 19, 2000, FFIC issued a Non-Profit Organization Liability Insurance Policy, Policy CND 620-34-86, to Multi-cap. The policy was effective until May 19, 2001. While the policy was canceled in 2001, an endorsement was issued (CND-0019) which extended the period for reporting losses/bad acts until July 30, 2002; although, the alleged wrongful act had to have been committed prior to July 30, 2001. See FFIC Non-Profit Organization Liability Insurance Policy (CND 620-34-86), attached as Exhibit A to *Fireman's Fund Insurance Company's*

Memorandum of Law in Support of its Motion for Summary Judgment.

2. Defendant Skaff was prior to, and at the time the policy was issued, the Executive Director of Multi-cap.²

3. In January 2000, the KCBE and Multi-cap entered into a contract, otherwise known as a Delegate Agreement, whereby the KCBE agreed to provide certain activities and services for the Head Start Program in Kanawha County for the period from June 1, 2000, through May 31, 2001. See Exhibit B attached to *Fireman's Fund Insurance Company's Memorandum of Law in Support of its Motion for Summary Judgment*. The Head Start Program was financed under a grant from the United States Department of Health and Human Services. See Skaff Deposition, attached as Exhibit C to *Fireman's Fund Insurance Company's Memorandum of Law in Support of its Motion for Summary Judgment* at p.19. In return for running the Head Start Program in Kanawha County, the contract required Multi-cap to reimburse the KCBE for their expenditures related to providing the services. The KCBE's expenses which required reimbursement included salaries, school supplies, maintenance on vehicles, insurance, retirement funding, site expenses, etc. *Id.* at p. 16-17.

4. According to the Amended Complaint, the KCBE performed all services required pursuant to the Delegate Agreement, but was not reimbursed by Multi-cap. Skaff reluctantly agreed that by failing to reimburse the KCBE that Multi-cap had breached the Delegate Agreement/contract. *Id.* at pp.54-55.

5. Multi-cap soon became the subject of several investigations on both a State and Federal level. During the civil and criminal investigations it was learned that Multi-cap had been

² Pursuant to an Employment Agreement, Skaff became the Executive Director on or about May 1, 1999.

engaging in what Skaff called “forward funding” whereby Multi-cap would use funds from the grant for Head Start for other purposes, or to reimburse prior year’s debts, and then planned to use other grant monies to reimburse the KCBE for running Head Start. *Id.* at pp.21-22. According to Skaff this practice had been going on since approximately 1993 and the Board of Directors of Multi-cap were aware of this practice. *Id.* at pp.23-26; See transcript of meeting of the Kanawha County Commission, May 22, 2001, at pp. 8-12, attached as Exhibit D to *Fireman’s Fund Insurance Company’s Memorandum of Law in Support of its Motion for Summary Judgment*. Multi-cap’s troubles began to become known when the Head Start grant, or some other grant, was not approved for Multi-cap. When this source of funding did not become available, Multi-cap was unable to meet its obligations under the Delegate Agreement/contract and became insolvent.

6. As a result of the investigations, it was determined that not only was Multi-cap engaging in “forward funding”, but Skaff was using Multi-cap monies and resources for personal and unauthorized uses. He was indicted in the Circuit Court of Kanawha County during the January 2002 term on seven counts including: embezzlement, fraudulent schemes, forgery (two counts), uttering, credit card forgery and obtaining. He eventually entered guilty pleas with regard to the embezzlement and uttering counts. See Exhibit E attached to *Fireman’s Fund Insurance Company’s Memorandum of Law in Support of its Motion for Summary Judgment*. Likewise, an Information was issued based upon the investigation completed by the United States Attorney’s Office which charged Skaff with the misapplication of federal monies to which he plead guilty. See Exhibit F attached to *Fireman’s Fund Insurance Company’s Memorandum of Law in Support of its Motion for Summary Judgment*.

7. As a result of not being reimbursed for its expenses, the KCBE filed a complaint

against Multi-cap in June 2001 bearing civil action number 01-C-1708. Said complaint alleged that the KCBE was owed money by Multi-cap for the services it rendered pursuant to the Delegate Agreement. As such, the claim against Multi-cap was for breach of contract and sought to recover the expenses which were owed to it pursuant to the Delegate Agreement.

8. FFIC denied coverage for the allegations set forth in the complaint on July 2, 2001, in part, because the policy contains an exclusion for damages arising from breach of contract. No other activity took place with regard to civil action number 01-C-1708.

9. On July 25, 2002, a new Complaint was filed the KCBE bearing civil action number 02-C-1958. See Exhibit I attached to *Fireman's Fund Insurance Company's Memorandum of Law in Support of its Motion for Summary Judgment*. This complaint named only Skaff as a Defendant asserting that due to his actions as the Executive Director of Multi-cap, Multi-cap was unable to reimburse the KCBE pursuant to the Delegate Agreement/contract. Specifically, the complaint asserts that Skaff:

- A. Drew down and used the federal funds that were intended solely for the Head Start Program, for other purposes;
- B. Failed to exercise control over and accountability for the federal funds that were intended solely for the Head Start Program;
- C. Improperly disbursed federal head Start funds out of the DHHS grant for the grant year beginning on June 1, 2000 to pay expenses for the prior program year which had ended on May 31, 2000;
- D. Failed to implement appropriate standards for financial management and reporting with regard to the federal funds that were intended solely for the Head Start Program;
- E. Failed to comply with applicable federal statutes and regulations related to the Head Start Program; and
- F. Was negligent, careless, reckless and/or grossly negligent in the handling of the federal funds that were intended solely for the Head Start Program.

Id. at ¶ 5.

10. Ultimately, however, the complaint against Skaff concludes that the KCBE suffered damages in the amount of \$710,974.85 as a result of Multi-cap's inability to reimburse the KCBE under the Delegate Agreement. Id. at ¶ 11. The damages asserted by the KCBE in the amount of \$710,974.85 represent the amount owed by Multi-cap to the KCBE pursuant to the Delegate Agreement. Id. at ¶ 4. Accordingly, the damages allegedly owed to the KCBE constitute the damages for Multi-cap's breach of the Delegate Agreement.

11. FFIC again denied coverage for this loss on August 15, 2002 and on December 9, 2002. See Exhibits J and K attached to *Fireman's Fund Insurance Company's Memorandum of Law in Support of its Motion for Summary Judgment*.

12. On January 16, 2003 a default judgment was entered against Skaff with a judgment order in the amount of \$997,175.48 having been entered on January 13, 2004.

13. Since that time, the KCBE has amended its complaint to include a count for declaratory judgment and counts for extra-contractual claims against FFIC.

14. FFIC has maintained that it owes no coverage to Skaff for the incidents set forth in either the KCBE's Complaint or Amended and Supplemental Complaint based upon the terms, conditions, and exclusions set forth in the policy.

15. The FFIC policy provides the following insuring agreement to its insured:

I. INSURING AGREEMENTS – WHAT WE COVER

- A. Coverage.** We will pay on behalf of the **Insured** all sums in excess of the retained amount shown in Item 4 of the Declarations which the **Insured** is legally required to pay as **Damages** because of a **Wrongful Act** to which this insurance applies.

See Exhibit A attached to *Fireman's Fund Insurance Company's Memorandum of Law in Support*

of its Motion for Summary Judgment at p. 1 of 8.

16. “Damages” is defined in section VII. DEFINITIONS as “amounts which an **Insured** is obligated to pay as compensation to claimants injured by **Wrongful Acts**.” “Claim” is defined as “a written notice alleging that an **Insured** is responsible for **Damages** or seeking non-monetary relief. The notice may be in the form of a letter, a legal summons and complaint or a notice of an administrative proceeding.” See Id. at p. 7 of 8.

17. However, the policy further contains the following exclusions:

II. EXCLUSIONS – WHAT WE DO NOT COVER

* * * * *

B. Breach of Contract. We do not cover **Damages** that result from or arise out of any actual or alleged breach of contract. But this does not apply to an employment contract.

See Id. at p. 3 of 8.

18. The policy further provides in **Section I, C. Defense, Investigation & Settlement of Claims**, that FFIC “has no duty to defend any Claim to which this insurance does not apply.” See Id. at p. 2 of 8.

19. The policy states that “[FFIC’s] right and duty to defend any Claim seeking Damages [as opposed to non-monetary relief] ends when we have used upon our limit of liability in the payment of judgments or settlements.” See Id. at p. 2 of 8.

20. As a final note, FFIC points out that at no time did Skaff ever forward a copy of the Amended and Supplemental Complaint to FFIC, Multi-cap, or anyone other than his attorney who represented him in his criminal matters. Nor did he ever contact FFIC to inform them of the suit or to provide them with any information. Despite his lack of action, he was well aware that Multi-cap had insurance policies in effect. See Exhibit C at pp.39-42, attached to *Fireman’s Fund Insurance*

III. ASSIGNMENTS OF ERROR RELIED UPON ON APPEAL AND THE MANNER IN WHICH THEY WERE DECIDED

FFIC asserts five assignments of error for this Honorable Court to consider on appeal.

1. The Circuit Court erred by holding that FFIC breached its duty to defend Skaff. See *Final Order* at ¶¶ 30 and 31.
2. The Circuit Court erred by holding that even if the breach of contract exclusion was applicable that FFIC could not rely upon the same to justify the insurer's refusal to defend its insured based upon the language contained in the breach of contract exclusion and the limiting language regarding FFIC's duty to defend its insured. See *Final Order* at ¶¶ 27, 29.
3. The Circuit Court erred by holding that FFIC's breach of its duty to defend Skaff, estopped it from raising any coverage defenses or policy exclusions related to its duty to indemnify Skaff, and that FFIC was ultimately liable to Skaff for the entire judgment entered against him. See *Final Order* at ¶¶ 32, 33, 34, 35, 36 and 53.
4. The Circuit Court erred by holding that FFIC was bound by the default judgment entered against Skaff, which established that Skaff was liable to the plaintiff in tort, thereby foreclosing any argument by FFIC that the breach of contract exclusion should be applicable to exclude coverage. See *Final Order* at ¶¶ 38, 54.
5. The Circuit erred/abused its discretion by failing to grant FFIC's *Motion for Relief from the November 18, 2004 Final Order and to Vacate the Same*.

V. POINTS AND AUTHORITIES RELIED UPON, DISCUSSION OF LAW, AND RELIEF PRAYED FOR

A. Standard of Review

We review a circuit court's grant of summary judgment *de novo*, Syl. pt. 1, Painter v. Peavy, 192 W.Va. 189, 451 S.E.2d 755 (1994), "and, therefore, we apply the same standard as a circuit court," reviewing all facts and reasonable inferences in the light most favorable to the nonmoving

party. Williams v. Precision Coil, Inc., 194 W.Va. 52, 58, 459 S.E.2d 329, 335-36 (1995), citing Matsushita Elec. Indus. Co. Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587-88, 106 S.Ct. 1348, 1356-57, 89 L.Ed.2d 538, 553 (1986). A grant of summary judgment “shall be rendered forthwith if the pleadings, deposition, answers to interrogatories, and admissions on file, together with the affidavits, if any, show there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law.” W.VA. R. CIV. P. 56(c).

The “determination of the proper coverage of an insurance contract when the facts are not in dispute is a question of law.” Syl. Pt. 1, Horace Mann Ins. Co. v. Adkins, 215 W.Va. 297, 599 S.E.2d 720 (2004). Moreover, “the interpretation of an insurance contract, including the question of whether the contract is ambiguous, is a legal determination that, like a lower court’s grant of summary judgment, shall be reviewed *de novo* on appeal.” Syl. Pt. 2, Id.

Additionally, the denial of a motion brought pursuant to Rule 60 is reviewed on an abuse of discretion standard. Poweridge Unit Owners Ass’n v. Highland Properties, Ltd., 196 W.Va. 692, 705, 474 S.E.2d 872, 885 (1996). This standard of review reflects the circuit court’s institutional position as the forum best equipped for determining the appropriate use of Rule 60(b) to ensure that litigants who have vigorously and diligently complied with the summary judgment mandates of Rule 56 are not penalized by the action of those who choose not to comply. Id.

Although subdivision (b) of Rule 60 of the West Virginia Rules of Civil Procedure does not explicitly allow a party to file a motion for clarification and reconsideration, it is well established that a proper motion under subdivision (b) may urge a court to reconsider or vacate a prior judgment. Id. at 704, 474 S.E.2d 884. One of the purposes of a Rule 60(b) motion is to provide a mechanism for instituting a collateral attack on a final judgment in a civil action. Hustead v. Ashland Oil, Inc.,

197 W.Va. 55, 475 S.E.2d 55 (1996).

In light of these principles, FFIC believes that it is appropriate, and necessary, for this Court to reverse the *Final Order* entered by the Circuit Judge.

B. Pursuant to the unambiguous terms of the FFIC policy, FFIC owed no duty to defend Skaff in the underlying civil action filed by the KCBE.

The errors which are assigned by FFIC all begin with the Circuit Court's determination that FFIC had an obligation to defend Skaff in the underlying civil action and failed to do so. As such, if this Court finds that FFIC did not breach its duty to defend Skaff, then there is no need for this Court to address the remaining issues set forth in this appeal, as the remaining issues would be moot. Accordingly, FFIC begins with its analysis by demonstrating why the Circuit Court erred in determining that it had an obligation to defend Skaff in the underlying civil action.

The FFIC policy states that FFIC has "no duty to defend any **Claim** to which this insurance does not apply." The policy also contains a breach of contract exclusion which provides that FFIC does "not cover **Damages** that result from or arise out of any actual or alleged breach of contract." FFIC took the position that the damages asserted by the KCBE were excluded from coverage as they arose from an alleged breach of the Delegate Agreement. Thus, as the damages sought by the KCBE were excluded, FFIC concluded that the insurance did not apply and that it had no duty to defend Skaff.

The Circuit Court, however, relying solely upon the fact that the breach of contract exclusion referenced only "damages" and not "claims", and that the limiting language with regard to FFIC's duty to defend referred only to "claims", found that FFIC was not justified in refusing to defend Skaff based upon the breach of contract exclusion. Exhibit 2 at ¶ 27. Specifically, the Circuit Court concluded that:

Even if the claims asserted by the Board of Education against Skaff were deemed to be claims for breach of contract as defined in the exclusion contained in Section II.B of the policy, the claims would still constitute "Wrongful Acts" as defined in the policy. Because the exclusionary language contained in Section II.B of the policy applies specifically to "damages" alone and not to "claims", the exclusion cannot be relied upon by Fireman's Fund to justify the insurer's refusal to defend its insured.

Exhibit 1 at ¶ 29.

However, in reaching this conclusion, the Circuit Court did not give effect to the plain meaning of the terms as defined in the policy and appears to have interpreted the policy so as to create an absurd result. It is the well recognized principle of law in West Virginia that the Courts:

will apply, and not interpret, the plain and ordinary meaning of an insurance contract in the absence of ambiguity or some other compelling reason. Our primary concern is to give effect to the plain meaning of the policy and, in doing so, we **construe all parts of the document together**. We will not rewrite the terms of the policy; instead, we enforce it as written.

Payne v. Weston, 195 W.Va. 502, 507, 466 S.E.2d 161, 166 (1995)(emphasis added). As such, "[w]here the provisions of an insurance policy contract are clear and unambiguous they are not subject to judicial construction or interpretation, but full effect will be given to the plain meaning intended." Id. Nor should an insurance policy be interpreted so as to create an absurd result; rather, it should receive a reasonable interpretation. Kelly v. Painter, 202 W.Va. 344, 348, 504 S.E.2d 171, 175 (1998). This Court has further cautioned that the Circuit Courts "should read policy provisions to avoid ambiguities and not torture the language to create them." Payne, 195 W.Va. at 507, 466 S.E.2d at 166. While the Circuit Court found no ambiguities in the terms "damages" and "claims", as both terms are defined in the policy, it did not, in the opinion of FFIC, construe the terms together to give them their intended meaning and in fact, twisted the terms so as to reach an absurd result.

The insuring agreement contained in the FFIC policy specifically provides:

A. **Coverage.** We will pay on behalf of the **Insured** all sums in excess of the

retained amount shown in Item 4 of the Declarations which the **Insured** is legally required to pay as **Damages** because of a **Wrongful Act** to which this insurance applies.

As such, the insuring agreement only requires that FFIC pay for “damages” incurred by the insured.

The FFIC policy further contains the following exclusion:

II. EXCLUSIONS – WHAT WE DO NOT COVER

* * * * *

- B. Breach of Contract.** We do not cover **Damages** that result from or arise out of any actual or alleged breach of contract. But this does not apply to an employment contract.

Moreover, the policy provides that FFIC has “no duty to defend any **Claim** to which this insurance does not apply.” In its *Final Order*, the Circuit Court appears to have relied solely upon the fact that the exclusion and the limiting language governing FFIC’s duty to defend contained different terms (“claims” versus “damages”) in arriving at its conclusion that FFIC breached its duty to defend Skaff. However, the Circuit Court failed to consider how those terms are defined in the policy and how their meaning when incorporated into the entire policy.

The policy defines “damages” as “amounts which an **Insured** is obligated to pay as compensation to Claimants injured by **Wrongful Acts.**” “Claim” is defined as “a written notice alleging that an **Insured** is responsible for **Damages** or seeking non-monetary relief. The notice may be in the form of a letter, a legal summons and complaint or a notice of an administrative proceeding.” Based upon these definitions, and after applying them to the provisions in the policy, there is simply no sound reason for the Circuit Court’s position that the exclusionary language contained in Section II.B of the policy could not be relied upon by FFIC to justify its decision not to defend Skaff. As set forth above, a “claim” may consist of either a written notice for “damages” or for non-monetary relief. There is no doubt that the definition of the term “claim” incorporates

and includes the term “damages”. In fact, a “claim” is nothing more than the mechanism by which “damages” or non-monetary relief are asserted. The term “claim”, as defined in the policy, does not imply that there is any additional coverage beyond what is set forth in the insuring agreement, which provides coverage solely for “damages”. As such, if there is no coverage for the “damages” asserted, then, likewise, there can be no coverage for the “claim” which asserts nothing more than those “damages” excluded by the policy.

In this matter, the KCBE only made a claim for monetary damages in its complaint (or its “claim”) related to Multi-cap’s failure to reimburse it pursuant to the Delegate Agreement. It is the position of FFIC that those monetary damages are excluded by the policy’s breach of contract exclusion. Therefore, the damages asserted by the KCBE in its “claim” are not covered by the policy, and in turn, the insurance provided by the policy does not apply to the KCBE’s “claim”. Accordingly, FFIC had no duty to defend Skaff as the claim (written notice for damages) was not covered by the policy.

FFIC’s position is further supported by simply reading other provisions of the policy as well. As noted above, the insuring agreement only obligates FFIC to pay sums which an insured is legally required to pay as “damages”. The policy further states that “[FFIC’s] right and duty to defend any Claim seeking Damages [as opposed to non-monetary relief] ends when we have used up our limit of liability in the payment of judgments or settlements.” See Exhibit A attached to *Fireman’s Fund Insurance Company’s Memorandum of Law in Support of its Motion for Summary Judgment* at p. 2 of 8. Clearly, the policy contemplates that the duty to defend ends when coverage has been exhausted for any “claim” (written notice that damages were sought) seeking “damages”. Likewise, if the damages sought in the claim were not initially covered under the policy, then FFIC had no

duty to defend Skaff. Any other interpretation of this policy will result in an absurd result, which is exactly what this Court has warned against.

As such, the Circuit Court erred in failing to properly analyze and interpret the exclusionary language set forth in the FFIC policy. Accordingly, the *Final Order* must be vacated and reversed with regard to the Circuit Court's ruling, relieving FFIC from the impact of the *Final Order* and finding that FFIC owed no duty to defend Skaff under the policy. In the alternative, the Circuit Court's ruling on this issue should be remanded to the Circuit Court with instructions to review the policy as a whole, considering all of the terms, provisions, definitions and exclusions contained therein.

- C. In the alternative, should this Court determine that the Circuit Court did not err in holding that FFIC breached its duty to defend Skaff, FFIC asserts that the Circuit Court erred in holding that FFIC was estopped from asserting any policy defense it might have had with regard to its duty to indemnify Skaff.**

Before the Circuit Court, the KCBE argued that because FFIC had breached its duty to defend Skaff, it was prevented, or estopped, from asserting any policy defense it might have had with regard to its duty to indemnify Skaff. In support of its position, and realizing that West Virginia had not yet addressed the issue, the KCBE urged the Circuit Court to adopt and apply foreign case law from the courts of Maine, Connecticut and Montana. These foreign courts have held that an insurer who wrongfully fails to defend its insured, waives its right to claim, or is estopped from claiming, that it had no duty to indemnify its insured.³ Adopting the position advanced by the KCBE, and relying solely on foreign case law, the Circuit Court ruled that because

³ See Anderson v. Virginia Surety Co. Inc., 985 F.Supp. 182 (D. Me. 1998); Twin City Fire, Ins. Co. V. City of Madison, Miss., 309 F.3d 901, 906 (5th Cir. 2002); Black v. Goodwin, Loomis and Britton, Inc., 239 A.2d 293 (Conn. 1996); Grindheim v. Safeco Ins. Co. of America, 908 F.Supp. 794 (D.Mont. 1995).

FFIC breached its duty to defend Skaff, it was therefore, “estopped from raising any policy exclusion related to its duty to indemnify Skaff, because of its breach of its duty to defend Skaff.” See *Final Order* at ¶ 33. Finding that FFIC could not challenge coverage, the Court took the next step and found that FFIC was liable to the KCBE for the judgment entered in the underlying action.

However, the rule of law adopted by the Circuit Court in its *Final Order* is clearly the minority rule, having been adopted by only a handful of States, and has been criticized by the overwhelming majority of jurisdictions which have addressed the issue. In fact, while the Circuit Court relied upon decisions from Maine in its *Final Order* to support this radical approach, those decisions have essentially been overturned, or limited, by *Elliott v. Hanover Ins. Co.*, 711 A.2d 1310 (Me. 1998). The Circuit Court’s adoption of the minority rule also ignores that under West Virginia law the duty to defend and duty to indemnify are distinct and separate duties. Accordingly, FFIC asserts, given the current state of West Virginia law, that this Court should not adopt the minority view as advanced by the KCBE and adopted by the Circuit Court.

1. The majority of States considering this issue have held that a failure to defend does not affect an insurer’s ability to contest coverage.

The overwhelming majority of jurisdictions which have addressed this issue hold that an insurer who has been found to have breached its duty to defend its insured, **is not** estopped, and does not waive its right to contest coverage. In reaching this decision, these States note that their position is based primarily upon the theory that the duty to defend and duty to indemnify are separate duties and one should not influence the other. West Virginia has long adopted this approach, finding that the duty to defend and duty to indemnify are separate duties. This Court has also noted time and time again that the duty to defend is broader than the duty to indemnify. *Aetna Cas. & Sure. Co. v. Pitrolo*, 176 W.Va. 190, 194, 342 S.E.2d 156, 160 (1986); See *Farmers & Mech. Mut. Ins. Co. of*

West Virginia v. Cook, 210 W. Va. 394, 557 S.E.2d 801 (2001). Thus, it follows that a breach of the duty to defend should not impact an insurers duty to indemnify its insured.

Based upon the differences between the two duties, the majority of courts considering this issue have held that a breach of the duty to defend cannot create or enlarge an insurers duty to indemnify beyond what is set forth in the insurance contract. Related to this idea, this Court has held that generally, the principles of waiver and estoppel are inoperable to extend insurance coverage beyond the terms of an insurance contract. Potesta v. USF&G Company, 202 W.Va. 308, 504 S.E.2d 135 (1998). In reaching its holding, the Circuit Court has ignored these fundamental principles, and in essence created coverage, or enlarged coverage beyond what is set forth in the FFIC policy. In fact, the rulings made by the Circuit Court appear to be nothing more than a punishment for FFIC's failure to defend Skaff.

As described above, FFIC asserts that the majority position, and the basis therefor, is more in line with West Virginia law than the minority position advanced by the KCBE and adopted by the Circuit Court. For example, in Colonial Oil Industries v. Underwriters Subscribing to Policy Nos. T031504670 and T031504671, 491 S.E.2d 337 (Ga. 1997), the Supreme Court of Georgia recognized that breach of the duty to defend did not obligate the insurer to indemnify its insured. In answering certified questions from the Eleventh Circuit, the Court held:

The second certified question concerns the insurer's right to raise policy defenses to coverage after it has made an unjustified refusal to defend. The Georgia Court of Appeals held in McCraney v. Fire and Cas. Ins. Co., that the insurer is not estopped to raise policy defenses. **The rationale for this rule is that when the insurer breaches the contract by wrongfully refusing to provide a defense, the insured is entitled to receive only what it is owed under the contract--the cost of defense. The breach of the duty to defend, however, should not enlarge indemnity coverage beyond the parties' contact. This rule, which is the majority position, recognizes that the duty to defend and the duty to pay are independent obligations.** Although McCraney dealt with a third-party judgment creditor of the

insured, the rationale has equal application to the insured. The insured is in no better position to create coverage that was never bargained for under its contract. Therefore, in this case, Underwriters may raise its policy defenses to coverage. [Emphasis supplied, footnotes omitted].

Id. at 339.

Likewise, the Court in Elliott v. Hanover Ins. Co., 711 A.2d 1310, 1313 (Me. 1998), also recognized that the duty to defend is separate from an insurer's obligation to indemnify its insured, and held that a breach of the duty to defend does not estop an insurer from litigating the issue of coverage:

[I]f an insurer who refuses to defend were estopped from asserting the lack of coverage as a defense in a subsequent action, then the insurer's duty to indemnify would be coextensive with its duty to defend. We, however, have repeatedly stated that an insurer's duty to indemnify is independent from its duty to defend and that its duty to defend is broader than its duty to indemnify. . . . An insurer that breaches its duty to defend therefore is not estopped from asserting noncoverage as a defense in a subsequent action brought by the insured or the insured's assignee. [Citation and footnote omitted].

This position has been adopted by other jurisdictions analyzing this issue. See Signature Development Cos. v. Royal Ins. Co. of Am., 230 F.3d 1215 (10th Cir. 2000); Western Alliance Ins. Co. v. Northern Ins. Co. of New York, 176 F.3d 825 (5th Cir. 1999); Enserch Corp. v. Shand Morahan & Co., Inc., 952 F.2d 1485 (5th Cir. 1992); Flannery v. Allstate Ins. Co., 49 F. Supp.2d 1223 (D. Colo. 1999); Johnson v. Studyvin, 828 F. Supp. 877 (D. Kan. 1993); Alabama Hosp. Ass'n Trust v. Mut. Assurance Soc'y of Alabama, 538 So.2d 1209 (Ala. 1989); Ringler Associates Inc. v. Maryland Cas. Co., 96 Cal. Rptr.2d 136, 80 Cal.App.4th 1165 (2000); Illinois Ins. Exch. v. Scottsdale Ins. Co., 679 So.2d 355 (Fla. 1996); Sentinel Ins. Co., Ltd. v. First Ins. Co. of Hawaii, Ltd., 875 P.2d 894 (Haw.1994); Sunseri v. Camperos Del Valle Stables, Inc., 185 Cal. App. 3d 559, 230 Cal. Rptr. 23 (1st Dist. 1986); Keller Industries, Inc. v. Employers Mut. Liability Ins. Co., 429

So. 2d 779 (Fla.App.3d Dist. 1983); Hirst v. St. Paul Fire & Marine Ins. Co., 683 P.2d 440 (Idaho 1984); Foreman v. Jongkind Bros., Inc., 625 N.E.2d 463 (Ind. Ct. App. 1994); Aselco, Inc. v. Hartford Ins. Group, 21 P.3d 1011 (Kan.Ct.App.2001); Cincinnati Ins. Co. v. Vance, 730 S.W.2d 521 (Ky. 1987); Fireman's Fund Ins. Co. v. Rairigh, 475 A.2d 509 (Md.1984); Polaroid Corp. v. Travelers Indem. Co., 610 N.E.2d 912 (Mass.1993); Servidone Constr. Corp. v. Security Ins. Co. of Hartford, 477 N.E.2d 441 (N.Y.1985); Sellie v. North Dakota Ins. Guar. Assoc., 494 N.W.2d 151 (N.D. 1992); Northwest Pump & Equip. Co. v. American States Ins. Co., 925 P.2d 1241 (Or.1996).

The Courts adopting the majority position have correctly reasoned that the duty to defend and the duty to indemnify are distinct and separate duties and a breach of the duty to defend has no bearing upon an insurer's contractual duty to indemnify. As noted above, West Virginia also recognizes these two duties are separate. The minority view adopted by the Circuit Court does not recognize this well-settled principle of law, and in fact, makes the duties coextensive with one another.

Instead, this Court has fashioned the appropriate remedy for situations in which the insurer is found to have breached a duty to defend. In such circumstances, the insured is entitled to recover the expenses incurred, including costs and reasonable attorney's fees, in defending the underlying litigation, as well as attorney's fees incurred in any declaratory judgment action filed for a coverage determination. Syl. Pts. 1 and 2, Aetna Cas. & Sur. Co v. Pitrolo, 176 W. Va. 190, 342 S.E.2d 156 (1986). There is no law in West Virginia which even remotely suggests that the appropriate remedy for an insurer's breach of its contractual duty to defend is an automatic finding of coverage where none may exist. Rather, the remedy allows an insured to recover the damages "which directly resulted from the insurer's breach of contract" -- the expenses of litigation including costs and

reasonable attorney's fees -- nothing more. Pitrolo at 193, 342 S.E.2d at 159.

2. The doctrines of waiver or estoppel may not be utilized to create coverage.

The Circuit Court, in espousing its position, relied upon estoppel, even though it is clear that estoppel does not, and cannot apply, to the facts in this matter. Exhibit 2 at ¶ 33. To begin, the Circuit Court ignored that this Court has held that the doctrine of estoppel generally is “inoperable to extend insurance coverage beyond the terms of an insurance contract.” Syl. Pt. 5, Potesta v. United States Fid. & Guar. Co., 202 W. Va. 308, 504 S.E.2d 135 (1998). In Potesta, the insurer denied coverage based upon certain exclusionary language within its policy. Subsequently, when a declaratory judgment action was filed against it, the insurer conceded it relied upon the wrong provision to deny coverage, but argued that other policy provisions precluded coverage. Id. at 312, 504 S.E.2d at 139. The Fourth Circuit certified to this Court questions regarding waiver and estoppel in the situation where the insurer relied upon one policy provision to deny coverage, but asserted a previously unarticulated policy provision in subsequent litigation.

Initially, the Potesta Court defined estoppel, noting that estoppel applies when a party “is induced to act or refrain from acting to her detriment because of her reasonable reliance on another party’s misrepresentation or concealment of a material fact.” Id. at 315, 504 S.E.2d at 142, quoting Ara v. Erie Ins. Co., 182 W. Va. 266, 387 S.E.2d 320 (1989). The Court further opined:

we hold that in order to rely on the doctrine of *estoppel* to prevent an insurer, who has previously stated one or more reasons for denying coverage, from asserting other, previously unarticulated reasons for denying coverage, the insured must prove that s/he was induced to act or to refrain from acting to her/his detriment because of his/her reasonable reliance on the previously stated grounds for declination.

Id. at 317, 504 S.E.2d at 144.

The doctrine of estoppel is inapplicable in the instant case. The KCBE (or Skaff) cannot

show, and did not demonstrate to the Circuit Court, that Skaff detrimentally relied upon any representations by FFIC. FFIC denied coverage to Skaff and stated early on that it would not defend him in the action. In fact, Skaff never contacted FFIC regarding the suit. As such, Skaff did not suffer any prejudice as a result of the denial of coverage and duty to defend and certainly did not rely on any statement or position of FFIC to his detriment. Accordingly, the Circuit Court was incorrect when it relied upon estoppel to prevent FFIC from asserting coverage defenses under the policy.

Based upon the foregoing, there is no question that the minority rule adopted by the Circuit Court is in direct conflict with the fundamental principles of West Virginia insurance law, and should not be adopted by this Court. Accordingly, to the extent that this Court believes that FFIC breached its duty to defend Skaff, the Circuit Court's *Final Order* must be vacated, reversed and remanded to allow FFIC the opportunity to litigate whether or not it owes indemnity to Skaff for the claims made by the KCBE.

D. Likewise, the Circuit Court erred by holding that FFIC was bound by the default judgment, thereby precluding it from relying upon the breach of contract exclusion to exclude coverage.

The Circuit Court found, largely based upon a decision from Maine, that FFIC was bound by the default judgment entered against Skaff, and that based upon its entry, FFIC was precluded from raising any issues which were decided by the entry of the default. *Final Order* at ¶¶ 38-41, 51, 54 and 55. It was, and still is, FFIC's position that the KCBE's Amended Complaint, while couched in terms of negligence, is in actuality, nothing more than a claim for breach of contract, and that such claims are excluded from coverage by the plain terms set forth in the policy.⁴ However, the Circuit Court refused to address this argument finding instead that the default judgment established that

⁴ This position is addressed more fully in subsection E.

Skaff was liable to the KCBE in tort, that FFIC could not challenge the issues decided by the entry of default judgment against Skaff, and therefore, the breach of contract exclusion was irrelevant. In making these findings, the Circuit Court failed to consider FFIC's argument that the allegations set forth in the KCBE's complaint sought nothing more than damages for breach of contract, thereby implicating the breach of contract exclusion. FFIC believes the Court erred for two principle reasons, which are set forth more fully below.

- 1. The Circuit Court erred as the Default Judgment, which purportedly found Skaff liable to the KCBE in tort, actually sought damages related solely to the breach of the Delegate Agreement thereby implicating the breach of contract exclusion set forth in the FFIC policy.**

First, the Circuit Court was incorrect in determining that because the default judgment against Skaff which held Skaff liable to the KCBE in tort, that FFIC was not able to rely upon the breach of contract exclusion set forth in its policy. It is the position of FFIC, that the Amended and Supplemental Complaint clearly contemplates a recovery based upon damages caused by a breach of the Delegate Agreement, which are excluded under the FFIC policy.

The Amended and Supplemental Complaint asserts that Multi-cap owed a fiduciary duty to the KCBE and that Skaff, as the Executive Director of Multi-cap, "approved of, sanctioned and/or ratified acts and conduct" which caused Multi-cap to breach its fiduciary duties and duties imposed by law to the KCBE. See *Supplemental and Amended Complaint* at ¶¶ 6-8. However, there should not be any dispute, that the duties Multi-cap owed to the KCBE arose from and existed only because of the Delegate Agreement. The KCBE further asserts that Multi-cap failed to reimburse the KCBE \$710,974.85 for services it rendered pursuant to the Delegate Agreement. *Id.* at ¶ 4. Moreover, the KCBE concludes that as a direct and proximate result of the conduct set forth in Count One of the Amended and Supplemental Complaint, that the KCBE suffered damages in the amount of

\$710,974.85, which of course, is the same amount which was to be reimbursed to the KCBE pursuant to the terms of the Delegate Agreement. Id. at ¶ 11. Thus, the damages, as plead by the KCBE, arise from the breach of the Delegate Agreement.

While the KCBE clearly attempts to couch its complaint in terms of a tort action in an effort to avoid the breach of contract exclusion, it cannot escape, no matter how artful the pleadings, that the damages it sought, and which were ultimately granted by the Circuit Court, arose from an breach of the Delegate Agreement. In fact, without a breach of the Delegate Agreement, the KCBE would not have any damages, even if Skaff had committed the acts alleged the complaint. Thus, it was not Skaff's acts which gave rise to the damages, but rather Multi-cap's breach of the Delegate Agreement, and the Amended and Supplemental Complaint make this clear. Skaff's conduct is simply the mechanism by which the Delegate Agreement was breached.

Thus, if the default establishes that Skaff is liable to the KCBE as to each cause of action in the complaint, it also establishes that the monies owed to the KCBE are due to a breach of the Delegate Agreement. See Cotton v. Otis Elevator Co., 627 F.Supp. 519, 521 (S.D.W.V. 1986)(when the promisee's injury consists merely of the loss of his contractual bargain, no tort claim arises because the duty of the promisor to fulfill the bargain arises only from the contract). Therefore, the Circuit Court was incorrect in determining that the breach of contract exclusion was irrelevant as the default judgment established, pursuant to the KCBE's own pleadings, that the KCBE's damages were caused by "Multi-cap's inability to reimburse the KCBE under the Delegate Agreement." Id. at ¶ 11.

Accordingly, the default judgment plainly establishes that the damages sought by the KCBE were caused by and arose from Multi-cap's breach of the Delegate Agreement, thereby directly

implicating the breach of contract exclusion set forth in the FFIC policy and making it relevant to the issue of FFIC's duty to indemnify Skaff. Again, the conduct allegedly committed by Skaff does nothing more than describe how the Delegate Agreement was breached. Thus, FFIC asserts that the application of the breach of contract exclusion did not require FFIC to relitigate any issues which were "decided" by the entry of default judgment against Skaff, but rather, relied upon the default's judgment's finding that the KCBE's damages were caused by Multi-cap's inability to reimburse it pursuant to its obligations under the Delegate Agreement. Accordingly, the Circuit Court erred by not considering FFIC's argument that the damages sought by the KCBE were for breach of the Delegate Agreement, and therefore, excluded by the breach of contract exclusion.

2. **Alternatively, FFIC asserts that the Circuit Court erred by holding that the default judgment entered against Skaff collaterally estops FFIC from challenging coverage based upon the allegations set forth in the Amended and Supplemental Complaint as Skaff and FFIC were not in privity with one another.**

Again, it is FFIC's position that the KCBE's Amended and Supplemental Complaint, while couched in terms of negligence, is in actuality, nothing more than a claim for breach of contract, and that such claims are excluded from coverage by the plain terms set forth in the policy. As such, and as set forth above, FFIC does not believe that the application of the breach of contract exclusion required the Circuit Court to relitigate any issues "decided" by the entry of default judgment against Skaff. The Circuit Court, however, did not address this argument. Rather, the Circuit Court found that FFIC was collaterally estopped from relitigating whether the Amended and Supplemental Complaint asserted a claim for breach of contract as the default judgment found, as a matter of law, that Skaff was liable to the KCBE in tort.

As there was no West Virginia law directly on point, and likely because the KCBE realized

that traditional principles of collateral estoppel would not assist in its argument, the KCBE relied upon a decision from the State of Maine, in which the Supreme Judicial Court of Maine held that it is:

well established that an insurer who had reasonable notice of the pendency of an action by the injured person against the insured and was requested to assume [his] defense but declined to do so electing to disclaim coverage, is bound by the judgment in that action as to issues which were or might have been litigated therein in a subsequent suit by the injured for recourse to the policy.

Marston v. Merchants Mut. Ins. Co., 319 A.2d 111, 114 (Me. 1974). The Circuit Court then applied the holding in Marston to this Court's decision in Farm Family Mut. Ins. Co. v. Thorn Lumber Co., 202 W.Va. 69, 75, 501 S.E.2d 785, 792 (1998), in order to reach its holding that FFIC could not relitigate any issue "decided" by the entry of default judgment against Skaff. In Thorn, this Court stated:

As a general rule, a default establishes, as a matter of law, that the defendant is liable to the plaintiff as to each cause of action alleged in the complaint. Therefore, the circuit court's finding of [the defendant's] default established as a matter of law that [the defendant] was negligent . . . and that the negligence was a proximate cause of [the plaintiff's claimed damages].

Thus, in essence, the Circuit Court held that FFIC was collaterally estopped from challenging coverage as it believed that FFIC's grounds for doing so required FFIC to relitigate issues decided by the default judgment against Skaff. (As set forth above, FFIC believes that this position is incorrect.) However, other than citing to language from the Marston and Thorn decisions, the Circuit Court failed to analyze, or even address, how collateral estoppel would operate to prevent FFIC from challenging the findings made by the entry of the default judgment against Skaff.

First and foremost, FFIC would point out that in Thorn this Court stated that default judgment "as a general rule . . . establishes, as a matter of law, that **the defendant** is liable to the

plaintiff as to each cause of action alleged in the complaint.” Id. (emphasis added). FFIC, however, was not **the defendant** in the underlying matter, and as such, Thorn is not applicable to prevent FFIC from challenging the findings made in the default judgment. Rather, the Circuit Court was required to utilize and analyze the facts in the instant matter to determine if FFIC was precluded from re-litigating the issues decided by the entry of the default judgment based upon traditional principles of collateral estoppel.

FFIC acknowledges that there is general support for the proposition that an insurer may be estopped in a subsequent action from raising issues which were, or could have been, decided in the underlying claim. However, several jurisdictions have found an exception to this general proposition and, in some circumstances, much like those which exist in the present litigation, allow an insurer to challenge an underlying judgment entered against its insured. This exception is based upon basic principles of collateral estoppel which the Circuit Court failed to consider in issuing its November 18, 2004 *Final Order* or in denying FFIC’s *Motion for Relief from the November 18, 2004 Final Order and to Vacate the Same*.

In the cases which provide an exception, the Courts have focused on the fact that the insured and the insurer often have conflicting positions when coverage disputes exist. For example, in Ferguson v. Birmingham Fire Ins. Co., 460 P.2d 342, 348 (Or. 1969), the Court noted that:

Where there is a conflict of interest between the insurer and insured and the judgment in the action against the insured can be relied upon as an estoppel by judgment in a subsequent action on the issue of coverage, the control of the action by the insurer could adversely affect the insured if the judgment was based upon conduct of the insured not falling within the coverage of the policy. Likewise, the insurer could be adversely affected by a judgment based upon conduct for which there is coverage. But we see no reason for applying the rule of estoppel by judgment in such cases. **The judgment should operate as an estoppel only where the interests of the insurer and insured in defending the original action are identical—not where there is a conflict of interests.** If the judgment in the original

action is not binding upon the insurer or insured in a subsequent action on the issue of coverage, there would be no conflict of interests between the insurer and the insured in the sense that the insurer could gain any advantage in the original action which would accrue to it in a subsequent action in which coverage is in issue. (footnotes omitted and emphasis added).

Following on this reasoning, the Supreme Court of Oregon held that estoppel will only operate against an insurer if there is no conflict of interest in the original case between the insurer and the insured. *See also, St. Paul Fire & Marine Ins. Co. v. Crosetti Bros., Inc.*, 475 P.2d 69, 71 (Or.1970).

In *Farmers Ins. Co. v. Vagnozzi*, 675 P.2d 703, 706 (Az. 1983), the Supreme Court of Arizona noted that collateral estoppel applied between an insured and his or her insurer is predicated upon an assumed identity of interests of the parties to the contract of indemnity in opposing the injured person's claim. The Court further understood that a conflict of interest arises where an insurer's interest in defending the claim on behalf of its insured is contrary to its own best interests with regard to coverage. *Id.* at 706. For example, in a policy dealing with an intentional tort exclusion, the Court noted that "the insured wants to prove either that he is not liable for the injury or that he was at most negligent [to invoke coverage], while the insurer wants to prove that the insured, if liable, is guilty of an intentional tort" so as to avoid coverage under the policy. *Id.* Ultimately, the Arizona Court held that "where there is a conflict of interest between an insured and his insurer, the parties will not be estopped from litigating in a subsequent proceeding those issues as to which there was a conflict of interest, whether or not the insurer defended in the original tort claim." *Id.* at 708.

Likewise, in *Willaimson v. State Farm Loyds*, 76 S.W.2d 64, 67 (Tex.Ct.App.2002), the Texas Court noted that in order to invoke collateral estoppel, that a party must show that the party against whom the doctrine is asserted was a party or in privity with a party in the first action. The

Court further found that an insurer and its insured do not share privity when they have a conflict of interest about the subject matter of the litigation. *Id.* at 68. In Williamson, the insured was sued for false imprisonment which was covered under the policy at issue. The insurer refused to defend and a judgment finding false imprisonment was entered. The Court found that despite the judgment, the insurer and insured were not in privity as they maintained conflicting positions with regard to whether the insured was guilty of false imprisonment. The Court held that the insurer was not collaterally estopped from re-litigating the issue of false imprisonment due to this conflict. *Id.* at 68.

This position has received support from other Courts as well. *See also Insurance Co. of North American v. Whatley*, 558 So.2d 120, 122 (Fla. Dist. Ct. App. 1990) (The exception to the privity doctrine exists where the interests of the insured and insurer are antagonistic towards each other in the initial tort action); *Evan v. Employers Mut. Liability Ins. Co.*, 391 F. Supp. 1230, 1232 (D. Ala. 1975) (Finding that the insurer was entitled to re-litigate issues decided in underlying matter as the primary action was never litigated and a conflict of interest existed between the insured and the insurer); *Alabama Farm Bureau Mut. Casualty Ins. Co. v. Moore*, 349 So.2d 1113, 1115 (Ala. 1977) (It is true that as a general rule, a judgment or decree is binding upon parties and their privity; but, technically speaking, there can be no privity, where there is not an identity of interest); *Glen Fall Ins. Co. v. American Oil Co.*, 254 A.2d 658 (Md. 1969).

West Virginia also requires in order for collateral estoppel to apply that the “party against whom the doctrine is invoked was a party or in privity with a party to a prior action.” *Neiswonger v. Hennessey*, 215 W. Va. 749, 601 S.E.2d 69 (2004). In the present case, FFIC was not a party, or in privity with Skaff, in the underlying action. In fact, there is no question that a conflict existed

between Skaff and FFIC. Under the terms of the policy, FFIC had an interest in making sure that the Circuit Court correctly determined that the claim against Skaff was actually a claim for breach of contract, thereby avoiding coverage, or that Skaff was not liable. However, this position could have exposed Skaff to personal liability. Skaff on the other hand, had an interest in making sure that he was either not liable, or if he was liable, that the liability was covered by the policy. There is no doubt that Skaff would have taken the position that he was not negligent, or that the damages asserted by the KCBE were due to his negligence so that he would be entitled to coverage.

Therefore, as noted in Ferguson, the control of the action by FFIC could have adversely affected Skaff if the judgment was based upon conduct of the insured not falling within the coverage of the policy. Likewise, FFIC could have been, or actually was, adversely affected by a judgment based upon conduct of Skaff for which there was coverage. If this Court finds that the judgment in the original action is not binding upon FFIC or Skaff in this subsequent action, then no conflict of interests exists between FFIC and Skaff in the sense that either party could gain any advantage in the original action which would accrue to it in a subsequent action in which coverage is in issue. Thus, in West Virginia, a State which is very cognizant of conflicts between insureds and insurers, a default judgment should operate as an estoppel only where the interests of the insurer and insured in defending the original action are identical--not where there is a conflict of interests.

Accordingly, the Circuit Court was incorrect when it held that collateral estoppel could be utilized to prevent FFIC from challenging the allegations set forth in the Amended Complaint. FFIC is not bound by the default judgment as it was not in privity with Skaff during the pendency of the underlying litigation so as to invoke the collateral estoppel doctrine. Thus, FFIC should be permitted to demonstrate to the Circuit Court that the claims asserted by the KCBE amount to

nothing more than a claim for breach of contract, and if so, that there is no coverage under the policy.

As such, the Circuit Court's Order in this regard is in direct conflict with the principles stated in Neiswonger, as it failed to analyze or address how FFIC is collaterally estopped from challenging the findings made by the entry of the default judgment. Accordingly, the *Final Order* must be vacated, reversed and remanded, relieving FFIC from the impact of the Court's *Final Order* and FFIC the opportunity to litigate whether or not it owes indemnity to Skaff for the claims made by the KCBE.

Finally, even if this Court disagrees with the FFIC, and maintains that Skaff and FFIC were in privity, exceptions exist which were not considered by the Circuit Court. Namely, these exceptions note that any judgment may be set aside, or reduced, if the insurer can demonstrate that the settlement was not made in good faith, or was reached through fraud or collusion. See Rhodes v. Chicago Ins. Co., 719 F.2d 116 (5th Cir. 1983); State Farm Mut. Auto. Ins. Co. v. Paynter, 593 P.2d 948 (Az.App.1979); Geddes & Smith, Inc. v. St. Paul-Mercury Indem. Co., 334 P.2d 881 (Cal.1959); Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589 (Fla. Dist. Ct. App. 1984).

This Circuit Court failed to raise or even address these potential exceptions, which present yet another issue for this Court's consideration, especially in light of Skaff's past criminal and questionable conduct. Moreover, Skaff likely had a valid defense to this claim which did not warrant him entering into a consent judgment for the entire amount of the monies owed to the KCBE. As an agent of a disclosed principal (Multi-cap), Skaff had an argument that he could not be held personally liable for acts committed within the scope of his authority, including a breach of contract by the principal. Hoon v. Hyman, 87 W.Va. 659, 105 S.E. 925 (1921); Hurricane Milling

Co. V. Steel & Payne Co., 84 W.Va. 376, 99 S.E. 490 (1919). As such, liability against Skaff was not altogether clear. Accordingly, to the extent that this Court believes that the Circuit Court was correct in holding that FFIC was bound by the default judgment entered against Skaff, it must allow FFIC an opportunity to determine whether the judgment was made in good faith.

E. The allegations contained in the KCBE's Amended and Supplemental Complaint seek nothing more than damages for breach of contract which are clearly excluded by the FFIC policy.

Assuming that this Court follows the clear weight of authority and does not decide to amend, modify or otherwise change existing West Virginia law, this Court must find that FFIC is entitled to demonstrate that there is no coverage under the FFIC policy to satisfy the damages claimed by the KCBE in its amended complaint. By all accounts, the Circuit Court chose to ignore FFIC's argument that the allegations asserted in the KCBE's Amended and Supplemental Complaint, while couched in terms of negligence, amount to nothing more than a claim for breach of the Delegate Agreement/contract between Multi-Cap and the KCBE. Instead, the Circuit Court simply reiterated that through either FFIC's breach of its duty to defend Skaff or the application of the default judgment, that FFIC was estopped from litigating any coverage defense which it had. However, as set forth above, the position adopted by the Circuit Court was without a legal basis, contravened West Virginia law and must be set aside, thereby allowing FFIC to demonstrate that the Amended and Supplemental Complaint should be read as a claim for breach of contract for which there is no coverage under the FFIC policy.

This Court, after reviewing the KCBE's Amended and Supplemental Complaint should not have any doubt that the damages the KCBE is seeking to recover are based upon Multi-cap's breach of the contract. In fact, the damages asserted by the KCBE in the Amended and Supplemental

Complaint clearly contemplate recovering monies owed to the KCBE by Multi-cap pursuant to the Delegate Agreement and nothing else.⁵ However, the KCBE disguised its Amended and Supplemental Complaint to mislead the reader into thinking that the damages asserted therein were based upon tort law, rather than contract law, by focusing on the actions of Skaff. However, it is of no consequence whether Skaff's actions were negligent, grossly negligent, intentional or criminal, as they, however categorized, resulted in a breach of the Delegate Agreement, and it is the breach of the Delegate Agreement that forms the entire basis of the KCBE's damages. There is no independent cause of action for Skaff's individual actions as no damages resulted from them separate from the breached Delegate Agreement/contract.

This Court has held as far back as 1913 that "a mere breach of contract cannot be sued on as a tort" Neil v. Flynn Lumber Co., 71 W.Va. 708, 77 S.E. 324 (1913). The United States District Court for the Southern District of West Virginia has expounded on this holding in Cotton v. Otis Elevator Co., 627 F.Supp. 519, 521 (S.D.W.V. 1986). In Cotton, the Court held that under West Virginia law "a mere breach of contract does not give rise to a tort claim." In reaching this holding the Court noted that the following language in Battista v. Lebanon Trotting Ass., 538 F.2d 111 (6th Cir. 1976) was persuasive:

It is no tort to carry a feeling of malice toward a person; it is no tort to breach a contract, regardless of motive. A tort exists only if a party breaches a duty which he owes to another independently of the contract, that is, a duty which would exist even if no contract existed. However, when the promisee's injury consists merely of the loss of his bargain, no tort claim arises because the duty of the promisor to fulfill the bargain arises only from the contract. The tort liability of the parties to a contract arises from the breach of some positive legal duty imposed by law because of the

⁵ The Amended and Supplemental Complaint concludes that Multi-cap owes the KCBE damages as a result of Multi-cap's inability to reimburse the KCBE under the Delegate Agreement.

relationship of the parties, rather than from a mere omission to perform a contract obligation.

Id. at 521. (emphasis added).

Based upon this language, the KCBE's claim for coverage must fail as its claim is one for breach of contract which is excluded by the FFIC policy.⁶ The specific allegations of wrongdoing by Skaff only demonstrate how the contract came to be breached and do not change the nature of the claim from one of contract to one of tort. There is no question that if there was no Delegate Agreement/contract between Multi-cap and the KCBE, there would be no damages. As noted in Cotton, when the promisee's injury consists merely of the loss of his bargain, no tort claim arises because the duty of the promisor to fulfill the bargain arises only from the contract. Therefore, there is no coverage for the KCBE's alleged damages as they are the result of a breach of contract which are clearly excluded under the policy.

This Court has also analyzed other cases in which parties have attempted to avoid exclusionary language in insurance policies by asserting claims which would be covered under the policy, but which were not applicable to the case at hand. In Smith v. Animal Urgent Care, Inc., 208 W.Va. 664, 542 S.E.2d 827 (2000), our Supreme Court stated that:

The inclusion of a negligence-oriented theory of recovery against Animal Care does not alter the essence of the claim for purposes of determining the availability of insurance coverage.

In Animal Care, the plaintiff filed an action against both Animal Care and one of its veterinarians

⁶ It should not be lost on the Court that the KCBE initially filed suit against Multi-cap directly asserting a claim for breach of contract. This suit brings nothing new to the table other than the fact that it is a suit against an officer of Multi-cap, for his actions while serving in his official capacity, and acting on behalf of Multi-cap. It still seeks the same damages for Multi-cap's breach of the Delegate Agreement.

alleging allegations of sexual harassment, wrongful discharge and intentional infliction of emotional distress. The policy at issue contained an intentional acts exclusion which the lower Court determined excluded coverage. On appeal, Animal Care argued that coverage was available under the policy because of the negligence allegations involving Animal Care's failure to properly supervise its employees. This Court noted that, "sexual harassment, in its inherently non-accidental nature, remained the crux of the case regardless of whether negligence is alleged against Animal Care." Id., at 669, 542 S.E.2d at 832. *See also, Tackett, supra.*

Smith is certainly analogous to the case at hand. Rather than alleging a claim for breach of contract, the KCBE attempts to disguise the claim to be grounded in tort. However, the fact that a tortious act may be alleged to have been committed by Skaff does not change the fact that the crux, if not the entirety, of this case is one for breach of contract and that the alleged tortious acts of Skaff simply form the basis of the breach, and not the basis for the damages. The damages in this case arise, without question, from a breach of the Delegate Agreement. The KCBE has never demonstrated that any other damages were being sought.

There is also no dispute that the FFIC policy does not provide coverage for "*damages that result from or arise out of any actual or alleged breach of contract.*" Again, without the Delegate Agreement/contract, the KCBE would not have any damages in this case from which to sue Skaff. Therefore, there is no coverage under the policy for the damages alleged by the KCBE as those damages arise from a breach of contract. And, even if the Court should determine that FFIC breached a duty to provide Skaff with a defense in the underlying case, an assertion which FFIC denies, FFIC still owes no coverage to for any wrongdoing for which Skaff is found to be liable.

FFIC acknowledges that in its briefs filed with the Circuit Court, the KCBE attempted to

suggest that Skaff owed a fiduciary duty to it independent of the contract. In support of this position, the KCBE cites to the 1915 case of Arnold v. Knapp, 75 W.Va. 804, 84 S.E. 895 (1915), which held that **when** a corporation becomes insolvent, its officers and directors become trustees of the corporate property and assets, for the benefit of all creditors. First, FFIC asserts that this duty would again arise from the existence of the Delegate Agreement as the KCBE would not have been a creditor of Multi-Cap but for the contract. Second, the allegations in the Amended and Supplemental Complaint do not suggest that Skaff committed any wrongful act **after** Multi-cap became insolvent as required in Arnold. Rather, the allegations set forth by the KCBE, as well as the facts as developed in this matter, clearly demonstrate that it was through both Skaff's and the Board of Directors' actions and direction which resulted in Multi-Cap's insolvency in or around January 2001. As such, if any duty did arise pursuant to Arnold, it was after Multi-Cap became insolvent and after Skaff committed the acts alleged in the complaint. Nor has the KCBE explained how Arnold is applicable in this matter.

Third, FFIC asserts that the Arnold decision has no relevance in this case at all. The Arnold decision dealt with bankruptcy issues and involved questions of priority of payments to creditors after a corporation has become insolvent. The Court held that the officers and directors of an insolvent corporation cannot prefer themselves or other creditors when distributing funds from the corporation after it has become insolvent, and all payments made within four months of filing bankruptcy are considered voidable. Thus, this decision does nothing more than protect creditors by disallowing preferential payments to preferred creditors once a corporation has become insolvent. There is no indication that the facts of the present litigation even remotely resemble the facts set forth in the Arnold decision, and as such, it is not applicable to assert a tort claim.

Finally, the KCBE attempts to argue that pursuant to Bowling v. Ansted Chrysler-Plymouth-Dodge, Inc., 188 W.Va. 468, 425 S.E.2d 144 (1992) that it may assert tort claims against a corporate officer for the tortious acts of the corporation, if the officer participated in, approved of, sanctioned or ratified such acts. First, the KCBE did not allege that the Multi-Cap engaged in any tortious conduct in the complaint. As such, the complaint provides no basis for holding Skaff liable for the torts of Multi-Cap as Multi-Cap was not alleged to have committed a tort.

Also, this decision is factually dissimilar to the facts in the current litigation, and as such, has no relevance to this case. In Bowling, the president of a car dealership was purchasing cars at commercial auctions knowing most of them were used rental cars. He then removed the evidence that they had been rental cars and sold them as factory vehicles. Notably, there was no underlying contract which formed the basis of the plaintiffs claims in Bowling, as there is in the present litigation. There is no question that the damages in the present litigation stem solely from Multi-Cap's breach of contract and not from any tort.

As such, the Circuit Court erred in failing to analyze whether or not the FFIC policy provided coverage for the damages asserted by the KCBE. Accordingly, the *Final Order* must be vacated, reversed and remanded, relieving FFIC from the impact of the Court's *Final Order* and finding that the KCBE's allegations and damages arise from a breach of contract. Therefore, FFIC must be permitted the opportunity to litigate whether or not it owes indemnity to Skaff for the claims made by the KCBE.

F. The Circuit Court Abused its Discretion by Failing to Grant the Relief Requested in FFIC's Motion for Relief from the November 18, 2004 Final Order and to Vacate the Same.

While the Circuit Court has wide discretion to grant a Rule 60(b) motion, it is the position of FFIC that based upon the grounds set forth in this Appeal, the Circuit Court erred in failing to relieve FFIC from the November 18, 2004 *Final Order*. As shown herein, the positions adopted by the Circuit Court are incorrect, based upon law reflecting the position of a minority of other States, and contrary to the law set forth and laid down by this Court. In its motion for summary judgment FFIC argued that there was no coverage under the policy based upon the breach of contract exclusion and that because of the exclusion, FFIC had no duty to defend Skaff. FFIC further argued to the Circuit Court, that if FFIC breached its duty to defend Skaff that its only damages were those set forth by this Court in Aetna Cas. & Sure. Co. v. Pitrolo, 176 W.Va. 190, 342 S.E.2d 156 (1986).

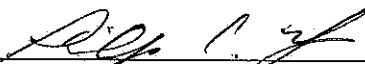
However, as set forth herein, the Circuit Court's rulings went far beyond the holdings expressed by this Court in any prior decisions. Given the nature, and unexpected ruling by the Circuit Court, FFIC filed a Rule 60(b) motion requesting that the Circuit Court reconsider its rulings in light of the vast weight of authority. The arguments set forth by FFIC in said motion are similar, and in many instances, identical to those set forth in this Appeal. As such, FFIC relies upon the arguments set forth above as support for its position that the Circuit Court abused its discretion in failing to grant FFIC's Rule 60(b) motion.

VII. PRAYER FOR RELIEF

WHEREFORE, for the foregoing reasons, your Appellant, FFIC, respectfully requests that this Honorable Court reverse the Final Order of the Circuit Court and conclude that FFIC did not breach its duty to defend Skaff pursuant to the terms of the policy. In the alternative, FFIC respectfully requests that this Court vacate, reverse and remand the Circuit Court's Final Order in so far as it holds that FFIC was estopped from raising any policy exclusions and allow FFIC the opportunity to litigate whether or not it owes indemnity to Skaff for the claims made by the KCBE.

Respectfully Submitted,

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NO. 32702

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA
CHARLESTON

FIREMAN'S FUND INSURANCE COMPANY,

Petitioner,

v.

From the Circuit Court of Kanawha County,
West Virginia
Civil Action No. 02-C-1958
Judge: James C. Stucky

**BOARD OF EDUCATION OF
THE COUNTY OF KANAWHA,**
a statutory corporation, and
PAUL R. SKAFF, JR.,

Respondents.

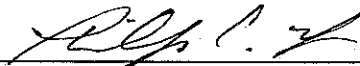
CERTIFICATE OF SERVICE

I, Phillip C. Monroe, do hereby certify that on June 24, 2005, I served **Fireman's Fund Insurance Company's Appeal Brief** upon counsel of record herein by depositing true copies thereof in the United States mail, postage prepaid, addressed to said counsel as follows:

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