

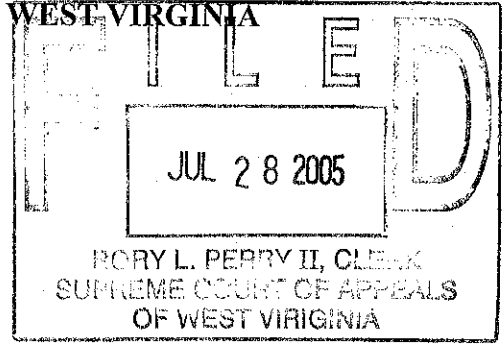
IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

**BOARD OF EDUCATION OF THE
COUNTY OF KANAWHA, a
statutory corporation,**

Appellee/Plaintiff,

v.

**No. 32702
CIVIL ACTION NO.: 02-C-1958
(Circuit Court of Kanawha County,
West Virginia
Judge James C. Stucky**



**PAUL R. SKAFF, JR., Defendant and
FIREMAN'S FUND INSURANCE COMPANY,**

Appellant/Defendant.

**BRIEF OF APPELLEE BOARD OF EDUCATION
OF THE COUNTY OF KANAWHA**

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**BRIEF OF APPELLEE BOARD OF EDUCATION
OF THE COUNTY OF KANAWHA**

“An insurer that refuses to indemnify or defend based upon a belief that a claim against its insured is excluded from a policy’s scope of coverage ‘[does] so at its peril, and if the insurer guesses wrong, it must bear the consequences, legal or otherwise, of its breach of contract.’”

Southern Guaranty Ins. Co. v. Dowse, 278 Ga. 674, 676, 605 S.E.2d 27, 29 (2004), quoting 49 A.L.R. 2d 694 at (I)(2b).

In this appeal, Appellant Fireman’s Fund Insurance Company (“Fireman’s Fund”) seeks to have this Court apply a much different rule than the universal proposition noted above. In this appeal, Fireman’s Fund asks this Court to permit an insurer to abandon its insured and then, bear no consequences for its actions.

In this case, Fireman’s Fund made a conscious and deliberate decision to refuse to defend Paul R. Skaff, Jr., its insured, when a lawsuit was filed against Mr. Skaff alleging that he had committed multiple errors, omissions and breaches of duty and seeking hundreds of thousands of dollars of damages from Mr. Skaff. Instead of defending Mr. Skaff under reservation of rights or even filing a declaratory judgment proceeding to determine the respective rights and obligations of the parties, Fireman’s Fund made a deliberate decision to stand idly by while Mr. Skaff was exposed to a default judgment.

Indeed, to prevail on this appeal, Fireman’s Fund is effectively asking this Court to reverse long-standing West Virginia law and to create new law unsupported by authority from any other jurisdiction and hold that:

- Questions concerning an insurer’s duty to defend under an insurance policy should be construed strictly against the insured and liberally in favor of the insurance company, and overrule Tackett v. American Motorists Ins. Co., 213

W. Va. 524, 584 S.E.2d 158 (2003) and the numerous cases cited in and relied upon by the Court in Tackett;

- In construing exclusions in the policy, the language of the exclusion should be liberally construed in favor of the insurance company and against the insured so that the insurance company can avoid obligations under the policy, and overrule syllabus point 5 of National Mutual Ins. Co. v. McMahan & Sons, Inc., 177 W. Va. 734, 356 S.E.2d 488 (1987) and the numerous cases since McMahan & Sons that have cited and applied syllabus point 5;
- An insurance company may unilaterally recast a third party's claims against its insured into terms that the insurer prefers so that the insurer may more readily attempt to avoid the duty to defend under a liability policy.
- Notwithstanding language in an insurance policy which requires the insurer to defend an insured, even if the allegations [of a third party's complaint] are groundless, false or fraudulent, an insurance company may unilaterally determine the legal or factual merits of a third party's claims against its insured and conclude, as a result of that determination, that it need not defend its insured.
- In attempting to avoid an obligation under an insurance policy, an insurance company can look to and rely on the portions of the policy that support its position and simply ignore those portions of the policy that do not support the insurer's position.
- When an insurance company breaches its duty to defend an insured who cannot afford to hire counsel to defend himself after the insurer's refusal to defend, the insurance company bears no consequences as a result of its breach.
- Despite being in privity with its insured, an insurance company is not bound by a default judgment entered against its insured after the insurer unilaterally decides to deny its insured a defense.

After failing to convince the Circuit Court of Kanawha County of the merits of its position, Fireman's Fund now asks this Court to assist it in avoiding the consequences of

its intransigence. This Court should soundly reject Fireman's Fund's arguments and affirm Judge Stucky's Orders.

I. STATEMENT OF FACTS

Paul R. Skaff, Jr. was the Executive Director of the Multi-County Community Action Against Poverty, Inc. ("Multi-Cap"), a non profit corporation in Charleston, Kanawha County, West Virginia. Multi-Cap was the recipient of certain federal grant money to run the Head Start Program in Clay, Boone, Putnam and Kanawha Counties and a portion of Fayette County, West Virginia. In January 2000, the Kanawha County Board of Education and Multi-Cap entered into a Delegate Agreement, whereby the Board of Education 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.

The Head Start Program was financed under United States Department of Health and Human Services Grant Number 2003 for the period from June 1, 2000 through May 31, 2001. Multi-Cap would receive the grant money from the federal government and hold those funds until the Board submitted "itemized funds requests" to Multi-Cap for reimbursement of the Board's costs incurred in running the program. Multi-Cap was then to reimburse the Board "within 10 days of receipt of the funds request."

The Board of Education performed all services required to be performed under the Delegate Agreement. However, beginning in or about January 2001, Multi-Cap failed to reimburse the Board of Education for costs incurred by the Board of Education during the 2000-2001 program year, as required by the Delegate Agreement, in the amount of \$710,974.85.

Fireman's Fund issued Policy No. CND 620-34-86 to Multi-Cap on June 3, 2000. The initial policy period was from May 19, 2000 to May 19, 2001. By endorsement, effective on May 19, 2001, the policy period was extended to July 30, 2001.

By endorsement, effective July 30, 2001, Fireman's Fund issued an "Extended Reporting Period Endorsement" which provided for an extended reporting period from July 30, 2001 to July 30, 2002. The Endorsement stated:

In consideration of the additional premium shown above, we agree to cover **Claims** reported to us during the extended reporting period shown above as if the **Claims** had been first made during the **Policy Period** of the policy to which this endorsement applies. But this applies only to **Wrongful Acts** which occur prior to the date shown above. [7-30-01.]

The extended reporting period is part of and not in addition to the **Policy Period**. Our aggregate limit of liability in respect of all **Claims** made during the **Policy Period**, including the extended reporting period, shall not exceed the limit of liability set forth in the Declarations of the policy to which this endorsement applies.

Emphasis in original.

The policy provided that Fireman's Fund "will pay on behalf of the insured all sums in excess of the retained amount shown in Item 4 of the Declarations [\$1,000.00] which the Insured is legally required to pay as Damages because of a Wrongful Act to which this insurance applies." The policy further provided that, "[a]t [Fireman's Fund's] expense, [the insurer] will defend any claim brought against the Insured alleging Wrongful Acts covered by this policy . . . even if the allegations are groundless, false or fraudulent."

The policy contained the following pertinent definitions:

A. **Claim** means a written notice alleging that an **Insured** is responsible for **Damages** or seeking monetary relief. The notice may be in the form of a letter, a legal summons and complaint or a notice of an administrative proceeding.

B. **Covered Person** means all of the following individuals:

1. any of [Multi-Cap's] past, present or future directors, officers, trustees, employees, or volunteers or those of a **Covered Subsidiary**;

...

D. **Damages** means amounts which an **Insured** is obligated to pay to **Claimants** injured by **Wrongful Acts**...

E. **Insured** means [Multi-Cap], any **Covered Person** and any **Covered Subsidiary**.

F. **Policy Period** means the period this policy is in effect from the inception date shown on Item I of the Declarations. Any extended period provided under Section V. Extended Reporting Period is part of and not in addition to the **Policy Period**.

...

I. **Wrongful Act** means:

1. Any actual or alleged error, omission, misstatement, or breach of duty committed by a **Covered Person**:

a. while serving [Multi-Cap] or a **Covered Subsidiary** in his or her capacity . . .

Emphasis in original. The Circuit Court found, and it is not contested by the insurer, that Paul Skaff was an insured under the Fireman's Fund policy.

II. PROCEDURAL HISTORY

On July 25, 2002, the Board of Education initiated this civil action in the Circuit Court of Kanawha County against Paul R. Skaff, Jr. As is obvious from the Complaint, Multi-Cap was not and never has been a party to this civil action. The Board's Complaint alleged that Mr. Skaff was the Executive Director of Multi-Cap and, while acting within the scope of his employment with Multi-Cap, committed certain tortious acts between June 1, 2000 and May 31, 2001, which acts proximately caused damage to the Board of Education. The Board's Complaint alleged that Multi-Cap was unable to reimburse the Board of Education as required by the Delegate Agreement because Mr. 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.

Board's Complaint ¶5.

The Complaint also alleged that Multi-Cap owed a fiduciary duty to the Board of Education as a result of the Delegate Agreement and that Mr. Skaff participated in, approved of, sanctioned and/or ratified acts and conduct which caused Multi-Cap to

breach its fiduciary duty to the Board of Education. **Board's Complaint ¶¶ 6, 7.** The Complaint further alleged that, as an officer of Multi-Cap, Mr. Skaff owed a fiduciary duty to Multi-Cap's creditors, including, but not limited to, the Board of Education and that Mr. Skaff breached his fiduciary duty to Multi-Cap's creditors, including, but not limited to, the Board of Education. **Board's Complaint ¶¶ 9, 10.** The Complaint did not assert that any contract existed between the Board of Education and Paul Skaff and did not assert that Paul Skaff breached any contract.

Mr. Skaff was served with the Board's Complaint on July 29, 2002. A copy of the Board's Complaint was sent directly to Fireman's Fund by the Board's counsel. Fireman's Fund admitted that it received a copy of the Board's Complaint against Skaff "prior to July 29, 2002." Mr. Skaff first learned of the Board of Education's tort claims against him when he was served with the Complaint. Despite being served, Skaff did not forward a copy of the Complaint to Fireman's Fund. Fireman's Fund did not request any information from Skaff about any matter related to the claim of the Board of Education after the insurer received the Board of Education's Complaint from the plaintiff's counsel.

In forwarding the Complaint to Fireman's Fund, the Board's counsel referred the insurer to Colonial Ins. Co. v. Barrett, 208 W. Va. 706, 542 S.E.2d 869 (2000). Syllabus Point 1 of Barrett provides that:

A provision in an insurance contract requiring a policyholder to give the insurance company notice of a claim may be satisfied when notice of a potential claim is provided to a claims representative for the insurance company regardless of whether it was the policyholder who provided the notice.

Under Barrett, all notice provisions of the policy were satisfied in a timely fashion by the Board's counsel, regardless of whether Mr. Skaff himself forwarded the Complaint to Fireman's Fund. Fireman's Fund does not challenge the Circuit Court's findings and conclusion in this regard. (Nov. 18, 2004 Order at Findings at ¶¶ 19-20, 26, Conclusions at ¶ 2).

Fireman's Fund did not provide a defense to Skaff, but responded with a letter from a claims adjuster to plaintiff's counsel dated August 15, 2002, which stated:

I also understand from your letters that Mr. Skaff, the former director of Multi-CAP has now been named in a new lawsuit filed by the Board of Education. Your letters are our only notice of this lawsuit and Mr. Skaff has not contacted Fireman's Fund regarding the lawsuit. Based upon my research, it appears Mr. Skaff was investigated and pled guilty to embezzlement charges. It is very unclear whether Fireman's Fund would defend Mr. Skaff when he does request a defense.

Contrary to the assertions in Fireman's Fund's brief, this letter made no reference to the "Breach of Contract" exclusion contained in Section II.B of the insurance policy.

In the weeks after sending this letter, Fireman's Fund still failed to provide a defense to Mr. Skaff and Mr. Skaff did not otherwise file a responsive pleading. By letter dated November 19, 2002, plaintiff's counsel informed Fireman's Fund that Mr. Skaff had been served and, again citing Barrett, requested that Fireman's Fund provide Mr. Skaff with a defense. The insurer was also informed that, if it did not provide Skaff with a defense, the Board of Education would seek a default judgment against Mr. Skaff.

By fax transmission dated December 9, 2002, Fireman's Fund responded by informing plaintiff's counsel that it would not provide Mr. Skaff with a defense. The December 9, 2002 fax transmission from a second Fireman's Fund adjuster stated:

A careful coverage analysis was done in this case by Ms. Butter and Meghan Dahl Ryan before her. I see nothing in this file that would cause me to disagree with their conclusions that we have no coverage for this claim and therefore no duty to defend Mr. Skaff, who, as you know, has ever asked us to defend him in this case. We will stand on our disclaimer.¹

No mention of the "Breach of Contract" exclusion was made in this communication. As this communication indicates, Fireman's Fund did not "drop the ball" in failing to provide Paul Skaff with a defense. In this case, the ball was handed to Fireman's Fund and the insurer chose to throw it to the ground.

Upon receipt of Fireman's Fund's December 9, 2002 communication, the Board filed a Motion for Entry of Default Judgment against Mr. Skaff on December 19, 2002. A copy of this motion was sent to both Mr. Skaff and Fireman's Fund. The insurer did not retain counsel to respond to the Board's motion on Mr. Skaff's behalf, nor did it respond in any way on its own behalf. The Circuit Court granted the Board of Education a default judgment as to Mr. Skaff's liability by Order dated January 16, 2003.

At this point, Mr. Skaff was facing personal liability to the Board, after being abandoned by his insurer. On January 8, 2004, to protect his personal assets, Mr. Skaff executed an assignment of his claims as an insured against Fireman's Fund to the Board of Education in exchange for the Board of Education's covenant not to execute against his personal assets. By Order dated January 13, 2004, the Circuit Court granted the Board of Education a judgment against Skaff (as agreed to by Skaff) in the amount of

¹ No "coverage analysis" by Meghan Dahl Ryan had been provided to either Paul Skaff or the Board's counsel. Apparently, this reference is to a denial of a defense for a different lawsuit against a different insured. In any event, Fireman's Fund did not submit a copy of Ms. Ryan's letter in support of its motion for summary judgment in this lawsuit and it is not in the record below.

\$997,175.48 for the claims asserted in the Board of Education's Complaint, which included damages for both prejudgment interest and annoyance and inconvenience.

By Order dated January 12, 2004, the Circuit Court granted the Board leave to file an Amended and Supplemental Complaint. The Board's Amended and Supplemental Complaint was filed on January 20, 2004, asserting five additional counts (on its own behalf and as assignee of Skaff) against Fireman's Fund.

After Fireman's Fund appeared in this action, Fireman's Fund and the Board agreed to submit cross-motions for summary judgment to the Circuit Court on the issues related to coverage under the insurance policy. By a detailed, 24 page Order dated November 19, 2004, the Circuit Court granted the Board's motion and denied Fireman's Fund's motion. After a detailed analysis of the uncontested facts and the applicable law, the Circuit Court concluded that Fireman's Fund had breached its duty to defend Paul Skaff in this civil action and further concluded that Fireman's Fund was liable to the Board for the January 13, 2004 monetary judgment that had been entered against Skaff, in its entirety. The Circuit Court's November 19, 2004 Order also dismissed the action from its docket.

Thereafter, both the Board and Fireman's Fund filed motions regarding the November 19, 2004 Order. The Board's motion sought reinstatement of the case to the active docket to allow the resolution of the Board's remaining, unresolved claims against Fireman's Fund seeking extracontractual and "bad faith" damages. Fireman's Fund's motion sought to have the Circuit Court reconsider its ruling.

The Circuit Court denied Fireman's Fund's motion for reconsideration by Order dated February 22, 2005. By Order entered that same date, the Circuit Court also granted

the Board's motion to reinstate the remainder of the case to the active docket and specifically certified its November 18, 2004 ruling on the insurance coverage issues as a final order under Rule 54(b) of the West Virginia Rules of Civil Procedure.

In this appeal, Fireman's Fund does not challenge Judge Stucky's findings and conclusions regarding two of the three Exclusions relied upon by the insurer in its motion for summary judgment. This appeal revolves solely around the "Breach of Contract" Exclusion in Section II.B of the policy.

III. APPELLEES RESPONSE TO APPELLANT'S ASSIGNMENTS OF ERROR

A. The Circuit Court correctly concluded that Fireman's Fund had a duty to defend Paul Skaff, its insured, in Civil Action No. 02-C-1958.

B. The Circuit Court correctly concluded that Fireman's Fund was responsible to pay the January 13, 2004 judgment entered against Paul Skaff, its insured, in Civil Action No. 02-C-1958.

1. Fireman's Fund was liable for the judgment under West Virginia contract law as a result of its breach of the duty to defend Paul Skaff.

2. Fireman's Fund was bound by the January 16, 2003 default judgment as to Paul Skaff's liability to the Board of Education in Civil Action No. 02-C-1958 for the causes of action asserted in the Board's Complaint.

3. The "Breach of Contract" Exclusion contained in Section II.B of Fireman's Fund's policy does not apply in this case.

4. Estoppel is not an issue in this case as Fireman's Fund was not estopped from asserting the applicability of any exclusion in Civil Action No. 02-C-1958.

IV. THE STANDARD OF REVIEW

Judge Stucky's November 18, 2004 Order resolved the declaratory judgment count of the Board's Amended and Supplemental Complaint. With regard to the appropriate standard of review in a declaratory judgment action, this Court has stated:

because the purpose of a declaratory judgment action is to resolve legal questions, a circuit court's ultimate resolution in a declaratory judgment action is reviewed *de novo*; however, any determination of fact made by the circuit court in reaching its ultimate resolution are reviewed pursuant to a clearly erroneous standard. Accordingly, we hold that a circuit court's entry of a declaratory judgment is reviewed *de novo*.

Cox v. Amick, 195 W. Va. 608, 612, 466 S.E.2d 459, 463 (1995). The November 18, 2004 Order granted the Board's motion for summary judgment and denied the insurer's motion for summary judgment. Review of the denial of a motion for summary judgment, where such a ruling is properly reviewable, is *de novo*. Findley v. State Farm Mutual Auto. Ins. Co., 213 W. Va. 80, 576 S.E.2d 807 (2002).

In this appeal, the Court must review the Circuit Court's interpretation of an insurance contract. In Syllabus point 2, Riffe v. Home Finders Associates, Inc., 205 W. Va. 216, 517 S.E.2d 313 (1999), this Court held:

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.

See also, Syllabus point 1, Tennant v. Smallwood, 211 W. Va. 703, 568 S.E.2d 10, (2002); Murray v. State Farm Fire & Cas. Co., 203 W. Va. 477, 482, 509 S.E.2d 1, 6 (1998) ("Determination of the proper coverage of an insurance contract when the facts

are not in dispute is a question of law."). Accordingly, the standard of review applicable to this appeal is a *de novo* standard.

V. ARGUMENT

A. **The Circuit Court correctly concluded that Fireman's Fund had a duty to defend Paul Skaff, its insured, in Civil Action No. 02-C-1958.**

The Fireman's Fund policy provides coverage for "Wrongful Acts." This is the broadest type of coverage that a liability insurance policy can provide. There is no requirement of an "occurrence" or even an "offense" as defined by the policy. *See e.g. Tackett v. American Motorists Ins. Co.*, 213 W. Va. 524, 584 S.E.2d 158 (2003), discussing the application of such terms in "Coverage A" and "Coverage B" sections of a Commercial General Liability Policy. Instead, as defined by Fireman's Fund's own policy, coverage is provided for "any actual or alleged error, omission, misstatement or breach of duty committed by a Covered Person . . . while serving [Multi-Cap] in his or her capacity . . . "

The law on the duty to defend in West Virginia, consistent with the law across the country, requires that "[a]ny question concerning an insurer's duty to defend under an insurance policy must be construed liberally in favor of an insured where there is any question about an insurer's obligations." Syllabus Point 5, *Tackett*, supra (emphasis added). As this Court has stated, and the Circuit Court concluded, "[u]nder West Virginia law, '[a]n insurer must meet a rigorous standard to avoid its obligation to defend' *Butts v. Royal Vendors, Inc.*, 202 W. Va. 448, 451, 504 S.E.2d 911, 914 (1998)." **November 18, 2004 Order at Conclusion 14.** Additionally, "[w]here the policy

language involved is exclusionary, it will be strictly construed against the insurer in order that the purpose of providing indemnity not be defeated. Syllabus Point 5, National Mutual Ins. Co. v. McMahon & Sons, Inc., 177 W. Va. 734, 356 S.E.2d 488 (1987).”

November 18, 2004 Order at Conclusion 21. To implicate the duty to defend, there is no requirement that the facts alleged in the complaint specifically and unequivocally make out a claim within the coverage. Aetna Casualty & Surety Co. v. Pitrolo, 176 W. Va. 190, 194, 342 S.E.2d 156, 160 (1986).

Other fundamental principles of West Virginia insurance law are also pertinent. In Syllabus Point 3 of Polan v. Travelers Ins. Co., 156 W. Va. 250, 192 S.E.2d 481 (1972), the Court held that: “An insurance policy which requires construction must be construed liberally in favor of the insured.” In Syllabus Point 2 of Farmers Mutual Ins. Co. v. Tucker, 213 W. Va. 16, 576 S.E.2d 261 (2002) the Court held that: “When the words of an insurance policy are, without violence, susceptible of two or more interpretations, that which will sustain the claim and cover the loss must be adopted.” West Virginia law also requires that “if part of the claims against an insured fall within the coverage of a liability policy and part do not, the insurer must defend all of the claims, although it might eventually be required to pay only some of the claims.” Horace Mann Ins. Co. v. LEEBER, 180 W. Va. 375, 378, 376 S.E.2d 581, 584 (1988).

Against this backdrop of its own policy language and the law, Fireman’s Fund asks this Court to allow it to do what no West Virginia court – and no court anywhere – has ever allowed an insurer to do, to re-write the Board’s Complaint against Fireman’s Fund insured in a manner that better suits Fireman’s Fund’s purposes of attempting to avoid its obligations under the policy. Yet, even if Fireman’s Fund’s remarkable

attempts to do so could succeed, the insurer is still left with an allegation of “a breach of duty committed by a covered person” under its policy. Thus, Fireman’s Fund is left with no choice but to further argue that, contrary to every principle of insurance law, its own policy language should be broadly construed in its own favor to relieve the insurer of its obvious obligations under the policy.

The Circuit Court properly rejected these arguments. In reviewing the ruling of the court below, this Court must first bear in mind that this lawsuit was instituted against Paul Skaff, and only Paul Skaff. The Board’s only claims in its initial Complaint in this civil action were against Paul Skaff. Contrary to the insurer’s assertions in its brief, this case does not “arise from a contractual dispute” between the Board and Multi-Cap. This case arises from a claim by the Board that Paul Skaff breached duties owed to the Board and caused damage to the Board. Whether Fireman’s Fund likes it or not, any analysis done by the insurer, by the Circuit Court or by this Court must start and finish with that fundamental fact. The issue in this case is whether Paul Skaff is entitled to coverage under the Fireman’s Fund policy for the claims that were asserted by the Board against Paul Skaff.

The duty to defend under a liability policy is not dependent on the legal or factual validity of the plaintiff’s claims. It is solely dependent on whether the Complaint alleges an act or omission that is covered under the language of the policy. “The existence of the duty to defend depends solely on the nature of the claim asserted against the insured and has nothing to do with the merits of the claim.” U.S. Fire Ins. Co. v. Green Bay Packaging, Inc., 66 F. Supp.2d 987, 995 (E.D. Wisc. 1999). This is so in this case because the insurance policy requires Fireman’s Fund to “defend any claim alleging

Wrongful Acts covered by [the] policy . . . even if the allegations are groundless, false or fraudulent.” *See also Pitrolo*, 176 W. Va. at 194, 342 S.E.2d at 160 (the generally recognized principle that the duty to defend is broader than the obligation to pay “ordinarily rises by virtue of language in the ordinary liability policy that obligates the insurer to defend even though the suit is groundless, false or fraudulent.”).²

A “Wrongful Act” under the policy is any “actual or alleged error, omission, misstatement or breach of duty committed by a Covered Person.” (Emphasis added.) Paul Skaff is a “Covered Person” under the policy. The Board’s Complaint alleges that Paul Skaff improperly drew down and used federal funds. That is an alleged error committed by a Covered Person. The Complaint alleges that Paul Skaff failed to exercise proper control and implement proper standards with regard to federal funds and failed to comply with federal statutes and rules. Those are alleged omissions committed by a

² Interestingly, Fireman’s Fund asserts in its brief that the Board “filed suit directly against Multi-Cap’s Executive Director . . . thereby attempting to avoid the breach of contract exclusion.” Appellant’s Brief at 1-2. While Fireman’s Fund has no knowledge of the reasons why the Board chose to sue Paul Skaff, this assertion does the insurer no benefit, because it still must defend Mr. Skaff even if it believes that the claims against him were “fraudulently asserted.”

Covered Person. The Complaint alleges that Paul Skaff was negligent in handling federal funds and breached fiduciary duties owed to the Board. Those are alleged breaches of duty committed by a Covered Person. Indeed, if these allegations are not allegations of “Wrongful Acts” as defined by the policy, one wonders what allegations Fireman’s Fund would require. More importantly, however, the Board’s Complaint does not allege that Paul Skaff was a party to any contract with the Board and does not allege that Paul Skaff breached any contract that he had with the Board of Education.

Fireman’s Fund’s repeated mantra in this appeal is that the Board’s Complaint fails to state a claim against Paul Skaff upon which relief can be granted. This argument has no bearing on the issue of coverage for Paul Skaff under the policy. Fireman’s Fund’s arguments that Skaff had no independent duty to the Board are arguments that may have been appropriately made on Skaff’s behalf in a motion to dismiss in the underlying claim, had Fireman’s Fund provided Skaff with a defense. But those arguments – even if correct – cannot and do not relieve Fireman’s Fund of its duty to defend in this case. An insurer may not unilaterally recast a plaintiff’s claims against its insured into terms that the insurer prefers, to avoid the duty to defend. *See Farmers Union Mutual Insurance Co. v. Staples*, 321 Mont. 99, 106, 90 P.3d 381, 385 (2004) (“The insurer is under a duty to construe the factual assertions from the perspective of the insured rather than solely from the insurer’s own perspective.”)

An insurer may not unilaterally determine the legal or factual merits of a plaintiff’s claims against its insured and conclude, as a result that the determination, that it need not defend its insured. As one court has observed, “[t]he allegations of the complaint, not the insurer’s belief as to the merits of the complaint, determine an

insurer's duty to defend." Premier Homes, Inc. v. Lawyers Title Ins. Corp., 76 F.Supp.2d 110, 115 (D. Mass. 1999).

Indeed, the duty to defend under a liability insurance policy is as important to an insured who has been wrongly accused of committing "wrongful acts," as it is to one who has clearly committed such acts. "Though policy coverage is often denominated as 'liability insurance', where the insurer has made promises to defend it is clear that [the coverage] is, in fact, 'litigation insurance' as well." Seaboard Surety Co. v. Gillette Co., 64 N.Y.2d 304, 310, 476 N.E.2d 272, 275, 486 N.Y.S.2d 873, 876 (1984). If Fireman's Fund believed that the Board's claims against Skaff lacked merit, the insurer's remedy – and indeed its contractual obligation – was to defend Skaff and seek to have those claims dismissed. In fact, as one court has noted, "[t]he nonliability of the insured is potentially the most effective bar to any policy claims against the insurer." Preferred America Insurance v. Dulceak, 302 Ill. App. 3d 990, 996, 706 N.E.2d 529, 533, 235 Ill Dec. 974, 978 (1999).

In discussing the duty to defend, the Seventh Circuit has also observed that:

Especially since the advent of notice pleading, in a case where there is doubt as to whether a theory of recovery within the policy coverage has been pleaded in the underlying complaint, the insurer must defend, and its defense obligations will continue until such time as the claim against the insured is confined to a recovery that the policy does not cover.... To hold otherwise would be to place upon the insured the burden of demonstrating in advance of the underlying litigation which of the competing theories of recovery against it was applicable for purposes of insurance, thereby frustrating one of the basic purposes of such a clause in the insurance contract, protection of the insured from the expenses of litigation.

Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178, 1185 (7th Cir.), *cert denied* 449 U.S. 1033 (1980), citations omitted, emphasis added. *See also* State of Idaho v. Bunker Hill Company, 647 F.Supp. 1064, 1068 (D. Idaho 1986) (“[S]ince the advent of notice pleading there will likely be broad ambiguous claims made against the insured making it more difficult for the insurer to determine whether the insurance policy covers the claims. But ..., where there is doubt as to whether a theory of recovery within the policy coverage has been pleaded in the underlying complaint, or which is potentially included in the underlying complaint, the insurer must defend regardless of potential defenses arising under the policy or potential defenses arising under the substantive law under which the claim is brought against the insured.” Emphasis added.); Gibson v. Farm Family Mut. Ins. Co., 673 A.2d 1350, 1352 (Me. 1996) (“If the allegations in the underlying tort action are within the risk insured against and there is *any potential basis* for recovery, the insurer must defend the insured regardless of the actual facts of which the insured’s ultimate liability may be based. . . . An insured is not at the mercy of the notice pleading of the third party suing him to establish his own insurer’s duty to defend.” Emphasis in original); Cunningham v. Universal Underwriters, 98 Cal. App. 4th 1141, 1148, 120 Cal.Rptr.2d 162, 167 (2002) (“In a duty to defend case, an insurer moving for summary judgment must establish *the absence of any . . . potential* for coverage, i.e., that the underlying complaint *can by no conceivable theory raise a single issue which could bring it within the policy coverage*. . . . In contrast, to prevail on its summary judgment motion, the insured need only show the existence of a *potential for coverage*, i.e., that the underlying claim *may* fall within policy coverage.” Emphasis in original, citations omitted); McCormack Baron Management Services, Inc. v. American Guarantee &

Liability Ins. Co., 989 S.W.2d 168, 170-71 (Mo. 1999) (“The duty to defend arises whenever there is a potential or possible liability to pay based on the fact at the outset of the case and is not dependant on the probable liability to pay based on the facts ascertained through trial. . . . The duty to defend is determined comparing the language of the insurance policy with the allegations in the complaint. If the complaint merely alleged facts that give rise to a claim potentially within the policy’s coverage, the insurer has duty to defend.”); Wentland v. American Equity Ins. Co., 267 Conn. 592, 600, 840 A.2d 1158, 1163 (2004) (“It is beyond dispute that an insurer's duty to defend, being much broader in scope and application than its duty to indemnify, is determined by reference to the allegations contained in the complaint.... The obligation of the insurer to defend does not depend on whether the injured party will successfully maintain a cause of action against the insured but on whether he has, in his complaint, stated facts [that] bring the injury within the coverage.... If an allegation of the complaint falls even possibly within the coverage, then the [insurer] must defend the insured.... Accordingly, an insurer's duty to defend its insured is triggered without regard to the merits of its duty to indemnify.”); Hugo Boss Fashions, Inc. v. Federal Ins. Co., 252 F.3d 608, 620 (2nd Cir. 2001) (“[A] separate, contractual duty to defend exists, and perdures until it is determined *with certainty* that the policy does not provide coverage.” Emphasis in original).

Yet, even if Fireman’s Fund is correct in its assertion that the Board’s claims against Mr. Skaff were really claims for breach of contract, Fireman’s Fund is still wrong in asserting that it had no duty to defend Paul Skaff.. The Circuit Court properly 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.

November 18, 2004 Order at Conclusion 29.

Section II of the Firemen's Fund policy is titled “Exclusions –What We Do Not Cover.” It contains nine separate exclusions. Seven of exclusions state, “We do not cover **Claims** . . .” of various types. (Emphasis in original.) The exclusion in Section II.C., for example, provides that the policy does not cover “claims” that result from or arise out of any bodily injury.

The “Breach of Contract” exclusion in Section II.B of the policy – the sole exclusion on which Fireman’s Fund bases its arguments in this petition for appeal – does not state that the insurer does not cover “Claims” that result from or arise out of any actual or alleged breach of contract. It is one of two exclusions that limit the policy’s coverages of “Damages” arising from a breach of contract.

Fireman’s Fund’s arguments that it has no duty to defend a breach of contract claim are nonsensical and simply ignore substantial portions of its own policy language. What purposes would be served by using the limitation on “Claims” in seven of the nine exclusions and the limitation on “Damages” in the other two, if the exclusions were to be applied identically? Fireman’s Fund correctly points at that West Virginia insurance law require a court to “construe all parts of the document together” (citing Payne v. Weston, 195 W. Va. 502, 507, 466 S.E.2d 161 166 (1995)), yet Fireman’s Fund’s argument would

require the Court to ignore substantial provisions of the insurance policy and re-write the definitions contained in the insurer's own policy.

A breach of contract is clearly a "breach of duty" which would qualify as a "Wrongful Act." See Arnold Agency v. West Virginia Lottery Commission, 206 W. Va. 583, 526 S.E.2d 814 (1999). See also American Casualty Co. of Reading v. Hotel and Restaurant Employees and Bartenders International Union Welfare Fund, 113 Nev. 764, 942 P.2d 173 (1997) (Coverage for "Wrongful Acts" in fiduciary liability policy was broad enough to include intentional breaches of contractual duties); Peoples Mortgage Corp. v. Kansas Bankers Surety Co., 62 Fed. Appx. 232 (10th Cir. 2003) (Allegation against insured of breach of contractual duty was "breach of duty" within policy definition of "Wrongful Acts"). The language in the policy that the insurer "ha[s] no duty to defend any **Claim** to which this insurance does not apply" does not support Fireman's Fund's position. To the contrary, this cited language supports the Circuit Court's conclusion that the lack of a duty to defend excluded "Claims" cannot be miraculously transposed into a lack of a duty to defend an allegation that might result in excluded "damages." This policy language simply means that the insurer has no duty to defend a "Claim" which falls under the Exclusions contained in sub-parts C, D, E, F, G, H, or I of Section II of the policy.

If an insured is sued for breach of contract, but the Complaint seeks only injunctive relief, the insurer must clearly defend. This would be a "Claim" within the definition provided by the policy, the alleged breach would be a "Wrongful Act" under the policy and "Breach of Contract" Exclusion in Section II.B would not apply. This is because the Exclusion in II.B. applies only to "Damages" and not to "Claims."

More importantly, if a claim for breach of contract seeking damages was asserted against an insured and the court or jury found for the defendant insured and awarded no damages to the plaintiff, what application would the Exclusion in II.B have? It would, of course, have none. Because the exclusion would not be triggered, the insurer would have to be obligated under the policy to defend the "Claim" for the alleged "Wrongful Act."

The language in the policy that the insurer's "right and duty to defend any Claim seeking Damages ends when we have used up our limit of liability in the payment of judgments or settlements," simply means that, if the insurer pays no damages (for whatever reason), its "right and duty to defend" continues until the Claim is ultimately resolved by final judgment or otherwise settled by the insured. Thus, none of these provisions of the policy cited by Fireman's Fund support Fireman's Fund's position.

In any event, Fireman's Fund's argument is much ado about nothing. The Board's claim against Paul Skaff is not a claim for breach of contract, no matter how long and hard Fireman's Fund may argue that it is.

B. The Circuit Court correctly concluded that Fireman's Fund was responsible to pay the January 13, 2004 judgment entered against Paul Skaff, its insured, in Civil Action No. 02-C-1958.

The Circuit Court's ruling that Fireman's Fund was responsible to pay the January 13, 2004 judgment entered against Paul Skaff was based on alternative conclusions of law, each of which standing alone would result in liability on the part of the insurer for the judgment rendered against its insured. To prevail in this appeal, Fireman's Fund must demonstrate that the Circuit Court was mistaken in each and

every one of its alternative legal reasons for reaching its ultimate holding that Fireman's Fund is liable for the judgment at issue in this case.

1. Fireman's Fund was liable for the judgment under West Virginia contract law as a result of its breach of the duty to defend Paul Skaff.

One of the Circuit Court's alternative reasons for finding that Fireman's Fund was responsible for indemnifying Skaff for the January 13, 2004 judgment, was based on well-established contract principles. **November 18, 2004 Order at Conclusions at 34-37.** This conclusion is fully consistent with this Court's prior ruling in Pitrolo and long-standing principles of West Virginia contract law. See Kentucky Fried Chicken of Morgantown, Inc. v. Sellaro, 158 W. Va. 708, 214 S.E.2d 823 (1975).

Contrary to Fireman's Fund's bald assertion, nothing in Pitrolo limits the remedy for a breach of the duty to defend by the insurer, to the fees and expenses incurred by the insured in defending himself. Under the facts present in Pitrolo, the insured did hire counsel at his own expense to defend himself. Under contract law principles, those expenses were the damages that resulted from the insurer's breach. In this case, Paul Skaff could not afford to and did not hire counsel to defend himself. Because no one defended Skaff, a default judgment was entered against him. In this case, the judgment against Skaff was a proximate result of the insurer's breach and becomes the responsibility of the breaching insurer under those same fundamental principles of contract law.

Fireman's Fund argues that an insurer that breaches its duty to defend, only owes compensation to an insured who has the financial resources to hire his own attorney to do what the insurance company should have done. Under Fireman's Fund's application of

Pitrolo, if the insured is too poor to hire his own counsel or otherwise unable to do so for whatever reason, the insured is simply out of luck and the insurance company can walk away from its breach with absolutely no consequences. This position is not only untenable under our long-standing law of contracts, it is outrageous.

As the Circuit Court's Order properly concluded, "[n]othing in Pitrolo suggests that the remedy for a breach of the duty to defend by the insurer must be limited to fees and expenses incurred by the insured in defending himself. Pitrolo simply suggests that the application of contract law principles is appropriate in determining the appropriate remedy for a breach of the contractual duty to defend. Under basic principles of contract law, Skaff's liability to the Board of Education for the \$997,175.48 default judgment is a direct and natural result of Fireman's Fund's breach of its contractual duties to defend its insured." **November 18, 2004 Order at Conclusions at 37.**

The Ninth Circuit (applying California law) has agreed:

The . . . rule [that an insurer that wrongfully refuses to defend is liable on the judgment against the insured] applies equally to judgments by default. When the insurer refuses to defend and the insured does not employ counsel and presents no defense, it can be said the ensuing default judgment is proximately caused by the insurer's breach of the duty to defend.

Dershing Park Villas Homeowners Ass'n. v. United Pacific Ins. Co., 219 F.3d 895, 902 (9th Cir. 2000) (citations omitted).

Numerous other courts have applied these same fundamental principles of contract law and have not limited the relief available to the insured to only fees and costs incurred in the insured's own defense when the insurer breaches its contractual duty to defend. See Elliott v. Hanover Ins. Co., 711 A.2d 1310, 1313 (Maine 1998) ("an

unjustified refusal to defend should be treated as a breach of the insurance contract and that normal contract damage principles apply.”); Liberty Mutual Fire Ins. Co. v. Canal Ins. Co., 177 F.3d 326, 336 (5th Cir. 1999) (“[A]s a general rule, an insurer’s wrongful refusal to defend an insured renders it liable for any damages sustained *as a result* of the breach of contract. These damages include reasonable attorneys’ fees, costs, expenses, *and* the negotiated or adjudicated amount of the claim.” Emphasis in original.); Tradewinds Escrow, Inc. v. Truck Insurance Exchange, 97 Cal.App.4th 704, 713 n.6, 118 Cal.Rptr.2d 561, 567 n.6 (2002) (“Where the insured is financially unable to mitigate damages from the breach of duty to defend by hiring [his] own counsel, a default judgment is considered a consequential damage of the breach of the duty.”); Miller v. Secura Insurance and Mutual Co. of Wisconsin, 53 S.W.2d 152, 155 (Mo. App. 2001) (“By breaching a contract by refusing to provide a defense to an insured under the policy, an insurance company is liable to its insured for any judgment recovered against the insured up to the limits of the policy plus attorney fees, costs, interest and any other expenses incurred by the insured in conducting the defense of the suit which it was the obligation of the company to perform under its contract.”) Kirk v. Mt. Airy Ins. Co., 134 Wash.2d 558, 561, 951 P.2d 1124, 1126 (1998) (“The general rule regarding damages for an insurer’s breach of contract is that the insured must be put in as good a position as he or she would have been had the contract not been breached. ... In the failure to defend context, recoverable damages include: (1) the amount of expenses, including reasonable attorney fees the insured incurred defending the underlying action, and (2) the amount of the judgment entered against the insured.” Citation omitted.); R.T. Vanderbilt Co., Inc. v. Continental Cas. Co., 273 Conn. 448, 470-71, 870 A.2d 1048, 1063 (2005) (“Where a

liability insurer is guilty of a breach of its duty to defend, it is liable to pay to the insured, not only his reasonable expenses in conducting his own defense, but also, in the absence of fraud or collusion, the amount of a judgment or settlement obtained against the insured up to the limit of liability fixed by the policy.”); Farmers Union Mut. Ins. Co. v. Staples, 321 Mont. 99, 105, 90 P.3d 381, 385 (2004) (“Where the liability insurer refuses to defend a claim and does so unjustifiably, that insurer becomes liable for defense costs and judgments.”); Fireman's Fund Insurance Co. v. Imbesi, 361 N.J.Super. 539, 564, 826 A.2d 735, 749 (2003) (“Where an insurer wrongfully refuses coverage and a defense to its insured, so that the insured is obliged to defend himself in an action later held to be covered by the policy, the insurer is liable for the amount of the judgment obtained against the insured or of the settlement made by him.”); Northern Ins. Co. of New York v. Morgan, 186 Ariz. 33, 35, 918 P.2d 1051, 1053 (1995) (“[W]hen an insurer erroneously denies coverage and refuses to defend, regardless of the ‘good faith’ of the insurance company, it is liable on any judgment subsequently entered”); Gray v. Grain Dealers Mutual Ins. Co., 684 F.Supp. 1108, 1111-12 (D.D.C. 1988) *affirmed* 871 F.2d 1128 (D.C.Cir. 1989) (“It is well settled that an insurer's refusal to defend a claim within the coverage of a liability policy constitutes a breach of contract rendering the insurer liable to the insured for the losses resulting. The damages recoverable therefor include not only the adjudicated or negotiated amount of the claim and the insured's expenses in resisting it but also any additional loss traceable to the breach.”).

The multitude of cases cited above simply apply the same basic contract law principles that this Court applied in Pitrolo to the facts as present in Pitrolo. Applying these fundamental contract law principles to the facts present in this case, clearly results

in Fireman's Fund's liability for the judgment that undeniably resulted from the insurer's breach of its duty to defend Paul Skaff. *See also* 49 A.L.R.2d 694 at (III)(7), ("[A] refusal, [to defend] even though based on an honest mistake of the insurer, is an unjustified refusal and renders the insurer liable for breach of contract. Thus, all the cases agree that where it is the insurer's duty to defend, and the insurer wrongfully refuses to do so on the ground that the claim upon which the action against the insured is based is not within the coverage of the policy, the insurer is guilty of breach of contract which renders it liable to the insured for all damages resulting to him as a result of such breach.").

2. Fireman's Fund was bound by the January 16, 2003 default judgment as to Paul Skaff's liability to the Board of Education in Civil Action No. 02-C-1958 for the causes of action asserted in the Board's Complaint.

The Circuit Court correctly concluded that Fireman's Fund was bound by the default judgment against Skaff. **November 18, 2004 Order at Conclusions 38-40.** In this regard, the Circuit Court correctly applied basic principles of collateral estoppel.

In Syllabus Point 3 of Holloman v. Nationwide Mutual Ins. Co., ___ W. Va. ___, ___ S.E.2d ___ (No. 32286, June 21, 2005), this Court recently reiterated that: "Collateral estoppel will bar a claim if four conditions are met: (1) The issue previously decided is identical to the one presented in the action in question; (2) there is a final adjudication on the merits of the prior action; (3) the party against whom the doctrine is invoked was a party or in privity with a party to a prior action; and (4) the party against whom the doctrine is raised had a full and fair opportunity to litigate the issue in the prior action."

Fireman's Fund argues that, despite the general rule that an insurer and its insured are in privity, it was not in privity with Skaff in this case because it had "a conflict with Skaff." Fireman's Fund argues that the "conflict" existed because, if the insurer successfully advocated its position that the Board's claim against Skaff was actually a claim for breach of contract, Skaff would have been exposed to personal liability.

Fireman's Fund Brief at 31. This assertion is simply wrong.

If, in fact, Fireman's Fund would be successful in persuading the Court that the Board's claims against Skaff were actually breach of contract claims, Skaff would have no liability to the Board at all, because the Board of Education had no contract with Paul Skaff. On this issue, the interests of Skaff and Fireman's Fund were identical. The cases cited by Fireman's Fund are all distinguishable from this case because they all involve policy exclusions that could potentially expose the insured to uninsured liability. As noted above, if Fireman's Fund could have convinced a court that the Breach of Contract Exclusion applied because this is actually a contract claim, Paul Skaff would not have any uninsured liability. He would have no liability at all.

Fireman's Fund's own brief best makes this point. Fireman's Fund's brief asserts that "Skaff likely had a valid defense to [the Board's] claim . . . [because] "[a]s an agent of a disclosed principle . . . he could not be held personally liable for acts committed within the scope of his authority, including a breach of contract by the principal." Appellant's Brief at 32.³ If this assertion is correct, Skaff would have no uninsured liability because he would have no liability of any kind.

³ Of course, Fireman's Fund's arguments ignore the law governing claims in tort, the only claims asserted against Paul Skaff in the Board's Complaint in this action.

Moreover, even in a case where the interests of the insurer and the insured were at odds, but where, as here, the insurer chose neither to file a declaratory judgment proceeding nor to defend its insured in a case pending in the Circuit Court of Harrison County, the United States District Court for the Northern District of West Virginia rejected an argument by the insurer that an exception to the privity rule should preclude the application of West Virginia's collateral estoppel principles against the insurer. In Johnson v. Acceptance Insurance Co., 292 F. Supp.2d 857 (N.D. W. Va. 2003), Judge Stamp found that the insurer "had a full and fair opportunity to litigate the issue of negligence in the underlying action and chose not to pursue that route. Accordingly, the exception to the privity rule is not applicable here and [the insurer] is bound by the liability and damages determination by the Circuit Court." 292 F.Supp.2d at 867-68.

Further, in Speros v. Fricke, 98 P.3d 28 (Utah 2004), the Supreme Court of Utah recently addressed the binding effect of a default judgment on an insurer that wrongfully failed to defend its insured. The Utah court stated:

The complaint in this case alleged that Hiatt's negligent act of grabbing and turning the steering wheel caused the accident. It further alleged that Hiatt was an insured person under Nationwide's policy with Fricke. These allegations created a duty on the part of Nationwide to defend Hiatt. Notwithstanding that duty, Nationwide responded to West American's complaint by filing a timely answer on behalf of only itself and Fricke. It failed to answer or defend on behalf of Hiatt, thus exposing Hiatt to the risk of a default judgment. When Nationwide exposed Hiatt to that risk in breach of its duty to defend, it also exposed itself to the risk that it could lose the ability to litigate the facts giving rise to Hiatt's alleged liability and that it could thereafter be held liable for the resulting judgment.

Despite the default judgment, Nationwide maintains that it must be provided a fair opportunity to litigate the underlying factual issues in the case. However, Nationwide was, in fact,

provided that opportunity. We have held that “as a general rule[,] when an insurer, whose policy requires it to defend its insured, receives notice of a suit against [the insured] and is allowed an opportunity to defend, but refuses, [the insurer] is bound by the findings and judgment therein.” McCarty v. Parks, 564 P.2d 1122, 1123 (Utah 1977).

• • •

When Nationwide chose not to defend Hiatt, it forfeited its opportunity to dispute the underlying facts of the accident. See McCarty, 564 P.2d at 1124 (“It is undoubtedly true that where any substantial question as to coverage exists, it may involve some risk on the part of the insurance company to refuse to defend.”). Nationwide cannot avoid the consequences of its failure to defend by asserting that it had no opportunity to refute the factual basis for the claims against Hiatt.

98 P.3d at 39. See also Elliott v. Hanover Ins. Co., 711 A.2d 1310 (Maine 1998) (Insurer bound by default judgment as to any factual issues that might have been litigated in the underlying negligence actions); Patrons Mutual Ins. Ass’n. v. Harmon, 240 Kan. 707, 732 P.2d 741 (1987) (Rejecting request by insurer to create special exception to general rule that insurer was in privity with its insured and was bound by judgment); Lozada v. Phoenix Ins. Co., 237 F.Supp.2d 664 (M.D.N.C. 2003) (With regard to claims against insured in which default judgment is obtained in favor of claimant, if insurer had right to defend injury action against insured, had timely notice of such action, and defends or elects not to defend, judgment, in absence of fraud or collusion, is binding upon the insurer as to issues which were or might have been litigated therein.) Cosmopolitan Mutual Ins. Co. v. Eden Roc Hotel, 258 So.2d 310, 312 (Fla.App. 1972), *cert denied* 262 So.2d 447 (Fla. 1972) (“It is a well-settled principle that where an insurer is obliged to defend its insured and pay damages in its behalf, and the carrier is duly notified of the

suit against its insured and full opportunity is afforded to defend the action, yet it refuses to do so, then the judgment will be conclusive against the insurer.”).

Fireman’s Fund deliberately and unilaterally chose not to defend Paul Skaff. An insurer that chooses not to defend, does so “at its own peril.” Liberty Mutual Ins. Co. v. Metzler, 586 N.E.2d 897, 901 (Ind. App. 1992). The Circuit Court was clearly correct in holding that Fireman’s Fund was bound by the liability determination of the default judgment against Paul Skaff.

3. The “Breach of Contract” Exclusion contained in Section II.B of Fireman’s Fund’s policy does not apply in this case.

Fireman’s Fund asserts that the “Breach of Contract” Exclusion contained in Section II.B of the policy must apply because Paul Skaff had no independent legal duties to the Board. Fireman’s Fund is simply wrong in this regard.

Fireman’s Fund itself asserted in the Court below that Multi-Cap was insolvent. **See Fireman’s Fund Summary Judgment Memorandum at 3, 4.** This fact was obviously confirmed by Multi-Cap’s bankruptcy. Paul Skaff was an officer of the corporation. **See Plaintiff’s Summary Judgment Response Exhibit B at 22.b.** As the Circuit Court concluded, West Virginia law has long recognized that, when a corporation becomes insolvent or in failing condition, its officers and directors become trustees of the corporate property and assets, for the benefit of all creditors. Arnold v. Knapp, 75 W. Va. 804, 84 S.E. 895 (1915); Lilly v. Ernst, 113 F.Supp. 178 (S.D. W. Va. 1952). Because of this trustee status, when a corporation becomes insolvent, its directors and officers owe a fiduciary duty to creditors. In re Thomas, 255 B.R. 648 (D.N.J. 2000). A breach of this fiduciary duty by Paul Skaff is clearly one of the allegations of plaintiff’s

Complaint. **Board's Complaint ¶¶ 9-10.** If the Board of Education proved at trial that Paul Skaff breached this duty, then the Board would certainly be entitled to any and all damages that were proximately caused by that breach of duty. Because of this possibility, there was clearly a duty to defend.

Fireman's Fund's feeble attempts to distinguish Arnold v. Knapp from this case, ignore its own representations to the court below and ignore the basic principles of notice pleading under our Rules of Civil Procedure. There is no requirement that the Board of Education plead the specific date on which Multi-Cap became "insolvent or in failing condition" to trigger a claim against Skaff under the principles enunciated in Arnold v. Knapp.

More fundamentally, the Board's Complaint clearly alleges a cause of action against Skaff for breach of fiduciary duty, regardless of the financial condition of Multi-Cap. In State ex rel Kitzmiller v. Henning, 190 W. Va. 142, 144, 437 S.E.2d 452, 454 (1993), the Court observed that it "has recognized that a fiduciary relationship arises: wherever . . . the property or pecuniary interests, in whole or in part, . . . of one person, is placed in the charge of another. McKinley v. Lynch, 58 W. Va. 44, 57, 51 S.E. 4, 9 (1905)." Multi-Cap was the holder of federal grant money in which the Board of Education had a pecuniary interest. This established a fiduciary relationship on the part of Multi-Cap, which the Board so asserted in its Complaint against Paul Skaff. **Board's Complaint, ¶ 6.**

In her concurring opinion in State ex rel Affiliated Construction Trades Foundation v. Vieweg, 205 W. Va. 687, 520 S.E.2d 854 (1999), Justice Workman observed that:

Although this Court has not previously identified precisely the elements of a cause of action for a breach of a fiduciary duty, courts have held that the elements of such a cause of action are the existence of the fiduciary relationship, its breach, and damage proximately caused by that breach. Pierce v. Lyman, 1 Cal.App.4th 1093, 3 Cal.Rptr.2d 236, 240 (1991). “A cause of action for breach of fiduciary duty requires proof of fraud, breach of trust, or an action outside the limits of the fiduciary’s authority.” Gerdes v. Estate of Cush, 953 F.2d 201, 205 (5th Cir. 1992).

205 W. Va. at 701-02, 520 S.E.2d at 868-69, Workman, J., concurring.

West Virginia law provides that an employee or agent of a corporate tortfeasor may be jointly and/or severally liable with his master for tortious conduct. *See, e.g.*, Syllabus pt. 3, Jarvis v. Modern Woodmen of America, 185 W. Va. 305, 406 S.E.2d 736 (W. Va. 1991); Syllabus pt. 3 Musgrave v. Hickory Inn, Inc., 168 W. Va. 65, 281 S.E.2d 499 (1981). Additionally, in Bowling v. Ansted Chrysler-Plymouth Dodge, Inc., 188 W. Va. 468, 425 S.E.2d 144 (1992), this Court held that an officer of a corporation may be personally liable for the tortious acts of a corporation, if the officer participated in, approved of, sanctioned or ratified such acts.

West Virginia has also long recognized that, in a tort action based on the alleged actionable conduct of a servant, the liability of the master and the servant is joint and several and that the plaintiff may at its election sue either or both. Willigerod v. Sharafabadi, 151 W. Va. 995, 1001, 158 S.E.2d 175, 178 (1967).

In its Complaint against Skaff, the Board asserted that Mr. Skaff, “participated in, approved of, sanctioned and/or ratified acts and conduct which caused Multi-Cap to breach its fiduciary duty to the Board of Education.” **Board’s Complaint**, ¶ 7. This allegation, if proven, is clearly sufficient to establish Paul Skaff’s liability for this tortious

conduct under either Musgrave or Bowling. Further, under the principles enunciated in Willigerod, the Board could chose to sue either Skaff or Multi-Cap or both for this tort.

Nor does it matter that a potential source of the fiduciary duties at issue is the Delegate Agreement. West Virginia law recognizes that a tort may “grow out of a contract” if it possesses all of the essential elements of tort. Syllabus Point 10, Lockhart v. Airco Heating & Cooling, Inc., 211 W. Va. 609, 567 S.E.2d 619 (2002). The cases cited above confirm the existence of the elements of the separate and distinct tort of breach of fiduciary duty. Similarly, in Clark v. Lubritz, 113 Nev. 1089, 944 P.2d 861 (1997), the Supreme Court of Nevada held that a breach of fiduciary duty arising from a contractual partnership agreement was a separate tort. In reaching its conclusion, the court referenced the following analysis:

Despite the contractual source of partners’ duties *inter se*, ... it is well established that when a fiduciary duty exists between the parties, and the conduct complained of constitutes a breach of that duty, the claim sounds in tort regardless of the contractual underpinnings.

Washington Medical Center v. Holle, 573 A.2d 1269, 1284 (D.C.C.App. 1990). The allegation of breach of fiduciary duty by Paul Skaff is clearly a “Wrongful Act” as defined by the policy that is not subject in any way, shape or form to the “breach of contract” exclusion relied upon by Fireman’s Fund.

4. **Estoppel is not an issue in this case as Fireman’s Fund was not estopped from asserting the applicability of any exclusion in Civil Action No. 02-C-1958.**

As noted above, the Circuit Court’s November 18, 2004 Order found that Fireman’s Fund was liable to the Board of Education for the January 13, 2004 Judgment against Paul Skaff for multiple, alternative reasons. Fireman’s Fund spends much of its

appeal brief addressing the issue of whether it should be estopped from raising its policy exclusions because it breached its duty to defend Paul Skaff. However, the Circuit Court's Order did not rely on the principles of estoppel to reach its ultimate conclusion. A review of the Circuit Court's November 18, 2004 Order clearly indicates that the Court only found that, "several courts have concluded that an insurer that wrongfully fails to defend its insured, waives its right to claim that it had no duty to indemnify the insured for a judgment entered in the underlying action." **November 18, 2004 Order, at Conclusions 32-33.** In fact, this concept is consistent with this Court's holding in Berry v. Nationwide Mutual Fire Ins. Co., 181 W. Va. 168, 381 S.E.2d 367 (1989), where the Court held that an insurer could not attempt to enforce the subrogation provisions of its policy after it was found to have wrongfully denied its insured's property damage claim.


Significantly, while the Circuit Court also found alternative reasons to conclude that Fireman's Fund's breach resulted in its responsibility for the judgment, the Circuit Court did not preclude Fireman's Fund from raising and arguing the policy exclusion contained in Section II.B. of the policy or any other exclusion. The Circuit Court's Order demonstrates that, after correctly noting that Fireman's Fund had the burden of proving the facts necessary to the operation of any exclusion (**November 18, 2004 Order, at Conclusion 22**), it considered and rejected each and every exclusion raised by Fireman's Fund in the insurer's motion for summary judgment. *See November 18, 2004 Order, at Conclusion 42, See also, Findings at 33-39 and Conclusions at 43-50*, rejecting Fireman's Fund reliance on Exclusion II.A; **Findings at 16-17, Conclusions at 51-57**, rejecting Fireman's Fund's reliance on Exclusion II.B; **Findings at 9-14, Conclusions at 23-24**, rejecting Fireman's Fund's reliance on Exclusion II.F. Fireman's Fund was not

“estopped” from anything in this case. Fireman’s Fund was given a full and fair opportunity to meet its burden of proof on any and every policy exclusion that it saw fit to raise. The insurer simply failed to meet its burden.

CONCLUSION

The Circuit Court’s Orders in this case were clearly correct. The Circuit Court’s Orders should be affirmed and this case should be allowed to proceed to its final conclusion. It simply failed to meet its burden.

**BOARD OF EDUCATION
OF THE COUNTY OF KANAWHA,
Appellee
By Counsel**



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IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

**BOARD OF EDUCATION OF THE
COUNTY OF KANAWHA, a
statutory corporation,**

Appellee/Plaintiff,

v.

**No. 32702
CIVIL ACTION NO.: 02-C-1958
(Circuit Court of Kanawha County,
West Virginia
Judge James C. Stucky**

**PAUL R. SKAFF, JR., Defendant and
FIREMAN'S FUND INSURANCE COMPANY,**

Appellant/Defendant.

CERTIFICATE OF SERVICE

I, John J. Polak, counsel for Appellee/Plaintiff, does hereby certify that on the 27th day of July, 2005, served the foregoing, "**BRIEF OF APPELLEE BOARD OF EDUCATION OF THE COUNTY OF KANAWHA**" upon the following parties listed below:

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