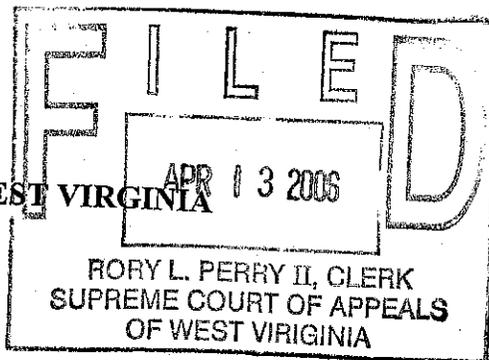


NO. 32972

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA



STATE OF WEST VIRGINIA, EX REL. HANLEY C. CLARK,
INSURANCE COMMISSIONER OF THE STATE OF WEST
VIRGINIA,

Applicant,

vs.

BLUE CROSS AND BLUE SHIELD OF WEST
VIRGINIA, INC.,

Respondent,

INTERNATIONAL UNION, UNITED MINE WORKERS OF
AMERICA,

Claimant and Intervenor

v.

RECEIVER OF BLUE CROSS AND BLUE
SHIELD OF WEST VIRGINIA, INC.

BRIEF OF APPELLANT UNITED MINE WORKERS OF AMERICA

From the Circuit Court of Kanawha County, West Virginia
Civil Action No. 90-C-3825

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KIND OF PROCEEDING AND RULINGS BELOW

This is an appeal by the United Mine Workers of America ("UMWA") from an order of the Circuit Court of Kanawha County entered on May 10, 2005. This dispute arises out of the insolvency proceeding instituted by the West Virginia Insurance Commissioner against Blue Cross and Blue Shield of West Virginia in 1990. The Circuit Court appointed J. Nicholas Barth as referee in the insolvency proceeding to hear and make findings of fact and recommendations regarding disputed claims and other matters. The Circuit Court's order of May 10, 2005, adopted the findings of fact, conclusions of law, and recommendations of the referee regarding the dispute between the UMWA and the Receiver.¹

The disputed issue between the UMWA and the Receiver was whether certain property which came into the hands of the Receiver was subject to a trust in favor of the UMWA. If so, the asset subject to the trust was the property of the UMWA and not property of the Blue Cross estate, and should have been returned to the UMWA. If not, then the UMWA has only a general unsecured claim against the estate, subordinate to the claims of policyholders and medical providers, and since the assets of the estate were insufficient to pay those claims in full, the UMWA receives nothing. The Receiver has set aside the amount in dispute pending the outcome of this dispute.

The UMWA and Receiver filed motions for summary judgment, with a lengthy factual stipulation and an agreed record. The referee filed a proposed order recommending that the

¹On October 26, 1990, the Circuit Court of Kanawha County entered an order enjoining and restraining all claimants and creditors from initiating or maintaining any action against BCBS-WV or the Receiver. Accordingly this dispute was handled within the insolvency case, through the claims process established by the Circuit Court by order dated June 16, 1993, which provided for submission to Mr. Barth as referee, a recommendation by the referee to the Court, an opportunity for the filing of exceptions, and a hearing on the exceptions, and a final order by the Court.

Receiver's motion for summary judgment be granted and the UMWA's motion be denied, which was inadvertently entered by the Circuit Court on October 20, 2003, without opportunity for exceptions. That order was subsequently vacated, exceptions were filed and argued, and the Circuit Court entered the referee's proposed order on May 10, 2005. The UMWA now appeals from that order.

STATEMENT OF FACTS

The UMWA and Blue Cross and Blue Shield of West Virginia ("BCBS") negotiated an agreement designated the "UMWA Emergency Care Pilot Program" in early 1986, four years prior to the insolvency petition. The agreement was executed on April 7, 1986, and was effective April 1, 1986. The purpose of the program was to provide an affordable minimum health insurance plan to unemployed and laid off UMWA members. Subscribers to the program were charged a premium for coverage and benefits were to be paid by BCBS.

As part of the Group Enrollment Agreement creating the program, the parties further agreed, in a document labeled "Appendix A" to the Group Enrollment Agreement, that the UMWA would remit to BCBS, within 30 days of the effective date of the agreement, the sum of \$1,000,000.00,

to be held by Plan [BCBS-WV] for Group [UMWA] IN TRUST, in accordance with the following terms and conditions:

- A. The term of the trust shall be one year, commencing from the date that Plan is in receipt of the trust corpus amount.
- B. Plan shall invest the trust corpus at an annual interest rate which is no less than one percent (1%) greater than the current yield to maturity on a one year Treasury Bill. Plan shall provide Group a monthly written statement setting forth the interest amount earned on the trust corpus.
- C. At the end of the one year term described herein, the entire trust corpus (\$1,000,000.00) shall be returned to the Group by Plan. Further, Plan at that time shall provide Group a written statement setting forth the amount of interest earned on the trust corpus during the term of the trust. Said interest

amount shall then be invested by Plan for a one year period ("investment period") at an annual interest rate that is no less than one percent (1%) greater than the current yield to maturity on a one year Treasury Bill.

- D. Upon the termination of the Group Enrollment Agreement, there shall be established a one year period known as the "claims run-out period." During that time, Plan shall pay all claims, subject to the terms and conditions of the membership certificate, incurred by the Group's members prior to the termination date. Plan is under no obligation, either express or implied, to pay any additional such claims after the expiration of the "claims run-out period."
- E. At the end of the investment period described in the Section C, Plan shall provide Group a written statement setting forth the amount of claims paid by Plan under the terms of this certificate, plus Plan's retention charge of ... (11.05%) of the aforesaid claims amount. In the event that said paid claims plus Plan's retention charge exceed the premiums received by Plan from the Group's members, then Plan shall retain an additional amount equal to such excess from the interest amounts earned during the one-year term of the trust and the investment period described in this Appendix A. The remaining interest earned, however, shall be returned by Plan to Group. In no event shall Group be required to pay Plan an amount greater than the interest amount earned during the term of the trust and the investment period, regardless of the total amount of claims paid.

Pursuant to this agreement, the UMWA wired to BCBS the sum of \$1 million on April 9, 1986. Following the initial agreement, the parties executed two subsequent agreements, the first on April 30, 1987, covering the period from April 1, 1987 to March 31, 1988, and the second on June 7, 1988, covering the period from April 1, 1988 to March 31, 1989. Both agreements were essentially identical to the original and contained an identical "Appendix A" carrying forward the terms of the trust. BCBS retained the original trust corpus wired to it on April 9, 1986. Although there was no new written agreement after April 1, 1989, the program continued under the terms of the 1988 agreement through April 30, 1990, when it was terminated. (Final Order at 2-4).

The \$1 million trust corpus was not segregated by BCBS into a separate account, but was wired to and deposited in BCBS's general account at Kanawha Valley Bank (Account 076-931-5), where it was immediately commingled with the funds of BCBS in that account and a related investment account (Account 33275). (Final Order at 7-8). On June 11, 1986, \$1.5 million in commingled funds from the general account were transferred to Prudential Bache Account 959115 and invested in a mutual fund, the Prudential Bache Government Securities Fund (the "PBGS fund"), further commingling the funds with other funds in that account. (Final Order at 8).²

In January 1987, the commingled funds from that account and specifically from the investment in the PBGS fund were used to purchase a \$1 million Treasury bond. That Treasury bond remained in the possession of BCBS until it was placed in receivership in October 1990. The \$1 million bond was transferred from the Prudential Bache account to other BCBS accounts, first to Shearson Account 716-03000 in October 1987, then, along with six other bonds, to Shearson Account 716-01104 in July 1990. The \$7 million in Treasury bonds was still in the latter account at the time the Receiver assumed control of BCBS. The Receiver subsequently ordered the bonds sold, and the net proceeds of the sale (an amount in excess of \$1 million), after playing off a margin loan owed to Shearson, were transferred to the Receiver's account. (Final Order at 8).

On October 26, 1990, the Circuit Court of Kanawha County entered an order of liquidation of BCBS, which order stayed and enjoined the commencement or continuation of any legal action against the BCBS estate. On October 30, Marty D. Hudson of the UMWA wrote to Insurance

²At the same time, BCBS also transferred from the general account \$2 million to each of two other brokerage accounts at E. F. Hutton and Shearson. There is no dispute that those funds were ultimately dissipated by BCBS prior to the insolvency proceeding.

Commissioner Hanley Clark, advising him of UMWA trust and enclosing a copy of the trust agreement. Clark forwarded that letter to the Receiver.

BCBS had deposited the \$7,000,000 in treasury bonds with Shearson as security for a \$5,700,000 renovation loan from One Valley Bank. BCBS repaid this loan on July 16, 1990, with a margin loan obtained from Shearson and secured by the bonds. At the direction of the Receiver, the bonds were sold on November 9, 1990, for \$6,313,315.22. Shearson withheld the balance of the margin loan from the sale proceeds, and remitted to the Receiver the remaining sum of \$1,035,592.56. (Final Order at 8). That amount was free of all encumbrances except that of the UMWA trust. Since only one of the bonds was subject to the UMWA trust, the proceeds of the sale of the UMWA bond was one-seventh of the total purchase price, or \$901,902.17. The UMWA contends that those proceeds were subject to the trust, were the property of the UMWA and not property of the BCBS estate, and should be returned to the UMWA along with interest earned by the Receiver on those proceeds.³

The UMWA filed its proof of claim on July 2, 1991, asserting that the UMWA trust fund was not an asset of the BCBS estate within the meaning of West Virginia Code §33-24-14, or, in the alternative that it was either a "special deposit claim" or a secured claim. The UMWA withdrew that claim that the trust constituted a "special deposit claim," but maintains its position that the trust

³The actual amount owed by BCBS to the UMWA pursuant to the trust at the time the Receiver took control was \$1,088,148.13, which included the original \$1 million trust and accrued interest earned on the trust corpus. This dispute is limited to the value of the treasury bond which can be traced to the commingled funds which included funds from the UMWA trust (\$901,902.17). To the extent that part of the trust was lost due to the mishandling of the trust corpus, the UMWA filed suit against the officers and directors of BCBS and recovered \$225,000 in damages, a part of which will be an offset against the recovery in this case if the Appellant prevails. Appellant anticipates that the parties will be able to stipulate those matters.

corpus was not the property of BCBS or, in the alternative, that the UMWA has a secured claim with respect to said trust.

The Receiver issued a Notice of Determination on the UMWA claim on June 22, 1992, stating that the UMWA had been determined not to be a secured claim, and also assigning as reasons for the rejection of the claim various form explanations for rejection, none of which were relevant to the UMWA's position. The UMWA filed an objection to the determination on August 11, 1992, restating its position. Following discovery proceedings, the dispute was submitted to the referee on a stipulated record and motions for summary judgment. The referee recommended that the Circuit Court grant the Receiver's motion and deny the UMWA's motion, and the Circuit Court adopted the referee's findings and conclusions of law.

ASSIGNMENTS OF ERROR

1. The Referee and the Circuit Court erred in holding that there was not an ascertainable trust *res* at the time the assets of BCBS came into the hands of the receiver.
2. The Referee and the Circuit Court erred in holding that the original trust *res* cannot be traced to a treasury bond which came into the hands of the receiver because the trust *res* was commingled with other funds of BCBS and not segregated or earmarked.
3. The Referee and the Circuit Court erred in holding that the commingled funds, including the UMWA trust *res* cannot be traced to the proceeds of the treasury bond in the hands of the Receiver.
4. The Referee and the Circuit Court erred in holding that West Virginia Code §33-24-27 bars the UMWA's claim that it is entitled to the return of property subject to the trust.

5. The Referee and the Circuit Court erred in holding that the establishment of a “sinking fund” by BCBS to repay the trust *res* demonstrates that only a debtor-creditor relationship existed between BCBS and the UMWA, rather than a settlor-beneficiary relationship.

There were no material disputes of fact, and the issues raised on appeal are solely issues of law. The standard of review of the Circuit Court's conclusions of law is *de novo*.

POINTS AND AUTHORITIES RELIED UPON

STATUTES

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| <u>West Virginia Code §33-24-14(j)</u> | 24 |
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CASES

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| <u>Carleton Mining & Power Company v. West Virginia Northern Railroad Company</u> , 113 W.Va. 20, 166 S.E. 536 (1932) | 16, 17 |
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| <u>Henson v. Lamb</u> , 120 W.Va. 552, 199 S.E. 356 (1938) | 14, 15, 23, 25 |
| <u>In re Bank Bldg. and Equipment Corp. of America</u> , 158 B.R. 138 (E.D.Mo. 1993) | 26 |
| <u>In re Building Dynamics, Inc.</u> , 134 B.R. 715 (Bankr. W.D. N.Y. 1992) | 26 |
| <u>In re Encinas</u> , 27 B.R. 79 (Bankr. D. Ore., 1983) | 26 |
| <u>In re General Office Furniture Wholesalers, Inc.</u> , 42 B.R. 232 (Bankr. E.D.Va. 1984) | 26 |

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| <u>In Re Imperial Insurance Company</u> , 203 Cal.Rptr. 664 (Cal. App. 1984) | 26 |
| <u>In re Property Leasing & Management, Inc.</u> , 50 B.R. 804 (Bankr. E.D. Tenn. 1985) | 26 |
| <u>In re San Diego Realty Exchange, Inc.</u> , 132 B.R. 424, (Bankr. S.D.Cal. 1991) | 26 |
| <u>In re Unicom Computer Corp.</u> , 13 F.3d 321 (9th Cir. 1994) | 26 |
| <u>In Re Yakel</u> , 97 B.R. 580 (D. Ariz. 1989) | 26 |
| <u>In the Matter of Maple Mortgage, Inc.</u> , 81 F.3d 529 (5th Cir. 1996) | 26 |
| <u>Keller v. Washington</u> , 83 W.Va. 659, 98 S.E. 880 (1919). | 11 |
| <u>Marshall's Executor v. Hall</u> , 42 W.Va. 641, 26 S.E. 300 (1896) | 15 |
| <u>Matter of Wellington Foods, Inc.</u> , 165 B.R. 719 (Bankr. S.D.Ga. 1994) | 26 |
| <u>Mid-Atlantic Supply, Inc. v. Three Rivers Aluminum Co.</u> , 790 F.2d 1121 (4th Cir. 1986) | 25 |
| <u>Pearlman v. Reliance Insurance Company</u> , 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed. 2d 190 (1962). | 25 |
| <u>Ream's Drug Store v. Bank of the Monongahela Valley</u> , 115 W.Va. 66, 174 S.E. 788 (1934) . | 14, 20, 23, 25 |
| <u>State ex rel. Blue Cross Blue Shield of West Virginia, Inc.</u> , 195 W.Va. 537, 466 S.E.2d 388 (1995) | 24 |
| <u>Sullivan v. Madeleine Smokeless Coal Company</u> , 115 W.Va. 115, 175 S.E. 521 (1934) . | 15, 23, 25 |
| <u>Williams v. S. M. Smith Insurance Agency</u> , 75 W.Va. 494, 84 S.E. 235 (1915) | 25 |

OTHER AUTHORITIES

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| <u>Restatement of Trusts</u> , 2d, §202, Comment (a) | 23 |
| <u>Restatement of Trusts</u> , 2d, Section 202, Comment i. | 20 |
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| <u>Restatement of Trusts, 2d, §12, Comment g.</u> | 12 |
| <u>Restatement of Trusts, 2d, §202.</u> | 15 |
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| <u>Restatement of Trusts, 2d, §202(1)</u> | 19 |
| Scott, <u>The Law of Trusts, §540</u> | 17, 23, 26 |

ARGUMENT

A. **The Agreement Between the UMWA and BCBS Established an Express Trust.**

The Final Order does not specifically address the question of whether or not a trust was created by the agreement of April 1, 1986, although the order apparently implicitly assumes that a trust was created. The conclusions of law focus on whether there was a segregated trust *res* as of October 26, 1990, the date of the liquidation order, and specifically whether the actions of BCBS somehow destroyed the trust and whether property subject to the trust can be traced to assets which came into the hands of the Receiver.

It is clear that a trust was created by the agreement of April 1, 1986. Whether an express trust is created depends upon the intent of the parties. It is difficult to understand how the agreement between the UMWA and BCBS could be construed as creating anything other than an express trust. The intent of the parties was expressed in a written document. The document provided that the \$1 million was to be held "in trust," subject to certain terms and conditions. Those terms substantially restricted the use which BCBS was entitled to make of the \$1 million. It was authorized only to invest it, at a rate *at least* 1% above the rate for treasury bills. It was not authorized to use the trust corpus in any other way, or to invade the trust corpus itself. The UMWA was entitled to whatever

interest was earned, unless BCBS was entitled to retain part or all of the interest under the provisions of paragraph E in the event of a shortfall of premium income, and BCBS was required to report the interest earnings to the UMWA monthly. The trust corpus was to be returned at the end of the agreement. The funds were clearly to be held solely for the use and benefit of the UMWA.

This Court has held that under such conditions, a valid express trust is created:

Where a person, not acting merely as agent, has or accepts possession and control of money, promissory notes, or other personal property, with the express or implied understanding that he is not to hold it as his own absolute property, but is to hold and apply it for certain specific purposes, or for the benefit of certain specified persons, a valid and enforceable trust exists.

Keller v. Washington, 83 W.Va. 659, 666, 98 S.E. 880 (1919).

Both parties to the agreement clearly understood it to create a trust. Virtually all correspondence between the parties and internal documents relating to the \$1 million refer to it as a trust, including the monthly reports of interest earned. The BCBS investment reports refer to it as a trust. Clearly a trust rather than a debt was created, notwithstanding the Receiver's assertion that this arrangement created a mere debt.

The trustee, BCBS, was not entitled to use the money as its own but was restricted to investing it for the benefit of the UMWA. It had no right to make any other use of the trust corpus, unlike a loan, where the loan proceeds would have been the property of BCBS, which it could use for any purpose.

In addition, the trust agreement did not simply provide that BCBS pay interest at a fixed rate on a loan, but provided that the UMWA was entitled to all interest earned on the investment unless the contingency in paragraph E arose, permitting BCBS to use the interest to offset its losses. The provision that the trust corpus was to be invested "at an annual interest rate which is no less than one

percent (1%) greater than the current yield to maturity on a one year Treasury Bill” is a further restriction on the type of investment BCBS was authorized to make on behalf of the UMWA, not an agreement by BCBS to pay interest on a loan at that rate.

It is clear from what occurred at the expiration of the original one-year term that the intent and understanding of the parties was that the UMWA was entitled to all interest on the trust amount, not just the minimum rate at which BCBS was authorized to invest the trust corpus. The contemporaneous documents reflect that the UMWA was entitled to all interest, and that there was an agreement to remit part of the interest, up to the minimum, and to retain the excess interest earned over the T-bill plus 1% minimum “as a new corpus” to cover any runoff liability. (Ex. 8, 9)⁴ The letter from John Britton remitting the partial payment of interest (Ex. 9) makes it clear that the parties understood that all the interest belonged to the UMWA, unless BCBS elected to invoke the right to use the interest to offset losses under paragraph E. of the trust agreement:

... After our total return on short term investments is available, *the difference between the interest paid and our actual return will be credited to your account per your agreement with Mr. Lavender.* (Emphasis added).

The Restatement of Trusts, 2d, §12, Comment g. states that whether a trust or a debt is created depends upon the manifested intent of the parties:

g. Manifestation of intention. If one person pays money to another, it depends on the manifested intent of the parties whether a trust or a debt is created. *If the intention is that the money shall be kept or used as a separate fund for the benefit of the payor or a third person, a trust is created.* If the intent is that the person receiving the money shall have unrestricted use thereof, being liable to pay a similar amount whether with or without interest to the payor or to a third person, a debt is created. (Emphasis added).

⁴References to “Ex. ___” are to the stipulated Exhibits provided to the Referee by the parties.

The Restatement further provides that in the event of insolvency, the beneficiary of the trust is entitled to his property:

f. Effect of insolvency. Although a trustee becomes insolvent or bankrupt, the beneficiary retains his interest in the subject matter of the trust if it can be identified, or in its product if it can be traced into a product, and *is entitled thereto as against the general creditors of the trustee.*

Restatement of Trusts, 2d, §12, Comment f. (Emphasis added).

The trust agreement itself clearly provides that the \$1 million was to be held in trust, to be invested for the benefit of the UMWA, and that the trust corpus was the property of the UMWA. BCBS had no right to the trust corpus, but only a contingent right to use the interest to offset losses if they should occur. It does not say that BCBS will pay interest on the \$1 million corpus at a rate 1% above the current T-bill rate, but rather that the corpus will be invested at a rate *at least equal* to that rate. The other documents and the testimony of the witnesses all confirm that the parties clearly understood the agreement to create a trust, not a loan or a debt.

It must be kept in mind that whether a trust was created is a separate question from the issue of whether the trustee (BCBS) breached its duties under that trust agreement. The agreement of the parties obviously created a trust. The actions of BCBS may well have breached its obligations as a trustee under that trust agreement. BCBS certainly commingled the trust corpus with its own funds, did not return the trust corpus when it was obligated to do so, and probably did not accurately track or report the actual interest earned on the trust corpus. The real question at issue, then, is whether those actions destroyed the trust, or whether the trust corpus, or funds or assets derived from the corpus or from commingled funds including the trust corpus, were still in the possession of BCBS at the time of the order placing BCBS in receivership.

B. The UMWA Trust Was Not Destroyed by the Commingling of the Trust Funds With Funds of BCBS, But Attached to the Entire Commingled Fund.

It is clear from the foregoing discussion that an express trust was created by the agreement between the UMWA and BCBS. It is equally clear that the assets in the hands of BCBS were directly augmented by the \$1 million transferred to BCBS by the UMWA pursuant to that agreement.

The Final Order, in holding that there was not a segregated trust *res* at the time of the liquidation order on October 26, 1990 (Final Order at 6-7), erroneously holds that the trust was extinguished because the trust funds transferred by the UMWA to BCBS were commingled with other funds in the accounts at Kanawha Valley Bank or Prudential Bache, rather than being segregated in a separate account or asset. The law of this state and the law governing trusts in general does not support that position. The fact that the funds were not segregated into a separate account, or "earmarked" as a trust deposit by BCBS, or that BCBS commingled the trust *res* in its general account with its own money did not destroy the trust or alter the status of the trust *res* as trust property.

The Final Order correctly finds that the \$1 million was received and placed in the BCBS general account at Kanawha Valley Bank, and commingled with the funds of BCBS in that account. (Final Order at 6). However, the law is clear that a trustee cannot destroy a trust by commingling the trust corpus with his own assets.

Where the trustee commingles the trust funds with his own funds, the trust funds do not lose their character as trust funds. The trust cannot be destroyed by the action, wrongful or innocent, of the trustee, except against the claim of a bona fide purchaser for value. Henson v. Lamb, 120 W.Va. 552, 199 S.E. 356 (1938), Ream's Drug Store v. Bank of the Monongahela Valley, 115 W.Va. 66, 174

S.E. 788 (1934). Where the trust funds are commingled with the trustee's own funds, the trust attaches to the entire commingled fund, and to any product of that fund.

Whenever a trust fund has been converted by the trustee into another form of property, the *cestui que trust* has the right to follow the trust funds into whatever property or form to which they have been converted, and to impress the trust on the product thereof. Marshall's Executor v. Hall, 42 W.Va. 641, 26 S.E. 300 (1896), County Court of Raleigh County v. Cottle, 81 W.Va. 469, 94 S.E. 948 (1918), Restatement of Trusts, 2d, §202.

In Henson v. Lamb, 120 W.Va. 553, 199 S.E. 356 (1938), plaintiff Henson paid off a note to the bank, which was acting as the agent of the holder of the note. The bank accepted the payment and agreed to pay the proceeds of the note to the holder when it was due, but became insolvent and went into receivership before it had done so. The Court held that the funds were impressed with a trust, and could be recovered as a trust deposit in preference to the general creditors of the bank, even though the trust funds were commingled with the other funds of the bank:

The fund, having been paid to the bank, for the purpose of payment to the insurance company is a special deposit, and not having been so applied came into the receiver's hands charged with a trust in the plaintiff's favor...

Though the funds were commingled with those of the trust company, they do not lose their character as trust funds. Once a trust is created, it cannot be destroyed by the action, wrongful or innocent, of the trustee except as against the claim of a purchaser for value without notice.

120 W.Va. at 560-561.

In Sullivan v. Madeleine Smokeless Coal Company, 115 W.Va. 115, 175 S.E. 521 (1934), the corporation deducted contributions from its employee's wages for a burial fund, but did not segregate the funds in a separate account, although it accounted for them separately on the books of the

corporation. A receiver was appointed for the corporation when it became insolvent, and it was held that the burial fund was trust property and had not lost its character as trust property by reason of being commingled with other assets of the company. The Court stated:

The commissioner found that there was thus created a trust fund in the control of the company. That finding seems not to be challenged, but the position is taken that such fund lost its identity by being commingled with other funds of the company. In our judgment, there is not thus presented a loss of identification of trust funds within the meaning of the general rule which counsel invokes. The burial fund account was set up separately on the books of the company. The money representing the balance of the account did not belong to the company, nor did the general creditors have any right to assert their claims against the same.

115 W.Va. at 118.

Similarly, in Carleton Mining & Power Company v. West Virginia Northern Railroad Company, 113 W.Va. 20, 166 S.E. 536 (1932), a trust was imposed upon a railroad extension and the profits earned from possession of the railroad extension in favor of Carleton, despite the fact that those profits were commingled with other funds of the railroad:

If there has been created a situation wherein accuracy is impossible, the defendant and not the plaintiff is responsible therefor. The reason that there cannot be an accounting by the defendant (according to its own answer) of the income and expenses of the Carleton extension is because those accounts have been blended with other accounts from other properties in the control of the defendant. There is a familiar principal of law and equity variously expressed, that all doubts shall be resolved against him who confuses another's property with his own. Where a person willfully and with fraudulent or other improper purpose intermingles the goods of another person with his own, so that their respective goods are indistinguishable, the wrongdoer forfeits his interest in the mixture to the other party. 12 Corpus Juris 491. "Substantially a like method is adopted with the same result in settling the accounts of negligent and faithless trustees who have kept no accounts, or have mixed indiscriminately the trust funds with their own..."

As long as trust property can be traced and followed, the property into which it has been converted remains subject to the trust; and if a man mixes trust funds with his, the whole will be treated as trust property, except so far as he may be able to distinguish what is his. This doctrine applies in every case of a trust relation, and as

well to moneys deposited in a bank, and to the debt thereby created, as to every other description of property.

113 W.Va. 23-24.

The law stated by this Court in the above cases is in accord with the general rule regarding tracing of trust funds where they are commingled with those of the trustee. The leading treatise on trusts, Scott, The Law of Trusts, §540 states the rule as follows:

Where the bank has mingled cash of the claimant with its own cash, it is perfectly well settled that the right of the claimant to follow his money is not lost. The mere fact that the cash of the claimant is indistinguishably mingled with the cash of the bank does not cut off the claimant's interest, but he acquires an equitable lien upon the whole of the mingled cash in the bank. This is in accordance with the general rule as to the effect of mingling funds. It is immaterial that withdrawals have been made from the cash and additions of the bank's own money have been made, as long as the amount of cash on hand is not diminished below the amount of the claimant's money that has been mingled in the fund. If the cash in hand after the receipt of the claimant's money has at no time been diminished below the amount of the claimant's money between the time when it was received by the bank and the time when the bank is taken over by a receiver or other public official, the claimant is entitled to receive from the cash the full amount of his claim in priority to the general creditors of the bank.

Where the amount of cash on hand, however, is at any time between the time of the receipt of the claimant's money and the closing of the bank diminished below the amount of the claimant's money, the better view is that unless the claimant can trace the money that was withdrawn he is entitled to receive in priority to other creditors only the amount of the lowest intermediate balance. This is in accordance with the general principles applicable to tracing money in a mingled fund.

Scott, The Law of Trusts, 4th Ed., §540.

Applying these principles to the undisputed facts of this case, it is clear that when the UMWA \$1 million wire transfer was deposited in the KVB general account (076-931-5) and commingled with other funds of BCBS in that account on April 9, 1986, the commingling of those funds did not destroy the trust, but rather the entire commingled fund became subject to the trust.

The same is true of the commingled funds that were moved from the KVB general account to the investment account (33275) and back again, which occurred on a regular basis from April 9, 1986 to June 11, 1986. Funds went into the investment account only from the general account, and went out of the investment account only to the general account. All funds in both accounts were commingled funds which included the UMWA trust funds, and all funds in both accounts were subject to the trust. The combined balance of those accounts from April 9, 1986 to June 11, 1986, always exceeded \$1 million. (UMWA's Proposed Findings ¶¶ 19-23).⁵ On June 10, 1986, BCBS deposited into the account the \$5.7 million proceeds of the building loan from Kanawha Valley Bank, which was also moved in and out of the investment account, and those funds were also commingled with the funds already in those accounts, subjecting the entire amount to the trust.

It is immaterial that there were numerous transfers of funds in and out of the general account, or between the general account and the investment account. As long as the balance in the two accounts exceeded \$1 million, \$1 million of that balance is conclusively presumed to be the trust property. If the balance had been reduced below \$1 million, then whatever balance remained would be presumed to be trust property, and the UMWA, as beneficiary of the trust, would have a claim against the trustee for the difference between that balance and the amount of the trust.

⁵Appendix 1 attached to this petition is a chart summarizing the transactions that establish that commingled funds including the UMWA funds held in trust by BCBS can be traced to an asset which came into the possession of the Receiver. Those transactions are summarized in detail in the UMWA's Proposed Findings, which are part of the record. In the interest of brevity, further citations regarding those transactions are to the UMWA's Proposed Findings, which provide a more detailed account of the transactions in question and specific citations to exhibits and depositions. Appellant believes that the facts of the transactions are not disputed, only the legal conclusions to be drawn from them.

C. The UMWA is Entitled to Recover Its Trust Property Because It Can be Traced to an Asset Which Came Into the Possession of the Receiver

The Final Order holds that the \$1,000,000 transferred to BCBS in 1986 cannot be traced to property in the hands of the Receiver on the date of the liquidation order. This conclusion appears to be based upon a misreading of the law regarding the effect of a trustee commingling trust property with the trustee's own property. The conclusions in the Final Order assume that the UMWA must demonstrate that the specific \$1 million received by BCBS in 1986 can be traced to the treasury bond in the possession of the Receiver in 1990, to the exclusion of all other possibilities. This is obviously not possible when dealing with funds commingled in a bank account, since there is no way to specifically identify the source of every dollar in a commingled account. The law, however, provides that where trust funds are commingled with the trustee's own funds, the trust attaches to the entire commingled fund, and if the UMWA can trace *any* of the commingled funds to an asset in the possession of BCBS at the time of the liquidation order, it is entitled to recover that asset as its trust property.

The law of trusts also holds that if funds subject to the trust are used to acquire other assets, the trust attaches to those assets and the beneficiary of the trust is entitled to enforce the trust against those assets. The Restatement of Trusts, 2d, §202(1) states that rule as follows:

Where the trustee by the wrongful disposition of trust property acquires other property, the beneficiary is entitled at his option either to enforce a constructive trust of the property so acquired or to enforce an equitable lien upon it to secure his claim against the trustee for damages for breach of trust, as long as the product of the trust property is held by the trustee and can be traced.

Restatement of Trusts, 2d, §202(1).

West Virginia law is consistent with that rule. In Ream's Drug Store v. Bank of the Monongahela Valley, 115 W. Va. 66, 174 S.E. 788 (1934), the Court stated that:

... So long as the trust fund may be identified either as the original property *or its product*, equity will pursue it. [citation omitted]. Thoroughly consistent with these pronouncements is "the better rule" given by Michie, as follows: " * * * according to the better rule *the plaintiff may follow and reclaim a deposit which is impressed with the character of a trust fund, even though it has been mingled with other funds of the bank so that the identity of the deposit is lost, provided it has passed into and swelled the funds of the bank.* And the doctrine that one can not follow trust money mixed with other money in an indistinguishable mass, because of its having no ear-mark, must be taken subject to the application of this rule. *It is not important that the commingled money bore no mark and cannot be identified. It is sufficient to trace it into the bank's vaults and find that a sum equal to it, and presumably representing it, continuously remained there until the receiver took it.* The modern rules of equity require no more.

115 W.Va. at 74-75, (emphasis added).

If the trustee transfers funds subject to the trust to another account, or uses those funds to acquire other property, the beneficiary has a right to follow the funds and enforce the trust against the account to which the funds were transferred or against the property acquired with those funds.

Section 202, Comment i. of the Restatement of Trusts, 2d, states:

Where the trustee deposits in a single account in a bank trust funds and his individual funds, and subsequently makes withdrawals from the bank account and dissipates the money so withdrawn, the beneficiary is entitled to an equitable lien upon the balance remaining in the bank for the amount of trust funds deposited in the account. It is immaterial in what order the deposits were made, whether the trust funds were first deposited or the trustee's individual funds, since there is no inference that the money first deposited is the money first withdrawn. The rule in Clayton's Case that withdrawals are presumed to be in the same order as that in which the deposits were made, has no application to this situation, where the intention of the wrongdoing trustee in making withdrawals is immaterial. *The beneficiary's lien is not restricted to any part of the deposit but extends to the whole deposit and can be enforced against any part of the funds remaining on deposit and against any funds which are withdrawn, so long as they can be traced. So also, there is no inference that the trustee withdraws his own funds first. If the funds withdrawn are preserved or can be traced, the beneficiary can enforce an equitable lien upon them or their product, even*

though the funds remaining on deposit are subsequently dissipated. (Emphasis added).

That is precisely what occurred in this case. On June 11, 1986, BCBS transferred \$5.5 million of commingled funds in the general account at KVB, which funds were subject to the UMWA trust, to three investment accounts at Shearson, E. F. Hutton, and Prudential Bache. (UMWA Proposed Findings, ¶26). Of that amount, \$1.5 million was transferred to Prudential Bache Account 959115, and invested in a specific mutual fund, the Prudential Bache Government Securities trust ("PBGS"). In January 1987, \$1.028 million of funds from that account and from the sale of shares of that specific mutual fund were used to purchase a \$1 million treasury bond. That treasury bond can be traced through two other accounts and eventually came into the possession of the Receiver along with the other assets of BCBS. (Proposed Findings, ¶¶ 26-31, 34). Accordingly, the UMWA was entitled to enforce the trust against that bond, and against the proceeds of the sale of that bond when it was sold by the Receiver.⁶

The Receiver argued that the UMWA trust funds cannot be traced because there is no way to identify the specific source of the dollars that were transferred from the general account to Prudential Bache. It is quite true that there is no way to identify the specific source of any of the money in that account once it was deposited in the account, or the source of the dollars that were transferred from that account to the three investment accounts. That is what the term "commingled" means. That is always the case with cash in an account. Money in an account does not carry a name tag or a birth

⁶If makes no difference how many transactions there have been, as long as the beneficial owner can ultimately trace the trust property or commingled funds including the trust property to an asset still in the possession of the trustee, or, in the case of a receivership, into the hands of the Receiver. Restatement of Trusts, 2d, §202, Comment b.

certificate. Here, it is established that the \$1 million trust went into that account, and was commingled with BCBS's own funds, including the proceeds of the building loan from KVB, which, like the general revenue deposited in the account, was the property of BCBS.

The Receiver's argument, adopted by the Circuit Court's Final Order, fails to recognize that there are well established legal rules which are designed to address that problem and sort out the rights of the parties where trust funds are commingled with the trustee's own funds, as discussed supra. Simply stated, the trust attaches to the entirety of the commingled funds and the beneficial owner of the trust property is entitled to any property which can be traced back to the commingled funds that included the trust funds.

Although these rules may seem complicated, they all flow from a rather simple rule -- where a trustee commingles trust funds with his own funds, the law always presumes that the trustee spends his own money first before he spends the money he holds in trust. If money from a commingled account is spent or otherwise dissipated, whatever is left is presumed to be the trust money, and only if the balance falls below the amount of the trust fund is the trust affected. Even so, whatever balance remains is subject to the trust. If, however, the trustee moves or invests part of the commingled funds, and then dissipates everything remaining in the original commingled account, whatever was moved or invested (or its product), if still in the possession of the trustee, is presumed to be the trust funds, and what was left in the original account and then spent is presumed to be the trustee's own property. The referee characterized the UMWA's "tracing effort" as "conjecture and speculation." It is nothing of the kind, but rather simply the application of well-established rules of law that govern situations where trust funds are commingled with the trustee's own funds.

The fact that BCBS lost substantial amounts of money between 1986 and 1990 does not mean, as the conclusions of the Final Order suggest, that "it is just as likely that the funds transferred by the UMWA were consumed by BCBS prior to the Order of Liquidation as it is that the funds were used to purchase a bond which ended up in the hands of the Receiver." The law of trusts presumes that BCBS consumed its own money first, and that any remaining part of the commingled funds which was not consumed remains subject to the trust. It is clear, as both experts (Larry Pack and Dixie Kellmyer) testified, that the treasury bond at issue can be traced directly back to the commingled funds which included the \$1 million trust. (Pack Deposition at 72-81, Kellmeyer Deposition at 31-33).

Where the trustee is insolvent and in receivership, it is clear that the beneficial owner of the trust property is entitled to that property, or its product, in preference to the general creditors of the trustee. Sullivan v. Madeleine Smokeless Coal Company, 115 W.Va. 115, 175 S.E. 521 (1934); Henson v. Lamb, 120 W.Va. 552, 199 S.E. 356 (1938); Ream's Drug Store v. Bank of the Monongahela Valley; 115 W.Va. 66, 174 S.E. 788 (1934); Restatement of Trusts, 2d, §202, Comment (a), Scott, The Law of Trusts, 4th Ed., §540.

D. The Provisions of West Virginia Code §33-24-27 Are Not Applicable to the UMWA's Right to Its Trust Corpus

The Final Order holds that even if the UMWA can trace the \$1 million trust, the UMWA is somehow prohibited from recovering its trust funds because of the language of West Virginia Code §33-24-27 that creditors may not circumvent the priority classes of §27 through the use of equitable remedies. That holding is erroneous. The UMWA contends that it is neither a "policyholder" or a "creditor," that its right to recover its property is not a "claim" as contemplated by that section, and

that it is not attempting to "circumvent the priority classes" through the use of "equitable remedies." Its contention is, and always has been, that the UMWA \$1 million trust was trust property held for the benefit of the UMWA and its members, was never the property of BCBS, and therefore is not an asset of the estate which may be distributed to the creditors of BCBS, as is recognized by the other sections of the liquidation statute, particularly the definition of "general assets."⁷ The provision contained in West Virginia Code §33-24-27 is apparently intended to enforce strictly the priority classes and prevent late claimants from avoiding the effect of the filing deadline by equitable means.⁸ It has nothing to do with the question of whether particular property is or is not part of the estate from which claims may be paid.

Nothing in §33-24-27 or anywhere else in the insolvency statute purports to convert property not belonging to the insolvent debtor into property of the estate for purposes of distribution to the debtor's creditors. Whether the property in question, the treasury bond which was the ultimate product of commingled funds including the UMWA's \$1 million trust corpus, was the property of BCBS is

⁷West Virginia Code §33-24-14(j) provides that "General assets" means all property, real, personal or otherwise, not specifically mortgaged, pledged, deposited or otherwise encumbered for the security or benefit of specified persons or a limited class or classes of persons."

⁸The only case which this Court has construed that provision is the appeal involving the Logan General Hospital claim in this case. State ex rel. Blue Cross Blue Shield of West Virginia, Inc., 195 W.Va. 537, 466 S.E.2d 388 (1995). Logan General Hospital filed a late claim and was classified by the Receiver as a Class VI claim. The hospital argued that its late filing should be excused based upon the equitable doctrine of substantial compliance, but the Court held that the statute, and particularly the sentence prohibiting the circumvention of the priority classes by equitable remedies, was intended to require strict compliance with the procedural requirements for filing claims, including the filing deadline. That was clearly the intent of that provision, and prevented Logan General from moving up from a Class VI claim to a Class III claim by the use of the equitable doctrine of substantial compliance with respect to the claim deadline. As the Court held, there are strong policy considerations favoring strict compliance with the claim filing requirements, and the provision relied upon by the Receiver was intended to require such compliance.

a question of the general application of property and trust law to the facts. Only if it were the property of BCBS would it be subject to the payment of claims to creditors of BCBS, and only then is the question of the priority of claims and the language relied upon by the Receiver relevant.

As the United States Supreme Court observed in a comparable situation involving the Bankruptcy Act,

Ownership of property rights before bankruptcy is one thing; priority of distribution in bankruptcy of property that has passed unencumbered into a bankrupt's estate is quite another. Property interests in a fund not owned by the bankrupt at the time of adjudication, whether complete or partial, legal or equitable, mortgages, liens, or simple priority of rights, are of course not a part of the bankrupt's property and do not vest in the trustee. The Bankruptcy Act simply does not authorize a trustee to distribute other people's property among a bankrupt's creditors. So here, if the surety at the time of adjudication was, as it is claimed, either the outright legal or equitable owner of this fund, or had an equitable lien or prior right to it, this property interest of the surety never became a part of the bankruptcy estate to be administered, liquidated, and distributed to general creditors of the bankrupt.

Pearlman v. Reliance Insurance Company, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed. 2d 190 (1962).

The question of whether a particular asset was property of BCBS, is an entirely different inquiry from the issue of whether there has been strict compliance with the requirements for filing claims. The courts have not hesitated to hold that property held in trust is not the property of the trustee or part of the trustee's estate in bankruptcy and receivership proceedings. Henson v. Lamb, 120 W.Va. 553, 199 S.E. 356 (1938); Williams v. S. M. Smith Insurance Agency, 75 W.Va. 494, 84 S.E. 235 (1915); Sullivan v. Madeleine Smokeless Coal Company, 115 W.Va. 115, 175 S.E. 521 (1934); Reams Drug Store v. Bank of the Monongahela Valley, 115 W.Va. 66, 174 S.E. 788 (1934); Pearlman v. Reliance Insurance Company, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed.2d 190 (1962); Begier v. Internal Revenue Service, 496 U.S. 53, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990); Mid-Atlantic

Supply, Inc. v. Three Rivers Aluminum Co., 790 F.2d 1121 (4th Cir. 1986); In the Matter of Maple Mortgage, Inc., 81 F.3d 529 (5th Cir. 1996); In re Unicom Computer Corp., 13 F.3d 321 (9th Cir. 1994); In re General Office Furniture Wholesalers, Inc., 42 B.R. 232 (Bankr. E.D.Va. 1984); Matter of Wellington Foods, Inc., 165 B.R. 719 (Bankr. S.D.Ga. 1994); In re Bank Bldg. and Equipment Corp. of America, 158 B.R. 138 (E.D.Mo. 1993); In re San Diego Realty Exchange, Inc., 132 B.R. 424, (Bankr. S.D.Cal. 1991); In Re Yakel, 97 B.R. 580 (D. Ariz. 1989); In re Encinas, 27 B.R. 79 (Bankr. D. Ore., 1983); In re Property Leasing & Management, Inc., 50 B.R. 804 (Bankr. E.D. Tenn. 1985); In re Building Dynamics, Inc., 134 B.R. 715 (Bankr. W.D .N.Y. 1992); In Re Imperial Insurance Company, 203 Cal.Rptr. 664 (Cal. App. 1984); Restatement of Trusts, 2d, §202, Comment (a); Scott, The Law of Trusts, 4th Ed., §540.

E. Any Expiration of the Trust Did Not Destroy the UMWA's Right to Its Property

The Final Order (pp.12-13) holds that the UMWA trust had terminated because the written agreement was not renewed after March 1989. This conclusion also is simply incorrect as a matter of law. That conclusion ignores the effect of the Statute of Uses, West Virginia Code §36-1-17. If it assumed that the trust did expire, the statute vested both legal and equitable title in the UMWA, the beneficial owner, thus making it clear that the trustee, BCBS, had no property interest whatsoever in the trust corpus, and that any funds subject to the trust in the possession of BCBS were clearly not part of the liquidation estate. The fact that BCBS, the trustee, failed to return the trust corpus when it should have did not destroy the trust, so long as the trustee still had the trust corpus or any property derived from the trust corpus. As demonstrated supra, the trust corpus and funds commingled with

it can be traced to the treasury bond which was sold at the direction of the Receiver, and the trust likewise attaches to the proceeds of the sale of the bond.

F. The Sinking Fund Established by BCBS Is Irrelevant.

The Final Order erroneously holds that the fact that BCBS established a sinking fund prior to the liquidation order "negates any argument the parties intended to create a trust relationship and operates to support the Receiver's argument that a debtor-creditor relationship existed between BCBS and the UMWA." This conclusion is clearly wrong as a matter of law. The establishment of a sinking fund, from other funds of BCBS, is entirely irrelevant to any issue in this case. The trust was established in 1986, not 1990, and whether there was or was not a trust depends on the agreement between the parties in 1986. Whether that trust was enforceable in 1990 depends on whether there was property in the hands of BCBS at the time of the liquidation order subject to the trust. For reasons set forth above, the answer to both those questions was "yes."

The expiration of the agreement terminating the trust did not destroy the trust or BCBS's obligations as trustee, but rather vested both legal and equitable title to the trust corpus in the beneficiary, the UMWA. Although BCBS attempted to obtain an agreement by the UMWA to permit BCBS to establish a sinking fund and delay return of the trust property, the UMWA never agreed to that proposal. (Deposition of Marty Hudson at 40-41, 45-47).

The treasury bond which was subject to the trust had been pledged as security to Shearson, and BCBS may not have been in a position to return that property to the UMWA at the time it proposed the sinking fund. The UMWA makes no claim with respect to the sinking fund. Its creation was a unilateral effort on the part of BCBS to which the UMWA did not agree, and it had no effect

on the legal status of the UMWA trust one way or the other. It establishes only that BCBS did not or could not return the UMWA trust funds at the time, but has no bearing on the rights and obligations of the parties under the trust agreement, or the right of the UMWA to recover its trust property from the Receiver.

CONCLUSION

For the reasons set forth above, the UMWA requests that the Court reverse the decision of the Circuit Court of Kanawha and remand the case with directions to order the Receiver to pay to the UMWA the \$901,902.17 proceeds of the sale of the bond which was subject to the UMWA trust, plus the interest which has accrued on the amount of the trust.

UNITED MINE WORKERS OF AMERICA,
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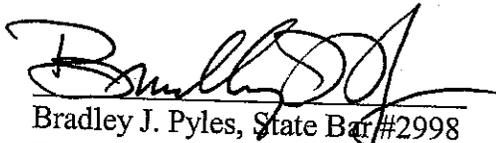
CERTIFICATE OF SERVICE

I hereby certify that the foregoing Brief of Appellant United Mine Workers of America was served on all parties in this matter by mailing a true copy thereof to their counsel of record in this matter, on April 12, 2006, as follows:

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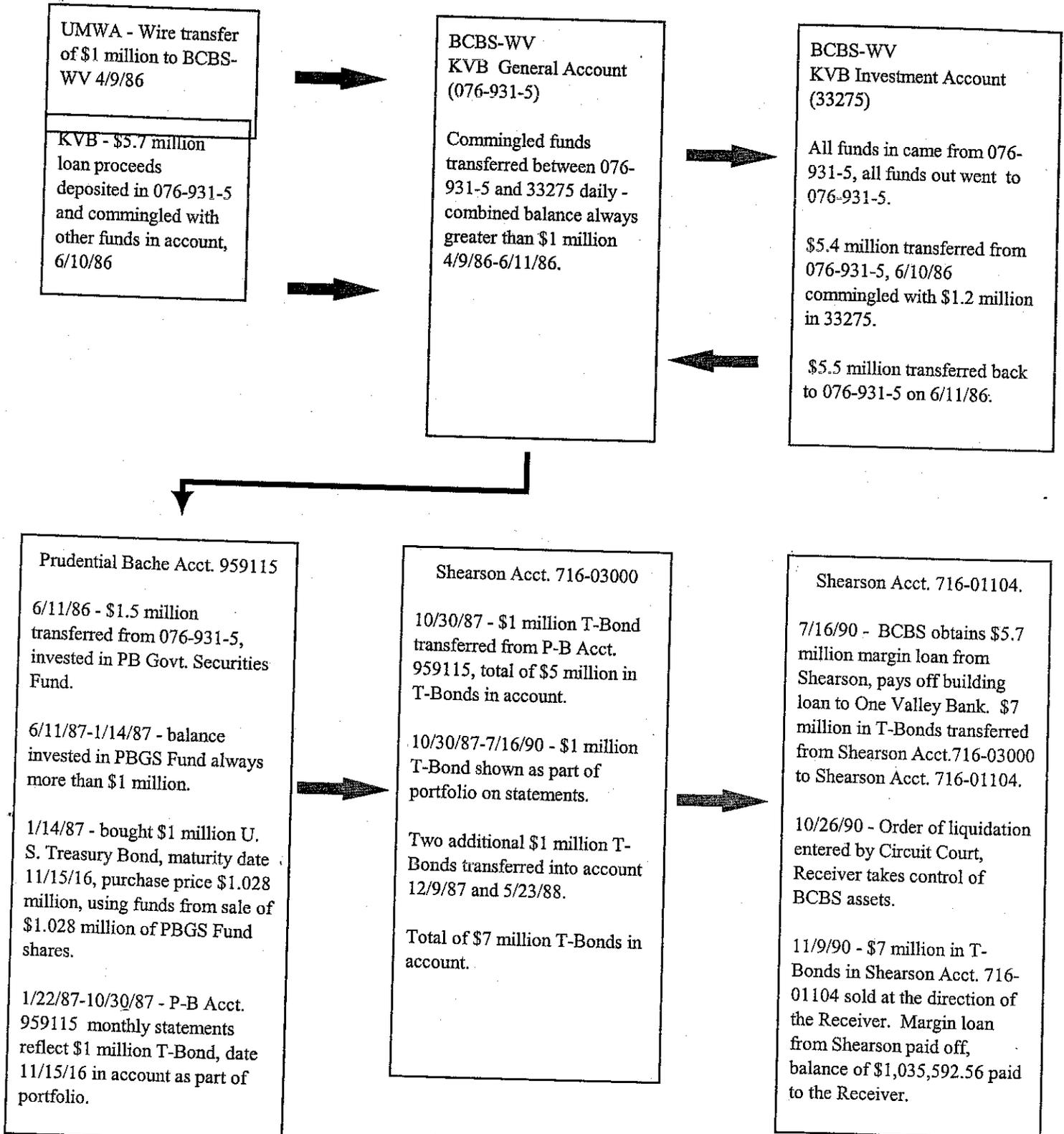
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TRACING OF UMWA TRUST FUNDS

Appendix 1



UMWA - Wire transfer of \$1 million to BCBS-WV 4/9/86

KVB - \$5.7 million loan proceeds deposited in 076-931-5 and commingled with other funds in account, 6/10/86

BCBS-WV KVB General Account (076-931-5)

Commingled funds transferred between 076-931-5 and 33275 daily - combined balance always greater than \$1 million 4/9/86-6/11/86.

BCBS-WV KVB Investment Account (33275)

All funds in came from 076-931-5, all funds out went to 076-931-5.

\$5.4 million transferred from 076-931-5, 6/10/86 commingled with \$1.2 million in 33275.

\$5.5 million transferred back to 076-931-5 on 6/11/86.

Prudential Bache Acct. 959115

6/11/86 - \$1.5 million transferred from 076-931-5, invested in PB Govt. Securities Fund.

6/11/87-1/14/87 - balance invested in PBGS Fund always more than \$1 million.

1/14/87 - bought \$1 million U. S. Treasury Bond, maturity date 11/15/16, purchase price \$1.028 million, using funds from sale of \$1.028 million of PBGS Fund shares.

1/22/87-10/30/87 - P-B Acct. 959115 monthly statements reflect \$1 million T-Bond, date 11/15/16 in account as part of portfolio.

Shearson Acct. 716-03000

10/30/87 - \$1 million T-Bond transferred from P-B Acct. 959115, total of \$5 million in T-Bonds in account.

10/30/87-7/16/90 - \$1 million T-Bond shown as part of portfolio on statements.

Two additional \$1 million T-Bonds transferred into account 12/9/87 and 5/23/88.

Total of \$7 million T-Bonds in account.

Shearson Acct. 716-01104.

7/16/90 - BCBS obtains \$5.7 million margin loan from Shearson, pays off building loan to One Valley Bank. \$7 million in T-Bonds transferred from Shearson Acct. 716-03000 to Shearson Acct. 716-01104.

10/26/90 - Order of liquidation entered by Circuit Court, Receiver takes control of BCBS assets.

11/9/90 - \$7 million in T-Bonds in Shearson Acct. 716-01104 sold at the direction of the Receiver. Margin loan from Shearson paid off, balance of \$1,035,592.56 paid to the Receiver.