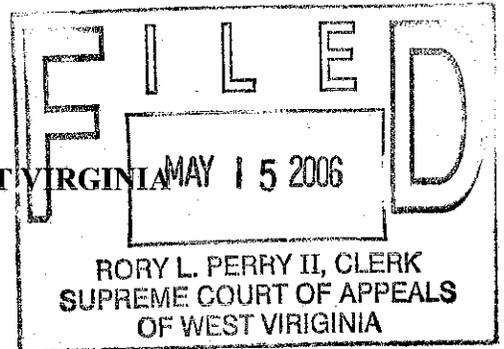


NO. 32979

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA



STATE OF WEST VIRGINIA, EX REL.,  
INSURANCE COMMISSIONER OF  
THE STATE OF WEST VIRGINIA,

Applicant,

v.

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

Respondent,

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INTERNATIONAL UNION, UNITED MINE WORKERS  
OF AMERICA,

Claimant and Intervenor,

v.

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

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**BRIEF OF THE APPELLEE**

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

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## **I. KIND OF PROCEEDING AND RULINGS OF THE CIRCUIT COURT**

### **A. Introduction**

Blue Cross and Blue Shield of West Virginia, Inc. ("BCBS"), was placed into receivership and liquidation pursuant to an "Order of Liquidation and Injunction", entered by the Circuit Court of Kanawha County, West Virginia, on October 26, 1990. The Application for the Order of Liquidation filed by Hanley C. Clark, the Insurance Commissioner of the State of West Virginia, alleged that BCBS was insolvent at the end of 1989 having a negative estimated balance of \$32,972,179.00.

Jane L. Cline, the current Insurance Commissioner of the State of West Virginia, is the Receiver of BCBS. Betty Cordial is the duly appointed Special Deputy Insurance Commissioner and Deputy Receiver for the Estate of BCBS and is the Court authorized fiduciary responsible for the collection and marshaling of all monies due and owing to the liquidating Estate of BCBS, and for making distributions to creditors of the Estate in accordance with the statutory scheme provided by W. Va. Code, § 33-24-23 and W. Va. Code, § 33-24-27.<sup>1</sup>

This case concerns \$1,000,000.00 transferred by the United Mine Workers of America (the "UMW") to BCBS on April 9, 1986. The money was immediately co-mingled and spent by BCBS in funding its substantial business losses.

The question before the Court is whether the UMW should be paid before other creditors based upon an asserted trust that the UMW attempts to establish under an equitable "trace" theory.

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<sup>1</sup> Note that W. Va. Code, § 33-24-14 was amended and §§ 33-24-15 through 33-24-19 and §§ 33-24-21 through 33-24-42 were repealed by Acts of 2004, but the repealed sections are applicable to the present case because it was pending prior to July 1, 2004, in accordance with the language set forth in the amended W. Va. Code, § 33-24-14.

The Circuit Court's Final Order entered on May 10, 2005, found that the UMW cannot prove a trace by clear proof, and even if the trace were proven, that the UMW could not utilize an equitable remedy to gain priority over the rights of other creditors contrary to the distribution scheme provided by statute. The UMW filed a Petition for Appeal on August 17, 2005, which was granted by this Court's Order of January 26, 2006.

### **B. The Claims Litigation**

The UMW filed a Proof of Claim with the Receiver in the amount of \$1,088,148.13, and asserted that the claim was subject to a trust or was, alternatively, a "special deposit" or a "secured claim." The Receiver determined that the UMW had a general unsecured claim pursuant to a "Notice of Determination," dated June 22, 1992. The Notice also stated that it was not likely that there would be sufficient funds to pay general unsecured claimants. The UMW filed its Objection to the Receiver's Notice of Determination on August 11, 1992.

On April 2, 1991, the Application of Receiver to Approve Plan of Liquidation was filed along with a Proposal for Control of Liquidation. The UMW filed an objection on the basis that certain monies being held by the Receiver were not subject to the liquidation proceedings because of the UMW's trust claim. As a result, the Receiver stipulated that the UMW would not be precluded from arguing that the Receiver was holding funds which were not subject to the liquidation proceeding, and the Circuit Court approved the Plan and Proposal.

On March 12, 1993, J. Nicholas Barth was appointed by the Circuit Court as the Referee. Incident to his duties as Referee, Mr. Barth filed a proposed Claimants' Rules of Procedure Before Referee. The UMW, along with other creditors, objected to the proposed rules. The objections were resolved, and on June 16, 1993, the Circuit Court entered an Order Adopting Rules of Procedure

Before Referee. This Order set forth the procedures for claims litigation before the Court appointed Referee, Mr. Barth.

The Referee, after reviewing the parties' Amended Joint Stipulation of Record, their separate Summary Judgment Motions and Proposed Findings of Fact and Conclusions of Law, recommended confirmation of the Receiver's Notice of Determination that the UMW does not have a trust or a secured claim.

On May 10, 2005, the Circuit Court entered a Final Order adopting the recommended decision of the Referee.

Significantly, the Final Order found that there was no fact or expert witness who testified that a certain trace could be made. Final Order, p. 9. The Final Order states that "the \$1,000,000.00 deposit made by the UMWA on April 9, 1986, cannot be traced with any confidence to property in the hands of the Receiver as of the Order of Liquidation." Final Order, p. 10. The Court held that the UMW failed to sustain its burden of proof and that the attempted trace was "conjecture and speculation". Final Order, p. 10.

In addition, the Court held that even if the trace were proven, the UMW could not rely on a trace theory because tracing was an equitable remedy barred in liquidation proceedings by W. Va. Code, § 33-24-27. Final Order, p. 11.

Finally, the Court held that the UMW does not have a secured claim as defined by W. Va. Code, § 33-24-14, although this is not assigned as error in the UMW's Petition. Final Order, pp. 12-13.

### **C. The Preference Action**

The Receiver's Notice of Determination also asserts that the UMW received a voidable transfer of \$1,072,889.10, and pursuant to W. Va. Code, § § 33-24-33 and 33-10-26, the Deputy

Receiver filed a preference action (Civil Action No. 92-C-5572) on September 25, 1992, to set aside and recover the transfer for the liquidating Estate.

The preference action (C.A. No. 92-C-5572) was consolidated with the claims litigation by Order, dated January 16, 1997, and because they shared common facts, the parties filed an Amended Joint Stipulation of Agreed Record for use in both cases. The preference action was initially decided by J. Nicholas Barth, Referee, and then adopted by the Circuit Court pursuant to a Final Order entered on May 10, 2005, the same day the Circuit Court entered the Final Order approving the Referee's decision in the claims litigation.

The Circuit Court's Final Order adopted the Referee's findings and granted the UMW's Summary Judgment Motion holding that there was no preferential transfer to the UMW. Although the claims litigation and the preference action were consolidated and shared the same record, the Court's decision in the preference action is not before this Court because the Deputy Receiver decided not to file a separate Petition for Appeal.

#### **D. Directors and Officers Insurance Settlement**

In December, 1991, Hanley C. Clark, the Insurance Commissioner of the State of West Virginia as the Receiver for the Estate of Blue Cross and Blue Shield of West Virginia, Inc., filed a lawsuit against Blue Cross and Blue Shield of West Virginia, Inc. seeking recovery under a directors and officers liability policy. Numerous parties, including the UMW, intervened.

The parties entered into a settlement agreement to which UMW's objected. Under the proposed settlement, the insurer agreed to pay the Receiver \$835,000.00. As part of a compromise approved by the Circuit Court's Order of October 2, 1992, the UMW shared in the \$835,000.00 settlement and received \$225,000.00, plus interest of \$5,011.47. The UMW agrees that the amount received from the directors and officers insurance settlement reduces the UMW's claim.

**E. Amount of the UMW's Claim**

The Circuit Court's Order determined that the UMW did not have a trust claim, but had an unsecured claim, but the Court did not determine the amount of the UMW's claim as there were not sufficient funds in the liquidating Estate to pay unsecured claims.

The UMW currently asserts a principal claim of \$901,902.17, plus interest, which should be further reduced by the \$225,000.00 in principal and the \$5,011.47 in interest paid to the UMW as part of the directors and officers insurance settlement.

**F. Status of Claims Against the Liquidating Estate**

On September 13, 2000, the Circuit Court entered an Agreed Order which approved a Plan of Interim Distribution in accordance with the statutory scheme set forth in W. Va. Code, § 33-24-27. Under the Order, Class I, Claims of Administration, were set at \$456,230.00. Pursuant to the Order, Class II claimants, which include subscribers and/or their medical providers, received an interim distribution of fifty percent of their total claims. If additional funds became available, subscribers with unpaid out-of-pocket claims will receive a pro-rata payment up to one a hundred percent distribution upon their out-of-pocket claims. Federal government claims on behalf of the Veterans Administration Hospitals and the Champus insurance program were treated as Class II claims and will receive a pro-rata distribution of up to one hundred percent along with the out-of-pocket subscriber claims. After Class II out-of-pocket subscriber and federal government claims are paid, Class II claims of subscribers and providers will be paid a pro-rata share of the remaining funds.

The final distribution to creditors has been delayed pending a resolution of the UMW's claim. Contrary to the UMW's Brief, money has not been "set aside" pending the outcome of the dispute. Appellant's Brief, p. 2.

As of December 31, 2005, the cash balance of the BCBS Estate is \$2,906,152.00. After reserving for estimated Class I, Administrative Claims, approximately \$2,449,000.00 will be available for distribution.

In the event the Circuit Court's Order is affirmed, Class II out-of-pocket subscriber claims will receive a one-hundred percent distribution of approximately \$1,647,000.00, and the federal government will receive a one-hundred percent distribution of approximately \$27,000.00. Thereafter, subscribers and providers will receive the remaining amount of approximately \$775,000.00, which is about an additional eight percent distribution on their total claims of approximately \$9,008,000.00.

If, on the other hand, the Circuit Court's Order is reversed and the UMW is found to have a trust claim, the approximate amount of the UMW's total claim including interest may be as much as \$1,235,000.00. Class I, Administrative Claims, will be paid, but Class II, out-of-pocket subscriber claims, will not receive a distribution of one hundred percent, but will only receive a distribution of approximately seventy-three percent. The remaining subscriber/provider claims will not receive a distribution of eight percent, but will receive no further distribution.

## **II. STATEMENT OF FACTS**

The UMW and BCBS entered into an agreement, the "UMW Emergency Care Pilot Program," in early 1986, under which BCBS was to "invest" \$1,000,000.00 "in trust" for a "... one year term." The agreement was extended by various agreements, but expired on March 31, 1989.

Despite the terms of the agreement, the monies were not invested in a trust, but were immediately deposited into BCBS's general account and commingled with other monies held by BCBS and then spent funding BCBS's significant business losses.

As found by the Circuit Court, the general account was subject to "tens of millions of dollars in deposits and withdrawals . . . made up of hundreds of individual transactions." Final Order, p. 9. There is not a fact or expert witness who testified that the \$1,000,000.00 deposited in April of 1986 could be clearly traced into monies held by the Receiver on October 26, 1990, the date of the Liquidation Order.

**III. RESPONSE TO THE UMW'S ASSIGNMENTS OF ERROR**

1. The Circuit Court's finding that the UMW could not establish a trace is a finding of fact in equity which can only be overturned on appeal if clearly wrong.
2. The Circuit Court did not commit clear error in finding that the UMW's attempted trace was not supported by any fact or expert witness and was "simply conjecture and speculation."
3. The Circuit Court did not commit clear error in holding that even if a trace were proven, W. Va. Code, § 33-24-27 prevents the UMW use of tracing, an equitable remedy, to elevate the UMW's claim from its presumed general unsecured status.
4. The Circuit Court did not commit clear error in holding that the UMW and BCBS had a debtor/creditor relationship, not a trustee/beneficiary relationship.

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**V. ARGUMENT**

**A. Summary of Argument**

Underlying the UMW's plea for equitable relief is the asserted unfair treatment the UMW received at the hands of BCBS prior to liquidation. The Receiver agrees that the UMW along with all of BCBS's creditors and policyholders were treated unfairly. The Receiver's duty is not to rectify this unfairness. This would be impossible because there is not enough money to pay all creditors.

The Receiver's duty is to properly administer and distribute the assets of the liquidating Estate to creditors and policyholders in accordance with the priority provisions of the statute. W. Va. Code, §§ 33-24-23(d) and 33-24-27. The Circuit Court's Order properly followed the statutory scheme.

Adopting the UMW's position would give the UMW priority over the claims of other creditors in a manner not envisioned by the statute.

The Circuit Court's finding in equity that the attempted trace was "conjecture and speculation" was not clearly wrong, and therefore, cannot be disturbed on appeal. Additionally, the Circuit Court correctly held that tracing is an equitable remedy barred by W. Va. Code, § 33-24-27.

**B. The UMW Did Not Sustain its Burden of Clearly Proving  
Its Asserted Trace And The Circuit Court's Findings In  
Equity Were Not Clearly Wrong And Cannot Be Reversed On Appeal**

**1. The Circuit Court's Findings Regarding the Attempted Trace**

The following is the Circuit Court's undisputed findings with respect to the deposits in and out of the various accounts of BCBS.

- A. The \$1,000,000.00 transferred by the UMWA to BCBS WV on April 9, 1986, was deposited into the "general account", No. 0769315, at Kanawha Valley Bank on April 9, 1986.
- B. On June 10, 1986, \$5,700,000.00 was borrowed by BCBS WV from Kanawha Valley Bank and deposited into the general account, No. 0769315, the same account into which the wire transfer was made.
- C. On June 10, 1986, \$5,400,000.00 was transferred from the general account to Kanawha Valley Bank Account No. 33275 to purchase short term securities.
- D. On June 11, 1986, \$5,500,000.00 was withdrawn from investment account 33275 and put into general account 0769315, both at Kanawha Valley Bank.
- E. One June 11, 1986, \$5,500,000.00 was taken from the general account and put into three separate brokerage accounts: Prudential Bache Account 959115 in the amount of \$1,500,000.00; E F Hutton Account C4306939 in the amount of \$2,000,000.00; and Shearson Account No. 716-01104 in the amount of \$2,000,000.00.
- F. On January 14, 1987, at the direction of BCBS WV, Prudential Bache purchased a \$1,000,000.00 Treasury Bond with assets in the account. The Treasury Bond was maintained in the account from January, 1987, to October, 1987.

- G. On October 30, 1987, the Prudential Bache Account No. 959115, including the Treasury Bond, was transferred to Shearson Account no. 716-0300-13-020. This account was posted as a collateral account for a loan then owed by BCBS WV to Kanawha Valley Bank.
- H. The Shearson account which held \$7,000,000.00 in Treasury Bonds was an asset of the BCBS WV at the time of the appointment of the Receiver on October 26, 1990. However, the Bonds were collateral for a margin loan owed to Shearson. The Bonds were sold on November 9, 1990, by the Receiver for \$6,313,315.22. Shearson withdrew the balance owed on the margin loan from the sales proceeds, and remitted to the Receiver the remaining sum of \$1,035,592.62.

Final Order, pp. 7-8.

In order to accumulate the funds to pay the UMWA, BCBS WV established a sinking fund at the brokerage firm of Shearson Lehman Hutton. The sinking fund had to be established because the \$1,000,000.00 received from the UMWA on April 9, 1986, was never segregated, but instead pooled with other monies of BCBS WV. Deposits of \$140,000.00 per month were made by BCBS WV to the sinking fund account from the general funds of BCBS WV. An agreed interest check on the \$1,000,000.00 was sent by BCBS WV to the UMWA for interest earned during the month of July and August, 1990. These checks were drawn upon the general fund of BCBS WV.

The last deposit to the sinking fund was made on October 9, 1990. Following entry of liquidation in this proceeding on October 26, 1990, placing BCBS WV in liquidation, the balance in the sinking fund of \$710,748.49 was transferred to the general account of Kanawha Valley Bank with all other BCBS WV cash and assets.

Final Order, p. 5.

## **2. Standard of Review and Burden of Proof**

The general standard of review for this case on appeal is as follows:

In reviewing challenges to the findings and conclusions of the circuit court, we apply a two-prong deferential standard of review. We review the final order and the ultimate disposition under an abuse of discretion standard, and we review the circuit court's underlying factual findings under clearly erroneous standard. Questions of law are subject to a de novo review.

State Ex Rel. v. Blue Cross Blue Shield, 203 W. Va. 690, 701, 510 S.E.2d 764, 775 (1998), quoting, Syl. pt. 2, Walker v. West Virginia Ethics Comm'n, 201 W. Va. 108, 492 S.E.2d 167 (1997).

Tracing is an equitable remedy. The very cases cited by the UMW support this proposition. The case of Henson v. Lamb was a "suit in equity." Henson v. Lamb, 120 W. Va. 552, 554, 199 S.E. 459, 460 (1938). The Ream's Drug Store case followed "modern rules of equity." Ream's Drug Store v. Bank, 115 W. Va. 66, 74-75, 174 S.E. 788, 792 (1934). The Court in Carleton Mining & Power Co. v. W. Va. Northern Railroad Company, 113 W. Va. 20, 22-23, 24, 166 S.E. 536, 537 (1932) held that a "constructive trust is imposed by equity" and that "[e]quity . . . shapes its decrees [and] . . . [a]s long as trust property can be traced . . . the property remains subject to the trust". See also, County Court v. Cottle, 81 W. Va. 469, 473, 94 S.E. 948, 949 (1918) (a court of equity has jurisdiction to follow and recover identified property or its proceeds); Marshall's Executor v. Hall, 42 W. Va. 641, 644, 26 S.E. 300, 301 (1896) (so long as the property can be traced, "equity will follow it").

One claiming a trust using the equitable remedy of tracing has a burden of showing a definite trace by clear proof. While it is possible that a trust res may be traced into a single commingled fund, or even to a specific piece of property, there must be "clear proof" of a definite trace into a specific property. Farmers National Bank of Burlington v. Pribble, 15 F.2d 175, 176 (8th Cir. 1926). The claimant "must definitely trace something of value which belongs to him . . . into the receiver's possession." Hoffman v. Rauch, 300 U.S. 255, 257 (1937). "The burden of proof is on the claimant to show what has become of the money." Scott and Fratcher, The Law of Trusts, §521.3 (4th Ed. 1989). The tracing "must be clearly shown." Picciano v. Miller, 137 P.2d 788, 791 (Idaho 1943), quoting, Ferris v. Van Vetchen, 73 N.Y. 113, 119 (1878); Hutchins v. Hutchins, 41 A.2d 612, 616 (Maine 1945). "It is indispensable that clear proof be made that the trust property or its proceeds has

gone into a specific fund, or into a specific identified piece of property . . . so that a court of equity can see with certainty that the trust property is in [the Receiver's] hands." Swan v. Childrens Home Society Of West Virginia, 67 F.2d 84, 88 (4th Cir. 1933) (brackets added), cert. denied, 290 U.S. 704 (1934); Hoffman, supra, 300 U.S. at 257. "It is not enough that the property claimed may have been the product of trust funds." Bogert, The Law of Trusts and Trustees, §921 (2nd Ed. 1995). Equity will not attach a trust to property purchased by a fiduciary in the "absence of evidence clearly showing" that trust monies were used to purchase the property. Johnson v. Bee, 84 W.Va. 532, 544, 100 S.E. 486, 491 (1919) (citations and quotations omitted). Absent a proven trace, "the claim of the beneficiary against the trustee for breach of trust is that of a general creditor." Restatement 2d, Trusts, §202(2).

If identification by tracing is in doubt, the doubt must be resolved in favor of the Receiver, "who represents all of the creditors of [BCBS], some of whom appear to have suffered in the same way." Schulyer v. Littlefield, 232 U.S. 707, 713 (1914) (brackets added).

It is indispensable to maintenance of a cestui que trust of a claim to preferential payment (by a receiver) out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver, and the claim can be sustained to that fund or property and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof which came to the hands of the receiver.

Pribble, supra, 15 F. 2d at 176; Swan v. Childrens Home Society Of West Virginia, 67 F.2d 84, 88 (4th Cir. 1933).

The question of whether an attempted trace is proven is an issue of fact in equity which will not be disturbed on appeal unless clearly wrong. "The Court will go as far as it can in this tracing and following trust money; but when, as a matter of fact, it cannot be traced, the equitable right of

the cestui que trust to follow it fails." Patterson v. Pendexter, 156 N.E. 687, 688 (Mass. 1927), quoting, Little v. Chadwick, 23 N. E. 1005, 1005 (Mass. 1890) (emphasis added). "[I]n equity the finding of fact of the trial chancellor will not be disturbed on appeal unless it is clearly wrong or against the preponderance of evidence." Lantz v. Reed, 141 W. Va. 204, 216, 89 S.E.2d 612, 618 (1955); Pepsi-Cola Bottling Co. v. Indian Rock Bottling Co., 98 W. Va. 269, 275, 126 S.E. 715, 717 (1925).

### 3. Discussion

In the present case, absent clear proof of a trace, the UMW's claim cannot be elevated above the claims of other creditors who also suffered as a result of the failure of BCBS.

Essentially, the UMW's position is that as long as there was any money held by BCBS when the Liquidation Order was entered, it is subject to the UMW's trust claim. However, the Circuit Court correctly held this is "not enough." Final Order, p. 7. The mere fact that the UMW transferred \$1,000,000.00 to BCBS in 1986 does not establish a trace. "A trust cannot be established in an aliquot share of a man's whole property as distinguished from a particular fund, by showing trust monies have gone into it." National City Bank of N.Y. v. Hotchkiss, 231 U.S. 50, 57 (1913) (Holmes, J.).

Based upon the foregoing, the Circuit Court did not commit clear error, when it found that the "trace" was not clearly proven.

First, the Circuit Court did not commit clear error in finding that between April 9, 1986, when the \$1,000,000.00 was deposited into the general account and "June 11, 1986, when \$1,500,000.00 was transferred from the general account to the Prudential Bache Account No. 959115, there were tens of millions of dollars in deposits and withdrawals from the account made up hundreds of individual transactions," and that it "would be impossible to identify which of the

millions of dollars transferred in and out of the general account were monies wired to the account by the UMW on April 9, 1986." Final Order, p. 9. Dep. Britton, pp. 204-08, 212-13, Exhibits 73, 74, and 75, Dep. Pack, pp.21-22, Exhibit 128 (Kellmeyer Opinion), Dep. Kellmeyer, pp. 31-33. The UMW's own expert, Larry Pack, acknowledges that it is not possible to identify which dollars coming out of the Kanawha Valley accounts were UMW dollars as opposed to loan proceeds from the Bank. Dep. Pack, pp. 24-25. Monies were merely transferred from one commingled account to another. Dep. Kellmeyer, p. 18.

Second, the Circuit Court did not commit clear error in finding that the \$5,500,000.00 "traced" by the UMW into three brokerage accounts on June 11, 1986, were most likely the product of a loan of \$5,700,000.00 from the Kanawha Valley Bank. Final Order, p. 9. An expert accountant, Dixie Kellmeyer, testified that the \$5,500,000.00 transferred to the three brokerage accounts on June 11, 1986, had to come from at least, in part, the loan proceeds from the Kanawha Valley Bank because there was not enough money in the general account to make the transfers without including at least some of the bank loan proceeds. Dep. Kellmeyer, pp. 32-33. This, in itself, cuts off the attempted trace of the UMW because the deposit of \$1,500,000.00 into the Prudential Account No. 959115 on June 11, 1986, was from the monies loaned by the Kanawha Valley Bank.

Third, the Circuit Court did not commit clear error in finding that based upon BCBS's huge "net losses" which caused a "hemorrhaging of cash," that it is "just as likely" that the monies deposited by the UMW in April of 1986 were "consumed by BCBS WV prior to the Order of Liquidation." Final Order, p. 10. "By weight of authority it is held that, where the wrong-doer uses the claimant's money in paying his unsecured debts, the claimant is not entitled to priority over other creditors." Scott and Fratcher, The Law of Trusts (4th Ed. 1989), § 521.2; Hoffman v. Ranch, 300 U.S. 255, 257 (1987).

[I]f it is shown that the property or its proceeds has been dissipated so that no product remains, or if the beneficiary fails to prove that the trustee still has property into which the trust property is traceable, his claim is only that of a general creditor of the trustee.

Restatement 2d, Trusts, § 202, Comment o.

The uncontradicted evidence is that BCBS spent the UMW's money almost immediately upon its receipt. The \$1,000,000.00 deposited on April 9, 1986, was long gone by June 11, 1986. "[T]hey had already commingled it and moved it out." Dep. Fox, pp. 35, 40. Between April 9, 1986, when the \$1,000,000.00 was deposited into the general account and June 11, 1986, when \$1,500,000.00 was deposited into Prudential account no. 959115, there were hundreds of transfers of millions of dollars in and out of the general account. Dep. Pack, pp. 21-22; Dep. Kellmeyer, pp. 31-33; Exhibit 128 (Kellmeyer Opinion).

Fourth, and most importantly, no witness testified that a trace could be clearly established.

The UMW states in its Brief that "It is clear, as both experts (Larry Pack and Dixie Kellmeyer) testified, that the treasury bond in issue can be traced directly back to the commingled funds which included the \$1 million trust." Appellant's Brief, p. 20. As explained in the Final Order, this is incorrect.

Both of the experts in this case testified that it would be impossible to identify which of the millions of dollars transferred in and out of the general account were the monies wired to the account by the UMW on April 9, 1986.

Final Order, p. 9.

Lawrence A. Pack, a Certified Public Accountant hired as an expert by the UMW, agrees that the monies were commingled into the general account, and that hundreds of transactions occurred in the account every month. Dep. Pack, pp. 21-22. Mr. Pack testified that "I cannot tell you exactly what happened to the million dollars." Dep. Pack, p. 22.

John Britton, the Director of Investments for Blue Cross, agrees with Mr. Pack that the million dollars cannot be traced.

"Q: Is there any way to track what happened to this million dollars, specifically those [UMW] dollars?

A: No."

Dep. Britton, p. 209 (brackets added).

Dixie Kellmeyer, the expert Certified Public Accountant hired by the Receiver, also testified that the monies deposited by the UMW with BCBS in April of 1986 cannot be traced into the hands of the Receiver in October of 1990. Dep. Kellmeyer, pp. 9, 11, 31-33; Exhibit 128. Ms. Kellmeyer's opinion states as follows. "[T]he money received from the UMWA was commingled with money received from various and numerous sources and cannot be traced. The UMWA money is unidentifiable in any other account of Blue Cross and Blue Shield." Exhibit 128.

In other words, contrary to the assertion in the UMW's Petition, there is no witness who testified that the monies could be directly traced. There is only the "conjecture and speculation" contained in the briefs filed by the UMW's Counsel. Final Order, p. 10. "Conjecture and speculation" in a brief is not enough to establish a trace by clear proof. Summary judgment cannot be defeated by the mere "factual assertions contained in the brief" of the opposing party. Morgantown v. W. Va. Univ. Medical Corp., 193 W. Va. 614, 620, 457 S.E.2d 637, 643 (1995).

Fifth, as discussed in more detail in Section D, below, once the money was deposited into the Shearson "Collateral Account For KVB," any trace was cut off because a secured creditor has the status of a bona fide purchaser for value.

#### **4. Conclusion - The Circuit Court's Findings in Equity Were Not Clearly Wrong**

There was not "evidence clearly showing" that the monies deposited in April of 1986 were used to purchase the treasury bonds held in the Shearson account at the time of the appointment of the Receiver in October of 1990. Johnson v. Bee, 84 W.Va. 532, 544, 100 S.E. 486, 491 (1919). Therefore, the Circuit Court correctly found that the UMW's attempted trace was "simply conjecture and speculation ... [and] the UMW has not been able to sustain its burden of proof with respect to the tracing of the funds." Final Order, p. 10.

Based upon the evidence, it appears that BCBS WV as Trustee dissipated the trust property so that its proceeds could not be followed, therefore the UMWA has only a personal claim against the estate of BCBS WV which is enforceable against the estate's assets, and in enforcing the claim, the UMWA stands in no better position than other creditors of the Receiver. Scott and Fratcher, Law of Trusts, § 202; Restatements of Trust 2d, § 202 (1 and 2).

Final Order, p. 10. This finding in equity cannot be overturned unless clearly wrong or against the preponderance of evidence. Lantz v. Reed, 141 W. Va. 204, 216, 89 S.E.2d 612, 617 (1955).

Finally, considering that no fact or expert witness testified to a clearly identifiable trace, the Circuit Court's decision is not plainly wrong or without supporting evidence, and therefore, this Court should affirm the decision of the Circuit Court that the UMW only has a general claim against the liquidating estate. Trovato v. Town of Star City, 166 W. Va. 699, 701, 276 S.E.2d 834, 836 (1981).

#### **C. The UMW Cannot Utilize Equitable Remedies To Elevate Its Claim Contrary To The Priority Provisions Of The Liquidation Statute**

The Circuit Court correctly held that "even if the UMWA could successfully trace the \$1,000,000.00 wired to BCBS WV on April 9, 1986, its attempt to create a remedy would be barred by the application of the provisions of West Virginia Code, § 33-24-27." Final Order, p. 11.

In liquidation proceedings, the general rule is that "creditors are entitled to share ratably in the distribution, subject to such priorities as are created by statute." Couch on Insurance, 3d, §6:8. In an effort to overcome this general rule, the UMW asserts a "tracing" argument for which, as discussed above, the UMW has a heavy burden of proof. And as discussed above, tracing is an equitable remedy. Scott, The Law Of Trust, §540; Ream's Drug Store v. Bank of the Monongahela Valley, 115 W. Va. 66, 74-75, 174 S.E. 788, 792 (1934). If the funds can be traced, the beneficiary can enforce an "equitable" lien. Restatement of Trusts, 2d §202, Comment i; County Court v. Cottle, 81 W. Va. 469, 94 S.E. 948 (1918).

The UMW may not resort to tracing because equitable remedies are not available to adjust the priority of the claims distribution scheme provided by the Liquidation Statute. "No claim by a policyholder or other creditor shall be permitted to circumvent the priority classes through the use of equitable remedies." W. Va. Code, §33-24-27. "Statutory priorities are generally required as exclusive and should not be disturbed by the creation of equitable priorities." Couch on Insurance, 3d, § 6:8.

In Washburn v. Dyson (In re Security Casualty Co.), 537 N.E.2d 775 (Ill. 1989), the Illinois Supreme Court decided that the statutory distribution scheme for the liquidation of insurance companies could not be disturbed by equitable remedies. In Washburn, the shareholders of the insurance company alleged a constructive trust in their favor based upon monies obtained by the company through securities fraud. Washburn, 537 N.E.2d at 778. The Court determined that whether the equitable remedy of a constructive trust was available was a "question of statutory interpretation" and that the Court's role was to "give effect to the intention of the legislature." Washburn, 537 N.E.2d at 779.

Similar to the West Virginia statute, the Illinois statute grants priority first to the costs and expenses of administration. Thereafter, monies are distributed to wage claims, then to claims of policyholders, then to claims of general creditors, and lastly, to shareholders. Washburn, 537 N.W.2d at 780. The Illinois statute, however, does not contain the language of West Virginia's statute which specifically provides that no claim "shall be permitted to circumvent the priority classes through the use of equitable remedies." W. Va. Code, § 33-24-27. Nonetheless, as a matter of statutory interpretation, the Illinois Supreme Court held that the statute "establishes a rule of absolute priority. . . . [and] there is no suggestion that the availability of other forms of relief inconsistent with the priorities of [the statute] was contemplated by the legislature." Washburn, 537 N.E.2d at 780 (brackets added).

Because the legislature has provided a comprehensive statutory scheme governing the distribution of assets from a liquidated insurer's estate, equitable relief different from that provided by statute was not available to the shareholders. . . . 'Equity follows the law,' and the legislature is, of course, empowered to limit the availability of equitable remedies.

Washburn, 537 N.E.2d at 781-82 (citations omitted). Therefore, the Court held that it was without equitable power to rule in a manner contrary to the statute's plain language.

We do not know of any power existing in a court of equity to dispense with the plain requirements of a statute; it has been always disclaimed, and the real or supposed hardship of no case can justify a court in so doing. When a statute has prescribed a plain rule, free from doubt and ambiguity, it is as well usurpation in a court of equity as in a court of law, to a judge against it; and for a court of equity to relieve against its provisions, is the same as to repeal it.

Washburn, 537 N.E.2d at 782, quoting, Stone v. Gardner, 20 Ill. 304, 309 (1858).

In Northwestern National Ins. Co. v. Kezer, 812 P.2d 688 (Colo. Ct. App. 1990), an "equitable lien" was not allowed under Colorado's "specific and comprehensive" insurance liquidation statute which "leaves no room for the judiciary to add to the type of claims to be preferred

or to establish a method of preference not created by the statute." Northwestern National Ins. Co. v. Kezer, 812 P.2d at 690. And, in Ohio, "because the legislature has provided a comprehensive statutory scheme governing the distribution from an insolvent insurer's estate, equitable relief different from the relief provided by statute is not available . . .". Benjamin v. Credit General Ins. Co., 2004 Ohio 7193, p. 23, 2004 Ohio App. LEXIS 6604, p. 16 (Ohio Ct. App. 2004).

The present case is even stronger because the West Virginia Legislature expressly prohibited the use of equitable remedies against the statutory scheme. This Court cannot by equity overrule the legislative mandate shown by the statute's plain rule. The rule in West Virginia is the same - "equity follows the law." Price v. Price, 122 W. Va. 122, 124, 7 S.E.2d 510, 511 (1940). "[W]henver the rights or the situation of the parties are clearly defined and established by law, equity has no power to change or unsettle those rights or that situation . . .". Price v. Price, 122 W. Va. 122, 127, 7 S.E.2d 510, 512 (1940), quoting, Magniac v. Thompson, 56 U.S. 281 (1853). For example, equity cannot disturb the priority of a statutory judgment lien in favor of non-lien claims. Price v. Price, 122 W. Va. 122, 7 S.E.2d 510 (1940).

Consistent with the rule that "equity follows the law", the Circuit Court correctly interpreted the clear language of W. Va. Code, § 33-24-27, when it held that the UMW cannot utilize an equitable remedy to circumvent the distribution scheme set forth in the liquidation statute.

The UMW's assertion that the prohibition of equitable remedies does not apply to the UMW, because the UMW owns a trust res and is not a creditor under §33-24-27, is illogical because the UMW is presumed to have a general claim, and the only way the UMW can overcome this presumption is by resorting to the equitable remedy of tracing.

The UMW argues that § 33-24-27 is only intended to prohibit "late claimants from avoiding the effect of the filing deadline by equitable means." Appellant's Brief, p. 24. The UMW's argument

is without merit, first, because the statute's language is not limited to late claims. Second, the case relied upon by the UMW, State ex rel. Clark v. Blue Cross Blue Shield of West Virginia, Inc., 195 W. Va. 537, 466 S.E.2d 388 (1995), held that the "strict compliance with all filing requirements" of §§ 33-24-25 and 33-24-33, would not allow the adoption of a "substantial compliance standard" for filing claims. Blue Cross, 195 W. Va. at 542, 466 S.E.2d at 393. While § 33-24-27 is cited in the opinion, it is not central to the holding, and the opinion hardly limits the application of § 33-24-27 to late claims.

The purpose of § 33-24-27 is to prohibit recourse to equitable remedies so as to assure that all creditors, including policyholders, are treated fairly. Its scope is not limited to late claims. Certainly, average policyholders, including single policyholders, "trusted" Blue Cross with their money. In essence, every creditor and policyholder of BCBS has some sort of equitable claim. To adjust, settle and consider all creditor claims based upon equitable principles would be difficult, if not impossible, and very expensive. Absent § 33-24-27, creditors with large claims would press equitable claims to the detriment of small claimants such as individual policyholders whose small claims would not justify the legal fees necessary to press their own claims in equity or to litigate against the equitable claims of larger creditors.

The statute's rationale is consistent with federal bankruptcy law, which does not favor trust theories to overcome a claimant's position in the statute's priority of payment scheme. Federal bankruptcy courts have been consistently wary of allowing those claiming trusts to obtain preferential treatment. "[W]e are not inclined to allow creditors to utilize a trust theory as a means of obtaining preferential treatment in a bankruptcy." In re Kulzer Roofing, Inc., 139 B. R. 132, 138 (Bankr. E.D. Pa. 1992), aff'd, 150 B.R. 134 (E.D. Pa. 1992); citing, In re Temp-Way Corp., 82 B.R. 747, 753 (Bankr. E.D. Pa. 1988). "Equality of distribution among creditors is a central policy of the

Bankruptcy Code. According to that policy, creditors of equal priority should receive pro rata shares of the debtor's property." Begier v. Internal Revenue Service, 496 U.S. 53, 58 (1990).

The Circuit Court correctly held that even if the UMW could prove a trace, that § 33-24-27 prohibits tracing because it is an equitable remedy, and this provision of the Code prevents the UMW, a presumed general creditor, from obtaining payment at the expense of policyholders and providers.

**D. The Receiver Standing in the Shoes of Bona Fide Purchasers for Value And Other Innocent Creditors Defeats the UMW's Trust Claim**

Although not specifically discussed in the Final Order, the Receiver also argued below that pursuant to W. Va. Code, § 33-24-33(c), the Receiver may assert the rights of secured creditors, which have the standing of bona fide purchasers for value and can, therefore, cut off a trace.

The UMW identified the Prudential Bache Account, No. 959115, as an account into which money can be traced. Dep. Pack, p. 34. The monies in this account were transferred into a Shearson Account, No. 716-03000-13-020, and this account was posted as collateral for a secured loan to BCBS from Kanawha Valley Bank in the amount of \$5,700,000.00. Dep. Britton, pp. 172-73, 183, Exhibits 87 and 90, Dep. Pack, p. 48. The Kanawha Valley Bank loan was paid off by a margin loan against the Shearson Account No. 716-0300-13-020, and Shearson, as a secured creditor under the margin loan, was paid when the account was liquidated. Dep. Britton, pp. 188-190, Exhibits 88 and 91.

A trace of a trust res will stop when the res is transferred to a bona fide purchaser.

Whenever a trust-fund has been wrongfully converted into another species of property, if its identity can be traced, it will be held, in its new form, liable to the rights of the cestui que trust. . . . So long as it can be identified either as the original property of the cestui que trust, or as the product of it, equity will follow it; and the right of reclamation attaches to it until detached by the superior equity of a bona fide purchaser, for a valuable consideration, without notice. The substitute for the

original thing follows the nature of the thing itself so long as it can be ascertained to be such.

Thompson's Appeal, 22 Pa. 16 (1853); Marshall's Executor v. Hall, 42 W.Va. 641, 644, 26 S.E. 300, 301 (1896). And a secured creditor taking collateral for value is a bona fide purchaser. See, Hubbard v. Hardeman County Bank, 868 S.W.2d 656, 660 (Tenn. 1993).

A creditor claiming a trust cannot take the collateral of a properly secured creditor. See, Hubbard, supra, 868 S.W.2d at 660 (a trust cannot follow funds into the hands of a secured creditor without notice of a breach of trust). A trust cannot be traced into the hands of a bona fide purchaser. Bogert, The Law of Trusts and Trustees (2nd Ed. 1995), §921, citing, Thompson's Appeal, 22 Pa. 16, 17 (1853). The cases cited by the UMW are in accord. Henson v. Lamb, 120 W. Va. 552, 561, 199 S.E. 459, 463 (1938) (a trust is destroyed "as against the claim of purchaser for value without notice"); Marshall's Executor v. Hall, 42 W. Va. 641, 644, 26 S.E. 300, 301 (1896) (a trace is "detached by the superior equity of a bona fide purchaser for valuable consideration without notice").

In addition, the intervening interests of other innocent creditors cuts off an equitable trace. "That a court of equity has jurisdiction at the suit of the owner of property to follow and recover such property, or the proceeds of it so long as it may be identified, and the interests of innocent parties do not intervene, cannot be doubted." County Court v. Cottle, 81 W. Va. 469, 473, 94 S.E. 948, 949 (1918) (emphasis added).

Under the Liquidation Statute, the Receiver is "vested by operation of law with the title to all the property, contracts, and rights of action and all the books and records of the corporation, wherever located, as of the date of the entry of the order directing him to . . . liquidate . . . and he shall have the right to recover the same and reduce the same to possession". W. Va. Code, §33-24-

23(b). The statute further provides for the recording of a certified copy of the Liquidation Order "in the same manner as deeds to real property are recorded", and that such recordation "shall impart the same notice as would be imparted by a deed, bill of sale, or other evidence of title duly recorded or filed." W. Va. Code, §33-24-23(c). Most significantly, the statute gives the Receiver the avoidance powers "which any creditor, subscriber or member of such corporation might have". W. Va. Code, §33-24-33(c) (emphasis added).

These sections, when read together, are very similar to the "strong-arm" provisions of the Federal Bankruptcy Code, 11 U.S.C. §544, which give a bankruptcy trustee the rights of a bona fide purchaser to avoid certain claims against property held by the trustee. 5 Collier on Bankruptcy, ¶¶ 544.01 and 544.02.

Based upon the foregoing, even if clearly proven, this UMW's trace cannot survive the Receiver's assertion of (i) the rights of secured creditors having the status of bona fide creditors for value or (ii) the intervening interests of the other "innocent" creditors of BCBS.

**E. The Court Correctly Found That Any Trust Agreement Expired And The Parties' Actions Evidence A Debtor/Creditor Relationship**

The Circuit Court found that the written trust agreement expired, and a debtor-creditor relationship followed. Final Order, p. 13.

As the record shows, after termination of the express trust, BCBS WV established a sinking fund to accumulate monies to repay the UMWA. The creation of a sinking fund 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 WV and UMWA, and not that of a settlor-beneficiary.

Final Order, p. 12.

Whether a trust is created is not determined solely by the wording of an agreement, but must also be shown by an actual investment of funds in a trust and by the parties' actions with respect to

the manner in which the funds are handled. Bowne v. Lamb, 119 W. Va. 370, 374-75, 193 S.E. 563, 566-67 (1937).

The written document the UMW relies upon, the unexecuted "Appendix A", specifically provides that "The term of the trust shall be one year, commencing from the date that Plan is in receipt of the trust corpus amount." Exhibit 3. The last Agreement relative to the Emergency Care Pilot Program in issue did not have an automatic renewal clause and expired on March 31, 1989. Exhibit 10. Therefore, by reference to the written documents, it is clear that after March 31, 1989, there was no express trust.

The Statute of Uses, W. Va. Code, § 36-1-17, provides that at the expiration of a trust, the trustee/beneficiary relationship expires and the trustee's legal title is passed to the former beneficiary. The equitable title of the beneficiary is then converted into legal title. Rogerson v. Wheeling Dollar Sav. & Trust Co., 159 W. Va. 376, 378, 222 S.E.2d 816, 819 (1976). In other words, when legal title is passed to the beneficiary, the trust itself expires. Therefore, BCBS was no longer a trustee and the UMW was no longer a beneficiary. In accordance with the Statute of Uses, on March 31, 1989, when the trust expired, the UMW took legal title to the money, and the UMW left the money with BCBS as an investment thereby establishing a debtor/creditor relationship.

This is consistent with the facts which show that BCBS treated the so-called trust as a "corp. obligation". Exhibit 11, Dep. Britton, p. 194. It was shown on the BCBS books as an "indebtedness to UMW". Dep. Sengewalt, p. 25. It was not set up as a trust. Mark Sengewalt, BCBS's Vice President of Finance, testified that "[a]t the time the [\$1,000,000.00] deposit was made a liability was set up". Dep. Sengewalt, p. 25.

The UMW also argues that the relationship was not a debtor/creditor relationship because "Appendix A" provided that BCBS was to "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," and if the money actually earned a higher rate, that the UMW was to receive the higher rate, less losses suffered by BCBS if premiums were insufficient to pay claims. Petition, p. 9.

Contrary to the language of "Appendix A," the actual conduct of the parties shows that BCBS paid the UMW at the stated interest rate. That is, the UMW never received anything more than one percent (1%) more than the Treasury Bill rate. See, Exhibits 22 and 23. It is clear that BCBS paid interest to the UMW at a fixed rate in a manner consistent with paying interest on a loan.

If the intention is that the person receiving the money shall have the 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. . . . If there is an understanding between the parties that the person to whom money is paid shall pay "interest" thereon (at a fixed or at the current rate, and not merely such interest as the money, being invested, may earn) the relationship is practically always a debt and not a trust.

Restatement 2d, Trusts §12, Comment g.

The parties' actual conduct shows that the UMW received a fixed rate, regardless of how much interest was actually earned by BCBS, and this establishes a debt, not a trust. Restatement 2d, Trusts, §12, Comment g. And, as the Circuit Court's Final Order correctly points out, the sinking fund established by BCBS after the extinguishment of the trust is indicative of a debtor/creditor relationship. Final Order, p. 12.

**F. The Monies Subject To The Attempted "Trace" Were Less Than One Million Dollars On The Date The Liquidation Order Was Entered**

The rule in tracing is that in order for the trace to be successful, it must be shown that the "fund into which it went has never been reduced below the sum claimed". Hancock County v. Hancock National Bank of Sparta, 67 F.2d 421, 422 (5th Cir. 1933) (emphasis added). "It is sufficient to trace it into the Bank's vaults and find that a sum equal to it, and presumably

representing it, continuously remaining there until the receiver took it." Ream's Drug Store v. Bank Of Monongahela Valley, 115 W. Va. 66, 75, 174 S.E. 788, 792 (1934) (emphasis added).

In fact, at various times, the general account, properly reconciled, had a balance of less than \$1,000,000.00 as did the Shearson Account 716-03000. Exhibit 128 (Report of Dixie Kellmeyer).

The UMW mistakenly relies on a Comment to the Restatement 2d, Trusts. See, UMW's Memorandum, pp. 12-13. The Comment discusses a circumstance entirely different from the present case. Comment i to Section 202 to the Restatement 2d, Trusts, covers the following circumstance:

Where the trustee deposits in a single account in a bank trust funds and his individual funds, and subsequently makes withdraws 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. . . . 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.

Restatement 2d, Trusts, §202, Comment i (emphasis added).

The facts recited in Comment i are much different than the facts of the present case. In the present case, the funds were not deposited into a "single account." Rather, the money was transferred out of the general account and into multiple accounts, and none of the money was in the general account when the Liquidation Order was entered. Therefore, pursuant to Comment i, the UMW must trace the money, which, as discussed above, the UMW cannot do.

The UMW asserts that when Shearson sold its collateral in satisfaction of its margin loan, there were sufficient monies left over to satisfy the UMW's claim. However, Shearson sold the collateral after the Liquidation Order was entered. According to Dixie Kellmeyer, an expert accountant, as of the date of the Liquidation Order, the value of the account (no. 716-01104), after

subtracting the margin loan debt, was less than one million dollars. See, Exhibit 128.<sup>2</sup> Therefore, in accordance with the established law, no trust res exists.

## VI. CONCLUSION

**WHEREFORE**, based upon the foregoing, Betty Cordial, as Deputy Receiver for Blue Cross and Blue Shield of West Virginia, Inc., respectfully requests that this Court affirm the Circuit Court's Final Order of May 10, 2005, and Ms. Cordial respectfully requests such other and further relief as this Court deems just and proper.

**BETTY CORDIAL, in her official capacity  
as Deputy Receiver of Blue Cross and Blue  
Shield of West Virginia, Inc.**

**By Counsel**



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<sup>2</sup> Note that pursuant to W. Va. Code, §33-24-32, the date when the Liquidation Order was entered establishes the date upon which the UMW's claim must be determined.

**CERTIFICATE OF SERVICE**

I, Christopher S. Smith, hereby certify that on the 15th day of May, 2006, the foregoing **BRIEF OF THE APPELLEE**, was served by United States first class mail, postage prepaid, on the following:

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