

NO. 32979

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

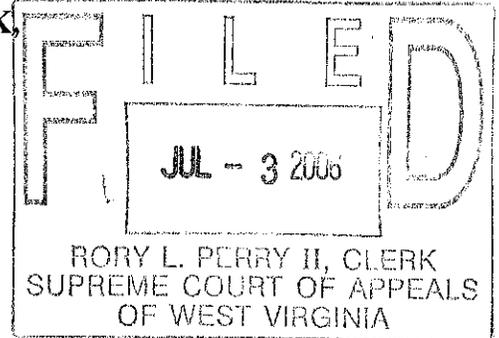
STATE OF WEST VIRGINIA, EX REL. HANLEY C. CLARK,
INSURANCE COMMISSIONER OF THE STATE OF
WEST VIRGINIA,

Applicant,

v.

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 ON BEHALF OF INTERVENOR WEST VIRGINIA HOSPITAL ASSOCIATION

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

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BRIEF ON BEHALF OF INTERVENOR WEST VIRGINIA HOSPITAL ASSOCIATION

I. KIND OF PROCEEDING AND RULINGS OF THE CIRCUIT COURT

A. Introduction

October 26, 1990 the Circuit Court of Kanawha County, West Virginia, entered an "Order of Liquidation and Injunction" placing Blue Cross and Blue Shield of West Virginia, Inc. ("BCBS") into receivership and liquidation. The Application for the Order of Liquidation filed

by the Insurance Commissioner of the State of West Virginia, alleged that BCBS was insolvent at the end of 1989 with an estimated negative balance of \$32,972,179.00.

The State Insurance Commissioner 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. The intervening West Virginia Hospital Association represents hospital creditors of BCBS entitled to share in the distribution of money collected and marshaled by the Receiver.

This case concerns \$1,000,000.00 that the United Mine Workers of America (the "UMW") transferred to BCBS on April 9, 1986. The money was 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. 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 UMW the 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.

The Court appointed Referee, J. Nicholas Barth, 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.

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 found that the UMW received a voidable transfer of \$1,072,889.00, 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 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 JReferee Barth, and his decision was adopted by the Circuit Court pursuant to a Final Order entered on May 10, 2005. On the same day the Circuit Court entered the Final Order approving the Referee's decision in the claims litigation now on appeal.

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 no appeal was filed by the Receiver.

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. 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 would 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.

There is an estimated \$2,906,152.00 available for distribution. After payment of estimated Class I, Administrative Claims, approximately \$2,449,000.00 will be available for distribution. The final distribution to creditors has been delayed pending a resolution of the UMW's claim.

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 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 any 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 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. No fact or expert witness 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 was not clearly wrong to find 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 was not clearly wrong to find that even if a trace were proven, W. Va. Code, § 33-24-27 prevents tracing, an equitable remedy, from elevating the UMW's claim from its presumed general unsecured status.
4. The Circuit Court was not clearly wrong to find that the UMW and BCBS had a debtor/creditor relationship, not a trustee/beneficiary relationship.

IV. POINTS OF AUTHORITY RELIED UPON

Carleton Mining & Power Co. v. W. Va. Northern Railroad Company, 113 W. Va. 20, 166 S.E. 537 (1932)

County Court v. Cottle, 81 W. Va. 469, 94 S.E. 948 (1918)

Farmers National Bank of Burlington v. Pribble, 15 F.2d 175 (8th Cir. 1926)

Hancock County v. Hancock National Bank of Sparta, 67 F.2d 421 (5th Cir. 1933)

Henson v. Lamb, 120 W. Va. 522, 199 S.E. 459 (1938)

Hubbard v. Hardeman County Bank, 868 S.W.2d 656 (Tenn. 1993)

J.A.S. v. D.A.S., 170 W.Va. 189, 292 S.E.2d 48 (1982)

Lantz v. Reed, 141 W. Va. 204, 89 S.E.2d 612 (1955)

Marshall's Executor v. Hall, 42 W.Va. 641, 26 S.E. 300 (1896)

National City Bank of N.Y. v. Hotchkiss, 231 U.S. 50 (1913)

Pepsi-Cola Bottling Co. v. Indian Rock Bottling Co., 98 W. Va. 269, 126 S.E. 715 (1925)

Ream's Drug Store v. Bank Of Monongahela Valley, 115 W. Va. 66, 174 S.E. 788 (1934)

Rogerson v. Wheeling Dollar Sav. & Trust Co., 159 W. Va. 376, 222 S.E.2d 816 (1976)

Schulyer v. Littlefield, 232 U.S. 707 (1914)

Stone v. Gardner, 20 Ill. 304 (1858)

Thompson's Appeal, 22 Pa. 16 (1853)

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W. Va. Code, § 36-1-17

OTHER AUTHORITIES

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Restatement 2d, *Trusts*, §202

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Scott and Fratcher, *The Law of Trusts*, §521.2 (4th Ed. 1989)

Scott and Fratcher, The Law of Trusts, §521.3 (4th Ed. 1989)

V. ARGUMENT

A. Summary of Argument

The Circuit Court and the Receiver properly followed the statutory scheme for administering and distributing the assets of the Estate to creditors and policyholders. W. Va. Code, §§ 33-24-23(d) and 33-24-27. The Circuit Court's finding in equity that the attempted trace was "conjecture and speculation" was not clearly wrong, and should not be disturbed on appeal. Additionally, the Circuit Court correctly held that tracing is an equitable remedy barred by W. Va. Code, § 33-24-27. The UMW's request that it be given priority over the claims of other creditors in a manner not provided by the statute should be rejected.

B. The Circuit Court Did Not Commit Clear Error, When It Found That The "Trace" Was Not Clearly Proven. There Is No Clear Proof Of A Trace And The UMW's Claim Is Not Above The Claims Of Other Creditors Who Also Suffered As A Result Of The Failure Of BCBS.

Tracing is an equitable remedy. See e.g., *Henson v. Lamb*, 120 W. Va. 552, 554, 199 S.E. 459, 460 (1938); *Ream's Drug Store v. Bank*, 115 W. Va. 66, 74-75, 174 S.E. 788, 792 (1934); *Carleton Mining & Power Co. v. W. Va. Northern Railroad Company*, 113 W. Va. 20, 22-23, 24,

166 S.E. 536, 537 (1932) (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". 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 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). 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).

The question of whether a trace is proven is an issue of fact that will not be disturbed on appeal unless clearly wrong. "[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); *J.A.S. v. D.A.S.*, 170 W.Va. 189, 190, 292 S.E.2d 48, 49 (1982).

The UMW argues 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, as 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.).

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. Even the UMW's expert, Larry Pack, testified 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. Apparently monies were just 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 fact, in itself, shows there is no trace because the \$1,500,000.00 deposit into the Prudential Account No. 959115 on June 11, 1986, was from the money loaned by the Kanawha Valley Bank.

Third, the Circuit Court did not commit clear error in finding that based upon BCBS's "net losses" and "hemorrhaging of cash," that it is "just as likely" that the money deposited by the UMW in April of 1986 was "consumed by BCBS WV prior to the Order of Liquidation." Final Order, p. 10. 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). See also Restatement 2d, Trusts, § 202 ([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.)

It is clear that BCBS spent the UMW money almost immediately. 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)

Lawrence A. Pack, a Certified Public Accountant 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, agreed that the million dollars cannot be traced. Dep. Britton, p. 209 Dixie Kellmeyer, a Certified Public Accountant, also concluded that the 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. Hence, there was no witness who testified that the money 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.

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. 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). Since no fact or expert witness testified to a clearly identifiable trace, the Circuit Court's decision is not plainly wrong and should be affirmed.

C. Tracing, An Equitable Remedy Is Not Available Under 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. "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.

D. The UMW's Trust Claim Cannot be Asserted Against the Receiver, who Stands in the Shoes of Bona Fide Purchasers for Value And Other Innocent Creditors

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

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 has the avoidance powers "which any creditor, subscriber or member of such corporation might have". W. Va. Code, §33-24-33(c) (emphasis added). Hence, 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 Circuit Court Correctly Found That The Written Trust Agreement Expired And Only A Debtor-Creditor Relationship Remained.

The alleged trust relied upon by the UMW, 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.

Under the Statute of Uses, W. Va. Code, § 36-1-17, on 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). When legal title passes to the beneficiary, the trust 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 making the UMW a creditor and BCBS a debtor.

This conclusion is consistent with the facts. BCBS treated the alleged 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. Further, 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.

F. There Was No "Trace" Because The Amount Was Less Than One Million Dollars On The Date Of The Liquidation Order

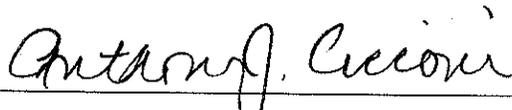
For a trace to be successful, it must be shown that the "fund into which [the money] went has never been reduced below the sum claimed". *Hancock County v. Hancock National Bank of*

Sparta, 67 F.2d 421, 422 (5th Cir. 1933). At various times, the general account, properly reconciled, had a balance of less the \$1,000,000.00, as did the Shearson Account. See Exhibit 128 (Report of Dixie Kellmeyer). Hence, even if the trace remedy were available, it has not been established here.

VI. CONCLUSION

WHEREFORE, based upon the foregoing, the Intervenor, the West Virginia Hospital Association respectfully requests that this Court affirm the Circuit Court's Final Order of May 10, 2005, and respectfully requests such other and further relief as this Court deems just and proper.

**The West Virginia Hospital Association
By Counsel**



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CERTIFICATE OF SERVICE

I, Anthony J. Cicconi, hereby certify that on the 30th day of June, 2006, the foregoing

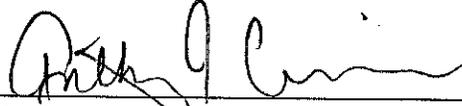
BRIEF OF THE INTERVENOR, was served by United States first class mail, postage prepaid,
on the following:

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