

NO. 32979

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

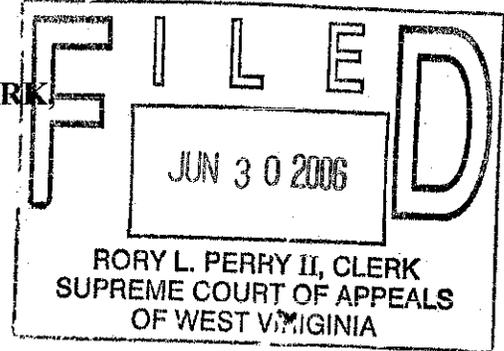
STATE OF WEST VIRGINIA, EX REL. HANLEY C. CLARK,  
INSURANCE COMMISSIONER OF THE STATE OF  
WEST VIRGINIA,

Applicant,

v.

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

Respondent,



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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 WEST VIRGINIA STATE MEDICAL ASSOCIATION IN SUPPORT  
OF AFFIRMING THE DECISION OF THE CIRCUIT COURT OF KANAWHA  
COUNTY, WEST VIRGINIA, IN CIVIL ACTION NO. 90-C-3825

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

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## I. INTRODUCTION

The appellant, the United Mine Workers of America ["UMW"], appeals the Final Order entered by the Circuit Court of Kanawha County, West Virginia, on May 10, 2005, holding that UMW is not entitled to priority over the rights of other creditors of Blue Cross and Blue Shield of West Virginia, Inc. ["Blue Cross"] based on the theory of equitable trace. The issue of priority became relevant after the Circuit Court of Kanawha County ordered Blue Cross into receivership on October 26, 1990, following a negative balance at the end of 1989.<sup>1</sup> UMW sought to jump to the front of the line of other creditors in order to recover \$1,000,000.00 the UMW transferred to Blue Cross on April 9, 1986. However, as the Circuit Court correctly determined, UMW may not recover before other creditors as the UMW cannot trace the \$1,000,000.00 transferred to Blue Cross. Therefore, as the UMW's transfer was co-mingled with Blue Cross' other monies and used to fund substantial business losses, UMW may not cut in front of other creditors.

The West Virginia State Medical Association ["WVSMA"], an association comprised of over 2,600 active and retired practitioners, medical students and residents, filed a motion to intervene in this appeal as a creditor of Blue Cross. WVSMA respectfully requests that this Honorable Court affirm the Circuit Court's order holding that UMW is not entitled to priority over other creditors of Blue Cross in accordance with W.Va. Code § 33-24-27 (2001) (repealed 2004).

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<sup>1</sup> The West Virginia Insurance Commissioner, Jane L. Cline, is currently Blue Cross' Receiver. Betty Cordial was appointed Special Deputy Insurance Commissioner and Deputy Receiver for the Estate of Blue Cross. As such, Ms. Cordial is responsible for the collection and marshalling of monies due and owed to the Estate of Blue Cross as well as making distributions to creditors in accordance with W.Va. Code § 33-24-23 and § 33-24-27.

## **II. FACTS**

### **A. UMW's Priority Claim.**

On June 22, 1992, Blue Cross's Receiver determined that \$1,088,148.13 transferred to Blue Cross from UMW was an unsecured claim rather than subject to a trust, a "special deposit," or secured claim as asserted by the UMW in a Proof of Claim submitted to the Receiver shortly after Blue Cross entered receivership. The Receiver rejected UMW's argument that its money had priority over other creditors pursuant to the equitable remedy of trace. Under the equitable remedy of trace, a claimant may recover their property if it can definitely trace the money and show the trace by clear proof.

UMW objected to the Receiver's findings on August 11, 1992. A referee appointed by the Circuit Court recommended confirmation of the Receiver's determination against UMW. On May 10, 2005, the Circuit Court adopted the referee's recommendation and entered the Final Order holding that UMW's transfer of money to Blue Cross constituted an unsecured claim. In so holding, the Circuit Court stated that, "the \$1,000,000.00 deposit made by the UMW[] 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 at p. 10. Moreover, even if UMW was able to prove the trace, the equitable remedy of trace is barred in liquidation proceedings pursuant to W.Va. Code § 33-24-27.

### **B. Status of All Claims Against the Estate of Blue Cross.**

On September 13, 2000, the Circuit Court entered an Agreed Order approving a plan of interim distribution of claims against the Estate of Blue Cross pursuant to W.Va. Code § 33-24-27. The Agreed Order set forth the following order of distribution:

1. Class I claims totaling \$456,230.00;<sup>2</sup>

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<sup>2</sup> Class I claims are defined by W.Va. Code § 33-24-27(a) as (1) the actual and necessary costs of

2. Class II claimants (Blue Cross subscribers and/or their medical providers) would receive 50% of their total claims;<sup>3</sup>
3. Blue Cross subscribers with unpaid out-of-pocket claims would receive pro rata payment up to 100% of their out-of-pocket expenses. Also federal government claims on behalf of Veterans Administration Hospitals and the Champus insurance program would receive a pro-rata distribution of up to 100% along with the out-of-pocket subscriber claims; and,
4. Class II claims of subscribers and providers would receive a pro rata share of the remaining funds after 1 – 3 are paid.

The final distribution to creditors was delayed pending resolution of UMW's claim.

To date, approximately \$2,906,152.00 is available for distribution from the Estate of Blue Cross. If this Court affirms the Final Order against UMW, Class II out-of-pocket subscriber claimants will receive a 100% distribution of approximately \$1,647,000.00 and the federal government will receive a 100% distribution of approximately \$27,000.00. Accordingly, the remaining subscribers and providers, including WVSMA, will each receive their pro rata amount, approximately \$775,000.00, or about 8% of their total claims against the Estate of Blue Cross totaling \$9,008,000.00.

Conversely, if this Court reverses the Circuit Court's Final Order and finds UMW does indeed have a trust claim, Class I claims will be paid, but Class II out-of-pocket subscriber claimants will only receive a 73% distribution. The remaining subscriber/provider claimants,

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preserving or recovering the assets of Blue Cross, (2) compensation for all services rendered in Blue Cross's liquidation, (3) an necessary filing fees, (4) the fees and mileage payable to witnesses, (5) reasonable attorneys' fees, and (6) all expenses incurred by the department of insurance arising out of the enforcement of Chapter 33 of the West Virginia Code. See W.Va. Code § 33-24-27(a).

<sup>3</sup> Class II claims are defined by W.Va. Code § 33-24-27(b) as, "[a]ll claims for refund of unearned premiums under nonassessable policies and all claims of policyholders including such claims of the federal or any state or local government as policyholders for losses incurred and third party claims of an insolvent insurer." W.Va. Code § 33-24-27(b).

including WVSMA, will not receive any distribution at all. However, UMW will receive the full value of its trust claim, plus interest, which may be as much as \$1,250,000.00.

### III. LAW & ARGUMENT

#### A. The Equitable Doctrine Of Tracing Is Not Available To Claimants Against The Estate Of Blue Cross.

The Circuit Court correctly held that the equitable doctrine of tracing is unavailable to creditors in lieu of the order of distribution established by W.Va. Code 33-24-27. As W.Va. Code § 33-24-27 clearly states, “*No claim by a policyholder or other creditor shall be permitted to circumvent the priority classes through the use of equitable remedies.*” (emphasis added) W.Va. Code § 33-24-27. Therefore, UMW should not receive priority over other creditors, including WVSMA, through equitable remedies such as tracing.

“Statutory priorities are generally required as exclusive and should not be disturbed by the creation of equitable priorities.” Lee R. Russ, Thomas F. Segalla & Steven Plitt, Couch on Insurance (Third), § 6:8 (2005). See e.g. In re Liquidation of Security Cas. Co., 537 N.E.2d 775 (Ill. 1989). As the West Virginia Supreme Court of Appeals reiterated in Price v. Price, 122 W.Va. 122, 7 S.E.2d 510, 512 (1940), “whenever 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 ... .” (quoting Magniac v. Thompson, 56 U.S. 281 (1853)).

Tracing is an equitable remedy whereby a claimant can enforce an equitable lien against funds that can be traced. See Ream’s Drug Store v. Bank of the Monongahela Valley, 115 W.Va. 66, 74 – 75, 174 S.E. 788, 792 (1934). See also Austin Wakeman Scott & William Franklin Fratcher, The Law of Trusts, § 540 (4th ed. 1987); Restatement (Second) of Trusts § 202 (1959) at cmt. i. Accordingly, UMW cannot relying on tracing to overcome the priority of distribution clearly set forth in W.Va. Code § 33-24-27. Otherwise, the purpose of W.Va. Code

§ 33-24-27, to assure that all creditors are treated fairly, would be defeated by allowing creditors to utilize a trust theory to obtain preferential treatment to the detriment of all other creditors. See W.Va. Code § 33-24-27 (“This act is hereby declared to be an emergency measure necessary for the immediate preservation of the public peace, health and safety. Such immediate action is required to ensure the orderly and prompt payment of claims filed in pending proceedings to liquidate corporations . . . .”) See also In re Kulzer Roofing, Inc., 139 B.R. 132, 138 (Bankr. E.D. Pa. 1992) (“[W]e are not inclined to allow creditors to utilize a trust theory as a means of obtaining preferential treatment in bankruptcy.”); Beiger v. IRS, 496 U.S. 53, 58 (1990) (“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.”)

As the Circuit Court correctly determined that UMW could not utilize the equitable remedy of tracing in lieu of the order of distribution set forth in W.Va. Code § 33-24-27, WVSMA respectfully requests the Court affirm the decision of the Circuit Court that UMW cannot rely on the equitable theory of trace to overcome a clear statutory mandate setting forth the priority of distribution in liquidation.

**B. The Circuit Court Properly Held That UMW Failed To Prove A Trace Even If Equitable Remedies Were Permitted In Lieu Of W.Va. Code § 33-24-27.**

Even assuming that UMW was permitted to overcome the priority of distribution set forth in W.Va. Code § 33-24-27 by asserting a trust using the equitable remedy of tracing, UMW still failed to fulfill its burden of showing a definite trace by clear proof. See Swan v. Children’s Home Soc. of W.Va., 67 F.2d 84, 88 (4<sup>th</sup> Cir. 1933) cert. denied 290 U.S. 704; Farmers Nat’l. Bank v. Pribble, 15 F.2d 175, 176 (8<sup>th</sup> Cir. 1926); See also The Law of Trusts at § 521.3; George G. Bogert & George T. Bogert, The Law of Trusts and Trustees, § 921 (2<sup>nd</sup> Ed. 1995).

UMW asserts that any money held by Blue Cross at the time of its liquidation is subject

to UMW's trust claim. However, UMW's mere transfer of money to Blue Cross in 1986 does not establish a trace. First, UMW's money was co-mingled with tens of million of dollars in one general account. Final Order at p. 9. Moreover, Blue Cross transferred millions of dollars in and out of the general account making it virtually impossible to identify the fate of UMW's money. Id. Second, the alleged trace of UMW's money was likely not UMW's money but rather loan proceeds to Blue Cross from the Kanawha Valley Bank. Id. Third, there is a good chance that UMW's money was used by Blue Cross to pay debts prior to Blue Cross's liquidation. If Blue Cross used UMW's money to pay off unsecured debts, then UMW is not entitled to priority over other creditors. See The Law of Trusts at § 521.2. See also Hoffman v. Ranch, 300 U.S. 255, 257 (1987). Finally, not one witness testified that a trace could be clearly established. Final Order at p. 9.

Any doubt of a clear trace must be resolved in favor of the Receiver. Schulyer v. Littlefield, 232 U.S. 707, 713 (1914); Swan, 67 F.2d at 88. Moreover, the Circuit Court's determination as to a valid trace cannot be disturbed on appeal unless clearly wrong. Lantz v. Reed, 141 W.Va. 204, 216, 89 S.E.2d 612, 618 (1955). The overwhelming evidence, at the very least, shows doubt of a clear trace of UMW's money. Accordingly, WVSMA respectfully requests the Court affirm the decision of the Circuit Court that UMW failed to prove a trace and cannot jump in front of the line of Blue Cross's other valid creditors.

#### **IV. CONCLUSION**

Wherefore, the West Virginia State Medical Association respectfully requests this Honorable Court affirm the Final Order entered by the Circuit Court of Kanawha County, West Virginia, holding that monies submitted to Blue Cross and Blue Shield of West Virginia by the United Mine Workers of America was not afforded a preferential status over other creditors.

Reversing the Circuit Court's Final Order based on an equitable theory running contrary to W.Va. Code § 33-34-27 defeats this very purpose of the statute itself; especially when the United Mine Workers was not able to trace its money, much less prove the trace, in order to assert the remedy.

**THE WEST VIRGINIA STATE  
MEDICAL ASSOCIATION,**

**By Counsel,**



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**CERTIFICATE OF SERVICE**

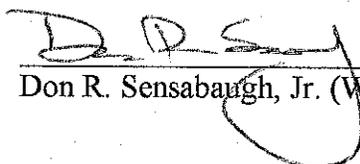
I, Don R. Sensabaugh, Jr., do hereby certify that I have served the foregoing **“BRIEF OF THE WEST VIRGINIA STATE MEDICAL ASSOCIATION IN SUPPORT OF AFFIRMING THE DECISION OF THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA, IN CIVIL ACTION NO. 90-C-3825”** upon the following counsel of record by depositing a true and accurate copy thereof in the United States Mail, postage prepaid, this 30<sup>th</sup> day of June, 2006, addressed as follows:

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