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IN THE
SUPREME COURT OF VIRGINIA

Record No. 161767

APPALACHIAN REGIONAL HEALTHCARE, *ET AL.*,

Appellants,

v.

JACQUELINE K. CUNNINGHAM, *ET AL.*,

Appellees.

REPLY BRIEF OF APPELLANTS

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ARGUMENT

I. Introduction

After spending more than a decade defending their legal status as policyholders and their legal rights in the ROA Receivership, the Hospitals submitted a claim for over $400,000 in fees and expenses incurred as part of those efforts (the "Claims"). The Deputy Receiver (the Commissioner of Insurance) and the State Corporation Commission (as Receiver for ROA) improperly denied those Claims and now seek to justify the decision by reconstructing the contracts at issue here. Their arguments fail primarily because they are built upon an erroneous principle: that the extent of ROA's liability to the Hospitals is limited by the characterization of the 1997 Merger Agreements between the Trusts[1] and ROA (the "Agreements") as assumption reinsurance transactions. In relying on this mistaken premise, the Commission and Deputy Receiver effectively rewrite those Agreements. Yet, contrary to the assertions of the Commission and Deputy Receiver, the Hospitals do not seek to impose unlimited liability on the Receivership; rather, they seek to apply the plain language of the Agreements to the undisputed facts.

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[1] As explained in the Hospitals' Opening Brief, the Trusts (individually known as "KHAT" and "CHAT") are the Hospitals' undisputed predecessors in interest. *See* Appellants' Opening Br. at 4-5.

The Deputy Receiver and Commission build upon their shaky legal foundation by mischaracterizing the source of the legal fees and expenses—the underlying Virginia and Kentucky Litigation, which turned on the Hospitals' status as policyholders under contracts of insurance. Indeed, based on the previous rulings of the Commission and its Hearing Examiner, the Hospitals entered contracts of insurance with ROA, whose ambiguities—if any—are construed against ROA (and the Receivership) and in favor of the Hospitals (and coverage of their Claims). The Commission attempts to curtail the application of these principles of insurance, but does not directly refute them. Accordingly, the Hospitals' Claims for fees and expenses incurred in the Virginia and Kentucky Litigation were wrongfully denied Class 2 priority in the Receivership under Va. Code § 38.2-1509(B)(1).

Having misapplied the straightforward language of the Agreements, the Commission's denial of the Hospitals' Claims should be reversed. The Agreements provide that the legal fees and expenses incurred in defending the Hospitals' rights as policyholders of ROA are reimbursable. Further, because the Hospitals' Claims constitute "claims of policy holders arising out of insurance contracts," the Hospitals are entitled to payment of their

Claims pursuant to Code § 38.2-1509(B)(1)(ii), and the Commission's 2016 Final Order to the contrary should be reversed.

II. The Plain Language of the Agreements Entitles the Hospitals to Indemnification for Legal Expenses Incurred in the Virginia and Kentucky Litigation.

A. Because the Hospitals' Claims "Arise Out Of" and Were Incurred "In Connection With" the Business Obligations Assumed by ROA, They Are Covered by the Agreements.

As a threshold matter, the Commission's Brief improperly attempts to bolster its erroneous Final Order on appeal by pointing out the factual deference to which its decisions are normally entitled. (Appellees' Br. at 14). However, this appeal presents pure issues of contractual and statutory interpretation subject to de novo review. *Babcock & Wilcox Co. v. Areva NP, Inc.*, 292 Va. 165, 178, 788 S.E.2d 237, 243 (2016). Accordingly, deference to the Commission's factual determinations are irrelevant to this Court's review and determination of the purely legal issues in this appeal.

More importantly, the Commission and Deputy Receiver's attempt to limit the plain language of the Agreements by emphasizing their "structure" or "nature" is unconvincing. The Agreements' nature is not at issue. Their plain language is. That language says:

> [ROA] agrees to indemnify and hold harmless [each Trust] and its member-insureds from any and all Damages arising out of or in connection with the Business, the Assumed Liabilities, the

> conveyance and delivery of the Transferred Assets, or related transactions.

(J.A. 154 and 336). Thus, the Commission and Deputy Receiver's attempt to limit the definition of "Damages" *a priori* and in isolation, without attention to all the terms employed in the Indemnification Agreements, is not just illogical but also unsupported by the language used in the Agreements. *Quadros & Assoc., P.C. v. City of Hampton*, 268 Va. 50, 54, 597 S.E.2d 90, 93 (2004) ("We consider the contract as a whole and do not place emphasis on isolated terms."). Hence, although the Commission and Deputy Receiver baselessly declare that the Hospitals' interpretation of the Agreements is "unreasonable" and "must be avoided," they simply divorce a few words from the entirety of the Agreements to support their own flawed position. (Appellees' Br. at 24-25).

Moreover, the Commission and Deputy Receiver seek to impose a limitation on the parties' chosen language based merely on their characterization of the Agreements as "assumption reinsurance contracts." However, the Commission's interpretation of the Agreements would not give effect to all the terms the parties included in the Indemnification Agreements and impose terms not used. Essentially, the Commission and Deputy Receiver would have this Court invent some strict temporal limitation on the "Damages" that could arise and be reimbursed under the

Indemnification Agreements. But this Court should resist the temptation to "indulge in [these] artificial interpretations or abnormal implications in order to save" the Commission from an unfavorable bargain. *Babcock & Wilcox*, 292 Va. 165, 189, 788 S.E.2d 237, 249 (quoting 11 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 32:11, at 771-72 (4th ed. 2012)).

The Commission and Deputy Receiver also fail to offer an alternative explanation of the terms in the Indemnification Agreements. Indeed, under their interpretation of the term "Damages," ROA's obligations in the Indemnification Agreements are strictly limited to the Trusts "equivalent obligation[s] prior to the Mergers." (Appellees' Br. at 20). The problem is that this interpretation fundamentally impairs the purpose of the Indemnification Agreements—to reimburse the Trusts for liabilities arising out of the Trusts business obligations, even those that might arise post-Merger.

But the Commission and Deputy Receiver do not, and indeed cannot, dispute that with the Agreements, ROA agreed to "assume and become responsible for all Assumed Liabilities" of the Trusts, i.e., all obligations in connection with their Business as insurance providers. (J.A. 67, 68, and 72 and J.A. 113, 114, and 118). In assuming all of the Trusts' Business

obligations, ROA thus accepted the chance that the Trusts or their constituents (the Hospitals) might become involved in litigation concerning either (1) their obligations to insureds and claimants under the Trusts' polices (also assumed by ROA in the Agreements) or (2) the Hospitals' own status as policyholders of ROA. The Appellees' attempt to amend the Agreements by inserting artificial "pre-Merger" limitations on this assumption of liability is belied by the Agreements' plain language. When ROA agreed to indemnify the Trusts for any "liability, expense, cost, or obligation" (i.e., Damages) "arising out of or in connection with" ROA's Assumed Liabilities, ROA agreed to indemnify the Hospitals essentially for any cost or expense that might arise from the Trusts business as self-insurers. This broad language encompasses both the Hospitals' participation in the Virginia Litigation to vindicate their rights and the rights of claimants under their policies issued by ROA, as well as the Kentucky Litigation to establish their rights as policyholders under insurance policies issued by ROA. (J.A. 530 and 629).

The Appellees' repeated incantation that the Agreements are assumption reinsurance contracts does not alter this basic fact. ROA's (and the Commission's) obligation to indemnify the Hospitals was not conditioned upon some extrinsic contractual obligation the Trusts had with

their own insureds prior to their merger with ROA. Rather, ROA's obligations are announced by the plain terms of the Agreements and extend to any of the Trusts' obligations "arising out of or in connection with" their Business as self-insuring trusts.

Hence, the Commission and Deputy Receiver's approach to the Agreements is incorrect because it ignores the Agreements' broad definition of the Trusts' "Business" as liability and workers' compensation insurance providers and the Damages assumed as those "arising out of" or "in connection with" any and all business obligations of the Trusts. The Indemnification Agreements thus encompass all Damages incurred in connection with or arising out of the Trusts' business and explicitly do not exclude any liabilities. (J.A. 158 and 340).

Accordingly, any obligation of the Trusts arising out of or in connection with their Business became a liability for ROA, regardless of the subsequent fate of ROA. *See St. Paul Fire & Marine Ins. Co. v. Ins. Co. of N. Am.*, 501 F.Supp. 136, 139 (W.D. Va. 1980) ("The term 'arising out of' is ordinarily understood to mean originating from, incident to, or connected with the item in question."). These terms thus naturally encompass maintaining insurance policies and seeking contribution from legally liable parties—the impetus behind the Hospitals' participation in both the Virginia

and Kentucky Litigation. Hence, the plain language of the Agreements—specifically the Indemnification Agreements—means that ROA, via the Commission, is liable for costs incurred in defending or adjudicating the Hospitals' status as policyholders in the Virginia and Kentucky Litigation.

B. The Agreements Should Be Analyzed under the Correct Contractual Interpretation Rules of This Court.

Additionally, the Appellees' reliance on matters beyond the four corners of the Agreements is misplaced and is intended to confuse the nature of the review of the contracts at issue. Admittedly, they begin their brief by acknowledging the principle that the plain language of a contract guides this Court in resolving contractual disputes. (Appellee's Br. at 14). But then the Commission and Deputy Receiver abstrusely attempt to open interpretation of the Agreements to extrinsic evidence or other considerations external to the contracts under the guise of "circumstances" directed at discovering the parties "probable intent." (Appellees' Br. at 15).

However, the parties' intent in a contract is derived principally from the plain language of the instrument itself. When the instrument is clear and unambiguous, the contract is the ultimate and unequivocal statement of the parties' intent, and the Court should not consider other evidence. *Babcock & Wilcox*, 292 Va. at 188, 788 S.E.2d at 249. ("When courts search for the parties' intent in an unambiguous contract provision, the search ends

where it begins—with the plain, usual, and ordinary meaning of the words themselves."). Thus, this Court need not—and should not—attempt to discern the parties' intent in entering the Agreements or the contracts' meaning based on extrinsic evidence because the language used in the Agreements themselves is clear. *Pocahontas Min. Liab. Co. v. CNX Gas Co., LLC*, 276 Va. 346, 353, 666 S.E.2d 527, 531 (2008) (holding that, when instrument is clear and unambiguous, courts do not go beyond the four corners to discern its meaning).

Nonetheless, the Commission and Deputy Receiver attempt to introduce extrinsic evidence aimed at shading the plain language of the Agreements. Indeed, they cite testimony from the Hearing Examiner's 2005 Report in the Virginia Litigation in an attempt to limit the contractual obligations that ROA undertook with the Agreements. (Appellees' Br. at 16). However, their attempt to reintroduce and rely on this extrinsic evidence—information not literally part of the Agreements—is a misplaced attempt to interpret the plain language of the Agreements without first demonstrating how (or even alleging *that*) the language of the Agreements is ambiguous. In fact, the Commission and the Deputy Receiver agree that the Agreements are *unambiguous*. (Appellees' Br. at 15) ("The contracts at

issue were not ambiguous . . . ."). Thus, it is unclear why the Commission now attempts to resort to extrinsic evidence to reinterpret the Agreements.

Further, the Commission has accused the Hospitals of misstating the findings of the Hearing Examiner in the Virginia Litigation, but has relied on and quoted the Hearing Examiner's *2016* rulings to set forth a finding not actually made in the Virginia Litigation in *2005*. (Appellees' Br. at 11). The Commission's specious arguments flow from a clear misperception of the Virginia Litigation and proceedings below. In fact, the Hospitals' arguments in their Opening Brief are correct: the Commission in 2005 held: "the Assumed Claims [assumed by ROA] are those of 'policyholders.' In this regard, while the 'policyholders' may have been the employers-members of the SITs and GSIAs [i.e., the Hospitals] rather than a third-party claimant or employee, we believe the language 'arising out of' is broad enough to encompass the Assumed Claims." (J.A. 541). But in 2016 both the Hearing Examiner and Commission ignored this previous finding. (J.A. 928-29 and 1021-22). The Commission should not be permitted to change course eleven years later simply because their previous position no longer suits them.

C. Properly Understood, the Agreements Encompass the Fees and Expenses Incurred in the Virginia and Kentucky Litigation.

Finally, in an attempt to support their erroneous contention that ROA's obligation to indemnify the Trusts is limited to "pre-Merger obligations," the Commission and Deputy Receiver mischaracterize the Virginia and Kentucky Litigation. They essentially allege that the Hospitals unnecessarily joined in or initiated these lawsuits. However, in both proceedings, the Hospitals were forced to litigate and defend their status as policyholders of ROA through no fault of their own.

At issue in the Virginia Litigation was whether the Hospitals, as successors to the Trusts and policyholders of ROA, were entitled to distributions from the Receivership. (J.A. 528-31). There, in analyzing the facts presented, the Hearing Examiner explained the issue as "whether the members of the SITs and GSIAs [i.e., the Hospitals] were "policyholders under insurance contracts." (J.A. 456). Likewise, in its 2005 Final Order, the Commission concluded that "the [self-insured trusts and the Trusts] or employers thereof constitute 'other policyholders arising out of insurance contracts' pursuant to § 38.2-1509 B 1 ii of the Code of Virginia" and that the Workers' Compensation Claims that ROA assumed from the Trusts and others "are those of 'policyholders.'" (J.A. 530 and 541). Thus, despite the

Commission and Deputy Receiver's emphasis on the Hospitals' lack of "invitation" to join this litigation (Appellees' Br. at 10 and 13), the Hospitals were compelled to join the Virginia Litigation to protect their rights in the ultimate adjudication of this issue and those of claimants under the insurance policies issued by ROA. The Commission and Deputy Receiver's belated attempts to reverse course and deny the Hospitals' claims based on a contorted reading of the Agreements is thus both illogical and self-contradictory.

Likewise, the Kentucky Litigation centered around the Hospitals' status as policyholders of ROA under contracts of insurance, and so the expenses incurred in that litigation are contemplated by the plain language of the Agreements. Indeed, the Hospitals' rights in ROA's Receivership and those at issue in the Virginia Litigation directly prompted the Kentucky Litigation. At the time, the Hospitals' right to payment for workers' compensation claims in the Virginia Litigation was uncertain and the Kentucky Insurance Guaranty Association ("KIGA") also refused to acknowledge or pay those claims. (J.A. 527, 547, and 549-55). Thus, while waiting for the Commission's determination of these claims in the Virginia Litigation, KIGA refused to honor its statutory obligations. Hence, the Hospitals were left holding insurance claims they had no obligation to pay.

Without the Virginia and Kentucky Litigation, the Hospitals would have been liable for these claims. Accordingly, the Hospitals were forced to litigate their status as policyholders not only in Virginia, but simultaneously in Kentucky, in order to preserve their rights and those of claimants under their insurance policies from ROA.

Thus, the initiation of the Kentucky litigation was hardly "voluntary." (Appellees' Br. at 24). As with the Virginia Litigation, the Hospitals' obligation to defend their status as policyholders in Kentucky is an obligation that: (i) arose from the Trusts' Business as self-insurers; (ii) was assumed by ROA in the Agreements; and (iii)is encompassed by the plain language of the Indemnification Agreements. As such, the fees and expenses incurred in the Kentucky Litigation should be allowed in the Receivership.

Rather than being limited only to those pre-Merger obligations the Trusts owed directly to their members and insureds, the plain language of the Agreements encompasses indemnification by ROA and the Receivership for the legal fees and expenses incurred in litigating the Hospitals' status as policyholders under contracts of insurance with ROA. Accordingly, the Commission's 2016 Final Order to the contrary should be

reversed with an instruction to allow the Hospitals' Claims in the Receivership.

III. Because the Agreements Are Insurance Contracts, They Are Construed Against the Receiver and Deputy Receiver and in Favor of the Hospitals.

In their attempt to limit Virginia law favoring expansive insurance coverage, the Commission and Deputy Receiver set up an unsuccessful strawman argument. They try to limit the application of this apposite principle by citing the parties' equal bargaining power in drafting the Agreements. (Appellees' Br. at 26). Importantly, however, the Commission and Deputy Receiver make no effort to refute or even rebut the application of Va. Code § 38.2-100—expressly recognizing indemnity contracts as contracts of insurance—to the Agreements, or the applicability of this Court's *Group Hospitalization* test. (Appellants' Br. at 35-36); *Group Hospitalization Med. Serv., Inc. v. Smith*, 236 Va. 228, 230-31, 372 S.E.2d 159, 160 (1988) (setting forth factors to determine whether a contract is one for insurance).

Thus, notwithstanding the Commission and Deputy Receiver's attempts to limit standard *contra proferentem* principles, they have implicitly conceded the applicability of the legal tests for contracts of insurance, the Agreements' nature as insurance contracts, and their consequent

construction in favor of coverage of the Hospitals. *Ayres v. Harleysville Mut. Cas. Co.*, 172 Va. 383, 389, 2 S.E.2d 303, 305 (1939) ("ambiguous and doubtful language must be interpreted most strongly against the insurer."). Therefore, to the extent any part of the Agreements' language is susceptible to more than one interpretation, it should be construed against the insurer—ROA and the Commission—and in favor of coverage of the Hospitals. Accordingly, any doubts about the meaning of the terms in the Agreements should be resolved in favor of reimbursement of the Hospitals for expenses incurred in defending their status as policyholders of ROA in the Virginia and Kentucky Litigation. Finally, because the Agreements are insurance contracts, the Hospitals' Claims constitute "claims of other policyholders arising out of insurance contracts" entitled to second priority in ROA's Receivership under Va. Code § 38.2-1509(B)(1).

CONCLUSION

For all the foregoing reasons, and for those stated in their Opening Brief, the Hospitals respectfully request that this Court vacate the Commission's 2016 Final Order denying indemnification of the Hospitals for the fees and expenses incurred in the Virginia and Kentucky Litigation and order that the Hospitals' Claims for the same be allowed in the Receivership.

Respectfully submitted,

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CERTIFICATE OF SERVICE

In compliance with Rule 5:26 of the Rules of the Supreme Court of Virginia, I hereby certify that on May 5, 2017, the correct number of true and accurate copies of this Reply Brief were hand-filed with the Supreme Court of Virginia and an electronic copy filed via VACES in PDF format, and an electronic copy via email in PDF format was served upon counsel for the Appellees:

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