SCV: Submitted on 04-24-2017 14:55:56 EDT for filing on 04-24-2017

IN THE

SUPREME COURT OF VIRGINIA

RECORD NO. 161767

(SCC Case No. INS-2014-00244)

APPALACHIAN REGIONAL HEALTHCARE, et al.,

Appellants,

v.

JACQUELINE K. CUNNINGHAM
COMMISSIONER OF INSURANCE, et al.,

Appellees.

BRIEF OF APPELLEES

Robert D. Perrow, Esq. (VSB 14766)
Williams Mullen
Williams Mullen Center
200 South 10th Street, Suite 1600
Richmond, Virginia 23219
(804) 420-6000
(804) 420-6507 Fax
bperrow@williamsmullen.com

Counsel for Appellees

Patrick H. Cantilo, Esq. (*Pro Hac Vice*)*
Joseph N. West, Esq. (*Pro Hac Vice*)*
CANTILO & BENNETT, L.L.P.
11401 Century Oaks Terrace, Suite 300
Austin, Texas 78758
(512) 478-6000
(512) 404-6550 Fax
phcantilo@cb-firm.com
jnwest@cb-firm.com
service@cb-firm.com

Counsel for Appellees

* Admitted *pro hac vice* by Virginia State Corporation Commission by Order dated April 4, 2003, in Case No. INS-2003-00024.

TABLE OF CONTENTS

STATEMENT OF THE CASE. 5
Nature of the Case. 5
Statement of Facts. 6
The Underlying Business Combinations were Structured as Assumption Reinsurance Transactions. 6
TVIR/ROA Provided No Warranty of Guaranty Association Coverage Under the Assumption Reinsurance Transactions 8
The Virginia State Corporation Commission Receivership Proceeding (Case No. INS-2003-00239). 9
The Kentucky Declaratory Judgment Action (Case No. 03-Cl-1236). 12

ARGUMENT. 13
Standard of Review. 14
The Business Combinations Between TVIR/ROA and CHAT/KHAT were Assumption Reinsurance Transactions in which TVIR/ROA Stepped into the Shoes of CHAT/KHAT. 15
The Commission Properly Interpreted the Term "Damages" as Limiting the Obligations TVIR/ROA Assumed from CHAT/KHAT. 18
CHAT/KHAT had no Pre-Mergers Obligation to Reimburse the Kentucky Hospitals for the Expenses Sought for Recovery. 20
The Kentucky Hospitals' Interpretation of the Indemnification Agreements is Unreasonable as it Creates a Limitless Indemnity Obligation 24
The Doctrine of *Contra Proferentem* is Not Applicable to Construction of the Indemnification Agreements. 25
The Costs Sought for Recovery Are Not Policyholder Claims Arising out of Insurance Contracts in Accordance with Va. Code Ann. § 38.2-1509. 27

CONCLUSION. 28

TABLE OF AUTHORITIES

CASES

Am. Realty Tr. v. Chase Manhattan Bank, N.A.,
222 Va. 392, 281 S.E.2d 825 (1981). 25

Appalachian Voices v. State Corporation Commission,
277 Va. 509, 675 S.E.2d 458 (2009). 14, 22

Bridgestone/Firestone, Inc. v. Prince William Square Associates,
250 Va. 401, 463 S.E.2d 661 (1995). 14

Cary v. Nw. Mutual Life Ins. Co.,
127 Va. 236, 103 S.E. 580 (1920).. 14

Charles E. Russell Co. v. Carroll,
194 Va. 699, 74 S.E.2d 685 (1953).. . . . . 14, 25

Colonial Am. Life Ins. Co. v. Commissioner,
491 U.S. 244 (1989). 16

Hairston v. Hill,
118 Va. 339, 87 S.E. 573 (1916).. 25

Jones v. Gammon,
140 Va. 704, 125 S.E. 681 (1924).. 15

St. Joe Co. v. Norfolk Redevelopment & Hous. Auth.,
283 Va. 403, 722 S.E.2d 622 (2012). 14

Standard Ice Co. v. Lynchburg Diamond Ice Factory,
106 S.E. 390 (Va. 1921). 25

Sydnor & Hundley, Inc. v. Wilson Trucking Corp.,
213 Va. 704, 194 S.E.2d 733 (1973). 27

Winn v. Aleda Constr. Co.,
227 Va. 304, 315 S.E.2d 193 (1984). 25

STATUTES

Ky. Rev. Stat. Ann. § 304.36-050(6). 12

Va. Code Ann. § 38.2-1509.. . . . . 27, 28

Va. Code Ann. § 38.2-1509(B)(1)(ii). 10, 12

OTHER AUTHORITIES

Restatement (Second) of Contracts § 206 cmt. (a) (1981). 26

STATEMENT OF THE CASE

A. Nature of the Case

Despite the Appellants' (the "Kentucky Hospitals") lengthy Opening Brief, the issues in this case involve the rather straightforward application of the rules governing contract construction and interpretation in this case as to identical indemnification agreements executed as part of twin assumption reinsurance transactions (the "Indemnification Agreements"). In the case below, the Virginia State Corporation Commission (the "Commission") implicitly found the contracts at issue to be clear and unambiguous and held that their plain language required adoption of the construction espoused by the Appellee, Commissioner of Insurance, Jacqueline K. Cunningham, in her role as Deputy Receiver of Reciprocal of America ("ROA") and The Reciprocal Group ("TRG") (the "Deputy Receiver"). The Commission also found that interpretation to be fully consistent with the express intent of the parties and the transactional purposes underlying assumption reinsurance. In contrast, Appellants, the Kentucky Hospitals, labor mightily to identify ambiguities where none exist, and argue for tortured construction of the parties' agreements wholly inconsistent with the underlying transactional purposes, seeking to create a limitless or unbounded obligation for indemnity and a warranty against the insolvency of ROA that the parties simply never contemplated, let alone

intended. Applying basic rules of contract construction, the Commission properly determined that the claims of the Kentucky Hospitals for recovery of costs incurred from their voluntary participation in litigation against the Kentucky Insurance Guaranty Association ("KIGA") and various other state insurance guaranty associations should be denied. Accordingly, the Commission's Final Order in this regard should be affirmed.

B. Statement of Facts

1. The Underlying Business Combinations were Structured as Assumption Reinsurance Transactions

The Indemnification Agreements under which the Kentucky Hospitals seek recovery were part of two essentially identical business combinations (the "Mergers") entered into on November 1, 1997, by and between ROA's predecessor, known as The Virginia Insurance Reciprocal ("TVIR"), and two trusts, the Compensation Hospital Association Trust ("CHAT") and the Kentucky Hospital Association Trust ("KHAT"). (J.A. 66ff and 107ff). Put simply, these transactions sought only to substitute ROA for the trusts as insurers of certain Kentucky hospitals as to specified risks. The parties structured these business combinations as assumption reinsurance transactions, the intent of which was to have the assuming insurer, TVIR/ROA, step into the shoes of the ceding insurer, CHAT/KHAT, creating a direct insurance

obligation between TVIR/ROA and the Kentucky Hospitals beginning at the inception of their involvement as members of CHAT/KHAT. (J.A. 413-20 and 520). In effectuating this intent, TVIR/ROA and CHAT/KHAT entered into Indemnification Agreements in which at Section 2, the parties agreed as follows:

> **Indemnification**. In consideration of the transfer by KHAT [CHAT] of the Transferred Assets and Assumed Liabilities to TVIR [ROA], and acceptance thereof by TVIR [ROA] as further described in the Bill of Transfer and Agreement of Assumption, TVIR [ROA] agrees to indemnify and hold harmless KHAT [CHAT], 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 any related transactions, provided no such indemnification shall be provided for any and all Damages of such member-insureds relating to their obligations under their respective policies of insurance issued by TVIR [ROA]. The indemnification by TVIR [ROA] provided under this Section 2 shall include reasonable costs and expenses (including fees and expenses of KHAT's [CHAT's] or any of its member-insured's counsel) in defending itself against any claim Damages arising from or in connection with the Damages.

(J.A. 154 and 336).

"Damages" are defined under the Indemnification Agreements as "any liability, expense, cost or obligation, however incurred or characterized, assumed by TVIR [ROA] as provided for in this Agreement." (Id.) Under the Agreement of Assumption of Liabilities ("Agreement of Assumption") at Section 2, the parties agreed as follows:

> **Assumption of Liabilities**. In consideration of the sale and assignment by KHAT [CHAT] to TVIR [ROA] of the Transfered Assets pursuant to the Bill of Transfer, and subject to the terms and conditions of this Agreement, TVIR [ROA] agrees to assume and become responsible for all of the Assumed Liabilities at the Closing Date. TVIR [ROA] shall not assume or have any responsibility, however, with respect to any Excluded Liabilities, and KHAT [CHAT] shall retain all liability with respect to the Excluded Liabilities.

(J.A. 263-68).

"Assumed Liabilities" are defined under the Agreement of Assumption as "all obligations of KHAT [CHAT] in connection with its Business, the conveyance and delivery of the Transferred Assets, and any related transactions, except for the Excluded Liabilities." (Id.) There were no Excluded Liabilities under the Mergers. (Id.)

2. TVIR/ROA Provided No Warranty of Guaranty Association Coverage Under the Assumption Reinsurance Transactions

The Kentucky Hospitals have admitted that the documentation for the Mergers (the "Merger Agreements") included no TVIR/ROA warranty or guarantee that KIGA would provide coverage for the claims of the Kentucky Hospitals assumed by TVIR/ROA under the Mergers. (J.A. 748-59). Moreover, the Merger Agreements included no TVIR/ROA warranty or guarantee against its insolvency and resulting receivership. (Id.) These matters were simply never addressed. And the Kentucky Hospitals concede that TVIR/ROA insurance policies provide no basis for recovery on the subject claims for indemnification. (Id.)

It is also undisputed that CHAT and KHAT were not members of KIGA. (Id.) Furthermore, there is no dispute that KHAT and CHAT had no legal obligation to secure KIGA coverage for any of the insurance claims of the Kentucky Hospitals, or to cover the costs incurred by the Kentucky Hospitals in doing so themselves. (Id.) Nonetheless, the Kentucky Hospitals seek in this proceeding to compel ROA to reimburse them for the cost of their voluntary litigation against third parties in pursuit of such KIGA coverage.

3. The Virginia State Corporation Commission Receivership Proceeding (Case No. INS-2003-00239)

The Deputy Receiver's Application for Order Authorizing the Continuation of Workers' Compensation Disability Payments by Reciprocal of America and The Reciprocal Group for Workers' Compensation Claims Denied Coverage by State Guaranty Associations before the Virginia State Corporation Commission (the "Virginia Litigation") is one of two matters for which the Kentucky Hospitals seek indemnification for the costs and expenses associated with their voluntary participation. The Virginia Litigation was initiated by the Deputy Receiver because several state guaranty associations, including KIGA, were denying those claims of the Kentucky Hospitals and other similarly situated insureds that first arose under policies issued by certain Self-Insured Trusts ("SITs") and certain Group Self-

Insurance Associations ("GSIAs"), such as CHAT/KHAT, whose businesses and liabilities had been assumed by TVIR/ROA (the "Assumed Claims"). (J.A. 527-28). The state guaranty associations were denying these Assumed Claims because the SITs and GSIAs (collectively, the "Assumed Businesses") were not members of the state guaranty associations and/or the policies under which the claims first arose were not ROA policies. (Id.) As such, the Deputy Receiver initiated the Virginia Litigation in an effort to alleviate any potential hardship on workers' compensation claimants that may result from the denial of the Assumed Claims by the state guaranty associations. (Id.)

The position of the Deputy Receiver in the Virginia Litigation was that the Kentucky Hospitals and all other insureds of the Assumed Businesses were direct insureds of ROA as a result of the assumption reinsurance transactions and therefore, the Assumed Claims, even though they first arose under policies issued by the Assumed Businesses, were properly accorded classification under Va. Code Ann. § 38.2-1509(B)(1)(ii) as the "claims of other policyholders arising out of insurance contracts." (Id.) It was also the position of the Deputy Receiver that the Assumed Claims were covered under the various state insurance guaranty fund statutes. (J.A. 520). The Kentucky Hospitals, without invitation, voluntarily joined the Virginia Litigation in support of the position of the Deputy Receiver. (J.A. 589-90).

As a point of clarification, the Kentucky Hospitals overstate one of the issues in the Virginia Litigation as whether the SITs, including CHAT/KHAT, were entitled to distributions from the receivership. (Appalachian Br. at pg. 27). The issue is more accurately characterized as a consideration of the priority of distributions for the Assumed Claims as distinguished from a question of entitlement to such distributions. (J.A. 590-96). Moreover, the Kentucky Hospitals deliberately conflate the underlying liability and workers' compensation insurance contracts issued by CHAT/KHAT with the overriding Indemnification Agreements. In this regard, the Kentucky Hospitals misstate the findings of the Hearing Examiner in the Virginia Litigation as concluding that the Merger Agreements and the Indemnification Agreements therein were contracts of insurance, when in fact there was no such express finding. (Appalachian Br. at pgs. 9-10). Indeed, the Hearing Examiner found precisely the opposite: "[T]he Indemnification Agreements are <u>not</u> contracts of insurance . . . ." (J.A. 928) (emphasis added). The Hearing Examiner in the Virginia Litigation only determined that the arrangements in which the Assumed Businesses—including CHAT/KHAT—provided workers' compensation, and liability coverage to their employer members—like the Kentucky Hospitals—were insurance contracts. (J.A. 510 and 524). Moreover, the Kentucky Hospitals wrongly state as a fact that the "Commission decided that the Trusts themselves were 'policyholders' of 'insurance contracts' with

ROA." (Appalachian Br. at 10). The Commission made no such finding but did determine that "the contracts by and among the Assumed Businesses and their employer members were "insurance contracts," and that the Assumed Claims constituted claims of "policyholders arising out of insurance contracts," pursuant to Va. Code Ann. § 38.2-1509(B)(1)(ii). (J.A. 536-42).

4. The Kentucky Declaratory Judgment Action (Case No. 03-Cl-1236)

The second matter for which the Kentucky Hospitals seek recovery under the Indemnification Agreements was a declaratory rights action which, as summarized by the Kentucky Circuit Court in its Amended Opinion and Order, was brought by the Kentucky Hospitals in order to obtain a determination on whether certain workers' compensation claims, which were assumed by the now insolvent TVIR/ROA, are "covered claims" as that term is defined in Ky. Rev. Stat. Ann. § 304.36-050(6), which KIGA is obligated to pay and administer ("Kentucky Litigation"). (J.A. 610). Similar to the findings of the Commission, the Court in this matter found that the policies assumed from CHAT by TVIR/ROA under the Merger Agreements are contracts of workers' compensation insurance under Kentucky law. (J.A. 617-618). Again consistent with the findings of the Commission, the Court found that the Assumed Claims were direct insurance obligations of TVIR/ROA. (J.A. 620-621). Going beyond the findings of the Commission, the Court in this matter found that the

Assumed Claims were "covered claims" afforded guaranty coverage by KIGA. (J.A. 625).

ARGUMENT

This matter presents a simple contract interpretation issue regarding whether the subject Indemnification Agreements obligated ROA to reimburse the Kentucky Hospitals for legal fees and expenses incurred in their pursuit of guaranty fund coverage through a Kentucky state court declaratory rights action and their uninvited voluntary participation in the ROA/TRG receivership proceedings. Under the unambiguous language of the Indemnification Agreements — and consistent with the express intent of the parties and the transactional purposes underlying assumption reinsurance — ROA's indemnity obligation is equivalent to the obligations CHAT/KHAT owed to the Kentucky Hospitals prior to the Mergers. It is undisputed that ROA assumed all insurance obligations of CHAT/KHAT to the hospitals, but because reimbursement of the costs at issue in this matter were not within the insurance obligations of CHAT/KHAT prior to the Mergers, they are wholly outside of the scope of ROA's obligations under the Indemnity Agreements. As such, the Kentucky Hospitals' claims for recovery were properly denied and the Commission's Final Order in this matter should be affirmed.

I. Standard of Review

In an appeal from a grant or denial of summary judgment, this Court reviews the application of law to the undisputed facts de novo. St. Joe Co. v. Norfolk Redevelopment & Hous. Auth., 283 Va. 403, 407, 722 S.E.2d 622, 635 (2012). However, decisions by the Commission come to this Court with a presumption of correctness and the Commission's findings of fact should not be overruled unless contrary to the evidence or without evidence to support it. Appalachian Voices v. State Corporation Commission, 277 Va. 509, 675 S.E.2d 458 (2009). The Commission's decisions are entitled to respect due judgments of a tribunal informed by experience, and its analysis should not be disturbed when based upon the correct principles of law. Id.

Axiomatically, in matters of contract interpretation the court must be guided first by the plain language of the agreement, and refrain from inserting terms that the parties did not include. Bridgestone/Firestone, Inc. v. Prince William Square Associates, 250 Va. 401, 407, 463 S.E.2d 661, 664 (1995). Only in the case of ambiguity should the court go beyond the plain language of the agreement. Charles E. Russell Co. v. Carroll, 194 Va. 699, 703, 74 S.E.2d 685,687 (1953). In determining the meaning of the contracts at issue, the Indemnification Agreements, consideration is foremost given to the probable intent of the parties. Cary v. Nw.

Mutual Life Ins. Co., 127 Va. 236, 242-44, 103 S.E. 580, 582-83 (1920). In determining the probable intent of the parties, consideration is given to the surrounding and attendant circumstances of the Indemnification Agreements and the language of the agreement is to be construed and interpreted in light of those circumstances. Jones v. Gammon, 140 Va. 704, 125 S.E. 681 (1924). As such, the Indemnification Agreements must be interpreted in a manner consistent with the underlying transactional purpose. In the case at bar these rules produced a simple result in the court below which should not be disturbed on appeal. The contracts at issue were not ambiguous and their plain language compelled the result suggested by Deputy Receiver and adopted by the Commission. There is simply no contractual basis for the indemnification sought by the Kentucky Hospitals.

II. The Business Combinations Between TVIR/ROA and CHAT/KHAT were Assumption Reinsurance Transactions in which TVIR/ROA Stepped into the Shoes of CHAT/KHAT

It is undisputed that the Indemnification Agreements are part of business combinations structured as assumption reinsurance transactions. (J.A. 752). Mr. Paul Walther, expert witness for the Kentucky Hospitals and the Deputy Receiver in the Virginia Litigation, testified that based on his review of the various transaction documents, the Mergers were structured as assumption reinsurance transactions through which the SITs, such as CHAT, intended to transfer all their obligations,

including their insurance obligations, to ROA, and to effect a novation or replacement of those obligations from their original inception date with the obligations of ROA. (J.A. 412-20). Mr. Walther also testified that in his opinion by virtue of the Merger Agreements with the SITs, ROA effectively stepped into the shoes of those entities and created a direct insurance obligation to the members of those entities from the inception of the members' involvement in those entities. (Id.) The Hearing Examiner in the Virginia Litigation agreed with Mr. Walther, finding that the Merger Agreements effected an assumption reinsurance transaction in which ROA assumed the insurance obligations at that time of the SITs, GSIAs, and their employer-members on the policies of insurance that had been written by the SITs and GSIAs. (J.A. 520). Moreover, the Circuit Court in the Kentucky Litigation also found that TVIR/ROA and CHAT effected an assumption reinsurance transaction and noted the following language in a decision of the United States Supreme Court:

> In the case of assumption reinsurance, the reinsurer steps into the shoes of the ceding company with respect to the reinsured policy, assuming all of its liabilities and its responsibility to maintain required reserves against potential claims. The assumption reinsurer thereafter receives all premiums directly and becomes directly liable to the holders of the policies it has reinsured.

Colonial Am. Life Ins. Co. v. Commissioner, 491 U.S. 244, 105 (1989). (J.A. 621).

The testimony of Mr. Walther, and the findings of the Hearing Examiner and the Kentucky Circuit Court, all underscore the principal intent of assumption reinsurance transactions like the one at bar as effectuating the transfer of all obligations by the ceding insurer (CHAT/KHAT), and the assumption of all such obligations by the assuming insurer (TVIR/ROA). As with the typical assumption reinsurance transaction, the intent of the parties to the Merger Agreements was to have TVIR/ROA step into the shoes of CHAT/KHAT by assuming nothing more than all of the obligations of CHAT/KHAT in exchange for all of the assets of CHAT/KHAT. What the transaction did not do, and could not have done, was to transfer to (and impose upon) TVIR/ROA greater obligations than the transferors, CHAT/KHAT, had in the first place.

CHAT and KHAT did not before the transaction have, and could not have transferred, the obligations the Kentucky Hospitals now seek to impose on ROA. The Kentucky Hospitals have not, and in fact can not point to any provision within the Merger Agreements, including the Indemnification Agreements, as support for the parties intending to have TVIR/ROA assume obligations more extensive than those owed to the Kentucky Hospitals by CHAT/KHAT. Indeed, the economics of these assumption reinsurance transactions, summarized as a transfer of all obligations in exchange for all assets, conclusively establishes an equivalency between the pre-

Mergers obligations of CHAT/KHAT and the post-Mergers obligations of TVIR/ROA. The intended equivalence of pre-Mergers and post-Mergers obligations is borne out in the definition of the term "Damages."

III. The Commission Properly Interpreted the Term "Damages" as Limiting the Obligations TVIR/ROA Assumed from CHAT/KHAT

The Indemnification Agreements at Section 2 provide:

> **Indemnification**. In consideration of the transfer by CHAT [KHAT] of the Transferred Assets and Assumed Liabilities to TVIR [ROA], and acceptance thereof by TVIR [ROA] as further described in the Bill of Transfer and Agreement of Assumption, ***TVIR [ROA] agrees to indemnify and hold harmless CHAT [KHAT], 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 any related transactions***, provided no such indemnification shall be provided for any and all Damages of such member-insureds relating to their obligations under their respective policies of insurance issued by TVIR [ROA]. The indemnification by TVIR [ROA] provided under this Section 2 shall include reasonable costs and expenses (including fees and expenses of CHAT's [KHAT's] or any of its member-insured's counsel) in defending itself against any claim Damages arising from or in connection with the Damages.

(J.A. 154 and 336) (Emphasis added). Based on the plain meaning of the emphasized language above, the threshold inquiry for the indemnity obligation must start with a finding of "Damages" which is defined in the Indemnification Agreements at Section 1.8 as "any liability, expense, cost or obligation, however incurred or characterized, ***assumed*** by TVIR [ROA] as provided for in this Agreement." (Id.) (Emphasis

added). Applying the definition of Damages, it is clear and can not be disputed that the indemnity obligation extends only to any liability, expense, costs or obligation that was assumed by TVIR/ROA. In this regard, the indemnity obligation is unambiguously limited expressly to the scope of TVIR/ROA's assumption of responsibility.

The Indemnification Agreements limit the obligations undertaken by TVIR/ROA to those specified in the "Agreement of Assumption" entered into by the parties as part of the Mergers transactions. (Id.) The Agreement of Assumption at Section 2 provides that "TVIR agrees to assume and become responsible for all of the 'Assumed Liabilities' at the Closing Date." (J.A. 263-68). The Agreement of Assumption at Section 1.2 defines "Assumed Liabilities" in pertinent part as "all obligations of CHAT/KHAT in connection with its Business, the conveyance and delivery of the Transferred Assets, and any related transactions." (Id.) Unambiguously, the scope of responsibility assumed by TVIR/ROA in the Merger Agreements can be no greater than the pre-Mergers obligations of CHAT/KHAT. Therefore, as a threshold matter the Kentucky Hospitals cannot prevail unless they first establish that prior to the Mergers, CHAT/KHAT would have been responsible for reimbursing the Kentucky Hospitals for the expenses related to their participation in the Virginia Litigation and the Kentucky Litigation. Even the Kentucky Hospitals

concede that TVIR/ROA can have no obligation under the Indemnification Agreements to reimburse them for the claimed expenses if CHAT/KHAT had no equivalent obligation prior to the Mergers. (Appalachian Br. at 23). But the Kentucky Hospitals do not suggest that CHAT/KHAT had any such obligation to them before the Mergers.

IV. CHAT/KHAT had no Pre-Mergers Obligation to Reimburse the Kentucky Hospitals for the Expenses Sought for Recovery

The Kentucky Hospitals have admitted that CHAT/KHAT had no legal obligation to secure KIGA coverage for any of the insurance claims of the Kentucky Hospitals, or to cover the costs incurred by the Kentucky Hospitals in doing so themselves. (J.A. 748-59). The absence of such a CHAT/KHAT obligation is undisputed given the agreed fact that CHAT and KHAT were not members of KIGA. (Id.) As such, the failure, indeed inability of the Kentucky Hospitals to establish the pre-Mergers obligation of CHAT/KHAT to cover the costs sought for recovery forecloses any right to recovery under the Indemnification Agreements because without the pre-Mergers obligation of CHAT/KHAT, the threshold definition of Damages as an obligation assumed by TVIR/ROA from CHAT/KHAT can not be satisfied.

The Kentucky Hospitals' challenge to the Deputy Receiver's interpretation of the Indemnification Agreements contends that the Deputy Receiver and Commission

mis-framed the issues in the case by grounding their decision on a factual finding that the Kentucky Hospitals' participation in the Virginia Litigation and the Kentucky Litigation was pursued in an effort to secure guaranty fund coverage. (Appalachian Br. at 21-22). This argument is unavailing. Clearly, Appellee, the Deputy Receiver, has argued *ab initio* that the unambiguous plain language of the parties' agreements simply does not create the indemnity obligations suggested by the Kentucky Hospitals. In turn, the Hearing Examiner and the Commission have come to the same obvious conclusion.

The Kentucky Hospitals go on to argue that the more accurate characterization of their participation in these matters was to defend their status as policyholders. (Appalachian Br. at 16-20). That is of course irrelevant to whether their participation in that litigation (in whatever capacity) was an obligation that CHAT/KHAT had pre-Mergers. It was not. Notably, in framing the issue in this manner the Kentucky Hospitals completely ignore the fact that their adversaries in the actions were certain state guaranty associations and not ROA. (J.A. 585 -86). As noted by the Kentucky Circuit Court in its Amended Opinion and Order, the action was one brought for a determination on whether certain workers' compensation claims, which had been assumed by the insolvent TVIR/ROA, were covered claims that KIGA was obligated to pay and administer. (J.A. 610). The attempt of the Kentucky Hospitals to

characterize the Kentucky Litigation as a defense of their status as policyholders under contracts of insurance is not only unsupportable; it is wholly irrelevant. Even adopting the characterization of the Kentucky Hospitals, they remain unable to establish the threshold obligation for recovery under the Indemnification Agreements — CHAT/KHAT pre-Mergers responsibility for costs incurred in an effort to compel KIGA to accept their status as policyholders under insurance contracts covering the Assumed Claims. Without a pre-Mergers obligation by CHAT/KHAT to pursue such litigation (which undeniably there was not), there could be no post-Mergers obligation for ROA to fund it. The claims of the Kentucky Hospitals must fail.

The failure to establish a threshold obligation mandates a similar result with respect to the Kentucky Hospitals' claims related the Virginia Litigation. Here, the factual finding by the Hearing Examiner and the Commission that the essence of the Kentucky Hospitals' participation was an effort to secure guaranty fund coverage should not be disturbed unless it is found to be contrary to the evidence or without evidence to support it. Appalachian Voices v. State Corporation Commission, 277 Va. at 509, 675 S.E.2d 458 (2009). It is important to note that the Hearing Examiner for the matter at bar also served as Hearing Examiner in the Virginia Litigation where he concluded his participation by entry of a thorough 130-page report summarizing the procedural history, issues, testimony, positions, and arguments of the parties, as

well as providing the Commission with his findings and recommendations for its decision. (J.A. 395-525). The purpose underlying the Kentucky Hospitals' participation in the Virginia Litigation was certainly well within the understanding of the Hearing Examiner.

As with the Kentucky Litigation, the Kentucky Hospitals' are not able to establish a pre-Mergers obligation of CHAT/KHAT to cover the costs incurred by the Kentucky Hospitals in seeking guaranty fund coverage in the Virginia Litigation. Moreover, the Kentucky Hospitals' contention that they were required to participate in the Virginia Litigation in an effort to defend their status as policyholders against the assertions of various guaranty associations, apart from being inacurate, also does not rise to the level of a pre-Mergers obligation of CHAT/KHAT. Therefore, the costs incurred from the actions of the Kentucky Hospitals, whether stated as an effort to secure guaranty fund coverage or as an effort to compel the guaranty associations to accept the Assumed Claims as those of policyholders, do not satisfy the threshold definition of Damages and were rightly rejected by the Commission.

As an independent ground for denial of the Kentucky Hospitals' claims for recovery, it is important to note that the participation of the Kentucky Hospitals in the Virginia Litigation, even if helpful to the Deputy Receiver's cause, was completely voluntary as the Kentucky Hospitals have made no showing that they were a

necessary or indispensable party to the matter. Moreover, the Kentucky Hospitals cannot claim that they were required to participate in this proceeding when their joinder in the matter was expressly in support of the position of the Deputy Receiver, who brought the action in an effort to protect the interests of all insureds, policyholders, and especially all workers' compensation claimants, payments to whom were opposed by certain guaranty associations because their claims, although assumed by TVIR/ROA, first arose under policies issued by a self-insured trust like CHAT and not by TVIR/ROA.

V. The Kentucky Hospitals' Interpretation of the Indemnification Agreements is Unreasonable as it Creates a Limitless Indemnity Obligation

The interpretation of the Indemnification Agreements sponsored by the Kentucky Hospitals ignores the clear contractual requirement that Damages be limited to obligations assumed by TVIR/ROA from CHAT/KHAT. (Appalachian Br. at 30-34). In this regard, the interpretation of the Kentucky Hospitals concedes the premise that only obligations of CHAT/KHAT were assumed by TVIR/ROA, but then fails to establish that the litigation costs for which they seek indemnification had ever been an obligation of CHAT/KHAT and therefore available for assumption by TVIR/ROA. By resting solely on a "connection" element and not the required "assumption" element, the Kentucky Hospitals' interpretation seeks to create an unlimited

indemnity obligation that the parties simply had not contemplated in the Mergers. That broader exposure clearly was not within the scope of the agreed indemnity obligation. Such a result is totally unreasonable and must be avoided under fundamental rules of construction. Hairston v. Hill, 118 Va. 339, 87 S.E. 573, 575 (1916).

VI. The Doctrine of *Contra Proferentem* is Not Applicable to Construction of the Indemnification Agreements

It is important to note that the Kentucky Hospitals' contention that any ambiguity under the Indemnification Agreements should be resolved in their favor is not supported by the facts. In the construction of a contract, in cases of reasonable doubt, pursuant to the doctrine of *contra proferentem*, the language is to be taken most strongly against the drafter. Am. Realty Tr. v. Chase Manhattan Bank, N.A., 222 Va. 392, 403, 281 S.E.2d 825, 831 (1981) ("It is a familiar legal maxim that ambiguous contractual provisions are construed strictly against their author."); Winn v. Aleda Constr. Co., 227 Va. 304, 308, 315 S.E.2d 193, 195 (1984). However, this rule of construction is not favored by the courts and should not be invoked where the language of the contract is clear. Standard Ice Co. v. Lynchburg Diamond Ice Factory, 106 S.E. 390, 392 (Va. 1921); Charles E. Russell Co. v. Carroll, 194 Va. at 699, 703, 74 S.E.2d 685, 687 (1953).

The rule's justification can be stated in the following manner: "Where one party chooses the terms of a contract, he is likely to provide more carefully for the protection of his own interests than for those of the other party. He is also more likely than the other party to have reason to know of uncertainties of meaning. Indeed, he may leave meaning deliberately obscure, intending to decide at a later date what meaning to assert. In cases of doubt, therefore, so long as other factors are not decisive, there is substantial reason for preferring the meaning of the other party." Restatement (Second) of Contracts § 206 cmt. (a) (1981). The rule is often invoked in cases of standardized contracts and in cases where the drafting party has the stronger bargaining position. (Id.)

The Indemnification Agreements clearly are not standardized contracts, nor did the parties to the contracts, CHAT/KHAT and ROA, have unequal bargaining power. (J.A. 421-32, 928). The Kentucky Hospitals have admitted that CHAT and KHAT were sophisticated and experienced business entities. (J.A. 749-59). Moreover, the Kentucky Hospitals have admitted that CHAT and KHAT were represented by legal counsel in negotiating the terms for the Indemnification Agreements. (Id.) Furthermore, before consenting to final execution of the Merger Agreements, the Kentucky Hospitals had a full and complete opportunity to make an informed decision on the matter. (J.A. 407, 423, 613).

It is also important to note that the terms of the Indemnification Agreements themselves foreclose construction against ROA where at Section 3.9 it is provided that, "[t]he provisions of this Agreement were negotiated by the parties hereto and such Agreement shall be deemed to have been drafted by all the parties hereto." (J.A. 154 and 336). Moreover, as express third-party beneficiaries pursuant to Section 3.13 of the Indemnification Agreements, the Kentucky Hospitals are bound by the terms of the contract and subject to the defenses arising out of the contract. (Id.) Sydnor & Hundley, Inc. v. Wilson Trucking Corp., 213 Va. 704, 707, 194 S.E.2d 733, 736 (1973). Additionally, the fact that the interests of CHAT/KHAT and the Kentucky Hospitals were clearly aligned in the negotiation of the Merger Agreements should not be overlooked. In light of the foregoing, the facts of the case at bar are distinguishable from the cases cited supporting application of the doctrine of *contra proferentem* and therefore, the contention that the Indemnification Agreements should be construed against ROA should be rejected.

VII. The Costs Sought for Recovery Are Not Policyholder Claims Arising out of Insurance Contracts in Accordance with Va. Code Ann. § 38.2-1509

The Kentucky Hospitals contend that the claims in this matter should be given class two priority under Va. Code Ann. § 38.2-1509. However, the claims of the Kentucky Hospitals arise under the Indemnification Agreements and not under

"insurance contracts" as this term is applied in Va. Code Ann. § 38.2-1509. The fact that the Assumed Claims, which underlay the Virginia Litigation and Kentucky Litigation, are properly considered the claims of policyholders arising out of insurance contracts is wholly irrelevant, and no justification for extending class two priority to the completely unrelated costs incurred by the Kentucky Hospitals in an effort to secure guaranty fund coverage. The Assumed Claims arose under professional liability, general liability, workers' compensation, or employers' liability policies issued by CHAT/KHAT and ROA. The claims at bar did not. They arose solely from the Kentucky Hospitals' voluntary prosecution of litigation against guaranty associations.

CONCLUSION

The intent of the parties to the Merger Agreements, as expressed in their decision to structure the Mergers as an assumption reinsurance transaction, was to have TVIR/ROA step into the shoes of CHAT/KHAT and replace them as insurer through a complete assumption of all CHAT/KHAT obligations in exchange for the transfer of all CHAT/KHAT assets supporting the assumed obligations. The interpretation and construction of the Indemnification Agreements asserted by the Deputy Receiver and adopted by the Commission is consistent with the intent of the parties and the underlying transactional purpose of the business combinations. In

contrast, the interpretation sponsored by the Kentucky Hospitals is inconsistent with the intent of the parties and the underlying transactional purposes, creates an unreasonable and unlimited indemnity obligation, and seeks to establish a warranty against the insolvency of TVIR/ROA when no such warranty existed in the Merger Agreements. The Kentucky Hospitals' have failed to put forth any evidence that the parties intended for the TVIR/ROA indemnity obligation to extend beyond the CHAT/KHAT pre-Mergers obligation and as such, their claim for recovery must also fail. Therefore, the Court should affirm the Commission's 2016 Final Order granting the Deputy Receiver summary judgment on the claims of the Kentucky Hospitals.

Respectfully submitted,

Jacqueline K. Cunningham, Commissioner of Insurance, State Corporation Commission, Bureau of Insurance, as Deputy Receiver of Reciprocal of America and The Reciprocal Group

By: /s/ Robert D. Perrow

Robert D. Perrow, Esq. (VSB 14766)
Williams Mullen
Williams Mullen Center
200 South 10th Street, Suite 1600
Richmond, Virginia 23219
(804) 420-6000
(804) 420-6507 Fax
bperrow@williamsmullen.com

Patrick H. Cantilo (*Pro Hac Vice*)*
Joseph N. West (*Pro Hac Vice*)*
CANTILO & BENNETT, L.L.P.
11401 Century Oaks Terrace, Suite 300
Austin, Texas 78758
(512) 478-6000
(512) 404-6550 Fax
phcantilo@cb-firm.com
jnwest@cb-firm.com
service@cb-firm.com

Counsel for Appellees

* Admitted *pro hac vice* by Virginia State Corporation Commission by Order dated April 4, 2003, in Case No. INS-2003-00024.

CERTIFICATE OF SERVICE

In compliance with Rule 5:26 of the Rules of the Supreme Court of Virginia, I hereby certify that on April 24, 2017, the correct number of true and accurate copies of this Brief of Appellees were hand-filed with the Supreme Court of Virginia, and an electronic copy filed VACES in PDF format, and an electronic copy via e-mail in PDF format was served upon the following:

John O. Cox, Associate General Counsel
STATE CORPORATION COMMISSION
1300 E. Main Street
P.O. Box 1197
Richmond, Virginia 23218
john.cox@scc.virginia.gov

William H. Chambliss, General Counsel
STATE CORPORATION COMMISSION
1300 E. Main Street
P.O. Box 1197
Richmond, Virginia 23218
William.Chambliss@scc.viginia.gov

William C. Gullett, Esq. FROST
BROWN TODD LLC The
Pinnacle at Symphony Place
150 3rd Avenue South, Suite 1900
Nashville, Tennessee 37201
(615) 251-5550
(615) 251-5551 Fax
wgullett@fbtlaw.com
Counsel for Appellants

Greg E. Mitchell, Esq. William
J. George, Esq. FROST
BROWN TODD LLC
250 W. Main Street, Suite 2800
Lexington, Kentucky 40507
(859) 231-0000
(859) 231-0011 Fax
gmitchell@fbtlaw.com
bgeorge@fbtlaw.com
Counsel for Appellants

Eric M. Page, Esq.
ECKERT SEAMANS CHERIN & MELLOTT, LLC
SunTrust Center
919 East Main Street, Suite 1300
Richmond, Virginia 23219
(804) 788-7771
(804) 698-2950 Fax
epage@eckertseamans.com
Counsel for Appellants

/s/ Robert D. Perrow