LANE HOME BUILDERS, INC. ***v.*** **MAINE EMPLOYERS' MUTUAL INSURANCE COMPANY** **DOCKET NO. INS-08-100**	]]]]]]]]	**DECISION AND ORDER**

Lane Home Builders, Inc., the Petitioner, as its name implies, is a corporation engaged in the construction business, owned and operated by Gary Lane. Maine Employers' Mutual Insurance Company (MEMIC) has denied workers' compensation insurance coverage to the Petitioner because another corporation owned by Mr. Lane owes MEMIC an undisputed premium debt. Because the Petitioner is not the same employer that owes the outstanding debt, and MEMIC has not proven that the corporate veil should be pierced, the denial of coverage was not appropriate.

The essential facts are undisputed. In 2003, Mr. Lane formed a corporation to conduct his construction business, which he named Gary Lane, Inc. He was the sole owner. Initially, he obtained insurance from MEMIC in his own name, but the policy was renewed in the name of the corporation in January of 2005. Upon auditing the policies, MEMIC concluded that certain workers the corporation had treated as independent contractors were actually employees. Rather than challenge MEMIC's audit or pay the premium, the corporation, which also faced other debts, went out of business and has since been administratively dissolved by the Secretary of State. There were no voluntary or involuntary bankruptcy proceedings, so the outstanding debts of Gary Lane, Inc. remain unchallenged, undischarged, and unpaid. MEMIC has obtained a writ of execution in the amount of $24,410.25, but was unable to find any corporate assets against which to execute.

Mr. Lane then formed a new corporation, the Petitioner, in 2006. The Petitioner obtained a MEMC policy in November of 2007, but MEMIC cancelled the policy after realizing that Mr. Lane's prior corporation had an outstanding premium debt. The Petitioner is not contesting the cancellation itself, and represents that it has turned down any business that would require it to hire employees or carry workers' compensation coverage until the dispute is resolved. Rather, the Petitioner requests that the Superintendent order MEMIC to issue a new policy. The Superintendent held an adjudicatory hearing to consider the Petition on April 7, 2008,[1] and the record closed upon the submission of the Petitioner's brief on May 5.[2]

MEMIC is Maine's statutory "carrier of last resort," obligated by 39-A M.R.S.A. § 3711(1) to offer workers' compensation coverage to any eligible employer. The exceptions to eligibility are extremely limited, considerably more limited than the permitted grounds for cancellation of an insurance policy under 24-A M.R.S.A. § 2908(2). Therefore, if MEMIC seeks to deny coverage to an employer, it must meet the same burden of proof as an insurer seeking to cancel an existing policy must meet under 24-A M.R.S.A. § 2908(6).

MEMIC contends that the Petitioner is ineligible for coverage, pursuant to 24-A M.R.S.A. §§ 3711(3), because it is an "employer who owes undisputed premiums to a previous workers' compensation carrier." As MEMIC acknowledges, however, the Law Court (reversing a Decision and Order of the Superintendent)[3] held in *National Industrial Constructors, Inc. v. Superintendent of Insurance,* 655 A.2d 3442 (Me. 1995), that an "employer" means a single legal entity, so that the combined experience of two corporations under common ownership could not be used to place both of them in the program that was the predecessor of MEMIC's high-risk program that is now governed by 24-A M.R.S.A. § 3714(7). By the same reasoning, an insurer could not use an outstanding premium debt owned by one corporation as a basis for denial of coverage under 24-A M.R.S.A. §§ 3711(3) or 2385-F to all other corporations under common ownership, or for cancellation of their coverage under 24-A M.R.S.A. § 2908(2)(A). Indeed, 24-A M.R.S.A. § 2908(1)(C) expressly defines nonpayment of premium as the failure or inability "of the named insured" to discharge its premium obligations.

MEMIC argues, however, that *National Industrial Constructors* should be distinguished because that case was about sister corporations and this case involves two successor corporations, the same situation that was presented in *Lincoln Paper & Tissue, LLC v. MEMIC,* No. INS-05-103 (Me. Bur. Ins., October 14, 2005), in which the Superintendent upheld MEMIC's assignment of one employer to the high-risk program based on the experience of a predecessor corporation.

The whole point of *Lincoln Paper,* however, and of the decision below in *National Industrial Constructors,* is that the insurer in those cases was <u>not</u> seeking to hold one employer accountable for the obligations of another: "An accident history is not a corporate debt, but part of the description of the operations and premises being insured."*Lincoln Paper* at 3 (quoting *CWCO, Inc. v. MEMIC,* No. 93-89 at 7–8 (Me. Bur. Ins., December 19, 1995), *aff'd sub nom. CWCO, Inc. v. Superintendent of Insurance,* 703 A.2d 1258, 1261, 1997 ME 226, ¶ 7). The combinability of two corporations for experience rating purposes does not make the debts of one attributable to the other. Although this case arises under a different statute, the differences between the purposes of the statutes makes it even clearer that Section 3711 neither requires nor permits MEMIC to deny coverage to one legal entity based upon a debt owed by its owner or by a different legal entity under common ownership.

In order to prevail, therefore, MEMIC must pierce the corporate veil. The Petitioner is not an "employer who owes undisputed premiums" if Gary Lane, Inc. and Lane Home Builders, Inc. are the distinct legal entities that they purport to be.

The Petitioner contends that this is the end of the inquiry, that the Superintendent lacks jurisdiction to consider whether the facts in this case support piercing the corporate veil. In other words, the Petitioner has jurisdiction to grant the relief requested but does not have the jurisdiction to deny it. That would be absurd and inequitable. The power to decide whether MEMIC has violated the Insurance Code necessarily includes the power to decide all subsidiary questions that are necessary to a fair decision on the merits. Whether to pierce the corporate veil is more than just a necessary subsidiary determination, it is the issue that is at the heart of this dispute.

The Law Court has explained that: "corporations are separate legal entities with limited liability. As such, courts are generally reluctant to disregard the legal entity and will cautiously do so only when necessary to promote justice. However, a court may pierce the corporate veil when equity so demands, and may disregard the corporate entity 'when used to cover fraud or illegality, or to justify a wrong.' An examination of the different tests courts apply suggests two common elements that a plaintiff must establish before a court will disregard the corporate entity: (1) some manner of dominating, abusing, or misusing the corporate form; and (2) an unjust or inequitable result that would arise if the court recognized the separate corporate existence." *Johnson v. Exclusive Properties Unlimited,* 1998 ME 244, ¶¶ 5–6, 720 A.2d 568, 571 (internal citations omitted), cited in *Project Staffing Inc. v. MEMIC,* No. INS-05-101 at 11 (Me. Bur. Ins. February 10, 2006).

Saddling a creditor with an uncollectible debt, in and of itself, cannot constitute an abuse of the corporate form or an "unjust or inequitable result" for purposes of piercing the veil, because that is precisely what limited liability means. The American business system allows an entrepreneur to conduct business through a wholly-owned corporation, and allows the entrepreneur to start over and try again if the first corporation fails. Except in certain regulated industries, there are no minimum capital requirements to form a corporation.

MEMIC observes, however, that it is not in the same situation as creditors that choose to do business with thinly capitalized corporations, because MEMIC has no choice and does not have the right to insist on a personal guaranty as a condition of doing business. On the other hand, this is an issue that the Legislature has already considered. The balance struck between the need for employers to have access to coverage and the need for insurers to protect themselves is set forth in 39-A M.R.S.A. § 402, which allows an insurer to require prepayment of premium but no more than three months in advance. Although that system failed here, because the actual premium as developed on audit turned out to be considerably higher than the estimated premium that MEMIC had collected in advance, bad debt cannot be eliminated completely in a market economy. No evidence was adduced of fraud or bad faith on Mr. Lane's part.

Nevertheless, as the Law Court emphasized in *Exclusive Properties,* the inquiry is not focused solely on fraud or bad faith. The Court listed twelve factors that have been considered in determining whether the corporate form has been abused: (1) common ownership; (2) pervasive control; (3) confused intermingling of business activity, assets, or management; (4) thin capitalization; (5) nonobservance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at the time of the litigated transaction; (9) siphoning away of corporate assets by the dominant shareholders; (10) nonfunctioning of officers and directors; (11) use of the corporation for transactions of the dominant shareholders; and (12) use of the corporation in promoting fraud. 1998 ME ¶ 7, 720 A.2d at 571, quoted in *Project Staffing*at 11.

Several of the listed factors are present here, but many of them are common features of one-man corporations and thus are insufficient, without more, to support a finding of abuse. The factor giving rise to the greatest concern that there might be "something more" is the concededly thin capitalization of the corporation, which ultimately led to its insolvency. However, there is no evidence of "insolvency at the time of the litigated transaction," that is, that the corporation was already insolvent at the time it took out the MEMIC policy, and there is no evidence that the corporation's subsequent insolvency was brought on by "siphoning away of corporate assets by the dominant shareholders."

That is the crucial distinction between the instant case and cases like *Ohio Bureau of Workers' Compensation v. Widenmyer Electric Co.,* 72 Ohio App. 3d 100, 593 N.E.2d 468 (1991). In *Widenmyer,* a successor corporation was held liable for a purely contractual debt incurred by a failed predecessor corporation under common ownership, just as MEMIC seeks to do here. There, however, the owners transferred corporate assets from the first corporation to the second, an action that was essential to the court's holding, because, as the court explained, "successor liability does not arise when the transferor corporation is dissolved, but arises when the transferee corporation has so depleted the transferor's assets as to leave creditors' claims unsatisfied." 72 Ohio App. 3d at 104, 593 N.E.2d at 470. Here, by contrast, there is no evidence that there were any assets to transfer, except for what both parties have referred to as "a truck the bank owns"; in other words, the old corporation owned no equity in the truck when the new corporation took over payments on the loan.

MEMIC's attempt to apply the reasoning in *Lincoln Paper* to corporate debt breaks down for the same reasons. In that case, the Superintendent held that successor corporations could be treated as the same "employer" for purposes of assignment to the high-risk program because "It would be irrational to treat predecessors and successors as separate 'employers' for purposes of the high-risk program whenever they are separate legal entities, because to do so would render the high-risk program a nullity – any employer could simply sell its assets to a new corporation whenever it would otherwise be assigned to the high-risk program." *Lincoln Paper* at 7–8. Creditors, on the other had, would not be injured by such a maneuver, which is why there is no universal rule of successor liability for corporate debt. Unless there is a lien on the specific assets that are transferred, the seller's debts stay with the seller after an asset sale, and may be satisfied from the sale proceeds. If the sale proceeds are inadequate or nonexistent, that is a different story, the asset depletion scenario that is one of the classic patterns giving rise to successor liability, but that is not what MEMIC has proven here.

According to the Petitioner, MEMIC is left in exactly the same position as if MEMIC had put Gary Lane, Inc. into bankruptcy – the corporation would have been liquidated and the debt would have been discharged. This begs the question, since the record is insufficient to determine whether the debt would have been discharged with no personal liability attaching to Mr. Lane. However, if the debt is recoverable in whole or part from Gary Lane personally, that is MEMIC's appropriate recourse and MEMIC cannot, under current Maine law, deny coverage to a corporation merely because it is owned by Mr. Lane. And if the debt is not recoverable from Gary Lane personally, then perforce it is not recoverable from Lane Home Builders, Inc.

Order and Notice of Appeal Rights

It is therefore *ORDERED* that the Petition is hereby *GRANTED.* MEMIC shall not use the debt incurred by Gary Lane, Inc. as a basis for denying or terminating coverage for Lane Home Builders, Inc.

This Decision and Order is a final agency action of the Superintendent of Insurance within the meaning of the Maine Administrative Procedure Act. It is appealable to the Superior Court in the manner provided in 24-A M.R.S.A. § 236 (2000) and M.R. Civ. P. 80C. Any party to the hearing may initiate an appeal within thirty days after receiving this notice. Any aggrieved non-party whose interests are substantially and directly affected by this Decision and Order may initiate an appeal on or before July 7, 2008. There is no automatic stay pending appeal; application for stay may be made in the manner provided in 5 M.R.S.A. § 11004.

[1] Pursuant to 24-A M.R.S.A. § 210, the Superintendent has appointed Bureau of Insurance Attorney Robert Alan Wake to serve as hearing officer, with full decisionmaking authority.

[2] Because MEMIC, though it is the Respondent, has the burden of proof, MEMIC filed first. MEMIC waived filing a reply brief.

[3] *National Industrial Constructors, Inc. v. NCCI,* No. INS-90-7 (Me. Bur. Ins., October 14, 1993).

PER ORDER OF THE SUPERINTENDENT OF INSURANCE

MAY 27, 2008

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ROBERT ALAN WAKE
DESIGNATED HEARING OFFICER