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

On May 27, 2008, the Superintendent issued a Decision and Order granting the Petition of Lane Home Builders, Inc. (LHB), and prohibiting the Maine Employers' Mutual Insurance Company (MEMIC) from using the debt incurred by Gary Lane, Inc. (GLI), a dissolved corporation with the same owner (Gary Lane), as a basis for denying or terminating coverage for LHB.[1] On June 11, MEMIC filed a timely motion for reconsideration, pursuant to Bureau of Insurance Rule 350, § 19, tolling the time for appeal. The motion to reopen the decision is granted, but upon reconsideration, the decision to grant the petition is reaffirmed.

Under the laws governing the former Maine residual market mechanism, Bureau of Insurance Rule 440, Article III, § 1(D)(3) provided that "An employer is not in good faith entitled to insurance if .... the employer, or an enterprise with a common managing interest, has an outstanding obligation for premium on previous workers' compensation insurance which is not the subject of a *bona fide* dispute." Public policy arguments can be made for preserving or reinstating the "common managing interest" provision, and MEMIC has made these arguments eloquently, but under current law, 24-A M.R.S.A. § 3711(3) restricts ineligibility for outstanding debt to an "employer who owes undisputed premiums to a previous workers' compensation carrier." Especially in light of the Law Court's decision in *National Industrial Constructors, Inc. v. Superintendent of Insurance,*655 A.2d 3442 (Me. 1995), it cannot be inferred that the change was purely stylistic and that when the Legislature said "employer," it really meant "employer, or an enterprise with a common managing interest."[2]

Therefore, LHB may not be denied coverage merely because GLI or Mr. Gary Lane or any other enterprise under common management owes undisputed premiums. MEMIC must prove either that LHB is not really the "employer" that has applied for coverage or that LHB itself owes the premium debt. In other words, MEMIC must prove that that GLI and LHB are legally indistinct, or at least that any legal distinction has eroded to the point where LHB is responsible for GLI's debts.

In its motion, MEMIC argues that the same principles of successor liability should apply for determining an employer's premium delinquency under 24-A M.R.S.A. § 3711 as apply for determining an employer's high risk status under 24-A M.R.S.A. § 3714(7). In *Lincoln Paper & Tissue, LLC v. MEMIC,* No. INS-05-

103 (Me. Bur. Ins., October 14, 2005), a paper mill was assigned to the high-risk program on the basis of its accident history, even though the mill was owned by a different corporation at the time of the accidents. Therefore, MEMIC argues, an employer may be denied coverage because of a predecessor employer's poor payment history.

The flaw in that argument, as discussed extensively in the initial Decision and Order, is that *Lincoln Paper* turned on the fact that "An accident history is not a corporate debt, but part of the description of the operations and premises being insured." This is a corporate debt, and there are well-established rules for determining when the successor acquires the debts of its predecessor, and when the owner acquires the debts of the corporation.

MEMIC's contention that premium debts and loss history should be judged by the same standards would not even pass the straight face test if, as in *Lincoln Paper,* the predecessor and successor corporations had different owners. In this case, though, they did have the same owner. Mr. Lane testified that he incorporated his construction business in order to avoid putting his house at risk, and incorporated it again a second time under a different name after the first corporation failed. He is allowed to do this. An essential attribute of a corporation is limited liability, and the purpose of limited liability is to allow a business to fail without exposing its owner(s) to unlimited personal liability. If one business fails, the owner has the legal right to try again. Early chapters in many biographies of famous entrepreneurs tell similar stories.

It must be emphasized at this point that Mr. Lane is not a party to this proceeding, and the issue of whether Mr. Lane is responsible for GLI's debt is not properly before the Superintendent except to the extent that it is incidental to deciding whether LHB is responsible for GLI's debt. Although the two questions are related, it puts the cart before the horse to argue that it is unfair to allow Mr. Lane to escape responsibility for his debts by incorporating LHB and buying insurance in LHB's name. Arguments of this nature are premature at best because at this point, no tribunal of competent jurisdiction has even been asked to rule on whether Mr. Lane owes MEMIC anything. The proper forum for determining whether to pierce the veil between GLI and Mr. Lane is the courts, especially since the fundamental question – was it unfair for Mr. Lane to collect his $900-a-week salary while the corporation was operating on such a slim margin that an unexpected $25,000 debt sent it into insolvency? – has nothing to do with insurance law nor with any technical matters within the expertise of the Superintendent.[3] Furthermore, the record in this proceeding would be inadequate to decide that question even were it properly before the Superintendent.

MEMIC might respond that we are not talking about allowing Mr. Lane to escape responsibility for his debts, we are talking about allowing GLI to escape responsibility for its debts. But that is already a *fait accompli.* GLI went broke, and GLI has been dissolved. A formal bankruptcy filing is unnecessary when

there are no assets left and the creditors and investors all walk away emptyhanded. The debts of GLI cannot be attributed to LHB (nor to Mr. Lane) unless MEMIC can prove that GLI's insolvency was not a mere business failure, but the result of an abuse of the corporate form.

Under Maine law, that question is decided on the basis of the twelve-factor analysis set forth in *Johnson v. Exclusive Properties Unlimited,* 1998 ME 244, ¶¶ 7, 720 A.2d 568, 571. In its motion, MEMIC presents a table purporting to show that eleven of the twelve *Exclusive Properties* factors favor MEMIC in this case, and that the twelfth is unclear. However, the facts are not nearly as clear as MEMIC portrays them.

One factor that would weigh heavily in MEMIC's favor – if proven – is "use of the corporation in promoting fraud." MEMIC alleges that Mr. Lane made material misrepresentations on GLI's insurance applications, though acknowledging that they "may not rise to the level of fraud." On the 2004 application – which was erroneously submitted as a renewal application for the unincorporated business Mr. Lane operated before establishing GLI – Mr. Lane told MEMIC that he would only be subcontracting approximately 5% of his work, and that no work would be sublet without certificates of insurance. These statements were incorrect. GLI hired a number of workers as subcontractors during the policy year. Two of them did not have insurance coverage. When MEMIC audited the policy in 2005, it determined that they were actually employees rather than subcontractors, and billed GLI accordingly for additional premium. GLI did not contest the bill. MEMIC ultimately obtained a writ of execution for $24,410 plus interest and costs, but GLI had no assets upon which MEMIC could execute.

Mr. Lane testified that the statements at issue were made in good faith, and that he had not expected to get as much general contracting work at the time of the application as he ended up getting. He testified that he did have general practice of verifying insurance coverage, but that one of the additional subcontractors he hired to deal with the unanticipated volume of work was a close friend and another was a family member, so he trusted them when they told him they were insured but discovered after the audit that they had lied. He testified further that the reason he did not challenge the finding that these workers were employees and did not contest MEMIC's collection action was because he could not afford a defense. Instead, he shut down GLI and started a new corporation.

This testimony is not implausible, and MEMIC made no effort at the hearing to impeach or refute it. Furthermore, although MEMIC asserts in its motion for reconsideration that if either of these workers had been injured on the job, "any loss that MEMIC would have had to pay by *[sic]* the uninsured contractor would have resulted from the misstatement," MEMIC presented no evidence of what, if anything, it would have done differently if the answers on the application had been more accurate. On this record, therefore, MEMIC has not shown that the

inaccuracies in the applications constitute any basis for attributing GLI's debts to Mr. Lane or to LHB.

On another factor that would cast serious doubt on the legitimacy of GLI's separate existence, MEMIC misconstrues the meaning of the test. "Insolvency at the time of the litigated transaction" cannot mean insolvency at the time the creditor sought to collect the debt. If "the litigated transaction" referred to the collection action, then any uncollectible debt could be used to pierce the veil and limited liability would be meaningless. The question, rather, is whether GLI was insolvent at the time it incurred the debt, and no evidence was presented on that point.

Another *Exclusive Properties* factor is "no dividends," and it is undisputed that neither GLI nor LHB has paid Mr. Lane anything but a salary. Nevertheless, in this case that factor actually favors LHB, because this is not a case where the owner is seeking to shelter assets in the corporation, and the evidence shows that paying a dividend would have been highly imprudent.

Some of the other factors have little relevance here. MEMIC questions what meaningful activity took place at the annual corporate meeting, for example, but that corporate formality was indisputably observed, and a "meeting" of a sole shareholder cannot be anything other than a formality. Likewise, there is nothing abusive about a sole shareholder exercising "pervasive control." As acknowledged in the Decision and Order "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." In its motion, MEMIC responds that one-man corporations are inherently suspect and "Courts will often find against one-man corporations who would hide behind a very thin corporate veil." To the contrary, it is well established in American law that a corporation with a single individual owner or single parent corporation is every bit as entitle to limited liability as a publicly traded corporation. Many veil-piercing decisions do involve sole shareholders, but that is not the reason the veil was pierced in those cases.

Nevertheless, there remain other factors that provide some support for MEMIC's position. As the Decision and Order acknowledged: "The factor giving rise to the greatest concern ... is the concededly thin capitalization of the corporation, which ultimately led to its insolvency." The rationale for honoring limited liability is that when the business fails, the owner shares the pain. If the owner had no investment to lose, that rationale no longer holds and the case for piercing the veil becomes stronger. "Siphoning away of corporate assets" is therefore the most decisive of the *Exclusive Properties* factors in the circumstances of this case. Whether GLI's corporate status was misused to avoid its debts depends on whether the assets that should have been used to pay those debts were wrongfully transferred. The record is inadequate to decide that question conclusively, but as discussed earlier, the issue is not simply whether GLI

should lose the benefit of the corporate veil, but more specifically, whether it is LHB that should be held responsible for GLI's debts.

On that point, the evidence is abundantly clear. If the assets that should have paid GLI's debt to MEMIC were siphoned away from GLI, they were not siphoned into LHB. That is the distinction between this case and *Ohio Bureau of Workers' Compensation v. Widenmeyer Electric Co.,* 72 Ohio App. 3d 100, 593 N.E.2d 468 (1991). As MEMIC observes,*Widenmeyer* does stand for the proposition that it is possible to find the successor corporation liable for the debts of the predecessor without finding the common sole shareholder liable. But not on these facts. MEMIC is technically correct when it asserts that "every single asset that corporation one had was transferred – siphoned if you prefer – to corporation two." Those assets, however, as catalogued by MEMIC, consisted of: "the use of Mr. Lane's personally owned tools, the use of a truck, the use of Mr. Lane's home office, the book of business or customer list, and the goodwill generated by Mr. Lane himself." The aggregate value that creditors could potentially realize from all these intangible assets put together adds up to zero. There is also title to the truck itself, but it is undisputed that the equity in the truck is also zero. It would be pointless, therefore, to order a tracing remedy that would hold LHB liable for the portion of GLI's debt that could be paid from assets acquired from GLI.

MEMIC's arguments that the Decision and Order lead to an unjust and inequitable result presume that MEMIC should be entitled to collect the debt from someone. If so, that someone is Mr. Lane and the proper remedy is a civil action against him. The formation of LHB is not, as MEMIC suggests, a vehicle by which Mr. Lane can evade his obligation to pay GLI's debt. If Mr. Lane does not owe GLI's debt in the first place, there is no obligation to evade. If Mr. Lane does owe it, LHB as currently structured does not impede MEMIC's ability to collect.

Order and Notice of Appeal Rights

It is therefore *ORDERED* that the decision granting Lane Home Builders, Inc.'s Petition is *REAFFIRMED,* for the reasons set forth above and in the original Decision and Order of May 27 which is hereby incorporated by reference.

This Decision and Order on Reconsideration 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 August 27, 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] The Decision and Order had noted that another way in which an insurer can protect itself against premium debts is to require prepayment, and that the Legislature had authorized this but placed limits on the amount of advance payment that insurers may require. In its motion, MEMIC replies that this provision, 39-A M.R.S.A. § 402, could not have been drafted with MEMIC in mind, because it is the successor to a provision in former Title 39 that dates back to 1973. I did not mean to suggest that it was adopted with MEMIC specifically in mind, nor even that it was adopted with the former residual market mechanism specifically in mind, since it applies equally to all insurers. My point was only that the Legislature considered this issue and expressly drew a line that balanced the interests of the insurer and the policyholder.

[3] There is, however, a different theory under which Mr. Lane might be held personally liable that does implicate insurance law and insurance expertise. Even if GLI's own debts died with GLI, Mr. Lane might be personally liable for the resulting loss to MEMIC if the premium debt were the result of Mr. Lane's fraud or negligent misrepresentation. However, that would be a tort action and would still be for the courts to decide, and for the reasons discussed below, the record is insufficient to decide the underlying facts in any event.

PER ORDER OF THE SUPERINTENDENT OF INSURANCE

JULY 18, 2008

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ROBERT ALAN WAKE
DESIGNATED HEARING OFFICER