

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF BUSINESS REGULATION
INSURANCE DIVISION
1511 PONTIAC AVENUE, BLDG. 69-2
CRANSTON, RI 02920

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| <u>EAST BAY METAL ERECTORS, INC.,</u> | : | |
| COMPLAINANT, | : | |
| | : | |
| v. | : | DBR No. 06-I-0063 |
| | : | |
| <u>BEACON MUTUAL INSURANCE COMPANY</u> | : | |
| <u>RESPONDENT.</u> | : | |

DECISION

This matter came before the Department as the result of cancellation of a policy of workers compensation insurance issued to East Bay Metal Erectors, Inc. (“East Bay”) by Beacon Mutual Insurance Company (“Beacon”).

I.
TRAVEL

Beacon cancelled the policy issued to East Bay on the basis that was the “successor in interest” to TriState Steel Erection, Inc. (“TriState”) under 2003 P.L. ch. 410, Section 11(b)(2). It is undisputed that TriState owes \$29,843.50 to Beacon for a workers compensation insurance policy which was in effect from January 19, 2003 to January 19, 2004. East Bay appealed the cancellation to the Department pursuant to 2003 P.L. ch. 410, Section 11(b)(3). This is an issue of first impression for the Department.

The Director of the Department issued an Order appointing the undersigned as Hearing Officer and providing notice of complaint hearing. A prehearing conference was held on September 5, 2006. Following the prehearing conference an order was issued providing (1) that the Complainant would file a Complaint detailing the allegations in the administrative proceeding to which Respondent may respond; (2) Discovery was to be

completed by January 1, 2007; (3) discovery conducted in the Superior Court proceedings between these parties could be used in the administrative proceedings and (4) the hearing in this matter was scheduled for January 16, 2007. A Complaint was filed by East Bay on September 14, 2006 and an answer was filed by Beacon on September 26, 2006.

The parties requested a continuance of the hearing date which was granted. On April 12, 2006 Beacon filed a motion to dismiss. That motion was predicated on three grounds: that the Department did not have subject matter jurisdiction in this matter under 2003 P.L. ch. 410, Section 11(b)(3) because (1) East Bay's appeal was not filed within thirty (30) days of the cancellation (2) the cancellation was based upon nonpayment of premium and (3) 2003 P.L. ch. 410, Section 11(b)(2) placed determination of who is a "successor in interest" solely within Beacon's discretion without the availability of administrative review. East Bay filed an opposition and oral argument on the Motion to Dismiss was held on April 27, 2006. On June 5, 2006 the Hearing Officer issued an order denying the motion to dismiss. That order is attached hereto as Exhibit A and incorporated herein.

On June 1, 2007 East Bay filed a hearing brief with 27 exhibits. On July 11, 2007 Beacon filed a hearing brief with 30 exhibits. On August 15, 2007 East Bay filed a Reply Brief with an additional 4 exhibits. Oral argument on the briefs took place on October 29, 2007.

On November 5, 2007, in response to questions raised by the Hearing Officer during the course the hearing, East Bay filed a Brief on the necessity of an asset transfer to impose successor liability. On February 15, 2008 Beacon filed a response and on

February 29, 2008 East Bay filed a rebuttal. The Hearing Officer has considered all of the briefs and exhibits, as well as the oral argument of counsel, in coming to a decision in this matter.

II. ISSUES

1. What is the meaning of the term “successor in interest” as that term is used in 2003 P.L. ch. 410, Section 11(b)(2).
2. Is East Bay a “successor in interest” to Tristate under 2003 P.L. ch. 410, Section 11(b)(2).
3. Was Beacon’s cancellation of East Bay’s workers compensation insurance policy permissible under 2003 P.L. ch. 410, Section 11(b)(2).
4. What is the effect of the Department’s correspondence of February 8, 2006 concerning East Bay’s complaint regarding cancellation of its workers compensation insurance policy?

III. MATERIAL FACTS AND DISCUSSION

A. Propriety of Cancellation

East Bay and Tristate are two corporations owed by either Frank Petty, Sr. and Frank Petty, Jr. (father and son) that performed construction in Rhode Island. The incorporation documents filed with the Secretary of State list Frank Petty, Jr. as the sole owner and operator of Tristate. Tristate has no assets and has not operated as an active business since August of 2004. Tristate owes Beacon \$29,843.50 for a workers compensation insurance policy which was in effect from January 19, 2003 to January 19, 2004.

East Bay was incorporated on April 5, 2005. The incorporation documents list Frank Petty, Sr. as the president of East Bay. On May 5, 2005 East Bay applied for and received workers compensation insurance from Beacon. Beacon thereafter determined that East Bay was a “successor in interest” to Tristate and cancelled the workers compensation policy effective September 25, 2005. This appeal followed.

Before detailing the extensive facts presented to the Department by both parities, the Department takes this opportunity to detail the background of Beacon and 2003 P.L. ch. 410. Beacon was formed by the Rhode Island legislature as a “nonprofit independent public corporation” which was to be operated as a “domestic mutual insurance company.” 2003 P.L. ch. 410, Section 3. Any Rhode Island employer may apply to Beacon for workers compensation insurance and Beacon must issue the policy, unless there is a basis for denial under 2003 P.L. ch. 410(b)(2). This requirement makes Beacon Rhode Island’s “residual market” or “market of last resort.” The legislature has placed this obligation on Beacon to provide a market for employers which no competitive insurer will voluntarily write. In a line such as workers compensation, which is mandatory for most employers, a residual market is vital to assure that businesses can operate within the state.

Beacon is the only workers compensation insurance carrier writing in Rhode Island which has a residual market obligation. All other insurers may cancel or nonrenew for any reason allowed by law and the terms of the insurance contract. Other insurers may, therefore, decline to issue insurance to an employer that is poorly capitalized or has a poor credit history. Beacon cannot make this type of evaluation and must issue the

insurance regardless of the capitalization or credit record (other than payments to Beacon itself) of the employer.

The statute at issue in this case is one that relates specifically to Beacon's residual market obligation and applies only to Beacon. The statutory provision under which Beacon cancelled East Bay's policy provides:

The nonpayment of premiums for current or prior policies issued by the fund to applicant, *or to another entity for which the fund deems the applicant to be a successor in interest*, may be a basis for the fund to deny, not renew or terminate coverage.

2003 P.L. ch. 510, section 11(b)(2) (Emphasis added.)

There are a number of undisputed facts in this case with regard to the relationship between Frank Petty, Sr. and Frank Petty, Jr. and their involvement with Tristate and East Bay. With regard to Tristate, the corporate papers on file with the Secretary of State show that Frank Petty, Jr. was the sole officer of that corporation. (East Bay Brief of of 6-1-07, Exhibit 2). Prior to the existence of TriState Frank Petty, Jr. owned an unincorporated business which owed premium to Beacon and Beacon would not issue the policy to TriState until that debt was satisfied. (East Bay Brief of of 6-1-07, Exhibit 9). It is undisputed that Frank Petty, Sr. arranged for the purchase of the workers compensation insurance policy from Beacon and signed the application on behalf of Tristate. (Beacon brief of 7-11-07, exhibit E) The Beacon application lists Frank Petty, Sr. as President and Frank Petty, Jr. as Treasurer and excludes both of them from coverage as owners of the business. (Beacon brief of 7-11-07, exhibit E). While the briefs spend a great deal of time on whether Frank Petty, Sr. filled out the application, it is undisputed that he signed it. The employer has the duty to assure that the information it submits to the insurer is accurate and it cannot claim later that it did not read the application to disavow the

information provide. The application lists the mailing address of TriState to be 25 Kinnicutt Ave, Warren, Rhode Island 02885, which Frank Petty, Jr. testified was Frank Petty, Sr.'s "personal home address." (Beacon brief of 7-11-07, exhibit B, page 22) Frank Petty, Jr. testified that his father would work for TriState on occasion as an on site supervisor but would not necessarily be paid for that work (Beacon brief of 7-11-07, exhibit E, page 39). In addition Frank Petty, Sr. would loan money to his son if it was needed to make payroll or pay vendors. (Beacon brief of 7-11-07, exhibit E, page 40) During the time that TriState was insured by Beacon it was subjected to annual audits by Beacon in which Beacon contacted TriState and obtained information regarding the corporation. On each of these audit reports Tristate's primary business address was listed as 25 Kinnicut Avenue, Warren, Rhode Island and Frank Petty, Sr. was listed as President and Frank Petty, Jr. as Vice President of TriState. (Beacon brief of 7-11-07, exhibit L)

The question, therefore, is what is meant by the phrase "another entity for which the fund deems the applicant to be a successor in interest" as that term is used in 2003 P.L. ch. 410, section 11(b)(2). The first inquiry must be the purpose for which the legislature included this provision. As a mutual insurance company, Beacon is owned by its policyholders, there are no "stockholders" who derive any "profit" from the operation. Therefore any "bad debt" is borne by the remaining policyholders of the company. With a voluntary carrier which can reject or nonrenew an employer, the insurers underwriting decisions are responsible for the amount of bad debt it suffers. This is not the case with the residual market carrier. Beacon, as the carrier of last resort, must write all employers unless the employer is disqualified under 2003 P.L. ch. 410, section 11(b)(2). The legislature, therefore, provided that those employers who have not paid their bills, or who

have moved onto operation in another form, should not be provided the benefit of the statutorily created residual market.

There is no case law interpreting the meaning of the phrase "...or to another entity for which the fund deems the applicant to be a successor in interest..." The only case law is with regard to "successor liability" for the debt of a predecessor corporation. In the majority of those cases there has been an asset purchase by the "new" corporation that asserts that it is not liable for the debts of the "old" corporation. East Bay's position is that the phrased "successor in interest" in 2003 P.L. ch. 410, section 11(b)(3) must be read to be the equivalent of "successor liability" under the civil law.

The legislature added the phrase "...which the fund deems..." to the phrase "successor in interest." The Department cannot simply ignore this language. The only logical conclusion is that the legislature decided that "successor in interest" under the common law was not sufficient. By adding the phrase "...which the fund deems..." the legislature was giving additional discretion to avoid the adverse impact of bad debt from residual market risks on all policyholders of Beacon.

East Bay further argues that the meaning of the phrase "successor in interest" must be judged in light of the "asset purchase" cases which determine whether or not the purchaser of the assets of a corporation is liable for the debts of that corporation. With corporations such as involved here, with essentially no capitalization or assets, this interpretation would mean that a succession of corporations could be formed for which Beacon would be required to issue workers compensation insurance. However, since the corporation could have limited or no assets the same individuals could operate the

business under a different corporate formation with Beacons other policyholders on the hook for the “bad debt.”

East Bay claims that Beacon’s cancellation “put it out of business.” This would only be true if East Bay was unable to obtain workers compensation insurance in the voluntary market. Voluntary writers are allowed to and do, write workers compensation insurance in Rhode Island. The statute in question is not a bar to East Bay obtaining insurance from any voluntary insurer. The only question here is whether East Bay should be able to obtain workers compensation insurance in the residual market while Tristate still owes premium to Beacon.

The Department believes that the facts before it are exactly the type the legislature sought to address. In this case Frank Petty, Sr. and Frank Petty, Jr. operated a series of construction companies, under a number of different forms of ownership. They did not strictly observe corporate formalities as evidenced by the fact that Frank Petty, Sr. signed the application to Beacon listing himself as president. Notwithstanding the fact that they did not observe strict corporate formalities they expect that Beacon should. In essence, East Bay is asking that Beacon be required to issue workers compensation insurance to a new corporation Frank Petty, Sr. has formed, while the other employers insured by Beacon absorb the debt owed by Tristate.

The Department does not accept that the phrase “...which the fund deems...” means that Beacon has unfettered discretion to deny or nonrenew workers compensation insurance without any appellate review for reasonableness. Rather, the Department believes that the legislature has provided that appellate review with the appeal to the Department under 2003 P.L. ch. 410, section 11(b)(3).

The standard which the Department uses to evaluate the cancellation or nonrenewal is the “reasonableness” of Beacons’ determination. In this case the Department find that Beacon’s determination that East Bay was a successor in interest to Tristate for the purpose of eligibility for residual market workers compensation insurance was reasonable.

**B.
Effect of Departmental Complaint Process**

Beacon has alleged in these proceedings that the Department’s letter of February 8, 2006 constituted a binding “ruling” on this issue. The Department has an informal complaint process in which consumers, such as East Bay, submit written complaint and receive written responses from the Department. These responses are not intended as formal administrative decisions and do not comply with the due process requirements of the Administrative Procedures Act.

In cases such as this, employers such as East Bay have a statutory right to contest cancellation or nonrenewal of their workers compensation insurance policies pursuant to 2003 P.L. ch. 410, section 11(b)(3). The fact that a complaint is submitted by the consumer and responded to by a Department employee does not vitiate these statutory rights. In this case, therefore, the Department rejects Beacon’s contention that the Departments’ letter of February 8, 2006 has any authority in this matter. The Department has not considered that letter in its decision in this matter.

**IV.
FINDINGS OF FACT**

1. Frank Petty, Sr. arranged for the purchase of the workers compensation insurance policy from Beacon and signed the application on behalf of Tristate.

2. Frank Petty, Sr. listed himself as President and Frank Petty, Jr. as Treasurer on the Beacon application.
3. The Beacon policy lists both Frank Petty, Sr. and Frank Petty, Jr. as owners and, therefore, does not charge premium for any of the work done by them for the corporation.
4. The application lists the mailing address of TriState to be 25 Kinnicutt Ave, Warren, Rhode Island 02885, which was Frank Petty, Sr.'s home address.
5. Frank Petty, Sr. worked for TriState but would not always get paid for that work.
6. Frank Petty, Sr. provided capital to TriState payroll and vendors.
7. The Beacon annual audit reports list Tristate's primary business as 25 Kinnicut Avenue, Warren, Rhode Island, Frank Petty, Sr. as President and Frank Petty, Jr. as Vice President of TriState.
8. TriState owes Beacon the sum of \$29,843.50.
9. East Bay is a corporation owed by Frank Petty Sr.
10. Frank Petty, Jr. worked for East Bay as a subcontractor although the application to Beacon did not disclose that this would occur.
11. Beacon cancelled the insurance policy of East Bay on the basis that East Bay was an entity which Beacon deemed to be a successor in interest to TriState.

**V.
CONCLUSIONS OF LAW**

1. The Department has jurisdiction in this matter pursuant to 2003 P.L. ch. 510 section 11.

2. 2003 P.L. ch. 510 section 11(b)(2) grants to Beacon the ability to deny or nonrenewal workers compensation insurance for nonpayment of premium by the insured or “another entity for which the fund deems the applicant to be a successor in interest” to an employer which failed to pay the full premium on a prior policy of workers compensation insurance.

3. The phrase does not limited cancellations to corporations which are the “successor in interest” in common law, rather, it allows Beacon to take into account other factors to make a determination.

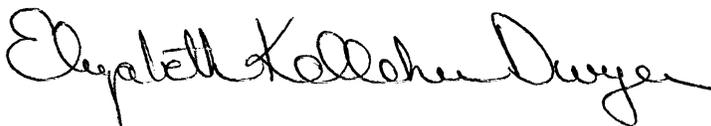
4. Beacons’ determination as to whether a insured is a “successor in interest” is reviewable by the Department under 2003 P.L. ch. 410, section 11(b)(3).

5. The standard which the Department uses to evaluate the cancellation or nonrenewal is the “reasonableness” of Beacons’ determination.

6. In this case the determination that East Bay was the successor in interest to Tristate for the purposes of 2003 P.L. ch. 410, section 11(b)(2) was reasonable.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends that Beacons' cancellation of East Bays' workers compensation insurance policy be held to be reasonable under the terms of 2003 P.L. ch. 410, section 11(b)(2).



Dated: August 25, 2008

Elizabeth Kelleher Dwyer
Hearing Officer

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby

ADOPT
 REJECT
 MODIFY

the Decision and Recommendation.



Dated: August 25, 2008

A. Michael Marques
Director

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DEPARTMENT OF BUSINESS REGULATION PURSUANT TO R.I.G.L. § 42-35-12. PURSUANT TO R.I.G.L. § 42-35-15, THIS ORDER MAY BE APPEALED TO THE SUPERIOR COURT SITTING IN AND FOR THE COUNTY OF PROVIDENCE WITHIN THIRTY (30) DAYS OF THE MAILING DATE OF THIS DECISION. SUCH APPEAL, IF TAKEN, MUST BE COMPLETED BY FILING A PETITION FOR REVIEW IN SUPERIOR COURT. THE FILING OF THE COMPLAINT DOES NOT ITSELF STAY ENFORCEMENT OF THIS ORDER. THE AGENCY MAY GRANT, OR THE REVIEWING COURT MAY ORDER, A STAY UPON THE APPROPRIATE TERMS.