

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)
)
S. I. EXTENDED CONTRACTORS,) Bankruptcy Case No. 98-41201
INC.,)
)
Debtors.)

OPINION

This matter having come before the Court for trial on an Objection to Claim filed by the Debtor as to the claim of Travelers Casualty and Surety Company for workers compensation insurance premiums, and Travelers Casualty and Surety Company f/k/a Aetna Casualty and Surety Company's Response to Debtor's Objection to Claim; the Court, having heard sworn testimony and arguments of counsel and being otherwise fully advised in the premises, makes the following findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

At the outset, the Court will note that the Debtor, S. I. Extended Contractors, Inc., has raised two bases in objecting to the claim of Travelers Casualty and Surety Company (Travelers): (1) that S. I. Extended Contractors, Inc. did not enter into a contract with Travelers, and (2) that Aetna Insurance Company did not conduct an audit within three years of the termination date of the policy and said audit is a requirement to calculating a final premium. As for the first basis in objecting to the claim of Travelers, the Court was advised prior to the commencement of trial on October 16, 2000, that the Debtor was no longer claiming that it had not entered into a contract with Travelers. It was learned in discovery that Travelers was the successor in interest of Aetna Casualty and Surety Company, and, as such, both

companies are one and the same. Therefore, trial proceeded on the remaining objection of the Debtor that an audit was not conducted within three years of the date of the termination of the policy, thus rendering the claim of Travelers in the amount of \$2,659,134, as a final workers compensation insurance premium, void.

Findings of Fact

On or about July 6, 1998, the Debtor, S. I. Extended Contractors, Inc., filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code scheduling, as a creditor, Aetna Casualty and Surety Company. Subsequently, on or about February 18, 1999, Creditor, Travelers, received notice of the need to file a proof of claim with respect to the Debtor Corporation. In response to this notice, on May 14, 1999, Creditor, Travelers, filed its proof of claim in the United States Bankruptcy Court for the Southern District of Illinois. The claim in question was filed for workers compensation insurance premiums due for the period of December 7, 1993, through and including December 7, 1994, in the amount of \$2,659,134.

It is undisputed that the Debtor Corporation was involved in the business of employee leasing, and that, on or about December 7, 1993, Aetna Casualty and Surety Company issued a contract of insurance for workers compensation insurance to the Debtor Corporation for the policy period of December 7, 1993, through and including December 7, 1994. Travelers is the successor to Aetna Casualty and Surety Company's interest in the policy. The insurance policy in question was issued pursuant to the Debtor's participation in the Illinois Assigned Risk Plan for Workers Compensation and Occupational Diseases Acts coverage.

The evidence adduced at trial indicates that during the period from December 7, 1993 until the time that the Debtor ceased its business operations on December 31, 1994, the Debtor paid monthly premiums

that were billed on the workers compensation insurance policy at issue. However, the policy at Part Five, entitled "Premiums," Section E, entitled "Final Premium," stated:

The premium shown on the Information Page, schedules, and endorsements is an estimate. The final premium will be determined after this policy ends by using the actual, not the estimated, premium basis and the proper classifications and rates that lawfully apply to the business and work covered by this policy. If the final premium is more than the premium you paid to us, you must pay the balance. If it is less, we will refund the balance to you. The final premium will not be less than the highest minimum premium for the classifications covered by this policy.

At issue in this proceeding is the amount, if any, of the final premium which is due from the Debtor Corporation to the Claimant.

Under Section G of Part Five of the insurance policy in question entitled "Audit," it is stated:

You will let us examine and audit all your records that relate to this policy. These records include ledgers, journals, registers, vouchers, contracts, tax reports, payroll and disbursement records, and programs for storing and retrieving data. We may conduct the audits during regular business hours during the policy period and within three years after the policy period ends. Information developed by audit will be used to determine final premium. Insurance rate service organizations have the same rights we have under this provision.

The insurance policy in question expired by its terms on December 7, 1994. Pursuant to Section G of Part Five of the policy, on December 9, 1994, Kenneth Kupec, an auditor for the Claimant Insurance Company, sent correspondence to the Debtor Corporation requesting a date and documentation for a final audit. The Court finds that Kenneth Kupec was a credible witness, and his testimony indicates that, on January 3, 1995, he contacted David Odom, president and shareholder of the Debtor Corporation in an effort to arrange an appointment to perform the final audit on the expired policy. In that conversation, David Odom indicated that the applicable tax returns which would be necessary to complete the audit would not be finalized by his accountant until at least January 31, 1995. On or about January 31, 1995,

Kenneth Kupec again attempted to contact the Debtor Corporation to follow up on scheduling of the final audit, only to discover that the telephone number for the Debtor Corporation had been disconnected. Subsequently, on February 1, 1995, Kenneth Kupec was able to speak with David Odom by telephone at his home, and was advised that the Debtor Corporation was no longer in business, and that the tax documents necessary for the audit had not yet been completed. On or about February 17, 1995, Kenneth Kupec again spoke with David Odom by telephone and was again advised that the pertinent tax information for the fourth quarter of 1994 was not yet ready, but that he would attempt to obtain the information as soon as possible from his accountant who he indicated was very busy. On or about March 7, 1995, Kenneth Kupec again spoke with David Odom by telephone, and, at that time, David Odom stated that the tax information necessary for the audit had been received. As such, an appointment for the final audit was scheduled for March 30, 1995, at 8:30 a.m.

One of the factors used in determining the amount of premiums for a workers compensation insurance policy is the "experience modification factor" of the company. The testimony at trial indicated that new companies receive an experience modification factor of 1 when being issued a new workers compensation insurance policy. However, those companies that are not new or have had prior coverage under workers compensation insurance may, and often are, assigned an experience modification factor that is higher than 1, which when multiplied by premiums due increases the amount of premiums required under a given workers compensation insurance policy. In the instant case, the Debtor Corporation was assigned an experience modification factor in excess of 1, based upon an application by the Claimant requesting that the Debtor Corporation be assigned the same experience modification factor of a predecessor corporation known as MOAR Contract Services, Inc. (MOAR), which had conducted the same type of business as

the Debtor herein. The evidence indicated that David Odom, on behalf of the Debtor Corporation, disputed the application of MOAR's experience modification factor to the Debtor Corporation. He appealed this matter to its highest level at the Illinois Department of Insurance, which issued an Order, Finding of Fact, Conclusion of Law and Recommendation of Hearing Officers on April 17, 1996, ruling that the experience modification factor of MOAR was applicable to the insurance policy in question. This decision was not appealed further. This Court will not revisit the issue of the application of the experience modification factor by the Illinois Department of Insurance, but will note that the facts indicate that approximately 75% of the clients of the Debtor Corporation were formerly clients of MOAR the president of the Debtor Corporation, David Odom, was also a corporate officer of MOAR, and the other principals of MOAR were employees of the Debtor Corporation.

Although the application of the experience modification factor of MOAR to the Debtor Corporation is not at issue in this proceeding, it is relevant to the sequence of events that occurred surrounding the Claimant Insurance Company's attempt to conduct a final audit of the Debtor Corporation's records in order to determine a final premium under the subject insurance policy. The evidence indicates that on or about March 29, 1995, the day before the final audit was scheduled, Kenneth Kupec received a telephone call from David Odom stating that the planned audit date was to be canceled and that an audit was not going to be permitted. The basis for David Odom's position was that no audit would be permitted until such time as the question of the experience modification factor was finally resolved. As stated above, the issue of the experience modification factor was finally decided on or about April 17, 1996, when the Illinois Department of Insurance upheld the application of the experience modification factor of MOAR to the Debtor Corporation.

Following the cancellation of the final audit scheduled for March 30, 1995, Travelers was advised by David Odom that he would not permit an audit of the Debtor's records until such time as the experience modification factor issue was resolved. The evidence indicates that the documents necessary for a final audit to be conducted by Travelers were never made available by the Debtor Corporation. As a result, on April 10, 1998, Travelers filed a six count complaint in State Court alleging breach of contract by the Debtor, requesting an accounting, and setting forth an alter ego theory as between the Debtor Corporation and MOAR. The filing of the Debtor's Chapter 7 bankruptcy petition herein has stayed the litigation in State Court pending a resolution of the matters as raised in this proceeding.

The Debtor herein takes the position that, since a final audit was never conducted of its records as provided in Section G, Part Five, of the subject insurance policy, Travelers is now estopped from claiming any additional premiums due under the insurance policy which was in force between December 7, 1993, and December 7, 1994. It is Travelers' position that they were never allowed to conduct the final audit as a result of the actions of David Odom as president of the Debtor Corporation, and that, as such, the final premium due has been calculated from the best information available from the clients of the Debtor and their records of the individual employees that were leased from the Debtor Corporation. There is no dispute that the necessary documentation to conduct the final audit was never made available to the Claimant. The Debtor Corporation's president, David Odom, testified that some of these records were destroyed as a result of a fire at his new place of business following the cessation of the Debtor Corporation's activities, and that still other records were stolen. The testimony of David Odom as to the disappearance of the records necessary for the taking of an audit was not credible. There was considerable conflict in the testimony of David Odom concerning the disappearance of the records in this case. In particular, he

testified that the records were taken to the office that he now works out of, and that some of those records, including applicable tax returns, were stolen, together with a brief case. He testified that this matter was reported to the proper authorities, namely the Franklin County Sheriff's Department. Not until the morning of trial was a copy of the Franklin County Sheriff's report produced, at which time it revealed that David Odom had reported a theft of a brief case on or about November 9, 1995. However, in contradiction to the testimony of David Odom, the Sheriff's Department report indicates that the brief case was reported stolen from David Odom's home rather than his place of business. Testimony as to the destruction of certain records and a fire in the building next to David Odom's current place of business was also conflicting in that David Odom testified at one point that the records were destroyed by fire, yet he had earlier testified that he believed that, during the clean up after the fire, some people involved in the restoration had actually taken the records. The conflict in this testimony was further exaggerated by affidavits which were submitted by David Odom and entered into the record. On cross-examination, David Odom indicated that he kept all records that would have been necessary for the audit until March 1999, even tax returns which would have had valuable information on them. This testimony is in direct conflict with his testimony that these tax returns were stolen, together with a brief case, in November 1995. In the final analysis, the testimony is clear that the necessary documentation to conduct an audit of the Debtor Corporation's records have disappeared. In the absence of those documents, the Claimant has calculated the final premium due on the subject workers compensation insurance policy with the best available documentation.

In reviewing the testimony of Kenneth Kupec and documentary evidence submitted at trial, the Court finds that, when Travelers filed suit against the Debtor Corporation in April 1998, it was following the only logical option that it had available to it, given the inability to conduct a final audit. There were three

options which were available: (1) to cancel the insurance policy, (2) conduct an estimated audit to encourage participation, and (3) file a breach of contract action. The option to cancel the insurance policy was not available in this instance, because, as stated above, the insurance policy in question had expired by its own terms. The option to conduct an estimated audit had previously been exercised to no avail. Filing breach of contract litigation was the option eventually chosen. Despite the fact that litigation has been pending in one form or another for over two years, the Debtor Corporation has never supplied the documentation which it has an obligation to supply pursuant to the subject insurance policy. It is now clear that said documentation no longer exists.

Conclusions of Law

The Court finds that it has jurisdiction to hear this matter in that it is a core proceeding arising under this bankruptcy case pursuant to 28 U.S.C. § 157(a). A proceeding to determine the validity of a proof of claim is a core proceeding under 28 U.S.C. § 157(b)(2)(B), therefore, this Court has core jurisdiction over all matters and issues involved in this case.

A creditor's proof of claim is deemed to be *prima facie* evidence of the validity of the amount of the claim pursuant to Rule 3001(f) of the Federal Rules of Bankruptcy Procedure. In this matter, Travelers has filed a proof of claim which acts as *prima facie* evidence of the validity of its claim. Upon the filing of the claim, the burden shifts to the objecting party, who must bring forth evidence to the contrary in equal probative force. See: In re Carlson, 126 F.3d 915, at 921 (7th Cir. 1997). In the event that the objecting party produces evidence to the contrary of the *prima facie* evidence presented in the proof of claim, the burden then reverts back to the claimant to prove the validity of the claim by a preponderance of the evidence. In re Carlson, *supra*, at 921. In this case, the Debtor, as the objecting party, has the burden of

going forward with evidence of an equal probative force to defeat the validity and amount of Travelers' claim. Based upon the evidence presented by the Debtor and the lack of credibility of the testimony of the Debtor's president, David Odom, the Court finds that the Debtor has failed to produce evidence to the contrary of the proof of claim filed by Claimant, Travelers, in an equal probative force such that the burden should shift back to Travelers to prove the validity of the claim by a preponderance of the evidence. In this case, Travelers has filed its proof of claim. This proof of claim is *prima facie* evidence of the validity and the amount of the claim. The Court is convinced that Travelers used its best efforts and information to derive the amount of the claim, and that, under the circumstances of this case, Travelers' claim should be found to be valid. Contrary to the arguments submitted by the Debtor, the Court finds that the provision allowing Travelers to conduct a final audit within three years of the expiration of the policy was not a statute of limitations. Further, the Court finds that the final premium amount claimed by Travelers in its proof of claim is not an amount based upon an estimation, but is rather an amount based upon investigation of records available through the entities which leased employees from the Debtor Corporation. Additionally, the Court finds that the terms of the insurance policy in this case are not ambiguous. Under the plain meaning of the terms of the insurance policy at issue, Travelers had the right, not the duty, to conduct an audit within three years of the termination of the policy. The Court further concludes that it was clear, under the policy in question, that the Debtor had a duty, under Section G, Part Five, entitled "Audit," to allow Travelers to examine and audit all records that relate to the policy. The credible evidence before the Court in this matter clearly indicates that the Debtor Corporation breached this duty, and that, as a result, cannot now complain of the amount of the final premium which was determined by Travelers through a reasonable investigation and examination of records and documents from sources other than the Debtor Corporation.

ENTERED: November 9, 2000.

/s/ GERALD D. FINES
United States Bankruptcy Judge