

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 1997

SESSION LAW 1998-3
SENATE BILL 993

AN ACT TO ESTABLISH PROCEDURES FOR CONVERSIONS BY HOSPITAL,
MEDICAL, AND DENTAL SERVICE CORPORATIONS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 58-65-130(3) reads as rewritten:

"(3) The charter of any corporation subject to the provisions of this Article and Article 66 of this Chapter may be amended to convert that corporation, so amending its charter, into either a mutual nonstock or stock accident and health insurance company or stock life insurance company subject to the provisions of Articles 1 through 64 of this Chapter provided the contractual rights of the subscribers ~~or~~ and certificate holders ~~in the reserves and capital of such of the corporation~~ are adequately ~~protected under rules and regulations adopted by the Commissioner of Insurance.~~ protected. The proposed amendment shall be considered pursuant to G.S. 58-65-131, 58-65-132, and 58-65-133. Other provisions of this section and this Article relating to the procedure for amending the charter shall not apply."

Section 2. Article 65 of Chapter 58 of the General Statutes is amended by adding the following new sections to read:

"§ 58-65-131. Findings; definitions; conversion plan.

(a) Intent and Findings. – It is the intent of the General Assembly by the enactment of this section, G.S. 58-65-132, and G.S. 58-65-133 to create a procedure for a medical, hospital, or dental service corporation to convert to a stock accident and health insurance company or stock life insurance company that is subject to the applicable provisions of Articles 1 through 64 of this Chapter. Except as provided herein, it is not the intent of the General Assembly to supplant, modify, or repeal other provisions of this Article and Article 66 of this Chapter or the provisions of Chapter 55A of the General Statutes (the Nonprofit Corporation Act) that govern other transactions and the procedures relating to such transactions that apply to corporations governed by the provisions of this Article and Article 66 of this Chapter.

The General Assembly recognizes the substantial and recent changes in market and health care conditions that are affecting these corporations and the benefit of equal regulatory treatment and competitive equality for health care insurers. The General Assembly finds that a procedure for conversion is in the best interest of policyholders because it will provide greater financial stability for these corporations and a greater

opportunity for the corporations to remain financially independent. The General Assembly also finds that if a medical, hospital, or dental service corporation converts to a stock accident and health insurance company or stock life insurance company, the conversion plan must provide a benefit to the people of North Carolina equal to one hundred percent (100%) of the fair market value of the corporation.

(b) Definitions. – As used in this section, G.S. 58-65-132, and G.S. 58-65-133:

- (1) "Certificate holder" includes an enrollee, as defined in Article 67 of this Chapter, in a health maintenance plan provided by the corporation or a subsidiary or by the new corporation or a subsidiary.
- (2) "Code" means Title 26 of the United States Code, the United States Internal Revenue Code of 1986, as amended.
- (3) "Conversion" means the conversion of a hospital, medical, or dental service corporation to a stock accident and health insurance company or stock life insurance company subject to the applicable provisions of Articles 1 through 64 of this Chapter.
- (4) "Corporation" means a hospital, medical, or dental service corporation governed by this Article that files or is required to file a plan of conversion with the Commissioner under subsection (d) of this section to convert from a hospital, medical, or dental service corporation to a stock accident and health insurance company or stock life insurance company.
- (5) "Foundation" means a newly formed tax-exempt charitable social welfare organization formed and operating under section 501(c)(4) of the Code and Chapter 55A of the General Statutes.
- (6) "New corporation" means a corporation originally governed by this Article that has had its plan of conversion approved by the Commissioner under G.S. 58-65-132 and that has converted to a stock accident and health insurance company or stock life insurance company.

(c) Compliance Required in Certain Events. – A corporation governed by this Article shall comply with the provisions of this section, G.S. 58-65-132, and G.S. 58-65-133 before it may do any of the following:

- (1) Sell, lease, convey, exchange, transfer, or make other disposition, either directly or indirectly in a single transaction or related series of transactions, of ten percent (10%) of the corporation's assets, as determined by statutory accounting principles, to, or merge or consolidate or liquidate with or into, any business corporation or other business entity, except a business corporation or other business entity that is a wholly owned subsidiary of the corporation. The ten percent (10%) asset limitation in this subdivision does not apply to:
 - a. The purchase, acquisition by assignment or otherwise by the corporation of individual accident and health policies or contracts insuring North Carolina residents, or with respect to accident and health group master policies or contracts, only the

percentage portion of those policies or contracts covering North Carolina resident certificate holders, and that are issued by a company domiciled or licensed to do business in North Carolina, if the purchase is first approved by the Commissioner after notice to the Attorney General, no profit will inure to the benefit of any officer, director, or employee of the corporation or its subsidiaries, the purchase is transacted at arm's length and for fair value, and the purchase will further the corporation's ability to fulfill its purposes;

- b. In the case of a purchase by the corporation of all the common stock of a company domiciled or licensed to do business in North Carolina, that portion of the value of the company which is determined by the Commissioner to be attributable to individual accident and health policies or contracts insuring North Carolina residents or, in the case of accident and health group master policies or contracts, the percentage portion of those policies or contracts covering North Carolina resident certificate holders, if the purchase is first approved by the Commissioner after notice to the Attorney General, no profit will inure to the benefit of any officer, director, or employee of the corporation or its subsidiaries, the purchase is transacted at arm's length and for fair value, and the purchase will further the corporation's ability to fulfill its purposes;
 - c. Granting encumbrances such as security interests or deeds of trust with respect to assets owned by the corporation or any wholly owned subsidiary to secure indebtedness for borrowed money, the proceeds of which are paid solely to the corporation or its wholly owned subsidiaries and remain subject to the provisions of this section; and
 - d. Sales or other transfers in the ordinary course of business for fair value of any interest in real property or stocks, bonds, or other securities within the investment portfolio owned by the corporation or any wholly owned subsidiary, the proceeds of which are paid solely to the corporation or any wholly owned subsidiary and remain subject to the provisions of this section.
- (2) Directly or indirectly issue, sell, convey, exchange, transfer, or make other disposition to any party of any equity or ownership interest in the corporation or in any business entity that is owned by or is a subsidiary of the corporation, including stock, securities, or bonds, debentures, notes or any other debt or similar obligation that is convertible into any equity or ownership interest, stock or securities. This subdivision shall not be construed to prohibit the corporation or a wholly owned subsidiary, with the approval of the Commissioner after notice to the Attorney General, from investing in joint ventures or partnerships with

unrelated third parties, if no profit will inure to the benefit of any officer, director, or employee of the corporation or its subsidiaries, the transaction is conducted at arm's length and for fair value, and the transaction furthers the corporation's ability to fulfill its purposes.

- (3) Permit its aggregate annual revenues, determined in accordance with statutory accounting principles, from all for-profit activities or operations, including but not limited to those of the corporation, any wholly owned subsidiaries, and any joint ventures or partnerships, to exceed forty percent (40%) of the aggregate annual revenues, excluding investment income, of the corporation and its subsidiaries and determined in accordance with statutory accounting principles; or
- (4) Permit its aggregate assets for four consecutive quarters, determined in accordance with statutory accounting principles, employed in all for-profit activities or operations, including, but not limited to, those assets owned or controlled by any for-profit wholly owned subsidiaries, to exceed forty percent (40%) of the aggregate admitted assets of the corporation and its subsidiaries for four consecutive quarters, determined in accordance with statutory accounting principles.

In determining whether the corporation must comply with the provisions of this section, G.S. 58-65-132, and G.S. 58-65-133, the Commissioner may review and consolidate actions of the corporation, its subsidiaries, and other legal entities in which the corporation directly or indirectly owns an interest, and treat the consolidated actions as requiring a conversion. An appeal of the Commissioner's order that consolidated actions require a conversion shall lie directly to the North Carolina Court of Appeals, provided that any party may petition the North Carolina Supreme Court, pursuant to G.S. 7A-31(b), to certify the case for discretionary review by the Supreme Court prior to determination by the Court of Appeals. Appeals under this subsection must be filed within 30 days of the Commissioner's order and shall be considered in the most expeditious manner practical. The corporation must file a plan of conversion within 12 months of the later of the issuance of the Commissioner's order or a final decision on appeal.

(d) Charter Amendment for Conversion. – A corporation may propose to amend its charter pursuant to this Article to convert the corporation to a stock accident and health insurance company or stock life insurance company subject to the applicable provisions of Articles 1 through 64 of this Chapter. The proposed amended charter and a plan for conversion as described in subsection (e) of this section shall be filed with the Commissioner for approval.

(e) Filing Conversion Plan; Costs of Review. – A corporation shall file a plan for conversion with the Commissioner and submit a copy to the Attorney General at least 120 days before the proposed date of conversion. The corporation or the new corporation shall reimburse the Department of Insurance and the office of the Attorney General for the actual costs of reviewing, analyzing, and processing the plan. The Commissioner and the Attorney General may contract with experts, consultants, or other professional advisors to assist in reviewing the plan. These contracts are personal

professional service contracts exempt from Articles 3 and 3C of Chapter 143 of the General Statutes. Contract costs for these personal professional services shall not exceed an amount that is reasonable and appropriate for the review of the plan.

(f) Plan Requirements. – A plan of conversion submitted to the Commissioner shall state with specificity the following terms and conditions of the proposed conversion:

- (1) The purposes of the conversion.
- (2) The proposed articles of incorporation of the new corporation.
- (3) The proposed bylaws of the new corporation.
- (4) A description of any changes in the new corporation's mode of operations after conversion.
- (5) A statement describing the manner in which the plan provides for the protection of all existing contractual rights of the corporation's subscribers and certificate holders to medical or hospital services or the payment of claims for reimbursement for those services. The corporation's subscribers and certificate holders shall have no right to receive any assets, surplus, capital, payment or distribution or to receive any stock or other ownership interest in the new corporation in connection with the conversion.
- (6) A statement that the legal existence of the corporation does not terminate and that the new corporation is subject to all liabilities, obligations, and relations of whatever kind of the corporation and succeeds to all property, assets, rights, interests, and relations of the corporation.
- (7) Documentation showing that the corporation, acting by its board of directors, trustees, or other governing authority, has approved the plan. It shall not be necessary for the subscribers or certificate holders of the corporation to vote on or approve the plan of conversion, any amendments to the corporation's articles of incorporation or bylaws, or the articles of incorporation or the bylaws of the new corporation, notwithstanding any provision to the contrary in this Article or Article 66 of this Chapter or in the articles of incorporation or bylaws of the corporation.
- (8) The business plan of the new corporation, including, but not limited to, a comparative premium rate analysis of the new corporation's major plans and product offerings, that, among other things, compares actual premium rates for the three-year period before the filing of the plan for conversion and forecasted premium rates for a three-year period following the proposed conversion. This rate analysis shall address the forecasted effect, if any, of the proposed conversion on the cost to policyholders or certificate holders of the new corporation and on the new corporation's underwriting profit, investment income, and loss and claim reserves, including the effect, if any, of adverse market or risk

selection upon these reserves. Information provided under this subsection is confidential pursuant to G.S. 58-19-40.

- (9) Any conditions, other than approval of the plan of conversion by the Commissioner, to be fulfilled by a proposed date upon which the conversion would become effective.
- (10) The proposed articles of incorporation and bylaws of the Foundation, containing the provisions required by G.S. 58-65-133(h).
- (11) Any proposed agreement between the Foundation and the new corporation, including, but not limited to, any agreement relating to the voting or registration for sale of any capital stock to be issued by the new corporation to the Foundation.

(g) Public Comment. – Within 20 days of receiving a plan to convert, the Commissioner shall publish a notice in one or more newspapers of general circulation in the corporation's service area describing the name of the corporation, the nature of the plan filed under G.S. 58-65-131(d), and the date of receipt of the plan. The notice shall indicate that the Commissioner will solicit public comments and hold three public hearings on the plan. The public hearings must be completed within 60 days of the filing of the conversion plan. The written public comment period will be held open until 10 days after the last public hearing. For good cause the Commissioner may extend these deadlines once for a maximum of 30 days. The Commissioner shall provide copies of all written public comments to the Attorney General.

(h) Public Access to Records. – All applications, reports, plans, or other documents under this section, G.S. 58-65-132, and G.S. 58-65-133 are public records unless otherwise provided in this Chapter. The Commissioner shall provide the public with prompt and reasonable access to public records relating to the proposed conversion of the corporation. Access to public records covered by this section shall be made available for at least 30 days before the end of the public comment period.

"§ 58-65-132. Review and approval of conversion plan; new corporation.

(a) Approval of Plan of Conversion.– The Commissioner shall approve the plan of conversion and issue a certificate of authority to the new corporation to transact business in this State only if the Commissioner finds all of the following:

- (1) The plan of conversion meets the requirements of G.S. 58-65-131, this section, and G.S. 58-65-133.
- (2) Upon conversion, the new corporation will meet the applicable standards and conditions under this Chapter, including applicable minimum capital and surplus requirements.
- (3) The plan of conversion adequately protects the existing contractual rights of the corporation's subscribers and certificate holders to medical or hospital services and payment of claims for reimbursement for those services.
- (4) No director, officer, or employee of the corporation will receive:
 - a. Any fee, commission, compensation, or other valuable consideration for aiding, promoting, or assisting in the conversion of the corporation other than compensation paid to

- any director, officer, or employee of the corporation in the ordinary course of business; or
- b. Any distribution of the assets, surplus, capital, or capital stock of the new corporation as part of a conversion.
- (5) The corporation has complied with all material requirements of this Chapter, and disciplinary action is not pending against the corporation.
- (6) The plan of conversion is fair and equitable and not prejudicial to the contractual rights of the policyholders and certificate holders of the new corporation.
- (7) The plan of conversion is in the public interest. The Commissioner shall find that the plan is in the public interest only if it provides a benefit for the people of North Carolina equal to the value of the corporation at the time of conversion, in accordance with the criteria set out in this subdivision. In determining whether the plan of conversion is in the public interest, the Commissioner may also consider other factors, including, but not limited to, those relating to the accessibility and affordability of health care. The Commissioner must determine that the plan of conversion meets all of the following criteria:
- a. Consideration, determined by the Commissioner to be equal to one hundred percent (100%) of the fair market value of the corporation, will be conveyed or issued by the corporation to the Foundation at the time the new corporation files its articles of incorporation. If the consideration to be conveyed is all of the common stock of the new corporation that is then issued and outstanding at the time of conversion, and there is no other capital stock of any type or nature then outstanding, it is conclusively presumed that the Foundation will acquire the fair market value of the corporation.
- b. At any time after the conversion, the new corporation may issue, in a public offering or a private placement, additional shares of common stock of the same class and having the same voting, dividend, and other rights as that transferred to the Foundation, subject to the applicable provisions of Chapter 55 of the General Statutes and any voting and registration agreements.
- (8) The plan of conversion contains a proposed voting agreement and registration agreement between the Foundation and the proposed new corporation that meets the requirements of G.S. 58-65-133.
- (9) The Attorney General has given approval pursuant to G.S. 58-65-133(h).

(b) New Corporation. – After issuance of the certificate of authority as provided in subsection (a) of this section, the new corporation shall no longer be subject to this Article and Article 66 of this Chapter but shall be subject to and comply with all

applicable laws and regulations applicable to domestic insurers and Chapter 55 of the General Statutes, except that Articles 9 and 9A of Chapter 55 shall not apply to the new corporation. The new corporation shall file its articles of incorporation, as amended and certified by the Commissioner, with the North Carolina Secretary of State. The legal existence of the corporation does not terminate, and the new corporation is a continuation of the corporation. The conversion shall only be a change in identity and form of organization. Except as provided in subdivision (a)(7) of this subsection, all property, assets, rights, liabilities, obligations, interests, and relations of whatever kind of the corporation shall continue and remain in the new corporation. All actions and legal proceedings to which the corporation was a party prior to conversion shall be unaffected by the conversion.

(c) Final Decision and Order; Procedures. – The Commissioner's final decision and order regarding the plan of conversion shall include findings of fact and conclusions of law. Findings of fact shall be based upon and supported by substantial evidence, including evidence submitted with the plan by the corporation and evidence obtained at hearings held by the Commissioner. A person aggrieved by a final decision of the Commissioner approving or disapproving a conversion may petition the Superior Court of Wake County within 30 days thereafter for judicial review. An appeal from a final decision and order of the Commissioner under this section shall be conducted pursuant to G.S. 58-2-75. Chapter 150B of the General Statutes does not apply to the procedures of G.S. 58-65-131, this section, and G.S. 58-65-133. This subsection does not apply to appeal of an order of the Commissioner issued pursuant to G.S. 58-65-131(c).

(d) Attorney General's Enforcement Authority; Legal Action on Validity of Plan of Conversion. –

- (1) Nothing in this Chapter limits the power of the Attorney General to seek a declaratory judgment or to take other legal action to protect or enforce the rights of the public in the corporation.
- (2) Any legal action with respect to the conversion must be filed in the Superior Court of Wake County.

"§ 58-65-133. Creation and operation of foundation.

(a) Creation. – A Foundation shall be created to receive the fair market value of the corporation as provided in G.S. 58-65-132(a)(7) when the corporation converts.

(b) Purpose. – The charitable purpose of the Foundation shall be to promote the health of the people of North Carolina. For a period of 10 years from the effective date of the conversion, the Foundation may not, without the consent of the Attorney General, establish or operate any entity licensed pursuant to Chapter 58 of the General Statutes that would compete with the new corporation or any of its subsidiaries.

(c) Board of Directors. – The initial board of directors of the foundation shall consist of 11 members appointed by the Attorney General from a list of nominees recommended pursuant to subsection (d) of this section. The Attorney General shall stagger the terms of the initial appointees so that six members serve two-year terms and five members serve four-year terms. The board shall fill a vacancy in an initial term. Their successors shall be chosen by the board of directors of the Foundation in accordance with the bylaws of the Foundation and shall serve four-year terms. No

member may serve more than two consecutive full terms nor more than 10 consecutive years. The Foundation may increase or decrease the size of the board in accordance with its bylaws, provided that the board shall have no fewer than nine directors and no more than 15 directors and that a decrease in size does not eliminate the then current term of any director.

(d) Advisory Committee. – An advisory committee shall be formed to (i) develop, subject to the approval of the Attorney General, the criteria for selection of the Foundation's initial board of directors and (ii) nominate candidates for the initial board of directors. The advisory committee shall be comprised of the following 11 members: three representatives of the business community selected by North Carolina Citizens for Business and Industry, three representatives of the public and private medical school community selected by The University of North Carolina Board of Governors, three representatives of private foundations and other nonprofit organizations selected by the North Carolina Center for Nonprofits, a representative of the North Carolina Association of Hospitals and Health Care Networks, and a representative of the North Carolina Medical Society. After receiving a copy of the proposed plan of conversion, the Attorney General shall immediately notify these organizations, and the advisory committee shall be constituted within 45 days thereafter.

The advisory committee's criteria shall ensure an open recruitment process for the directors. The advisory committee shall nominate 22 residents of North Carolina for the 11 positions to be filled by the Attorney General. The Attorney General shall retain an independent executive recruiting firm or firms to assist the advisory committee in its work.

(e) Foundation and New Corporation Independent. – The Foundation and its directors, officers, and employees shall be and remain independent of the new corporation and its affiliates. No director, officer, or employee of the Foundation shall serve as a director, officer, or employee of the new corporation or any of its affiliates. No director, officer, or employee of the new corporation or any of its affiliates shall serve as a director, officer, or employee of the Foundation. This subsection shall no longer apply after (i) 10 years following the effective date of the conversion or (ii) the divestment by the Foundation of at least ninety-five percent (95%) of the stock of the new corporation received pursuant to G.S. 58-65-132(a)(7)a. and subsection (a) of this section, whichever occurs later.

(f) Voting and Stock Registration Agreement. – The Foundation and the new corporation shall operate under a voting agreement and a stock registration agreement, approved by the Commissioner and the Attorney General, that provides at a minimum for the following:

- (1) The Foundation will vote the common stock in the new corporation for directors of the new corporation nominated by the board of directors of the new corporation to the extent provided by the terms of the voting agreement.
- (2) The voting restrictions will not apply to common stock of the new corporation sold by the Foundation.

- (3) The board of directors of the new corporation will determine the timing of any initial public offering of the new corporation's common stock, either by the new corporation or by the Foundation, and the Foundation shall have demand registration rights and optional "piggy-back" or "incidental" registration rights in connection with any offerings of the new corporation's common stock by the new corporation, on the terms and conditions set forth in a stock registration agreement and agreed upon by the new corporation and the Foundation and approved by the Commissioner and the Attorney General.
- (4) The voting agreement may contain additional terms, including (i) voting and ownership restrictions with regard to the common stock of the new corporation and (ii) provisions for the voting or registration for sale of any common stock to be issued to the Foundation by the new corporation.

(g) Costs. – The corporation shall pay the reasonable expenses of the advisory committee and executive search firm and the costs of any consultants, experts, or other professional advisors retained by the Attorney General incident to review under this section.

(h) Attorney General's Approval. – Before the Commissioner approves a plan of conversion pursuant to G.S. 58-65-132, the Attorney General, on behalf of the public and charitable interests in this State, must approve the determination relating to the fair market value of the corporation under G.S. 58-65-132(a)(7), the articles of incorporation and bylaws of the foundation, and all proposed agreements between the new corporation and the Foundation, including stock voting or registration agreements. The Attorney General may seek advice on these matters from consultants, investment bankers, and other professional advisors engaged by the Commissioner or Attorney General incident to review of the plan. The proposed articles of incorporation of the Foundation shall provide for all of the following:

- (1) State that the Foundation is organized and operated exclusively for charitable purposes and for the promotion of social welfare.
- (2) State that no part of the net earnings of the Foundation shall inure to the benefit of any private shareholder or individual.
- (3) State that the Foundation shall not engage in any political campaign activity or the making of political contributions.
- (4) Prohibit the Foundation from paying or incurring any amount that, if paid by an organization classified as a "private foundation" under section 509(a) of the Code, would constitute a "taxable expenditure" as defined by sections 4945(d)(1) and (2) of the Code.
- (5) Prohibit the Foundation from engaging in any self-dealing for the benefit of its directors, officers, or employees.
- (6) Provide for an ongoing community advisory committee to offer broad public input to the Foundation concerning its operations and activities.

- (7) Provide that the Foundation, after its first three years of operation, will pay out the lesser of (i) "qualifying distributions" of "distributable amounts," as defined in section 4942 of the Code, as if the Foundation were classified as a private Foundation subject to the distribution requirements, but not the taxes imposed, under that section or (ii) substantially all of its income, less qualifying expenses. In no event shall the Foundation be required to invade its corpus to meet the distribution requirements under this subdivision.
- (8) State that provisions in the articles of incorporation that are either required by this subdivision or designated by the Attorney General cannot be amended without the prior written approval of the Attorney General.

Within 120 days of the end of its fiscal year, the Foundation shall provide the Attorney General, the Commissioner, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate its State and federal tax returns for the preceding fiscal year. The tax returns shall be made available for public inspection."

Section 3. G.S. 58-65-160 is repealed.

Section 4. This act is effective when it becomes law.

In the General Assembly read three times and ratified this the 20th day of May, 1998.

s/ Dennis A. Wicker
President of the Senate

s/ Harold J. Brubaker
Speaker of the House of Representatives

s/ James B. Hunt, Jr.
Governor

Approved 9:45 a.m. this 22nd day of May, 1998