

INCORPORATION BY REFERENCE OF A STATUTE FROM A FOREIGN JURISDICTION

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Background

The State of Michigan has been the port of entry for a majority of the Canadian life insurance industry since the late 1880's. The Canadian life insurers historically have used a "branch" corporate structure, rather than forming a U.S. subsidiary, for admission into Michigan and the U.S. market. In 1994 Michigan became the first state to adopt the NAIC State of Entry Model Law.¹

The Michigan Insurance Commissioner ("Commissioner") is the primary U.S. regulator for the U.S. branch of the Canadian life insurers entering the U.S. through Michigan. While falling within the definition of "alien insurer,"² the Commissioner recognizes the U.S. branch of an alien insurer as domiciled in Michigan for insurance regulatory purposes. The other 49 states and the District of Columbia then recognize the U.S. branch as an admitted "foreign" insurer.

In early 1998, three of the Canadian life insurers announced their intention to demutualize. Manulife Financial, Sun Life Assurance, and Canada Life Assurance entered into a two-year process of converting from mutual to stock companies. All three of these insurers are chartered or incorporated under the Federal Government of Canada and the Insurance Companies Act (Canada). Their primary regulator in Canada is the Superintendent of the Office of Financial Institutions.

The Plans of Demutualization for these demutualizing insurers were prepared pursuant to the authority set forth in the Insurance Companies Act and the regulations promulgated pursuant to the Act. One of the major determinations under a Plan of Demutualization is what categories of policyholders are vested with ownership rights in the insurer and thus are determined to be "eligible members" who participate in the demutualization benefits.

The Commissioner and the demutualizing insurers agreed that each Plan of Demutualization would have to be filed for approval by the Commissioner pursuant to Chapter 59 of the Michigan Insurance Code ("Code"), "Conversion of Domestic Mutual Insurer to Domestic Stock Insurer."³ This chapter provides for a subscription rights plan of demutualization or an alternative plan which provides for the issuance of stock or cash to policyholders instead of subscription rights.⁴

In negotiations over the Plans of Demutualization, the Commissioner and the demutualizing insurers recognized the need to clarify which law governed the criteria for determining who is an eligible member entitled to demutualization benefits – Canadian law or the Michigan law applicable to domestic insurers incorporated and domiciled in Michigan. In the Spring of 1998, the Michigan Legislature agreed to adopt an amendment to section 5915 of the Code which states:

For an alternative plan submitted under subsection (1) by a U.S. branch of an alien insurer, 'eligible member' means a policyholder eligible to receive a benefit upon demutualization in accordance with the plan of demutualization approved in, and the demutualization statute and regulations of, the jurisdiction in which the alien insurer is domiciled, and approved by the commissioner as consistent with the purposes of this chapter. As used in this subsection, 'U.S. branch' means a business unit through which insurance is transacted within the United States by an alien insurer that uses this state as a state of entry.⁵

The Constitutionality of Section 5915(2): Does the Amendment Unconstitutionally Delegate Legislative Power to the Canadian Government?

A question could be raised regarding whether section 5915(2) unlawfully delegates legislative power to the Canadian government in violation of Article 3, Section 2 of the Michigan Constitution.⁶ In fact, the reference to Canadian law

is not a delegation, but rather a recognition of the internal affairs doctrine. Moreover, a close analysis of the statute demonstrates that it does not delegate the Commissioner's authority to approve a demutualization plan to the Canadian government or any other entity. The statute provides:

For an alternative plan submitted under subsection (1) by a U.S. branch of an alien insurer, "eligible member" means a policyholder eligible to receive a benefit upon demutualization in accordance with the plan of demutualization *approved in, and the demutualization statute and regulation of, the jurisdiction in which the alien insurer is domiciled, and approved by the commissioner as consistent with the purposes of this chapter.* As used in this subsection, "U.S. branch" means a business unit through which insurance is transacted within the United States by an alien insurer that uses this state as a state of entry.

MCL 500.5915(2)(emphasis added).

By including the italicized language in the statute, the Legislature actually reduced the power delegated to the Commissioner by legislatively mandating that the Commissioner could not approve a plan of demutualization unless, in addition to meeting the requirements of Chapter 59, it also (i) was approved by the domiciliary regulator and (ii) complied with the demutualization statute and regulations of the alien insurer's domiciliary jurisdiction. In fact, for all practical purposes, the addition of these two requirements simply specifies what the Commissioner must determine in any event before he can reach a determination that a demutualization plan meets the requirements of Chapter 59. (*See*, section 5915(1) which sets forth the standards to be applied by the Commissioner reviewing an alternative demutualization plan under Michigan law.) A plan of demutualization by an alien insurer which is not approved by the domiciliary regulator or which fails to comply with the statute and regulations of the domiciliary jurisdiction, could almost certainly not be approved by the Commissioner in the prudent exercise of his regulatory responsibilities.

The Legislature has not adopted by reference any "future" rules, regulations and statutory amendments in section 5915(2), which might in certain circumstances be considered a delegation of legislative power. The base line standards to be applied by the Commissioner are those spelled out by the Michigan Legislature itself in Chapter 59. These standards include instructions to the Michigan Commissioner not to approve an alien insurer's Plan of Demutualization if two additional criteria are not met: (a) approval by the domiciliary regulator, and (b) compliance with the domiciliary statute and regulations. Such a direction by the Michigan Legislature is not a delegation of any powers to a foreign official, but simply a recognition that Michigan public policy requires these two criteria to be met in addition to any other standards spelled out by the Legislature in Chapter 59.

The distinction between a delegation of authority and the incorporation by reference of standards to be used by an administrative agency can be summarized as follows:

Statutes often incorporate other outside references, such as paying interest at the current prime rate or a percentage below it. These references are treated simply as sources for the administrative agency to use to determine the facts in a particular setting rather than as a delegation of power to the authority or entity engaged in the function referred to.

Don LaDuc, Michigan Administrative Law, § 2:25 (West 1993).

The mere fact that section 5915(2) requires compliance with the laws of a foreign jurisdiction which may not yet be fully developed, or which may later be amended, does not render it an unconstitutional delegation of power. The leading case discussing constitutional issues relating to the delegation of legislative authority is *State Conservation Dep't. v. Seaman*.⁷ In addressing the constitutionality of a commercial fishing law, the Michigan Supreme Court developed a three-part "adequate standards" test applicable when analyzing a statute for a delegation issue. First, the statutory provision in question must be read as a whole and construed with reference to the entire Act. Second, standards established by the statute should be as reasonably precise as the subject matter permits or requires. Third, if possible, the statute should be construed as valid, not invalid; as conferring administrative, not legislative power; and as vesting discretionary, but not arbitrary authority.⁸

Section 5915(2) passes constitutional muster under these tests. When construed as a whole, Chapter 59 of the Michigan Insurance Code provides adequate standards to guide the Commissioner in evaluating whether the demutualization plan should be approved. Specifically, section 5915(1) provides that an alternative plan should be approved if the Commissioner finds that the “plan does not prejudice the interests of the members, is fair and equitable, and is not inconsistent with the purpose and intent of this chapter.”⁹ These standards are as reasonably precise as the subject matter requires, and indeed are virtually identical to the standards to be applied by the Commissioner in evaluating a subscriptions rights demutualization as set forth in section 5903(3). They are more specific than criteria set forth in other provisions of the Insurance Code, such as section 1341(1)(a), which authorizes the Commissioner to approve transactions within a holding company system if he finds that the transaction is “fair and reasonable.”¹⁰

Furthermore, even if section 5915(2) could be construed to incorporate the future laws of Canada, it is constitutional because of the statutory language stating the plan “must be approved by the commissioner as consistent with the purposes of this chapter.” The Michigan Courts have held that this type of language avoids a pure delegation of legislative power to another jurisdiction, and is therefore constitutional. For example, in *Warren v. State Constr. Code Comm.*,¹¹ the Michigan Court of Appeals considered whether the State Construction Code Act unconstitutionally incorporated a building code promulgated by Building Officials & Code Administrators International, Inc., a private entity. The Court noted that while it was well established that the Legislature may incorporate existing statutes, and by analogy, nationally recognized model building codes, an attempt to adopt by reference future legislation, rules, regulations or amendments would constitute an unlawful delegation of legislative power.¹² But in *Warren*, the State Construction Code Commission, pursuant to standards set forth in the State Construction Code Act, had the authority to modify the private building code prior to promulgation. Accordingly, because the State Construction Code Commission had the statutory right to modify the private building code, the Court held that the State Construction Code Act did not result in an unconstitutional delegation of legislative power.¹³

Similarly, in *Dukesherer Farms, Inc. v. Ball*,¹⁴ the plaintiff challenged the Agricultural Commodities Marketing Act (“Marketing Act”) contending that the Marketing Act unconstitutionally delegated legislative power to private agricultural producers. The Marketing Act allowed private agricultural producers to create, by petition to the Department of Agriculture, marketing programs funded by special assessments collected from producers of any marketable agricultural commodity directly affected by the proposed marketing program. If a proposed program was approved by the Department of Agriculture and by a referendum of affected producers, the program took effect. The approved marketing program then controlled the sale of the agricultural commodity. Because the Marketing Act allowed for approval in accordance with detailed standards by the Department of Agriculture, the Court found that the ratification of the administrator’s actions by the affected industry did not result in an unlawful delegation of legislative power to that industry group.¹⁵ The Court treated the approval process as one of private participation where the administrative agencies retained sufficient authority to avoid delegation to a private entity. Applying the *Seaman* adequate standards test, the Marketing Act was found by the Court to contain adequate standards.

The holding of the Court in *Dukesherer* was followed in a recent opinion of the Attorney General.¹⁶ In that opinion, the Attorney General considered whether portions of the Natural Resources and Environmental Protection Act, which permit a consultant retained by the owner or operator of a leaking underground fuel storage tank “flexibility” in meeting the requirements of that Act, result in a unconstitutional delegation of legislative authority to the consultant. Because actions taken by consultants are subject to full and timely review by the Department of Environmental Quality, it was the opinion of the Attorney General that the challenged provisions of the Act did not unconstitutionally delegate legislative authority to a non-governmental entity.¹⁷

Because section 5915(2) retains the requirement that the Commissioner approve a plan of demutualization as consistent with the purposes of Chapter 59 of the Insurance Code, and provides adequate standards regarding the exercise of that discretion, the subsection does not unconstitutionally delegate legislative power.

Conclusion

The Legislature has spelled out with precision in Section 5915 the criteria to be applied by the Commissioner in determining whether to approve a demutualization which does not involve subscription rights. The criteria includes a determination in the case of a U.S. branch of an alien insurer, that the plan (i) complies with and has been approved by

the domiciliary jurisdiction and (ii) is consistent with the purposes of Chapter 59. The Legislature's approach articulates sound public policy and gives appropriate recognition to well-established choice of law principles and Michigan constitutional requirements.

Endnotes

1. Michigan Compiled Laws 500.431 - 433.
2. Michigan Compiled Laws 500.110(3).
3. Michigan Compiled Laws 500.5901 - 5927.
4. Michigan Compiled Laws 500.5915(1).
5. Michigan Compiled Laws 500.5915(2).
6. Section 2 of Article III of the Constitution of the State of Michigan states:

The powers of government are divided into three branches; legislative, executive and judicial. No person exercising powers of one branch shall exercise powers properly belonging to another branch except as expressly provided in this constitution.
7. *State Conservation Dep't. v. Seaman*, 396 Mich. 299; 240 N.W.2d 206 (1976).
8. *Id.* at 309; 240 N.W.2d at 210.
9. MCL 500.5915(1).
10. MCL 500.1341(1)(a).
11. *Warren v. State Constr. Code Comm.*, 66 Mich. App. 493, 239 N.W.2d 640 (1976).
12. *Id.* at 502-03; 239 N.W.2d at 644-45.
13. *Id.*
14. *Dukesherer Farms, Inc. v. Ball*, 73 Mich. App. 212, 251 N.W.2d 278 (1977).
15. *Id.* at 223-224, 251 N.W.2d at 283.
16. *See* OAG, 1996, No. 6928 (Dec. 20, 1996).
17. *See* OAG, 1996, No. 6928, p. 236, 237 (Dec. 20, 1996).