MERGER OF IOWA MUTUAL INSURERS

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Iowa lawyers and their clients have been uncertain for years about the procedural requirements and substantive basis for the merger or joinder of two mutual insurers. The Iowa Insurance Division has recognized this uncertainty and in a joint effort with several interested lawyers has created a major revision of a Chapter of the Iowa Code to provide both procedural and substantive certainty. In order to understand the new legislation, it is helpful to review the history of the issue.

When mutual insurers were first being incorporated in Iowa in the late 1800s, Iowa only had a rudimentary business corporation law. It only spoke of shareholders and nowhere addressed the rights of policyholders/members of a mutual. However, since it was the only statute available under which you could form a corporation, mutuals were forced to use its provisions and adapt them to the extent possible. This original business corporation law appeared in the Code Supplement of 1913 as Chapter 491 of the Iowa Code and has continued, largely unchanged, since that time.

In the 1960s Iowa finally adopted a version of the ABA's model business corporation act and in the late 1980s this was replaced by a later, updated edition now contained in Chapter 490. However, both of these updated statutes left the old Chapter 491 still on the books and Section 490.1701(2) specifically provides that Chapter 490 is not applicable to companies organized on the mutual plan. The effect of these two Code Chapters was to force mutuals that wanted to merge to try to find statutory authority in the old law under Chapter 491.

Section 491.101 et seq. did provide merger authority and procedures, but it only spoke of shareholders and required the approval of two-thirds (2/3) of all shareholders, not just two-thirds (2/3) present at a meeting. Because of its failure to mention policyholders/members and the burdensome approval requirement, the merger provisions of Section 491.101 et seq. were not, as a legal and practical matter, available to provide a vehicle for mutual merger. Also, the law is clear that there cannot be a common law merger. The power to merge must be supplied by statute.[1]

However, Iowa had another ancient statute, Section 521.12, which had been in the Code since the 1913 supplement. It provided, in substance, that when two non-life insurers (either mutual or stock) wished to "consolidate or reinsure", it was only necessary to submit a plan and receive the approval of the Commissioner and the Attorney General.[2] This statute contained no requirements for shareholder or policyholder approval, nor were there any stated standards or requirements for the plan in order to secure its approval. Approval was left to the total unfettered discretion of the Commissioner and the Attorney General.

Since the statute only spoke of consolidation, there was an issue with respect to whether consolidation could be read to include merger. This issue was resolved by the Eighth Circuit Court of Appeals, which held that the word "consolidation" included merger.[3] However, some lawyers were still doubtful about whether such a scheme without a requirement of notice, a meeting and the affirmative vote of policyholders was really anything more than a prohibited common law merger. Those lawyers generally opted to use the vehicle of bulk reinsurance to accomplish a merger. In these instances, the survivor would 100% reinsure the target, thereby securing all the assets and liabilities of the target, which would then be dissolved.[4] The ultimate result of this bulk reinsurance transaction was identical to the result of a statutory merger, i.e., one mutual disappears, its assets, liabilities and policyholders all being transferred to the survivor.[5] As is apparent, neither the merger plan nor the bulk reinsurance transaction were totally free from doubt.[6]

To resolve these uncertainties, the Commissioner's bill is a complete re-write of Chapter 521 and particularly Section 521.12, which is repealed and replaced by all the new provisions.

In summary, the revised Chapter 521 provides the following:

1. It applies to both stocks and mutuals, life and non-life.[7]
2. It includes "regular" insurers, as well as county mutuals and mutual holding companies.[8]
3. It authorizes plans of consolidation, merger and reinsurance.[9]

4. It provides authorization for the merger or consolidation of Iowa domestic mutuals, or merger or consolidation between an Iowa mutual and a foreign mutual.[10]
5. Merger of stock insurers would also be subject to the merger requirements of the general corporation law, Chapter 490.[11]
6. The revised law will not be applicable to the demutualization of a mutual where a mutual is converted to the stock plan. These transactions will still be governed by other Code chapters which specifically relate to such actions.[12]
7. While the statute requires that a plan of merger, consolidation or reinsurance be filed with the Commissioner, the statute fails to set out what must be included in the plan, other than to state that it "shall set forth the terms of the proposed contract of consolidation, merger or reinsurance, along with such other information as the Commissioner may require."[13]
8. Once a plan of merger, consolidation or reinsurance is filed, the Act sets out the procedural steps to secure approval:

    a. A Commission consisting of the Insurance Commissioner and the Attorney General is created with authority to approve, disapprove or modify the Plan.[14]

    b. The Commission has the option to act without notice or a public hearing. However, it may require a public hearing and notice to the target's members or shareholders.[15]

    c. The Commission also has the option to require a targeted mutual, but not the survivor, to submit the plan to its members for a vote. Approval of two-thirds (2/3) of the members voting is required.[16]

    d. In the event of a public hearing, any member, stockholder or policyholder of a stock company may appear and be heard.[17]

    e. The standard for approval of the plan is that the Commission must be satisfied that the "interests of the members, shareholders and policyholders" of the target "are properly protected and no reasonable objection to the plan exists."[18]

    f. A merger, consolidation or reinsurance plan is, in effect, a change of control of a domestic insurer and the provisions of Chapter 521A (The Holding Company Act) are applicable.[19]

Conclusion

The changes to the law should now resolve all doubts about whether a "common law" merger has occurred and provide a flexible vehicle for the merger of mutuals. While the Act will still allow bulk reinsurance transactions, prudence may dictate the use of a formal merger to allay any fears that the transaction would not qualify as tax free.

The Act does not specify what must be included in a mutual's plan, but it is safe to assume that the plan would have to provide for (i) membership of the target's policyholders in the survivor, with a preservation of their governance rights; (ii) assumption by the survivor of all obligations under the target's policies; and (iii) an adequate business rationale for the merger, including an analysis of the financial impact. Also, since the transaction is subject to the Holding Company Act, the five tests for approval of a change of control of a domestic insurer set out in 521A.3(4) would also have to be met. It may be worth noting that the new Chapter 521 says a public hearing is optional, while 521A.3(4) requires a public hearing. However, Section 521A.5 does give the Commissioner the option of not holding a hearing when she determines the transaction "is not comprehended within the purposes of this Section."

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[1] Rath v. Rath Packing Company, 136 N.W.2d 410 (Iowa 1965) where the Court stated: *The power of a corporation to merge must be derived from the law of the state that created it. There must be some plain enactment authorizing the merger. . . Legislative authority for a merger will not be implied. . .* Also *see*, Millers National Ins. Co. v. Iowa Kemper Mutual Ins. Co., 408 F.2d 534 (8th Cir. 1969) where the Court stated the rule to be: *. . .there can be no common law merger or consolidation of corporations and that statutory authority is a prerequisite to either a*

*consolidation or a merger. . .*Treatises also announce the same rule. See *Fletcher Cyclopedia Corporations*, Volume 15, Section 7048; *Merger of Insurance Companies* published by the ABA in 1966 at p. 9.

[2] Section 521.12, Code of Iowa (2005): *When any companies not named in section 521.2 desire to consolidate or reinsure, it shall only be necessary for such company or companies to submit the plan of consolidation or reinsurance with any other information that may be required, to the Commissioner of insurance and the attorney general and have the same by them approved.*

[3] Millers National Ins. Co. v. Iowa Kemper Mutual Ins. Co., *supra.*

[4] There is some authority to support this device. See, *Merger of Insurance Companies*, supra, where at p. 177, the authors state: *. . . absence of statutory authority should not prohibit an insurer. . . from engaging in a bulk reinsurance transaction.*

[5] In an attempt to follow the pattern of a statutory merger, as a part of the transaction, it was usually required that the bulk reinsurance agreement and dissolution receive the approval of two-thirds of the target's policyholders/members present at a meeting. The dissolution was then completed in compliance with statutory authority contained in section 491.23, which allowed dissolution in compliance with the corporation's articles of incorporation, which could be amended prior to the agreement to authorize dissolution upon approval of two-thirds of the policyholders/members present at a meeting.

[6] One issue which arose from a bulk reinsurance agreement was whether the transaction was a tax-free reorganization within the meaning of sections 368(a)(1)(c) of the Internal Revenue Code. At least one Private Letter Ruling of July 28, 1986, 1986 WL370562 (IRS PLR) indicated the transaction would qualify as tax free. Also *see*, Paulsen v. Commissioner of Internal Revenue, 469 U.S. 131, 105 S. Ct. 627 (U.S. Sup. Ct. 1985).

[7] 521.1.

[8] 521.1.

[9] 521.2

[10] 521.2(1). In addition, it exempts mutual insurers from the requirements of section 491.101-105, which are the requirements of the "old" business corporation act requiring the approval of two-thirds of the shareholders.

[11] 521.2(2).

[12] 521.2(3). *See* Chapters 508B and 515G for the provisions governing demutualization and conversion to a stock plan by life and non-life insurers.

[13] 521.3.

[14] 521.4.

[15] 521.5. The standard for requiring notice and a hearing if the Commission determines it is "necessary to conserve the interests of the" target's members, policyholders or shareholders.

[16] 521.5; 521.10. It is interesting to note that .10, which has the requirement for approval of two-thirds of the members present, only applies to mutuals. Approval of a merger of stock insurers would be governed by chapter 490, which only requires a majority vote. Also, 521.10, in an attempt to pattern mutual mergers after the provisions of 490.1104(17) relating to stock mergers, states that notice of plan of merger or reinsurance is not required if (i) the corporation will survive the merger or is the reinsurer, (ii) the survivor has more members than the target, and (iii) it has a larger surplus. The effect of this is to relieve the surviving mutual, in most instances, of the notice and member meeting requirements.

[17] 521.7.

[18] 521.8.

[19] 521.18.