

ACT 260

S.B. NO. 2575

A Bill for an Act Relating to Corporations.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. The legislature finds that Blue Cross/Blue Shield Plans have been converting from nonprofit organizations to for-profit corporations. In the conversion process, assets of the nonprofit are usually transferred to the for-profit. Federal law requires the nonprofit organization to transfer the nonprofit's assets to another nonprofit organization if the nonprofit is no longer a qualified tax exempt corporation. These nonprofit organizations may have gained valuable assets in the community through their tax-exempt status, philanthropic actions, and public efforts. A nonprofit organization can also be considered to be subsidized by the State through tax exemptions and therefore, assets accumulated should revert back to the public if there is no longer a charitable purpose.

Another concern is the valuation of a nonprofit organization's assets. To conform to federal law, the converting nonprofit organization must transfer its assets to another nonprofit organization. The converting nonprofit organization may have a valuable piece of property and may obtain a low appraisal of the property. The converting nonprofit organization may then transfer to another nonprofit organization the cash equivalent of the appraised value of the property in lieu of transferring the property. The property is retained by the converting nonprofit corporation which then reorganizes to a for-profit corporation. The for-profit corporation later sells the property for more than the appraised value and cash transferred to the other nonprofit organization. The stockholders of the for-profit corporation have realized the difference between the cash transferred and the selling price as a gain. Usually, former directors and officers of the nonprofit organization become shareholders of the for-profit corporation.

The purpose of this Act is to provide procedures and means of ensuring that if a nonprofit organization desires to convert its assets to a for-profit entity, the public will be allowed input on the conversion, and that the assets of the nonprofit organization are reasonably valued for transfer to other nonprofit organizations.

SECTION 2. Title 24, Hawaii Revised Statutes, is amended by adding a new chapter to be appropriately designated and to read as follows:

**“CHAPTER
CONVERSION OF NONPROFIT ASSETS**

§ -1 Definitions. As used in this chapter:

“Commissioner” means the insurance commissioner.

“Conversion” means the transfer or sale of a significant amount of a nonprofit entity's assets to a for-profit entity or through any other means as determined by the commissioner. The department of commerce and consumer affairs' business registration division shall assist the commissioner in determining whether a conversion is about to occur or has occurred. As used in this definition, “significant” means twenty per cent or more of the assets of the nonprofit entity or an amount where the for-profit entity gains control or majority ownership of total assets of the nonprofit entity.

“For-profit entity” means a corporation organized under chapter 415, including a stock insurance company.

“Nonprofit entity” means any charitable organization operating pursuant to title 26 United States Code section 501(c)(3), (4), (8), (9), (26), or (e), and whose

primary purpose is to provide health insurance coverage or any type of health benefits to its members or the public.

§ -2 **Application for conversion.** (a) A nonprofit entity shall file an application with the commissioner at least six months prior to a proposed conversion. The application shall include a report of the activities of the nonprofit entity and a plan for the conversion including the following:

- (1) A board resolution indicating that a majority of the board of directors has approved the plan for conversion;
- (2) Copies of the original and amended articles of incorporation, if any;
- (3) The nature of the public benefit or charitable activities undertaken by the nonprofit entity;
- (4) Expenditures incurred by the nonprofit entity on the public benefit or charitable activities;
- (5) A means that establishes that the conversion shall not be prejudicial to the subscribers, contract holders, or residents of this State;
- (6) A comparative premium rate analysis of the nonprofit entity's major plans and products, with the analysis comparing actual premium rates for the past three years prior to the proposed conversion and projected premium rates for three years following the proposed conversion. The analysis shall address the projected impact, if any, of the proposed conversion upon the nonprofit entity's future underwriting profit, investment income, and loss and claim reserves, including the effect, if any, of adverse market or risk selection upon the reserves; and
- (7) A valuation of all assets held by the nonprofit entity.

(b) The commissioner may request any additional information that the commissioner deems necessary to carry out this chapter.

§ -3 **Approval process.** (a) No nonprofit entity may engage in a conversion without prior approval of the application for conversion by the commissioner. Any conversion without the commissioner's approval shall be voidable by the commissioner.

(b) Prior to approval of the conversion plan, the commissioner shall determine the fair market value of the assets of the nonprofit entity and shall ensure that the assets of the nonprofit entity are transferred to another nonprofit entity at the time of conversion pursuant to section -6.

(c) After reviewing the report and plan for conversion of the nonprofit entity, if the commissioner finds any discrepancy in the valuation of the assets of the nonprofit entity, the commissioner may obtain an independent party to provide a valuation of the assets. The commissioner shall have the discretion of making a final determination of the valuation of the assets of the nonprofit entity; provided that any issues arising from valuation are brought forth during the public hearing.

(d) A public hearing shall be conducted pursuant to chapter 91 prior to approving or disapproving the conversion. Prior to approving or disapproving the conversion, the commissioner may investigate and consider any matter or issue raised at the public hearing.

(e) Within sixty days after the public hearing, the commissioner shall disapprove or approve the conversion or approve an amended conversion plan; provided that the commissioner may extend this period if the commissioner deems more time is needed to resolve any issues brought forth during the public hearing or upon mutual consent of the nonprofit entity and the commissioner.

(f) The commissioner shall approve the conversion if the commissioner finds all of the following have been met:

- (1) The conversion plan is in compliance with section -2;

- (2) The plan is fair and reasonable and not contrary to law or to the interests of subscribers, contract holders, and the residents of the State; and
- (3) Upon conversion, the for-profit corporation will meet the standards and conditions applicable to stock insurance companies, including minimum surplus requirements.
- (g) The commissioner shall issue an order approving or disapproving the conversion or approving an amended conversion plan.

§ **-4 Directors, officers of nonprofit entity; prohibition.** (a) Directors or officers of a nonprofit entity are prohibited from directly benefiting from the conversion.

(b) No officer of the nonprofit entity who is employed by the nonprofit entity at the time the conversion application is submitted, at the time of conversion, or for a one-year period after conversion shall be employed by the for-profit entity.

§ **-5 Transfer of assets to other nonprofit entities.** The commissioner shall determine prior to any conversion, the nonprofit entities, if any, that are eligible to receive assets from the converting nonprofit entity. The charitable mission and grant-making functions of each eligible nonprofit entity must:

- (1) Be dedicated to promoting or serving the health care needs of residents of the State;
- (2) Not be in direct competition with the converting nonprofit entity; and
- (3) Be in existence and have qualified for tax-exempt status under title 26 United States Code section 501(c)(3), (4), (8), (9), (26), or (e), before the transfer of assets.

§ **-6 For-profit entity; after conversion.** After conversion, the for-profit entity shall not be subject to this chapter, but if a stock insurance company, shall be in conformance with title 24.

§ **-7 Judicial review.** Any final order or action by the commissioner may be subject to judicial review by the circuit court.”

SECTION 3. This Act shall take effect upon its approval.

(Approved July 20, 1998.)