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DEPT. OF INSURANCE
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STATE OF ARIZONA
DEPARTMENT OF INSURANCE

In the Matter of:)	Docket No. 97A-136-INS
)	
AMERICAN UNDERWRITERS LIFE)	ORDER
INSURANCE COMPANY)	
(NAIC No. 92649))	
)	
Petitioner.)	

On October 29, 1997, the Office of Administrative Hearings, through Administrative Law Judge Robert I. Worth, submitted a "Decision and Recommended Order" ("Recommended Order"), a copy of which is attached and incorporated by this reference. The Director of the Arizona Department of Insurance has reviewed the Recommended Order and enters the following order:


1. The recommended findings of fact and conclusions of law are adopted.
2. The Director approves the Form D Notice of a Transaction filed by or on behalf of American Underwriters Life Insurance Company. Thereby, the Director approves the terms of the option agreement concluded with Mr. R. Kell Hawkins which was and is the subject matter of said Notice.

NOTIFICATION OF RIGHTS

The aggrieved party may request a rehearing with respect to this Order by filing a written petition with the Office of Administrative Hearings within 30 days of the date of this Order, setting forth the basis for such relief pursuant to A.A.C. R20-6-114(B).

1 The final decision of the Director may be appealed to the Superior Court of Maricopa
2 County for judicial review pursuant to A.R.S. § 20-166. A party filing an appeal must notify the Office of
3 Administrative Hearings of the appeal within ten days after filing the complaint commencing the appeal,
4 pursuant to A.R.S. §41-1092.10.

5 DATED this 28 day of November, 1997

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7
8 
9 John A. Greene
 Director of Insurance

10 A copy of the foregoing mailed
11 this 28 day of November, 1997

12 Charles R. Cohen, Deputy Director
13 Gregory Y. Harris, Executive Assistant Director
14 Gary Torticill, Assistant Director
15 Jeffrey S. Solem, CFE, Chief Analyst
16 Arizona Department of Insurance
17 2910 N. 44th Street, Suite 210
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19 Office of Administrative Hearings
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21 Phoenix, AZ 85007

22 Michael J. De La Cruz
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Kathy Lindu

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2 **IN THE OFFICE OF ADMINISTRATIVE HEARINGS**
3

4 **In the Matter of:**

Docket NO. 97A-136-INS

5 **AMERICAN UNDERWRITERS LIFE**
6 **INSURANCE COMPANY**

7
8 **DECISION AND RECOMMENDED ORDER**

9 **NAIC No. 92649**

10 **Petitioner**
11

12
13 **HEARING:** October 20, 1997

14 **APPEARANCES:** Petitioner, American Underwriters Life Insurance Company,
15 (herein called "AUL") was represented by its attorney,
16 Thomas E. Haney, Esq.

17 The Arizona Department of Insurance (herein called the
18 "Department") was represented by Assistant Attorney
19 General, Michael J. De La Cruz, Esq.

20 **ADMINISTRATIVE LAW JUDGE:** Robert. I. Worth

21
22 Evidence and testimony were presented, and based upon the entire record, the
23 following Findings of Fact, Conclusions of Law and Recommended Order have been
24 prepared and are hereby submitted by the undersigned Administrative Law Judge to
25 the Director of the Arizona Department of Insurance (herein called the "Director") for
26 review, consideration, approval and adoption.

27 **FINDINGS OF FACT**

28
29 1. Petitioner, AUL, is an Arizona corporation whose major, and virtually the sole,
30 stockholder is Mr. R. Kell Hawkins (herein called "Mr. Hawkins"), holding 99% of all
outstanding shares.

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1 2. The aforesaid corporate entity, AUL, holds all of the outstanding stock of
2 Casualty Underwriters Insurance Company (herein called "CUIC"), a Utah corporation.

3 3. Home State Life Insurance Company (herein called "HSL") is a Kansas
4 corporation, 80% of whose outstanding stock is held by AUL, and the remaining 20% of
5 stock is held by AUL's wholly owned subsidiary, CUIC.

6
7 4. It was not disputed that, effective as of January 1, 1996, AUL and HSL had
8 entered into an assumptive reinsurance agreement pursuant to which AUL assumed all
9 of the insurance business responsibilities of HSL arising out of policies in force, and
10 that the only remaining assets of HSL consisted of and still consist of financial
11 investments.

12 5. Credible testimony at the hearing tended to indicate that for the past three
13 years, ongoing attempts to sell HSL as a shell company have been unsuccessful, not
14 even generating any offers to purchase.

15 6. In early January, 1997, AUL entered into a formal agreement with Mr.
16 Hawkins, its virtual sole stockholder, purporting to grant Mr. Hawkins an option to
17 purchase AUL's entire 80% stock interest in HSL.¹ The granted option was to be
18 exercised, if at all, before the end of the 1997 calendar year, and the stated
19 consideration for such option was the payment of \$4,000.00 to AUL from Mr. Hawkins.
20 The option was made renewable for one further calendar year upon payment of another
21 \$4,000.00. The purchase price of the shares to be acquired pursuant to any exercise
22 of the option was to be determined by reference to the statutory book value of HSL as
23 of December 31, 1996.

24 7. The above-described option agreement was independently ratified and
25 approved on January 14, 1997 by unanimous resolution of AUL's Board of Directors,
26 not including Mr. Hawkins.

27 _____
28 ¹ A separate agreement between CUIC (AUL's wholly owned subsidiary) and Mr. Hawkins
29 providing him with a right or option to purchase the remaining 20% interest in HSL was
30 admittedly not the subject of the instant hearing which involved the Department's appealable
agency action only with respect the agreement between AUL and Mr. Hawkins.

1 8. AUL subsequently filed a Form D Prior Notice of a Transaction (herein called
2 "Form D") with the Department, seeking approval of its option agreement with Mr.
3 Hawkins. After review and evaluation, the Department declined to approve the Form D,
4 as filed, thereby also disapproving the option agreement which was the subject of such
5 filed form. The denial notification had afforded Petitioner an opportunity to clarify,
6 supplement or resubmit a revised Form D. However, the Department's position was
7 unchanged after further consideration of the contents of a subsequent response on
8 behalf of AUL.

9 9. The written notification of disapproval by the Department was expressly and
10 primarily based upon a concern as to an apparent conflict of interest on the part of Mr.
11 Hawkins, although after the instant hearing was requested by AUL, the Department
12 additionally asserted that their disapproval action was also based upon the potential of
13 a result that the ultimate purchase price for the shares of HSL at the time the option
14 may be exercised might not be fair and reasonable.

15 10. Inherent in the very concept of an option is the creation of a right to acquire
16 property, tangible or intangible, real or personal, at a predetermined cost price. The
17 parties granting and/or receiving option rights necessarily contemplate that a future
18 increase in the value of the subject property will generate a tendency to exercise the
19 option in order to realize the favorable price differential benefits. Conversely, any
20 future decline in value would tend to discourage the exercise of an option to purchase
21 the property at a higher price, thereby resulting in the loss of the original advance cost
22 paid for acquiring the option right. Nevertheless, the use of an option as a sales tool,
23 especially in cases where, as here, prior potential purchasers were conspicuous by
24 their absence, is well established as a legitimate and recognized form of inducement to
25 prompt prospective buyers to enter into sales arrangements.

26 11. No requirement is found to exist, by applicable statute or rule, for a
27 proposed transaction to be based upon a price determined at the time of sale rather
28 than upon a historic price fixed at the time an option to purchase is granted. Any
29 realistic concern by the Department that the rights granted to Mr. Hawkins under the
30 option agreement may possibly result in an unfair or unreasonable ultimate sales price,

1 and consequently a potentially significant loss of profits by AUL, would be
2 impermissibly based upon mere speculation or conjecture. In point of fact, the book
3 value of HSL stock was shown to have decreased considerably since the date fixed for
4 valuation under the option agreement. In any event, this tribunal remains mindful of the
5 fact that a corporation's book value, even if computed according to strict statutory
6 guidelines, will not always coincide with the dollar amount upon which a willing buyer
7 and a willing seller may agree in a sale and purchase situation. Any differential may
8 not and should not be equated with unfairness in pricing for sales purposes.

9 12. Not only does the existence of any sales price advantage appear to be
10 illusory, at best, but also the beneficiary of any possible advantageous results would be
11 the identical individual in light of the extent of Mr. Hawkins' stock ownership in the
12 corporate entity selling its holdings in a dominantly owned subsidiary. Moreover,
13 neither the granting of the option right for a fixed consideration, not shown to have
14 been commercially unrealistic, nor the setting of an exercise price at the stock's book
15 value are found to constitute any form of emolument or special benefit to Mr. Hawkins
16 arising out of his position as an officer and director of AUL. It is difficult, if not
17 impossible, to find any violation of the spirit and intent of the statutory conflict of
18 interest provisions under all the circumstances of this case.

19 13. There was no indication under the evidence and testimony presented that
20 the transaction sought to be approved was motivated by any imminent fear of possible
21 insolvency or financial difficulties of AUL or of any subsidiary. Instead, the primary
22 objectives of both the individual and the corporate entities in formulating the option
23 agreement and possible future sales terms appeared to be based primarily upon
24 legitimate tax avoidance considerations.

25 14. Nothing in this decision is intended to infer or imply that members of the
26 Department were acting other than in good faith when evaluating the contents of the
27 submitted Form D or in arriving at and communicating disapproval determinations
28 which were unfavorable to Petitioner. The evidence and testimony at the hearing was
29 fully consistent with the demonstration of a *bona fide* attempt by or on behalf of the
30 Department to analyze and to voice somewhat understandable concerns as to whether

1 the transaction being scrutinized was or could tend to be violative of any applicable
2 statutes or rules.

3
4 **CONCLUSIONS OF LAW**

5
6 1. Pursuant to A.R.S. §20-481.12(B), the Director has authority to review and
7 evaluate sale and purchase transactions between a domestic insurer and a person in
8 its holding company system. Any proposed transaction may be disapproved by the
9 Director if its terms do not meet the standard of being fair and reasonable as set forth in
10 A.R.S. §20-481.12(A)(1).

11 2. Notwithstanding a broad degree of discretion that must necessarily be given
12 to the Director in reviewing and evaluating Form D submissions for approval of
13 proposed transactions, the exercise of such discretion must be reasonable and based
14 upon the application of some objective standards.

15
16 3. Based upon the totality of all the facts and circumstances of this case, as
17 presented during an administrative hearing on the merits, Petitioner has sustained its
18 burden of proving that the terms of the option agreement were neither unfair nor
19 unreasonable, and also that no realistic conflict of interest existed or presently exists, in
20 point of fact.

21 4. An approval by the Director of the Form D, as filed by AUL, is fully
22 appropriate and warranted, such approval to effectively encompass the option
23 agreement as well as any future exercise by Mr. Hawkins of the option during the
24 specified time period, as may be contractually extended by the agreement's terms. It is
25 unnecessary at this time to decide whether the application of certain other statutory
26 provisions may have an impact on the Department's future transaction approval
27 determinations in the event of an exercise of the option followed very shortly thereafter
28 by another sale by Mr. Hawkins to a third party involving individual profits that may
29 have otherwise been realized by the corporate entity.

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RECOMMENDED ORDER

In view of the foregoing, it is recommended that the Director issue his Order approving the Form D Notice of a Transaction filed by or on behalf of American Underwriters Life Insurance Company, thereby also approving the terms of the option agreement concluded with Mr. R. Kell Hawkins which was and is the subject matter of said Notice.

Dated: October 29, 1997.

OFFICE OF ADMINISTRATIVE HEARINGS



Robert I. Worth
Administrative Law Judge

Original transmitted on 10/29/97

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