INSURANCE CONVERSION PROPOSALS REJECTED OR WITHDRAWN IN KANSAS, MARYLAND, WASHINGTON and NORTH CAROLINA

In four other states, applications for nonprofit insurance conversions have been rejected or withdrawn since 2001**.** In each state, the conversion proposal received detailed scrutiny from insurance regulators, including the hiring of independent outside experts to determine the impact on the insurance market and access to health care.

KANSAS

In May 2001, BCBS of Kansas (BCBSK) and Anthem Insurance Companies, Inc., an Indiana-based mutual insurance company that was in the process of converting to for-profit, jointly announced their intent to affiliate. In this transaction, described as a "sponsored demutualization," Anthem planned to provide $370 million to BCBSK, of which $190 million was to cover BCBSK's outstanding expenses and $180 million would have been paid to eligible policyholders. BCBSK would then become a wholly-owned subsidiary of for-profit Anthem.

During the review process the Insurance Commissioner served as an impartial adjudicator, and a testimonial team, comprised of Insurance Department staff and outside counsel, was created to review the terms of the deal on behalf of the people of Kansas. The Commissioner's role included presiding over the proceedings, examining the information assembled during the review process and then making a determination whether to approve or reject the proposed transaction. The information-gathering process included five public comment meetings held in various locations across the state, and three days of formal public hearings.

Concerned about the impact on health services and access, the Kansas Association for the Medically Underserved, the Kansas State Nurses Association, the Kansas Medical Society and the Kansas Hospital Association petitioned for and were granted intervenor status in the proceedings. Over 1,200 Kansans attended the meetings to question various aspects of the deal, including whether the conversion would benefit them and to criticize the lack of objective information available on the deal.

The testimonial team and intervenors called on independent financial and economic experts to help analyze the benefits and detriments of the deal. Chief among the detriments was an analysis of the Kansas insurance environment by PricewaterhouseCoopers, which found that imposing a shareholder profit requirement on Kansas's largest insurer would likely result in additional premium increases in the small and individual group markets of $248 million over five years. In the final hours before the public record was closed, Anthem added to the terms of the deal a $25 million rate stabilization fund that the state could use to subsidize premiums for small group policies payable to Anthem.

In January 2002, the testimonial team joined the four intervenors in formally opposing the transaction. Citing the additional premium increases, the testimonial team's report recommended rejecting the conversion proposal and took particular exception to Anthem's last minute offer of $25 million calling it, "an insult to the intelligence of [Kansans] and the Commissioner."

In February 2002, the Insurance Commissioner formally rejected the proposed conversion and became the first industry regulator in the nation to reject a for-profit health insurer's proposal to buy a state's Blue Cross and Blue Shield Plan. The proposal was found to be, "unreasonable to policyholders and not in the public interest, and hazardous and prejudicial to the insurance-buying public." BCBSK announced that it would appeal the Commissioner's final order and formally began the appeals process.

In June 2002, the Shawnee County District Court issued a Memorandum Order and Decision vacating the Order and remanding the case back to the Commissioner for further proceedings consistent with the ruling.

Undeterred, the Commissioner issued a written statement in which she promised "to protect the families and businesses of Kansas from millions of dollars in increased insurance rates." Making good on this vow, the Commissioner filed a Notice of Appeal in June 2002 arguing that it was within her statutorily-granted authority to disapprove the proposal as she did. In August 2003, the Kansas Supreme Court upheld the Commissioner's decision to deny the proposed sale of BCBSK to Anthem Insurance.

WASHINGTON

Premera Blue Cross: In May 2002, Premera Blue Cross of Washington and Alaska, which covers over one million people in both states, announced its plan to convert to a for-profit insurance company.

In February 2003, the Washington Insurance Commissioner allowed over two dozen individuals and organizations asserting a "significant interest" to intervene in the conversion. Several of the intervenors opposed the conversion of Premera and raised questions about whether the full value of the company would be preserved for the public in the event of a conversion.

In granting the motions to intervene, the Insurance Commissioner grouped the intervenors into five categories and required each to appoint a lead attorney. Each group was treated as a single party for purposes of discovery, presentation of evidence, oral and written argument, and cross-examination. The groups included: Washington consumers, Washington hospitals, Washington providers, and a coalition in Alaska.

In July 2004, the Washington Insurance Commissioner formally rejected the conversion proposal. Ten days later, the Alaska Director of Insurance echoed the Washington decision by rejecting the company's effort to convert Premera's holdings in Alaska. Each regulator thoroughly and critically examined the company's conversion proposal and concluded that it was not in the best interests of consumers. Premera appealed the decisions in both Alaska and Washington. The Washington decision was upheld on appeal (s*ee* 133 Wash.App. 23, 131 P.3d 930 (2006)) which prompted Premera to withdraw the appeal in Alaska.

MARYLAND

In 1997, BCBS of Maryland (BCBSMD) announced that it would merge with Group Hospitalization and Medical Services, Inc. (GHMSI) of the District of Columbia. The merger was completed on January 16, 1998. The companies are owned by a Maryland-based nonprofit holding company called CareFirst, Inc.

In April 1998, the Governor of Maryland signed conversion legislation giving the Commissioner of Insurance the authority to require a set-aside of all "public or charitable" assets possessed by health service plans such as BCBSMD. The legislation established a conversion foundation, the Maryland Health Care Foundation, to protect the charitable assets.

In March 2000, CareFirst affiliated with nonprofit Blue Cross and Blue Shield of Delaware. Anticipating a conversion, the Maryland Legislature amended the state's conversion law in April 2001. This amendment required that the conversion assets be preserved in a trust within the existing foundation to be expended only at the direction of the state legislature.

In January 2002, CareFirst filed an application with the Insurance Commissioners of Delaware, Maryland and the District of Columbia to convert to a for-profit corporation and merge with Well Point Health Networks, a California based for-profit. All three Insurance Commissioners had to approve the merger in order for it to go forward.

In 2002, the Maryland legislature passed two bills that created more-stringent requirements for conversions, including a requirement that the applicant bears the burden to prove that the conversion is in the public interest, a requirement that the purchase price be provided to the foundation in cash, and restrictions on compensation packages for executives.

The Insurance Commissioner contracted with four experts to assist him in his review of the application. The valuation experts returned their report on the value of CareFirst and advised the Commissioner that CareFirst was worth much more than the $1.3 billion purchase price. The Commissioner also contracted with experts to study the due diligence aspect of the transaction, foundation issues, the health impact of the conversion and the compensation packages of the executives of CareFirst. In addition to hiring experts, the Insurance Commissioner conducted five public meetings throughout the state and multiple hearings with testimony from CareFirst, Wellpoint, the Commissioner's experts and the public throughout 2002 and early 2003.

There was significant public outcry regarding the compensation arrangements for executives of CareFirst that would have resulted from the conversion. In the compensation provisions, $27.4 million would have been provided to CareFirst executives as incentive bonuses to stay on after the conversion and $47.8 million would have been provided to them in change of control payments.

After holding hearings, analyzing the documents, and listening to the concerns expressed by the community, the Insurance Commissioner rejected the application because it was not in the public interest. In his 300-page decision released on March 5, 2003, the Commissioner explained that the Board of CareFirst had failed to uphold its fiduciary duty, the company had abandoned its nonprofit mission, the Board had failed to obtain an appropriate purchase price for the plan, and the Board and management had not considered the impact on the community in deciding to sell the plan.

In April 2003, the Maryland legislature passed a bill to make CareFirst a more responsible nonprofit organization by changing the CareFirst Board members, stating its charitable mission in statute and establishing certain requirements for the nonprofit. In January 2005, acceding to pressure about its surplus and its failure to fulfill its charitable obligations, CareFirst Maryland agreed to distribute over $90 million to help stabilize premium rates and make its health insurance more affordable to consumers.

The CareFirst companies cover more than 3.3 million members in the Washington, D.C., Maryland, Delaware and Virginia, which is over 45% of the population in the service area.

NORTH CAROLINA

In 1998, North Carolina passed a comprehensive conversion law setting up a process for regulatory review of conversion proposals and requiring the full fair-market value of the assets to be set aside in a foundation.

In 2002, Blue Cross and Blue Shield of North Carolina (BCBSNC) filed with the Insurance Commissioner a proposal to convert to a for-profit corporation. The company proposed that it maintain a virtual stranglehold over the new foundation.

A sophisticated and politically savvy group of consumer advocates, led by the North Carolina Health Access Coalition (NCHAC), urged state regulators to carefully scrutinize the proposal. Active consumer participation was well matched by responsible public officials who became concerned about BCBSNC and the Blue Cross and Blue Shield Association's insistence that the company retain ultimate control of the stock that would have gone to the foundation. Under intense scrutiny, the company's efforts to argue that the conversion was good for consumers fell flat. Instead of suffering a rejection of their proposal by regulators, BCBSNC withdrew its proposal in July 2003.

From: Consumers Union, "Blue Cross and Blue Shield: A Historical Compilation, January 2008, available at: www.consumersunion.org/conv/