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# Analyzing the CareFirst Decision: What Does it Mean for Conversions Elsewhere?

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Community Catalyst is a national advocacy organization based in Boston, Massachusetts, that builds consumer and community participation in the decisions that shape our health system to ensure quality, affordable health care for all.

Working with a national network of state and local groups in over 30 states, Community Catalyst provides leadership and technical assistance to strengthen the voices of consumers and communities on health care issues. The range of assistance provided includes policy and legal analysis, strategic planning, and support for community organizing, organizational development, and coalition-building. Since 1997, Community Catalyst has helped preserve over \$16 billion in community health assets put at risk in the conversion of non-profit health institutions to for-profit status and through other market-driven health system changes. It has carried out this work as part of the *Community Health Assets Project*, a six-year joint project of Community Catalyst and the West Coast Office of Consumers Union that is funded by the W. K. Kellogg Foundation.

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## **Analyzing the CareFirst Decision: What Does it Mean for Conversions Elsewhere?**

Following nearly a decade of non-profit Blue Cross Blue Shield health plans converting to for-profit status across the country, the decision in March 2003 by Maryland's top insurance regulator to reject the proposed for-profit conversion and sale of CareFirst, that state's Blue Cross Blue Shield plan, sets important new precedents for state regulatory review of such complex health care transactions. Commissioner Steven Larsen ruled that allowing CareFirst to convert to a for-profit corporation and to be acquired by WellPoint Health Networks of California was not in the public interest.

Given its attention to the Maryland Blue Cross plan's nonprofit mission, its emphasis on the importance of the public review process, and its analysis of potential health impacts, Commissioner Larsen's decision is the most developed example to-date of how similar non-profit health plan—and hospital—conversion proposals should be reviewed and judged.

It builds upon and goes beyond the decision the spring 2002 decision by then-Kansas Insurance Commissioner, Kathleen Sebelius, which rejected a proposed for-profit conversion of Blue Cross Blue Shield of Kansas.

Larsen's more recent ruling provides the best model yet available for advocates and regulators to examine and follow if they are facing proposed for-profit conversions of health plans or hospitals in their states.

### **A MODEL FOR REGULATORY REVIEW**

Commissioner Larsen laid out three primary considerations in his review: whether the proposed conversion would be in the public interest; whether it would adversely affect the accessibility, availability, or affordability of health care services for the people of Maryland; and whether the public assets of the non-profit were fairly valued.

Maryland — like most states, whether by statute or administrative regulation — requires that this type of regulatory analysis be conducted prior to approval or rejection of health care conversion proposals.<sup>1</sup>

Commissioner Larsen's review process stands out, however, because of three elements:

- ⇒ It ensured that the people of the state had full public access to the decision-making process on the transaction;
- ⇒ It included a very comprehensive investigation and analysis of the many complex facets of the conversion proposal; and
- ⇒ It thoroughly examined the actions and decisions of CareFirst's board of directors and executive management using accepted non-profit corporate fiduciary standards.

## To Learn ‘What’s In the Public Interest,’ Ask the Public

*The people who will be affected by the transaction must have access to information and be active participants in the review process.*

Larsen viewed his responsibility as a regulator operating under state law to seek input from Maryland residents concerned about how the proposed Blue Cross plan conversion would affect them, and to preside over a completely “public” review process.

Most states include a public hearing requirement as part of their conversion review processes, but all too often implementation of this requirement has translated into very scanty public discussion. Many states have held just one hearing, typically not long after a conversion application has been filed, or perhaps they have granted time for public commentary at a final review hearing.

In contrast, Commissioner Larsen used the discretionary authority of his office to seek extensive public comment.

### **HOW TO KEEP THE PUBLIC INFORMED AND INVOLVED**

Maryland’s conversion law requires the state’s Insurance Commissioner to conduct at least one public hearing and provides that he “may” hire consultants to perform studies on aspects of a proposed conversion.<sup>2</sup> Using that authority, Commissioner Larsen worked hard to include consumers in the state’s regulatory deliberations.

As did Commissioner Sebelius in Kansas, Commissioner Larsen convened numerous hearings around the state to elicit questions and concerns from the public. He opened all of the Commission’s review hearings for public observation. Although Maryland’s law does not allow for interveners, the Commissioner held hearings in which the public was permitted to testify on the conversion application.

He also opened to the public hearings in which he questioned CareFirst and WellPoint officials and consultants, so that the general public could hear and assess the information the two companies were providing for his review. He provided a final opportunity for public comment before ending the state’s formal review hearings.

In addition, all the documents that could be made public were posted on the Insurance Commission’s website; these included all filings, hearing transcripts, expert reports, and decisions.

Hundreds of people attended and spoke at the CareFirst forums. Consumer advocates, many steeped in procedural details, projected the voice of the state’s health care consumers-at-large as the deal unfolded. These members of the public had spent time analyzing the deal, learning about earlier Blue Cross conversions in other states, and consulting with Community Catalyst staff, who

provided technical assistance for their deliberations. These combined efforts enabled advocates for the state's health care consumers to participate effectively in public consideration of the CareFirst proposal.

#### **WHAT WERE THE CONCERNS OF CONSUMERS?**

Throughout the entire conversion proceeding, public testimony focused on how Maryland consumers' access to health care would be affected by the proposed conversion. Advocates and other public speakers from communities around the state successfully brought the debate at each hearing back to the issue of consumer access to health care, which they stressed, was the most crucial element of the review process.

Many who testified stressed that CareFirst had already begun acting like a for-profit when it started making decisions based on maximizing financial profit, and not on meeting consumer needs. As a result, consumer advocates were worried about how the Blues plan would act if it actually became a for-profit corporation.

For example, consumer advocates noted, CareFirst had decided not to participate in some of the health coverage programs serving the state's most vulnerable consumers. They had pulled out of Medicaid, certain Medicare initiatives, and had withdrawn from a state program designed for people with high-cost, intensive medical needs.

Advocates emphasized these and similar aspects of the company's track record at each stage of the regulatory review process, which included consideration of valuation, analysis of compensation packages, review of the Board's due diligence process, analysis of the anticipated health impact of the transaction, and review of the overall purchase. The focus of public commentary was always the same: requesting that regulators consider each element of the transaction against the backdrop of future consumer impact and consumer protection.

## There's More to Evaluate than Accounting Reports and Financial Data

*A comprehensive investigation and analysis of all the facets and potential impacts of the proposal must be conducted.*

Regulators in many other states have focused their reviews of proposed health institution conversions on the issues of non-profit selling price and proposed use of financial proceeds. A noteworthy shift extending beyond that perspective began in Kansas where, at the request of Insurance Commissioner Sebelius, PriceWaterhouseCoopers studied the potential impact on Kansas health care consumers were Blue Cross Blue Shield of Kansas permitted to go for-profit and to be acquired by Anthem Inc. of Indiana.

Commissioner Larsen used this precedent to consider carefully the potential impacts that CareFirst's conversion would have on the health care system in Maryland. To do this, he conducted an in-depth analysis of how the proposed conversion might affect the accessibility, availability, and affordability of health care services.

That analysis, presented in the so-called "Fairness Report,"<sup>3</sup> answered some questions more successfully than others. Some of the research was thwarted by difficulty in obtaining data. WellPoint, for example, would not disclose certain crucial information about its underwriting and pricing policies, information that would have provided the Commissioner with a better sense of the conversion's potential impact on Maryland's health care consumers.

The very fact that the state's Insurance Commission asked such questions was important: their broad range helped articulate the extent of the conversion's potential impact on CareFirst subscribers and the general public.

Overall, the Fairness Report completed by Larsen's review team constituted a detailed health impact study which analyzed the conversion's potential effects on:

- ⇒ Premiums, including a projection of rates on current products in the small group and individual markets;
- ⇒ Underwriting losses, investment income, loss and claims reserves (including the effect of adverse market or risk selection on such reserves), administrative expenses and the cost of claims processing;
- ⇒ Provider compensation, the prompt payment of provider claims, the
- ⇒ terms of provider contracts, and any other factors which might impact the development of provider networks;
- ⇒ Loss of local control of CareFirst to a California health insurer;



- ⇒ The availability or accessibility of health care services in Maryland, particularly with respect to a change in the number of people insured in Maryland or a change in the extent of their health care coverage;
- ⇒ Maryland's hospital rate-setting system and Maryland's waiver from Medicare/Medicaid hospital reimbursement methodologies; and
- ⇒ Any other reasonable factors, as determined by the Commissioner.

The Fairness experts also reported on:

- ⇒ Whether other acquisitions made by the acquiring party (WellPoint) had resulted in material changes to health care benefit levels for individual and small group products;
- ⇒ A comparison of underwriting standards utilized by CareFirst for individual and small group products, and those used by the acquiring party (WellPoint) and any Blue Cross and Blue Shield plans it has acquired;
- ⇒ Whether other acquisitions made by the acquiring party (WellPoint) had resulted in material changes in the underwriting standards utilized for individual and small group products by the acquired party; and
- ⇒ A comparison of provider reimbursement practices and experience during the preceding five years for CareFirst, and those for the acquiring party (WellPoint) and any Blue Cross and Blue Shield plans it had acquired.

The significance of the examination of these issues is apparent: no subsequent regulatory review of whether a proposed health institution conversion is in the public interest could be complete without careful consideration of these factors.

## **Establishing Fair Market Value – What’s ‘Fair’ Depends on How You Define ‘Value’**

*The CareFirst board of directors had a fiduciary duty to protect not just the company’s business assets but its nonprofit mission, as well.*

There are two ways to view the ‘value’ of a non-profit health care organization: the worth in dollars of its financial assets; and the worth of its non-profit mission to the community that the institution serves. In the nonprofit context, the board of directors owes a fiduciary duty to uphold the institution’s nonprofit mission on behalf of the community. This contrasts with the fiduciary duty of a for-profit board, which is owed to the company’s shareholders.

In his review of the proposed conversion, Commissioner Larsen looked at the value of CareFirst’s mission as well as the value of its financial assets in order to ensure that its board of directors had fulfilled its fiduciary duties.

### **VALUE AS PRICE – ISSUES AND REVIEW**

To determine whether the business assets of the corporation had been properly valued Commissioner Larsen asked:

- ⇒ Had there been proper due diligence in determining a fair price for CareFirst?
- ⇒ In the negotiating activities with potential buyers, were there any conflicts of interest?
- ⇒ Would the charitable assets be properly preserved for the people of the state?

Answering these questions always is a central part of conversion transaction review; it is important in order to ensure that the community be compensated for the full financial value of the health care organization in whose non-profit mission they have invested and relied upon.

Commissioner Larsen was exacting in his pursuit of the answers, hiring independent experts to review the CareFirst valuation; to review the charitable assets issue; to examine the company’s Due Diligence process; and to review the compensation packages that were promised to CareFirst executives.

### **VALUE AS PRICE – FINDINGS**

After an extensive review of the record of the Board’s decision-making regarding the terms of the conversion and sale, the Commissioner determined that both the process and the decisions themselves were deeply flawed.

In what the press referred to as “a stinging rebuke to the top management and board of directors

of CareFirst,”<sup>4</sup> Larsen’s review detailed evidence indicating that board members had failed to secure a fair and independent valuation of the company assets; that they had negotiated exorbitant compensation deals for CareFirst executives; and that they sought advice from consultants who were not credible because of conflicts of interest.

#### **VALUE AS MISSION – ISSUES AND REVIEW**

Recognizing that a health care organization with a non-profit mission to offer insurance at “minimum cost and expense” is of value to the community, Commissioner Larsen also focused on another key aspect of the deal which should be considered in future determinations of whether any proposed conversion ‘makes the grade.’ He asked Insurance Commission staff and outside **experts** to determine whether the CareFirst board of directors and its company management had considered the value of CareFirst’s non-profit mission—and whether the company had acted to properly preserve its total charitable assets for the people of the state.

Larsen’s focus on this question was retrospective and prospective. He looked at whether the CareFirst board, in its deliberations on the proposed sale of the plan’s charitable assets, had properly carried out its stewardship of these public assets. He also examined whether, in its decision to sell, the board had been acting properly to preserve the special nonprofit mission for which CareFirst assets were established and built.

Interpreted this way, the question of ‘value’ essentially became: To what extent had the CareFirst board fulfilled its special responsibility as the board of a nonprofit health institution?<sup>5</sup>

To make that assessment, the Commissioner undertook a further comprehensive investigation of the company’s decision-making process. In this area of review, he relied on the legal requirements that apply to the board of any nonprofit institution: its fiduciary duty to the organization’s non-profit mission.

#### **VALUE AS MISSION – FINDINGS**

##### **THE CAREFIRST BOARD ABANDONED THE CHARITABLE BLUE CROSS MISSION**

Reporting on the findings of this investigation, the Commissioner stated that the transaction documents did not even mention the mission of the nonprofit. In a review of more than 10,000 pages of board notes, meeting minutes, company reports and other documentation, Larsen specifically reported that his staff had found no indication that the board ever had considered questions about what it should do to uphold its fiduciary responsibility to the company’s nonprofit mission.<sup>6</sup>

Larsen concluded that there had been no consideration of how to maintain the nonprofit mission of CareFirst; rather the key question for the Board, it appeared, had been, ‘how do we pursue a deal to go for-profit?’

Since first being defined in 1937, the CareFirst mission always has required the nonprofit to provide

insurance at “minimum cost and expense.” Yet, Larsen concluded, in recent years the company has “adopted the strategies and objectives of many for-profit insurance companies and repudiated its corporate non-profit mission.”<sup>7</sup>

In the end, Commissioner Larsen gave the CareFirst proposal a failing grade, based in part on his conclusion that its board of directors had essentially abandoned the charitable, nonprofit mission under which CareFirst operates.

#### **THE COMMISSIONER REJECTED CAREFIRST’S CLAIMS TO NEED CAPITAL**

In attempting to justify its proposal to convert to a for-profit corporation, CareFirst continually asserted that it must be able raise capital through the stock market in order to be successful in the future. The independent experts hired by the Commissioner carefully analyzed this “business case.” They focused on the following key questions:

- ⇒ Was there a legitimate rationale for recommending that CareFirst undergo a conversion and then an acquisition or merger?
- ⇒ Could CareFirst reasonably be expected to continue as a viable non-profit company without converting and entering into a merger or other strategic alliance?
- ⇒ Could CareFirst’s capital needs be satisfied by means other than a merger or strategic alliance, such as issuance of debt instruments or organic growth?
- ⇒ Were the arguments advanced by CareFirst and WellPoint in favor of the transaction supported by verifiable industry trends and experience?<sup>8</sup>
- ⇒ Were the arguments advanced by CareFirst and WellPoint in favor of the transaction complete and based upon reasonable facts and assumptions?
- ⇒ Was it true that competitor health plans in Maryland whose stock is publicly traded, or are affiliates or subsidiaries of publicly-traded companies, have an advantage accessing necessary capital?<sup>9</sup>

CareFirst claimed that it needed to obtain more capital — and, therefore that it needed to become a for-profit company — in order to thrive financially and remain competitive in the Maryland insurance market. Companies seeking approval for a for-profit conversion frequently cite this as a key issue.

CareFirst and WellPoint never persuaded Larsen on this point. His final report stated that the “...data clearly support the notion that bigger is not necessarily better.”<sup>10</sup>

In fact, Larsen determined that it was not necessary for CareFirst to convert to for-profit status to increase its access to capital because the company already is financially strong and continues to be the

largest insurer in the state. Even CareFirst's own experts had said that the company could satisfy its capital spending needs. Larsen concluded that CareFirst never demonstrated that obtaining access to additional capital in order to fund future mergers and acquisitions was in the public interest.

## Conclusion

In its work over a period of several years with consumer groups around the country, Community Catalyst has argued consistently that policymakers must value and be attentive to preserving the charitable missions as well as the financial assets of nonprofit health institutions and that health care consumers need to be at the table whenever these important health system decisions are being considered.

For its groundbreaking focus on those two key principles—and its emphasis on preserving the accessibility, availability, and affordability of health care services for Maryland residents and their communities — Commissioner Steven Larsen's ruling on the proposed for-profit conversion of Maryland's CareFirst Blue Cross plan clearly is a watershed decision.

As regulators elsewhere are called upon to review similar proposed conversions, the Maryland decision should be viewed as raising the standard for any regulatory review process that aims to protect the public interest on these important and very complex health institution transactions.

## Endnotes:

- <sup>1</sup> Protecting Health Preserving Assets, A Comprehensive Study of Laws Governing Conversions, Mergers and Acquisitions Among Health Care Entities, Community Catalyst, August 2002. [http://www.communitycatalyst.org/acrobat/All\\_Conversion\\_August\\_2002%20Update.pdf](http://www.communitycatalyst.org/acrobat/All_Conversion_August_2002%20Update.pdf)
- <sup>2</sup> Md. Code Ann., State Gov't § 6.5-203(e)
- <sup>3</sup> *Fairness Analysis Impact Opinion and Impact Report*, Wakely Consulting Group, February 13, 2003, <http://www.mdinsurance.state.md.us/documents/FinalWakelyReport2-13-03.pdf>
- <sup>4</sup> *Insurance chief bars CareFirst sale*, M. William Salganik, March 6, 2003, Baltimore Sun.
- <sup>5</sup> see MIA Report Regarding the Conversion and Acquisition of CareFirst, pages 24 and 111. <http://www.mdinsurance.state.md.us/documents/FinalMIAReport-CareFirst3-5-03.pdf>
- <sup>6</sup> see MIA Report Regarding the Conversion and Acquisition of CareFirst, pages 111- 116.
- <sup>7</sup> Report of the Maryland Insurance Administration, Regarding the Conversion and Acquisition of CareFirst, Inc. to For-Profit Status and Acquisition by WellPoint Health Networks, Inc., Exhibit A, MIA No. 2003-02-0932, Page 202.
- <sup>8</sup> *Analysis of CareFirst, Inc. Business Case*, December 2002, The Blackstone Group, page 2. <http://www.mdinsurance.state.md.us/documents/CFBusinessCasereportFinal12-02.pdf>
- <sup>9</sup> *Analysis of CareFirst, Inc. Business Case*, December 2002, The Blackstone Group, page 2. <http://www.mdinsurance.state.md.us/documents/CFBusinessCasereportFinal12-02.pdf>
- <sup>10</sup> MIA Report Regarding the Conversion and Acquisition of CareFirst, page 203, <http://www.mdinsurance.state.md.us/documents/FinalMIAReport-CareFirst3-5-03.pdf>

