



Not in the Public Interest:

Insurance Commissioners in Washington and Alaska Reject Premera Blue Cross's Proposal, Costing Too Much, Offering Too Little

Introduction

On July 15, 2004, Washington Insurance Commissioner Mike Kreidler formally rejected a proposal by nonprofit Premera Blue Cross to convert to a for-profit corporation.¹ Ten days later, Alaska Director of Insurance Linda Hall echoed Kreidler's 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.

The rejections in Washington and Alaska are part of a new trend. Viewed in the context of similar recent rejections by regulators in Maryland² and Kansas, along with a Blue Cross company's withdrawal of its conversion proposal in North Carolina, the decisions in Alaska and Washington demonstrate the positive impacts that a careful, thorough regulator and committed consumer coalition can have in protecting the public interest during the conversion process.

Background on Premera and its proposal to convert

Premera Blue Cross is a nonprofit health care service contractor domiciled in the State of Washington, which operates a nonprofit hospital and medical service corporation in Alaska under the name Premera Blue Cross and Blue Shield of Alaska. The company covers approximately 1.2 million people in Washington and Alaska.

In September 2002, Premera filed its initial proposal to convert to a for-profit company with regulators in Washington and Alaska. Included in its proposal, Premera proposed to

¹ Commissioner Kreidler released his Findings of Fact, Conclusions of Law, and Final Order (the "Final Order") for OIC Docket Number G02-45, *In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates*, on July 15, 2004.

² For further information on the decision in Maryland, see *Analyzing the CareFirst Decision: What Does it Mean for Conversions Elsewhere?*, Community Catalyst, April 2003, which is available at www.communitycatalyst.org. Community Catalyst and Consumers Union comprise the Community Health Assets Project. The Project team works to protect services and preserve assets at risk in health conversions.

set aside stock in a nonprofit "Foundation Shareholder," which would make distributions to new health foundations in Washington and Alaska. But the company did not detail how the value of the stock would have been established, or whether the value would have reflected important assets such as the value of the Blue Cross trademark, goodwill, the value of its contracts with providers, and its subscriber lists.

Premera proposed to maintain control over the Foundation Shareholder's activities, including voting its stock, selling stock, and making distributions to proposed Washington and Alaska foundations. Premera also proposed that the Foundation Shareholder be authorized to conduct lobbying and propaganda activities to support health insurance interests.

While the Office of the Insurance Commissioner in Washington (the "OIC") was analyzing Premera's proposal, individuals and organizations asserting a "significant interest" filed a motion to intervene in the conversion of Premera Blue Cross of Washington and Alaska.³ In granting the motions to intervene, Kreidler grouped the intervenors into four categories and required each group to appoint a lead attorney. The groups included Washington consumers, Washington hospitals, Washington providers, and Alaska parties.

In February 2003, the Commissioner informed Premera that there were "significant substantive problems" with its conversion proposal and gave the company an opportunity to revise its proposal. One year later, Premera filed an amended proposal to convert with the insurance regulators in both states. In its amended proposal, the company altered its approach to establishing the Foundation Shareholder and instead set up two foundations, one in Alaska and one in Washington.

But the new scheme had its own problems. While the foundations were no longer intended to be lobbyists for Premera, the proposal envisioned foundations very much directed and controlled by the new for-profit company. For example, the new for-profit Premera would retain a right to sue the foundations and grant recipients for activities and grants that the company found materially adverse to the interests of health insurers.

Both regulators welcomed intervenors with a stake in the outcome

Among the four parties of intervenors, Washington consumers were represented by the Premera Watch Coalition ("PWC").⁴ Because PWC actively participated in all facets of the process in Washington, the role that the group played and the strategies they used

³ As authorized in RCW 48.31C.030(4). Washington law grants parties with a "significant interest" a right to participate in adjudicative hearings and it leaves the determination of such parties to the discretion of the Commissioner.

⁴ The Premera Watch Coalition maintains a web site at www.premerawatch.org. See also www.wacitizenaction.org.

provide a strong example for community groups addressing a conversion for the first time.⁵

Once they had reviewed Premera's proposal, members of the PWC established a set of principles to guide their approach to the conversion. The principles highlighted PWC's conclusions that the conversion proposal was not in the public interest, that it would harm Premera enrollees and other health care consumers, that it would increase rates and decrease benefits, and that more money would be spent by a for-profit Premera on marketing, lobbying, shareholder profits, and executive compensation. They urged the OIC to reject the conversion proposal. In the alternative, if the OIC accepted the proposal, the PWC urged the OIC to attach the following conditions:

1. Premera must guarantee that there will be no negative impact on current and prospective enrollees for six years by assuring that:
 - a. Premium increases will not increase by more than the medical inflation rate;
 - b. Its current service area will continue to be served;
 - c. It will neither reduce nor limit its benefits packages to current enrollees;
 - d. It will maintain its current medical loss ratio.⁶
2. Premera executives, employees and members should not profit from the conversion.
3. A comprehensive assessment of Premera's value should be completed and the company must transfer 100% of the value of its assets to a foundation.
4. Premera must not control the assets or the governance of the foundation.

The PWC conducted thorough reviews of all of the filings made pursuant to the proposal. It offered community trainings in the procedural and substantive aspects of the conversion proposal and supported the participation of local leaders in public hearings around Washington. It published everything from simple fact sheets for those who were just learning about conversions to more detailed reports on corporate accountability, executive compensation, and the hearing process in Washington.

Another successful aspect of the PWC's strategy was its effort to develop angles on the conversion proposal that piqued the interest of the press and were included in articles about Premera. In one, the *Seattle Times* reported on the amount of money Premera had spent pushing its proposal through the application and review process.⁷ In his Final Order

⁵ Each of the Washington and Alaska intervenors played a critical role in the review process. PWC, well versed in conversion issues from its prior work on another Blue plan transaction, is the focus of this case study because of its intensive focus on publicizing its principles, opinions, and activities, via the internet, print, and broadcast media.

⁶ Medical loss ratio refers to the percentage of dollars actually spent on medical care versus administrative costs or profit by an HMO. The higher the ratio, the more money is being spent on actual delivery of care.

⁷ Candace Heckman, "Premera conversion costs swell; \$31 million spent in health insurer's quest for for-profit status." *Seattle Post-Intelligencer*, April 26, 2004.

(see below), the Washington Insurance Commissioner mentioned the amount spent by Premera and related it to Premera's weakened performance on a measurement of its Risk-Based Capital.⁸ Another article highlighted the windfall that Premera's top executives would receive as a result of the conversion.⁹ The executive compensation issue was particularly tangible for Washingtonians with only a cursory understanding of Premera's proposal.¹⁰

A health impact analysis helped the regulators understand the affects on their states

A sub-grant from Consumers Union, leveraging contributions from other sources, enabled the Premera Watch Coalition and other intervenors to commission a health impact analysis of the conversion proposal.¹¹ The University of Washington Health Policy Analysis Program ("HPAP") conducted the study analyzing the role and recent behavior of Premera in the Washington and Alaska markets to provide a baseline from which to assess the impact of a conversion. Then it examined a number of likely post-conversion scenarios and identified several problems common to Blue Cross and Blue Shield conversions.

Such a health impact analysis was not required by law in Washington or Alaska, as it is in other states.¹² Here, the intervenors chose to commission one and it proved to have significant impact on the regulatory record.

Among the potential effects that HPAP found would result from a conversion of Premera were:

- A reduction in spending on medical care;
- An increase in spending on administration;
- Lower quality of care;
- Withdrawals from less profitable markets; and
- More aggressive medical underwriting.

⁸ "If Premera had not incurred the \$31 million + costs of its present effort to convert, its RBC level would probably have been greater than 450% at the time of the public conversion hearing in May 2004." Final Order, page 13.

⁹ Kyung Song, "Report shows stock options could enrich Premera executives," *Seattle Times*, February 19, 2004.

¹⁰ For additional information on executive compensation, see "How Much is Too Much? Executive Compensation Following the Conversion of Blue Cross and Blue Shield Plans from Nonprofit to For-Profit Status," Charles Bell, Consumers Union, 2003, which can be found at www.consumersunion.org/conv/pub/publicationsstates/000655.html.

¹¹ Aaron Katz, "Premera Conversion Study: Report 1, Premera Involvement in Washington and Alaska Health Insurance Markets, November 10, 2003"; "Premera Conversion Study: Report 2, Review of the Literature and Experiences of Other States, and Discussion of Potential Effects of a Premera Conversion," November 10, 2003; and "Supplemental Report of Aaron Katz," March 3, 2004.

¹² See, e.g., SB 317, signed into law in Montana in April 2005, which requires a health impact analysis. California, Colorado, Connecticut, Hawaii, Louisiana, Maine, Maryland, Nebraska, North Carolina, Oregon, Rhode Island, and Vermont also require a state regulator to consider health impact when rendering a decision on a conversion proposal.

Washington's open public process was fair for all parties

The OIC was exemplary in its efforts to keep the public informed about Premera's conversion proposal. Preparing for adjudicative proceedings, Commissioner Kreidler convened well-advertised public hearings in four locations in Washington. PWC and other intervenors, having conducted significant advance outreach, facilitated the participation of local individuals and groups at each of the hearings. At each location, members of the public had an opportunity to hear from, and question, Premera representatives about the conversion proposal and its potential impact on Washington consumers. For those who did not wish, or were not able, to speak publicly at the hearings, Commissioner Kreidler invited people from across the state to submit public comments via the OIC web site.

The OIC web site also became the repository for all legal documents in the transaction, including Premera's original and amended application's to convert, pre-filed testimony from all parties, consultants' reports, legal briefs, a copy of applicable Washington laws, concise information about the regulatory process and the regulatory role in this matter, news releases, and, once the adjudicatory hearings were underway, word-for-word transcripts of the proceedings. For regulators aiming to keep the public informed about conversion proposals in their states, the OIC's web site provides an excellent model. For additional information about the structure and content on the OIC's web site, which reveals Commissioner Kreidler's commitment to thorough public disclosure of every facet of the regulatory process in Washington, visit www.consumersunion.org/conv.

Washington adjudicatory hearing and final order

Having heard public comments from individuals and groups statewide, Commissioner Kreidler convened an exhaustive 11-day adjudicative proceeding in May 2004. At this proceeding, he took testimony from Premera, interested intervenors from Washington and Alaska, and his own staff, as well as experts representing all sides. Forty-one witnesses, including representatives of HPAP and Consumers Union, provided testimony and 290 exhibits were admitted into the record.

Applying Washington's Holding Company Act,¹³ the Commissioner issued a 58-page Final Order, finding that:

- While state law requires Premera to transfer the fair market value of the company's assets to a nonprofit organization, Premera's characterization of this required transfer as a "voluntary gift" does not comply with state law;
- While Premera testified that local management would best serve Washington subscribers, "for-profit status brings with it a high likelihood that Premera would be acquired by a national insurer";

¹³ Chapter 48.31B RCW, the Insurer Holding Company Act, and Chapter 48.31C, the Health Carrier Holding Company Act, governed Premera's proposal. The OIC referred to both acts, collectively, as the "Holding Company Act."

- While Premera, following Blue Cross and Blue Shield Association (BCBSA) rules has placed restrictions on the Washington foundation's ability to control and trade its stock, these restrictions would dilute the value of the assets going to the Washington foundation and the Commissioner is not bound by such restrictions; and
- Premera is financially sound and can remain sound without converting to a for-profit company.

The Commissioner thus concluded that Premera's plan for conversion was a) unfair and unreasonable to subscribers and not in the public interest, and b) likely to be hazardous or prejudicial to the insurance-buying public, in that:

- Premera's premiums in the individual and small group markets would likely increase in Eastern Washington;
- Premera's medical loss ratio would likely decrease;
- Premera would not transfer the fair market value of its assets to the Washington foundation; and
- Premera's proposal involved too much control by the for-profit company over the Washington foundation.

The Alaska decision

Alaska Insurance Director Linda Hall's Final Order followed by ten days the Washington decision. In one respect, it was directly influenced by the Washington Final Order: the Director concluded that the transactions outlined in the proposal, predominantly involving Washington corporations, could not occur without approval in Washington.

She concluded that the proposal, in its current form, was not fair and reasonable to Alaska policyholders and not in the public interest because it would likely result in higher premium rates, an increase in the number of uninsureds, and a loss of rate review. She concluded that the detriments outweighed the benefits of conversion.

Finally, she concluded that Premera had failed to articulate any concrete benefit to Alaskan policyholders that would counterbalance the negative impacts of the conversion.

But she left the door open for the company to file an amendment to its conversion proposal that satisfies a number of conditions. Among the conditions were requirements that Premera:

- Extend, for several years, the economic assurances it included in its current proposal;
- Provide some economic benefit to Alaskan subscribers; and
- Significantly reduce its level of control over the Alaska foundation.

Premera's response

On August 13, 2004, Premera filed a petition for judicial review of the Washington Insurance Commissioner's decision, claiming that the Commissioner had been "arbitrary and capricious" in his Final Order. While this is a very high standard to meet, it remains to be seen how the courts in Washington will handle this matter.

On August 25, 2004, Premera appealed Director Hall's conditional rejection of the company's proposal to convert.

Conclusion

Given Premera's appeals in Washington and Alaska, the record on the company's conversion proposal is not yet complete. For community members and regulators approaching conversion issues for the first time, however, efforts of PWC and the other intervenors in Washington and Alaska demonstrate the positive impact that community members can have when their nonprofit health provider announces an intention to convert. For regulators in other states, the Final Orders by Commissioner Kreidler and Director Hall stand as excellent examples of proper and thorough regulatory oversight that welcomed the voices of people from across each state.

Consumers Union remains committed to providing comprehensive, up-to-date information on the Premera conversion and others around the country. For the latest information, visit www.consumersunion.org/conv.