



January 16, 2019

Director Shelley Rouillard
Department of Managed Health Care
980 9th Street, Suite 500
Sacramento, California 95814

Dear Ms. Rouillard,

Consumer Reports, California Pan-Ethnic Health Network, Health Access, and the Western Center on Law and Poverty write to offer our thoughts on the applicability of Article 11 to Delta Dental of California's ("Delta Dental") proposed acquisition of Moda Health Plan. In a series of written queries, the Department asked Delta for information which gets to the question of whether Article 11 applies to this proposed transaction. Delta Dental claims that Article 11 does not apply. We disagree. Based on the publicly disclosed facts of the transaction and Delta Dental's history as a nonprofit, it seems clear to us that, despite Delta Dental's claims otherwise, Article 11 *does* apply.

Article 11 of the Knox-Keene Act is best known for the conditions it imposes on the conversion of a nonprofit health plan to for-profit status. However, Article 11 also imposes requirements when a nonprofit plan proposes merely to "restructure" its activities. Under the law, before a restructuring can be approved the plan must submit to the Department "a report summarizing the activities undertaken by the plan to meet its nonprofit obligations..."¹

This report must include a summary of the "nature of public benefit or charitable activities undertaken by the plan,"² the expenditures incurred on those activities, and a description of the public benefit or charitable activities the plan will engage in for the following year. In short, before a restructuring can be approved, the plan must demonstrate that it is meeting, and will continue to meet, its nonprofit obligations.

I. Delta Dental has a charitable trust obligation.

Because Delta Dental is a mutual benefit nonprofit plan and Article 11 applies to such plans only "to the extent that these plans have held or currently hold assets subject to a charitable trust obligation,"³ we address this issue first. In California, the law on charitable trusts is set forth primarily in case law. Its core element, proclaimed by the California Supreme Court in 1953, provides as follows:⁴

¹ California Health and Safety Code Section 1399.70.

² California Health and Safety Code Section 1399.70(1).

³ California Health and Safety Code Section 1399.75(a)

⁴ *Pacific Home v. County of Los Angeles*, 41 Cal.2d 844, 852 (1953).

All the assets of a corporation organized solely for charitable purposes must be deemed to be impressed with a charitable trust by virtue of the express declaration of the corporation's purposes, and notwithstanding the absence of any express declaration by those who contribute such assets as to the purpose for which the contributions are made. In other words, the acceptance of such assets under these circumstances establishes a charitable trust for the declared corporate purposes as effectively as though the assets had been accepted from a donor who had expressly provided in the instrument evidencing the gift that it was to be held in trust solely for such charitable purposes.

Another important aspect of the law, as noted in a primer on charitable trust law by the firm Adler & Colvin, is that charitable trust restrictions "apply not only to contributions and donations received and accepted by a nonprofit corporation but also to revenues generated by it from the performance of its charitable activities."⁵

Delta Dental's articles of incorporation, tax-exemption, and irrevocable dedication of assets are clear evidence of a public benefit purpose, and thus establish that its assets are held subject to a charitable trust obligation, for the following reasons.

- *Statement of purpose in articles of incorporation.* Delta Dental's original articles of incorporation clearly state a public benefit purpose: "...assist the people of California to have prompt, regular and adequate dental care and treatment *within their means.*" (emphasis added) This is presented as the overarching purpose that its primary and specific purpose of providing dental plans is intended to serve. With this founding document, Delta Dental has declared that its provision of dental plans is for a public benefit purpose: making dental care more accessible and affordable to Californians.
- *Tax-exemption as a social welfare organization.* Delta Dental enjoys federal and state tax exemption under 26 U.S. Code § 501 Section 501(c)4 and its mirror provision in California law. To qualify for exemption under these provisions of federal and state law, Delta Dental must be "operated exclusively for the promotion of social welfare." By claiming exemption under these provisions, Delta publicly represents that it operates for the promotion of social welfare. And its governing documents make clear that the corporation is intended to be operated for the social welfare of the public at large rather than just its dental plan members. As noted above, the original articles of incorporation identify the "people of California" as the corporation's intended beneficiaries. In addition, the current bylaws provide that a majority of Delta's corporate members, who make up its board of directors, are to consist of "public members," defined in the bylaws as any person who is not a dentist or involved in providing dental or other healthcare services to the corporation.⁶ Neither the articles of incorporation or bylaws give dental plan members per se any representation or property interest in the corporation.

⁵ See discussion of *Queen of Angels Hospital v. Younger*, 66 Cal. App. (1977) in "What Every Nonprofit Board Member Should Know," Robert A. Wexler and Sheila Warren of Adler & Colvin, September 20, 2007, p. 9.

⁶ See Delta Dental of California Bylaws, as amended through October 27, 2016, Article I, Section 4 and Article II, Section 3.

- *Irrevocable dedication of assets.* Delta Dental’s articles of incorporation include two provisions irrevocably dedicating the assets of the corporation to public benefit purposes. Article 3(B) provides that “all corporate property is irrevocably dedicated” to the purposes that the corporation was established to serve, and prohibits private inurement. Article 3(C) provides that upon dissolution of the corporation, any remaining assets must be distributed to organizations that have established tax-exempt status as 501(c)3 charitable or 501(c)4 social welfare organizations. These provisions establish beyond any doubt that Delta Dental holds its assets in trust, and that they are held in trust not for the benefit of private persons, but rather for public benefit purposes.

II. Delta Dental fails to establish that it does not have a charitable trust obligation.

In its responses to the Department, filed on December 13, Delta makes two arguments that it does not hold assets subject to a charitable trust obligation. It argues first, that “Delta has never received charitable donations, nor has it ever been legally authorized to accept tax-deductible donations”; and second, that “Delta is a 501(c)(4) nonprofit mutual benefit corporation, which does not hold any assets subject to charitable trust obligations.”

The fact that Delta Dental has never received charitable donations or been authorized to receive tax-deductible contributions is immaterial. As established in *Queen of Angels Hospital v. Younger*, 66 Cal. App. (1977), revenue from sources other than donations can also be impressed with a charitable trust obligation. As a matter of fact, non-profit hospitals get revenue from a variety of commercial sources while remaining a charitable trust under the Corporations Code. And as the Department knows, in previous conversions of California nonprofit health plans, the state has treated assets generated through the sale of health benefits as charitable assets.

Likewise, the fact that Delta Dental declared itself a mutual benefit corporation in 1988 has no bearing on the question of whether it holds assets in charitable trust. Contrary to Delta Dental’s suggestion, California law explicitly recognizes that some or all of the assets of a mutual benefit nonprofit corporation may be subject to a charitable trust obligation: “Nothing in Section 7130 or 7131 or in any provision of the articles of a mutual benefit corporation shall be construed to limit the equitable power of a court to impress a charitable trust upon any or all of the assets of a mutual benefit corporation or otherwise treat it as a public benefit corporation.”⁷

III. Delta Dental’s acquisition of Moda constitutes a “restructuring.”

Under Article 11, a transaction by a nonprofit plan is considered a restructuring and triggers the law’s requirements if the transaction involves a “substantial amount” of a plan’s assets, is not “undertaken in the normal and ordinary course of plan business,”⁸ and fails to satisfy one or more of the requirements specified in the law under Section 1399.71(e). The transaction constitutes a restructuring for the following reasons:

1. *The transaction involves a “substantial amount” of the plan assets.* Delta Dental argues that the transaction does not involve a substantial amount of its assets because the purchase price amounts to only 5% of the plan’s assets. However, “substantial” does not

⁷ Corporations Code Section 7135.

⁸ California Health and Safety Code Section 1399.71(d)(2).

mean “a large percentage of,” as the plan would have the Department believe. Article 11 does not specifically define the meaning of “substantial,” but the intent to attach to any transaction involving large sums of funds is clear and supported by the plain language definition of the word. For example, the Merriam-Webster dictionary defines the word to mean “not imaginary or illusory” and “considerable in quantity.” By that definition, \$154 million, even if only 5% of DDC’s assets, is clearly “substantial.” Further, if the definition Delta Dental seeks to adopt were appropriate, then the larger a nonprofit becomes, the more leeway it would have to spend nonprofit funds unchecked, with nonprofit giants having the greatest leeway of all. This could not have been the intent of the Article, and should not be the position adopted by the Department.

In addition, Article 11 provides that the Department may “[consolidate] actions taken by a plan for the purpose of treating the consolidated actions as a restructuring or restructure of the plan.”⁹ Since Delta itself points out that this transaction is just one in a series of investments in and acquisitions of for-profit entities—activity which clearly represents a departure from its core activity of providing dental plans to Californians on a nonprofit basis—it makes sense for the Department to do exactly that.¹⁰

2. *The acquisition of Moda is not in the normal and ordinary course of business for Delta Dental.* Delta Dental maintains that the transaction is in the normal and ordinary course of its business, as evidenced by its previous purchases of and investments in for-profit entities, many of which operate out-of-state. As noted above, Delta Dental’s moves over the years into for-profit business should be consolidated for purposes of your review. To the extent that such activity has become ordinary for Delta Dental, it is because it has for many years now engaged in business pursuits that are outside of the normal and ordinary course of business for a nonprofit plan. A pattern of activities outside the ordinary course of business should not thereby bless that activity as business as usual.

In any event, the purchase of a *health plan* would clearly be a significant departure from business as usual for Delta, even given its previous for-profit ventures, none of which has ever taken it into health insurance.

3. *The transaction is inconsistent with and does not further the plan’s ability to fulfill its nonprofit purposes.* As noted above, a transaction that involves a substantial amount of the plan’s assets and is not in normal course of business is considered a restructuring unless it meets certain requirements. Two of those requirements are that it be consistent with the plan’s nonprofit purposes and that it further the plan’s ability to fulfill its nonprofit purposes.¹¹

⁹ California Health and Safety Code Section 1399.71(d)(1).

¹⁰ In its December 13, 2018, filing with Department, in response to question #8, Delta writes that “the Plan has acquired interests and/or made investments in the following for-profits entities: Onsite Dental, Inc. in 2015, Allied Insurance Administrators in 2017; Dentegra Insurance Company in 2002; Delta Insurance Company in 1991, and Oral-Eye in 2018. Also, the Plan acquired several out-of-state, for-profit companies through a 2007 merger with its subsidiary Private Medical-Care, Inc.

¹¹ Health and Safety Code Sections 1399.71(e)(3)(B) and 1399.71(e)(3)(E).

Delta Dental argues that its nonprofit purpose is nothing more than to “provide dental benefit coverage through contracts with independent professional service providers.” As described by Delta Dental, its purpose is indistinguishable from for-profit, tax-paying dental plans. The Moda acquisition, according to Delta Dental, would further this essentially commercial purpose because it would enable Delta Dental “to bundle its dental coverage with Moda’s health plans in new territories outside of Oregon.”

However, Delta Dental’s view of its obligations as a nonprofit is wrong. As a tax-exempt social welfare organization and a nonprofit incorporated to make dental service available to Californians “within their means,” Delta has a trust obligation to actually do those things—promote social welfare by making dental coverage more available and affordable to Californians. The acquisition of Moda is neither consistent with nor would it further Delta’s ability to accomplish those purposes, and Delta makes no claims that it would.

4. *The transaction appears not to have been conducted at arm’s length and for fair market value.* A third requirement that a transaction involving a substantial amount of assets and not in the ordinary course of business must meet in order not to be treated as a restructuring is that it be conducted at arm’s length and for fair market value. Delta Dental appears to have a close relationship with CBIZ, the firm it contracted to conduct the valuation of Moda, which raises doubt about the independence of the valuation. In addition to employing as a managing director someone who was until 2017 a member of Delta Dental’s board of directors, CBIZ does extensive ongoing business with Delta Dental, providing actuarial support for its financial reporting to regulators. It would be appropriate, therefore, for the Department to conduct its own investigation into the fair market value of this transaction, to ensure that the nonprofit dollars that would be spent in this transaction are appropriately priced.

IV. Recommended steps to protect the interest of consumers should the merger be approved

Although undertakings do not have the power to make good what is a bad deal for consumers, undertakings are an opportunity for the Department to set up a clear and contractually binding roadmap to bring plans into alignment with the services they should be providing. For a nonprofit such as Delta Dental, that includes setting a framework within which the organization would rise to meet its charitable obligations. Prior to approving this merger, the Department should insist that Delta Dental commit to a set of undertakings that will ensure that it rises to the standards it implicitly agreed to when forming as a tax-exempt social welfare organization. To that end, Delta Dental should agree to:

- Make charitable contributions, such as:
 - Increasing its annual charitable contributions from the current amount to one more appropriate. Here, Delta Dental’s insistence that \$154 million, or 5% of its assets, is an appropriate measure for what is or is not a “substantial” sum can be a proxy measure for what could be considered an appropriate level of charitable

giving for a tax-exempt social welfare organization.

- Supporting locally-based consumer assistance programs targeting low-income individuals, including the Denti-Cal program.
- Contributions to strengthen the health and dental care delivery system through programs intended to improve infrastructure at the plan and provider level.
- Improve the quality of its products
 - Report to the Department on key quality metrics to ensure that dental plan enrollees have timely access to in-network care, and that the benefits are structured to promote dental health. Within a specified period of time after submitting the report, the dental plan would agree to work with the Department to identify and improve areas where quality scores should be improved.
 - Correct the root causes of the recent spike in enforcement actions, which appear centered around failure to follow the appropriate timeline in the grievance process.
- Guarantee that premium dollars go towards claims not profits and salaries
 - Make every effort to keep its dental insurance premium rate increases to a minimum. It should agree to submit proposed rate increases to the Department, and to meet with and confer with the Department and make a good-faith attempt to resolve differences regarding premium rate increases.
 - Adhere to a reasonable dental loss ratio, similar to the 80% (individual and small group) and 85% (large group) required of health plans.
 - Annually file with the Department an actuarial memorandum, signed by Delta Dental's chief actuary, Chief Financial Officer, or similar authorized officer, certifying that no portion of the cost components of any premium rate charged for any Delta Dental product offered in California includes a charge related to the acquisition purchase price or to charitable contributions. This would apply to all business lines offered by Delta Dental.
 - Refrain from granting, in connection with the merger, additional compensation of any kind, or hastening or increasing compensation of any kind, to any Delta Dental or Moda executive or manager, including compensation through a consulting agreement or bonus. Delta Dental should further agree that no additional distribution or payment of compensation will be made to its directors or officers in connection with this merger.
- Increase diversity of network providers and enrollees
 - Systematically review the representation of minority dentists within its network. Work with the Department to design and execute a strategy to actively engage in efforts to increase the representation of Black, Hispanic or Latino, and American

Indians or Alaska Natives among dentists in California.¹² Such as by creating more incentives and opportunities to recruit and place diverse dentists over a longer time period.

- Work with the Department to review availability and access to dental coverage in its geographic service areas, and design and execute strategies to maintain and improve access to coverage and care for underserved populations.

We thank the Department for conducting a rigorous review of this proposed merger and for ensuring that the interests of consumers remain at the forefront.

Sincerely,

Consumer Reports

California Pan-Ethnic Health Network

Health Access

Western Center on Law & Poverty

¹² According to report published in Health Affairs, the underrepresentation of minority dentists “raises concerns about the diversity of the dental workforce, disparities in access to dental care and in oral health status, and social justice.” Elizabeth A. Mertz, Cynthia Wides, Aubri Kottek, Jean Marie Calvo, and Paul E. Gates, *Underrepresented Minority Dentists: Quantifying Their Numbers and Characterizing the Communities They Serve*, Health Access (December 1, 2016).