SENATE PUBLIC HEALTH, WELFARE & SAFETY SB317

EXHIBIT NO. 7

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BILL NO. SB317

Blue Cross focus of bill

By CHARLES S. JOHNSON - IR State Bureau - 02/11/05

HELENA — As a Senate committee prepared to hear a strong bill today to regulate Blue Cross and Blue Shield of Montana's assets if it converts from a not-for-profit to a for-profit company, Blue Cross officials, the state's insurance commissioner and its attorney general were negotiating a separate agreement on these issues.

Senate Bill 317 is set for a hearing at 3 p.m. today before the Senate Public Health Committee. The original sponsor of the bill, Sen. John Cobb, R-Augusta, has handed over the so-called conversion bill to Sen. Greg Lind, D-Missoula, a physician.

Meanwhile, representatives of Blue Cross, state Auditor and Insurance Commissioner John Morrison and Attorney General Mike McGrath were negotiating their own agreement on conversions intended to replace the bill. The last version Lind said he saw was in its 12th draft.

The bill would apply to any insurance company that qualifies, but is aimed at Blue Cross and Blue Shield of Montana.

Blue Cross officials have told him they prefer an agreement to a bill, and they would like him to drop the bill, Lind said. Company officials have told legislators Blue Cross has no plans to convert to a for-profit corporation.

"My response is if there are no plans to convert, it (the bill) should be a non-issue," Lind said.

He said he asked four Blue Cross lobbyists to help him make the bill better, but they told him they want the agreement and see no need for the bill.

"I have to be convinced any written agreement would provide sufficient protections for Montana," Lind said. "My whole goal is to protect Montana assets for Montanans. If it's sufficient, I'm happy and I can (drop the bill and) expend my energies in other areas."

A number of Blue Cross companies around the country have converted in recent years from not-for-profit to for-profit companies, sometimes over the objections of consumer groups. State regulators have fought some of the conversions.

Among the key points in the bill, Lind said, are:

- Determining what becomes of the public assets accumulated by the not-for-for profit company if it becomes a for-profit entity.

- Outlining what role the state insurance commissioner and attorney play in approving any conversion.

- Stipulating that the insurance commissioner conduct a public hearing within 90 days after receiving a conversion request from Blue Cross or another insurance company.

- Authorizing the insurance commissioner, attorney general or both to hire experts to evaluate the conversion proposal and its impact on the state and its residents.

Blue Cross, under Peter Babin, its former chief executive officer, president and chairman, hired an East Coast law firm to prepare a conversion bill for the 2003 Legislature. After receiving a cool response from McGrath and Morrison, the company abruptly dropped plans and never tossed the bill in the hopper.

Babin resigned from the company earlier this year, after extensive criticism from some directors and senior management over how he ran the company.

In a letter sent last week to Lind, Cobb and Rep. Tom Facey, D-Missoula, Jerry Lusk, acting chairman of the Blue Cross board, said the directors wanted to assure them "that we have no interest in converting our company to a for-profit company." Lusk said the company didn't have any intention of doing so in the past, he said.

"We closely monitor health care policy direction at both the federal and state level," Lusk wrote. "Based on potential public policy changes and marketplace activities in 2001 and 2002, the CEO at BCBSMT (Babin) believed the company's future as a not-for-profit, independent Blue plan was uncertain."

Consequently, Lusk said, Blue Cross, prior to the 2003 Legislature, requested draft legislation to define the process by which a not-for-profit corporation could convert to a for-profit corporation.

"The purpose of the legislation was to provide a 'roadmap' only in the event such conversion became necessary because of external forces," Lusk said. "We no longer see public policy or business reasons to convert, and there is certainty that BCBSMT's future is as a not-for-profit, independent Blue Plan."

Lusk concluded by reiterating that the company "has no interest now or in the future of converting to a for-profit organization."

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EXECUTIVE SUMMARY

In the past decade, hundreds of nonprofit health care institutions–HMOs, health insurers, and hospitals–have converted into for-profit companies. In 1981, 82 percent of the nation's HMOs were nonprofit institutions; by 1995, only 29 percent fell into this category.[1] Nationally, the number of nonprofit hospitals merging with or being acquired by for-profit chains climbed from 18 in 1993 to 63 in 1996.[2]

Each of these nonprofit health care institutions is worth millions, sometimes billions, of dollars. A single nonprofit hospital can be worth hundreds of millions of dollars, while a nonprofit health insurance plan is generally much more valuable. A 1991 U.S. Senate committee report estimated that the country's Blue Cross and Blue Shield plans alone had assets of $30.1 billion, a number some say has doubled since then.[3] Malik Hassan, CEO of Health Systems International, one of the nation's largest health insurers, recently estimated the assets of the nation's nonprofit health insurers at $92 billion.[4]

How the conversion phenomenon will affect health care services is being examined and debated. Some health care analysts fear that the unprofitable but vital services traditionally provided by nonprofits are at risk. Others feel that the differences in services provided by nonprofits and for-profits are minimal.

In each conversion transaction questions emerge about the future of the assets held by the converting nonprofit. These charitable assets often were originally designated as permanently dedicated to serving the medical needs of local communities and were increased through charitable contributions, taxes foregone, and volunteer time.

Generally, when a nonprofit converts, both federal and virtually all state laws require it to dedicate or transfer the full value of its assets to a similar charitable purpose. In exchange for their special nonprofit status, these institutions were obligated to provide public benefits or services to the local community. Essentially, the laws require assets that have been dedicated to charitable purposes to be channeled into public benefits.

However, the actual stories of what happened to the assets of nonprofit health institutions as they converted into for-profit companies are mixed. In 1996, for example, Blue Cross and Blue Shield of Georgia (BCBSG) was allowed to transform into a for-profit company without setting aside any of its assets for charitable purposes. The year before that, the state legislature allowed BCBSG to amend its nonprofit corporation laws so that it could turn itself into a for-profit insurance company without transferring assets that were originally held in trust for the public. Also in 1996, Trigon Blue Cross and Blue Shield of Virginia was required to distribute $175 million to the state treasury and to disburse a small amount of stock to policyholders when it converted into a for-profit company. Finally, in the same year, Blue Cross of California, after receiving a great deal of public and regulatory attention, was required to transfer an amount equal to the full fair market value of its assets—over $3 billion—to two new foundations that continue its original charitable purpose of serving California's health care needs.

To ensure that these nonprofit assets remain focused on charitable projects and are neither lost to individual enrichment nor used to fund for-profit ventures, it is crucial to determine the proper valuation of the nonprofit health care institution's assets. Early conversions often were characterized by serious undervaluation, particularly those transforming nonprofit insurers into for-profit companies. In some cases, the nonprofit health plans' insiders received approval to purchase the organization for what they said it was worth and then garnered multimillion dollar windfalls when they sold shares in the new for-profit on the open market. In 1985, for instance, a group of managers, directors, and doctors affiliated with Group Health of Greater St. Louis, a nonprofit HMO, bought the organization for $4 million, issuing themselves stock valued at 33 cents a share. The $4 million "value" of the nonprofit was dedicated to charitable purposes. A year later, however, a quarter of the for-profit company's stock was sold for $10 million, or $14.28 a share—more than 43 times the original price. Thus, the real value of the institution went to the stockholders, not into any benefits or services for the public.[5] Ultimately, the amount that will be preserved for charitable purposes depends not just on the specifics of each case but also on the method of valuation used and the level of scrutiny by regulators, legislators, the media, and the public.

Just in the last year, increased public scrutiny and regulatory oversight of conversion transactions have reduced the potential for undervaluation of converting nonprofits' assets and multimillion dollar windfalls to for-profits. For example, in 1997, the Ohio Insurance Department rejected the proposed deal between Blue Cross and Blue Shield Mutual of Ohio and Columbia/HCA, the nation's largest for-profit hospital chain, because the deal deprived policyholders and the public of their rights. Also in 1997, Sharp Hospital, a nonprofit health system in San Diego, California, canceled a proposed deal with the for-profit hospital chain Columbia/HCA, stating that a prolonged fight with the California attorney general, who opposed the deal, was not in the best interests of the community or the organization.

Since 1996, legislation to clarify, and in some cases to increase, regulators' responsibilities and to provide for public scrutiny has been passed in 16 states and the District of Columbia including California, Nebraska, Arizona, Georgia, Ohio, and Washington. Similar legislation is pending in several other states.[6]

Conversions of nonprofit health care institutions into for-profit companies has already resulted in the largest transfer of charitable assets in history, according to a May 1997 *New York Times* article.[7] Many nonprofits that have converted in the last few years have distributed their assets to newly created private foundations. So far, nearly $9 billion has been transferred to at least 80 new foundations.[8] Recently, the mission and operations of these new conversion foundations have been closely examined, as has the composition of their boards of directors and the steps they have taken to respond to community needs and concerns. There has been considerable controversy over what types of projects the foundations should fund.

The benefit to Americans of the increasing dominance of for-profit health care entities continues to be debated, as does the future of the assets of converting nonprofits. It is clear, however, that the close attention of regulators and legislators, combined with greater public involvement, maximizes the potential for dedicating the full value of a converting nonprofit's assets to charitable health purposes.

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Differences Between Nonprofit and For-profit Health Corporations

The important distinctions between nonprofit and for-profit health corporations illustrate the special obligations nonprofits owe to their communities. These distinctions fall into the five following categories: **purpose, ownership, use of assets, dissolution** and **tax status.**

CHARACTERISTIC	NONPROFITS	FOR-PROFITS
MISSION AND PURPOSES	Organized for charitable, benevolent, educational, or social welfare purposes Serve the broader public	Primary concern is profit-making
OWNERSHIP	Effectively, the public is its only owner	Private Individuals Stockholders Private Investors Policyholders/Members
USE OF ASSETS	Assets generated must remain in nonprofit sector and further nonprofit purposes Prohibition against private inurement	Profit generated can be distributed to private individuals and used to increase value of stock and other investments
DISSOLUTION	Assets must be used to further nonprofit purposes	No similar obligation; assets can be distributed to private individuals
TAX STATUS	Full or partial tax-exemption	No tax-exemption

Purpose: The purpose of an organization establishes why it was formed and/or its mission. A nonprofit health corporation commits to uphold a charitable, educational, benevolent, or social welfare purpose and its activities must advance that public purpose. A for-profit focuses on the financial bottom line and works to maximize stockholder or private investor profits. While not all nonprofit corporations have charitable, benevolent or social welfare purposes (for example, the National Rifle Association (NRA) is a nonprofit corporation), most nonprofit health corporations are organized with a broad public and/or charitable purpose.

Ownership: Ownership determines who can benefit from the corporation and identifies to whom the board or executives are responsible. Essentially, the public is the owner of a nonprofit corporation. The board of directors and executives who run a nonprofit do not own it; rather they are trustees who manage the nonprofit and its assets to ensure that the charitable or public purpose is fulfilled.

In contrast, for-profits are owned and operated by private individuals -- often shareholders. In the health setting, the interests of the private investors - to maximize profit - can be diametrically opposed to the interests of health consumers - to get the best care possible, regardless of cost.

Use of Assets: A nonprofit is more restricted in its use of assets or money generated by the corporation than a for-profit corporation. Money made by a nonprofit must remain in the nonprofit sector and be used to further the charitable purpose of the organization. Assets, and money generated from the assets, cannot be used to benefit private individuals. When an insider, such as a board member or executive, personally benefits from the assets of a nonprofit it is called "private inurement" and is illegal.

Money made by a for-profit corporation, on the other hand, can be distributed to stockholders or private owners as dividends, can be invested back in the for-profit venture, or can be paid out in executive compensation. The prohibition against private inurement does not apply to a for-profit corporation.

Dissolution: Significant restrictions govern how nonprofit corporations may distribute their assets upon dissolution. When a nonprofit corporation can no longer continue its purpose and/or mission, its assets must be distributed according to the corporation's dissolution clause, usually found in the nonprofit's incorporation papers and/or under the state nonprofit code. Most state laws require nonprofits to transfer all of their assets upon dissolution to another nonprofit corporation that has a purpose similar to the dissolving nonprofit.

A for-profit can distribute its assets to private individuals and is under no obligation to continue to use the assets consistent with the original corporation's purpose.

Tax Status: The Internal Revenue Service categorizes nonprofits and for-profits differently. While for-profits must pay taxes and cannot accept tax deductible donations, many nonprofits are fully tax-exempt, paying no federal income taxes and no state or local income, sales or property taxes. Most can accept tax-deductible donations and all must use their assets for the nonprofit purposes identified in their incorporation papers. Nonprofits are commonly organized under sections 501(c)(3) or 501(c)(4) of the federal tax code. Although Blue Cross and Blue Shield plans pay federal taxes, they usually get reduced rates under section 501(m) of the federal tax code. In addition, nonprofits are often limited in their ability to lobby. For-profits are not restricted in their lobbying activity and are not required to organize or use their assets for any prescribed purpose.