THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS

1750 OCEAN PARK BOULEVARD, #200, SANTA MONICA, CA 90405 - 4938
TEL: 310-392-0522 • FAX: 310-392-8874 • NET: CONSUMERWATCHDOG.ORG

Monday, June 14, 2004

Cindy Ehnes
Director
California Department of Managed Health Care
980 9th Street, Suite 2450
Sacramento, California 95814

RE: Public Hearing on Proposed WellPoint/Anthem Merger Needed to Address Significant Patient Care Concerns

Dear Ms. Ehnes,

It is clear from the litany of serious questions raised at last week's legislative hearing on the pending merger between Blue Cross of California's parent company, WellPoint Health Networks, and Anthem Inc. that your Department must conduct its own public hearing and delay any decision to approve the deal.

The responsibility to protect the quality and continuity of patient care is yours and Governor Schwarzenegger's alone. We have provided a summary of unresolved issues below, the most troubling of which is how Blue Cross of California's $4.8 billion in assets will be used by, or transferred to the new merged company. As of March 31, 2004 Blue Cross of California had $1 billion in premium funded reserves – called Tangible Net Equity (TNE) – $792.9 million more than that required by state law.

In what appears to be a move to make the company more attractive to shareholders who must approve the merger deal, $188.5 million of Blue Cross's excess reserves have already been liquidated since December 31, 2003.

Those reserves represent payments made to Blue Cross of California in good faith by patients and employers to secure health care coverage. Every dollar siphoned away from the company means that patients and business owners must pay more for less health care or face cutbacks in coverage benefits, quality or access to care. For some families, even small increases in premium costs – following years of double digit increases – may mean that they must drop their coverage or move to catastrophic (high deductible) coverage.

Of particular concern is that the proposed $607 million pay out to company executives – an amount which has not been fully disclosed to shareholders – will in one way or another come from Blue Cross of California. Anthem Inc. CEO Larry Glasscock's testimony that Anthem Inc. will pay for the executive bonuses is a physical impossibility. Here's why:

1. The new merged company could immediately siphon off Blue Cross of California's premium funded reserves. Company executives have said this will not happen, but Blue Cross of California has been doing just that for years by transferring profits, called "upstreaming," to its current parent company, WellPoint Health Networks, Inc.
2. Anthem could pay for the executive bonuses with its own assets, which under the merged company are really the assets of WellPoint and Blue Cross of California, and transfer reserves and profits from Blue Cross over several months or years.

Either way, money is being stolen from Blue Cross patients. The excess reserves must be kept in the state and, i) refunded to Blue Cross of California enrollees whose premiums have paid for the reserves; or, ii) held in trust to provide health care for the thousands of California families that cannot afford skyrocketing health care costs.

In addition to the numerous unanswered questions, we were troubled by Kevin Donohue's – your representative at the hearing – unwillingness to acknowledge the Department's significant oversight authority. As you know, the Department has the authority to deny or require changes to the Change in Control request in order to assure continued access to quality health care and provide the full protection of state laws governing HMOs and health insurers. Donohue's reluctance bodes poorly for patients and gives the perception that political strings are being pulled by those outside the Department.

Equally troubling was your response to our Public Records Act request in which you cited concern over the privacy rights of company executives as the reason to withhold 500 pages of documents from public view. The public's right to know should trump the privacy rights of executives.

First of all, the Department must divulge all the details of the merger in order for the public and policy makers to evaluate its full impact. Based on the information we have, the key unresolved issues include:

<u>Size of the Proposed Executive Cash Payouts</u>

Company executives testified that the actual cost of the executive cash payouts would be closer to the lower end of the range provided, or $147 million. They argued that the majority of Blue Cross executives would remain employed at the new merged company and would therefore not be eligible for severance payouts constituting the upper end of the range, $356 million. Company executives testified that an employee would have to be "terminated" to receive severance pay.

However, on page 3 of the first attachment of the compensation document your office faxed to us on the evening before the legislative hearing, employees are provided a “constructive termination” option. This option allows company executives to receive severance payouts up to three years after the completion of the merger by meeting one of several give-away standards. These include: if their title or pay level changes or if they are required to relocate “more than 35 miles from his or her current employment location.”

Given the long period of time – 3 years – that a company executive would be able to secure a new job elsewhere while remaining eligible for severance, and the low threshold to qualify for “constructive termination,” the final total of cash payouts is likely to be much closer to the $356 million total.

Furthermore, these figures do not appear to include executive retirement benefit bonuses of $55.8 million described on pages 69-73 of the Anthem/WellPoint Joint Proxy Statement.

<u>Continuity of Care Guarantees</u>

These issues are unresolved because Anthem, WellPoint and Blue Cross of California representatives seem to be unwilling to guarantee in writing as undertakings in the merger agreement:

- ✓ That premiums, co-payments and other rates will not increase more than the rate of inflation for five years following the merger.
- ✓ Not to engage in "cherry-picking" to weed out severely ill customers.
- ✓ Not to change Blue Cross' network of doctors, physician protocols, hospitals and list of approved drugs for at least five years following the merger.
- ✓ To adequately integrate and improve information technology systems, arrangement of care and payment processing so that there is no disruption to Blue Cross patients after the acquisition.
- ✓ To preserve access to, and emphasis of preventive programs, preventive health care services, and disease management services.
- ✓ That the merged company will not adopt Anthem’s practice of barring patients from accessing new prescription drug treatments or medical technologies for six months from the date they are approved by the Food and Drug Administration.

Access to Public Programs

Blue Cross is the state's second largest health insurer and largest provider in the California Medi-Cal program which provides health care for low-income and disabled Californians. Will Anthem and WellPoint guarantee in writing that the merged company will continue coverage for patients enrolled in Blue Cross Medicare, Medi-Cal, Healthy Families, Access for Infants and Mothers (AIM), MRMIB and other public programs?

A merger of this magnitude with unknown impacts on patients and the stability of California's health care system should not be rushed through to meet the schedule of profiteering company executives.

Your responsibility to protect California patients and uphold the public trust requires that Department conduct extensive public hearings, reduce executive payouts, and demand continuity and quality of care guarantees before approving the merger.

Regards,

Jamie Court	Jerry Flanagan
(310 392-0522 ext. 327	(415) 633-1320

cc: Governor Schwarzenegger
Insurance Commissioner John Garamendi
California State Legislature
Business, Transportation and Housing Agency Secretary Sunne McPeak
Health and Human Services Agency Secretary Kim Belshe
Department of Managed Health Care Senior Council Kevin Donohue