GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF INSURANCE AND SECURITIES REGULATION

In Re: Group Hospitalization and Medical Services, Inc.	))))	**A-HC-97-01**

DECISION AND ORDER

Jurisdiction

Jurisdiction properly resides before the District of Columbia Department of Insurance and Securities Regulation (DISR) pursuant to the Holding Company Systems Act of 1993, D.C. Code § 3701, et seq. ("HCS Act") and the D.C. Administrative Procedures Act, D.C. Code § 1-1501 et seq., for the purpose of considering the proposed business combination agreement between Group Hospitalization and Medical Services, Inc. ("GHMSI"), a non-profit corporation organized under federal law, doing business as Blue Cross/Blue Shield of the National Capital Area ("BCBS-NCA"), and Blue Cross/Blue Shield of Maryland, Inc., a non-profit corporation organized under Maryland law ("BCBSMD").

Procedural History

On February 6, 1997 GHMSI and BCBSMD jointly filed a Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer (Form A) with the insurance administrations of the District of Columbia, Maryland and Virginia. The filing has been amended on several occasions, as recently as November 14. That filing is properly before the DISR pursuant to the authority referenced above.

GHMSI was federally chartered by an act of Congress. It has a license from the National Blue Cross/Blue Shield ("BCBS") Association, which enables it to market health insurance utilizing the BCBS trademark and trade name. GHMSI's BCBS Association territory includes the District of Columbia, the northern most portion of Northern Virginia and Prince George's and Montgomery Counties in Maryland. Because GHMSI does some business in Maryland, it is licensed by the Maryland Insurance Administration ("MIA") as a non-profit health services plan. It is also licensed in Virginia.

GHMSI is presently governed by the terms of a Consent Order (No. 93-09) which was ratified on February 12, 1993. Prior to that time, GHMSI, as a federally chartered entity, was not

clearly subject to the regulatory purview of DISR. During the first few years of this decade, GHMSI embarked upon a program of over-expansion and financial irresponsibility. See, e.g., Hearings before the U.S. Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs (Jan. 26-27, 1993); Gov't. Ex. 12. These hearings highlighted the financial and operational troubles of GHMSI. GHMSI's financial and operational decline was halted by an infusion of capital in the form of a subordinated surplus note in the amount of $55 million from the National BCBS Association and the institution of the Consent Order.

BCBSMD is a Maryland nonprofit corporation. It is licensed by MIA as a non-profit health services plan. It is also licensed by the National BCBS Association. Its territory includes the entire state of Maryland with the exception of Prince George's and Montgomery Counties.

In brief, the business combination proposal submitted for approval by DISR ("Proposed Transaction") would enable GHMSI and BCBSMD to collaborate at the business operations level without altering the corporate existence of either GHMSI or BCBSMD. As set forth the Business Combination Agreement filed by GHMSI and BCBSMD on March 28, 1997, this combination of operations will be attained by the establishment of a Maryland domiciled holding company ("HOLDCO"), which will become the sole voting member of both GHMSI and BCBSMD. The Proposed Transaction envisions that HOLDCO's Board of Directors will consist of eighteen members with representation from BCBSMD and GHMSI roughly proportionate to the relative size of those two entities.

The Proposed Transaction initially envisioned that legislation would be passed by the U.S. Congress repealing GHMSI's federal charter, which would then enable the rechartering of GHMSI under the District of Columbia Nonprofit Corporation Act, D.C. Code Ann. § 29-501 et seq. However, Congress did not pass such legislation. It did pass H.R. 3025, which amends GHMSI's charter to permit the GHMSI Board of Trustees to designate a class of no less than one nor more than 30 members and that any corporate member shall be a non-profit corporation.

The purpose of the Proposed Transaction is to establish a more competitive and efficient non-profit health service plan. It is intended to enhance the financial strength of the two companies, to maintain local control (rather than affiliating with a company from outside of the area), to take advantage of the resources of the two companies, to gain efficiencies of scale, and to enhance the ability to offer products demanded by consumers. See Tr. 9/8/97, p. 31-34.

The HCS Act requires the Mayor, or the duly authorized designee of the Mayor (in this case the Commissioner of the DISR), to approve any merger or acquisition of control unless, after a public hearing, the Mayor finds any one of the following criteria:

- After the change of control, the domestic insurer (GHMSI) "would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed". D.C. Code Ann. § 35-3703(g)(1)(A);

- The effect of the merger or acquisition of control would be "substantially to lessen competition in insurance in the District or tend to create a monopoly". D.C. Code Ann. § 35-3703(g)(1)(B);

- The financial condition of "any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interests of its policyholders". D.C. Code Ann. § 35-3703(g)(1)(C);

- The proposals to consolidate, sell assets or merge or to make any other "material change in its business or corporate structure or management" are "unfair and unreasonable to policyholders of the insurer and not in the public interest". D.C. Code Ann. § 35-3703(g)(1)(D);

- The "competence, experience, and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer or of the public to permit the merger or acquisition of control". D.C. Code Ann. § 35-3703(g)(1)(E);

- The acquisition is "likely to be hazardous or prejudicial to the insurance-buying public". D.C. Code Ann. § 35-3703(g)(1)(F);

In order to determine the facts necessary to make a finding under the criteria required by the HCS Act, the staff of DISR embarked upon a fact finding process prior to the commencement of the hearing envisioned under the HCS Act. The DISR staff held numerous meetings with representatives of GHMSI and BCBSMD, obtained voluminous documentation regarding the financial and operational aspects of the Proposed Transaction, see generally, DISR # 1-149,[1] and coordinated its efforts with the representatives of the Maryland Insurance Administration and the Virginia Bureau of Insurance.

DISR also coordinated its efforts with those of the District of Columbia Office of Corporation Counsel ("OCC"). The Hospital and Medical Services Corporation Regulation Act ("D.C. Medical Services Act"), D.C. Code Ann. § 35-4701 et seq., establishes that in the event that a non-stock, non-profit hospital and medical services corporation proposes to convert to a for-profit stock insurance company, D.C. Code Ann. § 35-4715(a), or mutual company, D.C. Code Ann. § 35-4716(a), the approval of the Mayor will be required. GHMSI has not yet been

[1] Citations to written documentation or oral testimony will be as follows: Transcript ("Tr. [date] ___); Exhibits received into evidence at the hearings ("Gov't. Ex.__ for DISR Exhibits and "GHMSI Ex." ___ for GHMSI Exhibits); All correspondence and legal documents received by DISR ("DISR # ___"). In some instances, documents will be included both in the DISR document record and the hearing record.

qualified as a Hospital and Medical services corporation, but the Proposed Transaction contemplates that it will do so.

DISR referred to OCC the question of whether the Proposed Transaction would qualify as a "conversion" and, in the event of such conversion, what the effect, if any, would be on the title to the assets held by GHMSI. On November 24, 1997, OCC submitted its Proposed Findings of Fact and Recommended Conditions on the Business Combination of Group Hospitalization and Medical Services, Inc. and Blue Cross/Blue Shield of Maryland, Inc. After receiving comment, OCC submitted its Conditions for the Approval of the Business Combination, which has been considered and, in part, been incorporated into this Decision and Order.

Pursuant to the authority contained in the HCS Act, D.C. Code Ann. § 35-3703(g)(3), DISR retained Deloitte & Touche as its financial consultants. The Deloitte & Touche Report, which was submitted on November 1, 1997, examined the potential impact of the Proposed Transaction upon the financial stability, corporate structure, and management on GHMSI. The Deloitte & Touche Report concluded that the Proposed Transaction would result in administrative and automation efficiencies, marketing and product offerings, and overall financial stability so long as conditions set forth in the Report were fulfilled. Deloitte & Touche Report, pp. 20-22, DISR # 93. Deloitte & Touche concluded that in approving the Proposed Transaction, DISR recommended imposing several conditions in the Order, which can be summarized as follows: (1) BCBSMD, GHMSI and HOLDCO should provide DISR with a detailed financial/business plan; (2) the business combination should be monitored by DISR to verify the execution of the business strategy; (3) DISR should monitor any changes in top management and/or senior executive compensation arrangements; (4) the allocation of affiliation expenses should be reviewed by DISR; and (5) DISR should review any tax sharing arrangement implemented among GHMSI, HOLDCO, and BCBSMD. Id. at 21-22.

Pursuant to the authority under the HCS Act, D.C. Code Ann. § 35-3703(g)(1), DISR held public hearings regarding the Proposed Transaction on September 8 and 9, 1997 and November 4 and 5, 1997. Notices of those hearings were issued on July 14, DISR # 6, August 1997, DISR #7, and September 6, 1997, DISR # 49. Testimony was presented by representatives of GHMSI, their financial consultant, Goldman, Sachs & Co., DISR's financial consultant, Deloitte & Touche, members of the public, and other interested persons.

DISR also participated in the hearings held by the Maryland Insurance Administration ("MIA") on September 4, 1997 and November 10, 1997. At these hearings, testimony was presented by representatives of BCBSMD, their financial consultant, Bear, Stearns & Co., the financial consultant for the Maryland Insurance Administration, KPMG Peat Marwick, and members of the public.

Findings of Facts

After having considered all of the testimony and all of the documents submitted for the record, we make the following findings of fact:

1. On or about February 6, 1997, GHMSI and BCBSMD filed a joint application with the DISR.

2. On or about March 28, 1997, GHMSI and BCBSMD filed a Business Combination Agreement with the DISR setting forth the structure and operating procedures for the new entity.

3. GHMSI and BCBSMD are proposing to merge operations under a to-be-formed, upstream holding company, which will be domiciled in the State of Maryland.

4. In support of the Proposed Transaction, GHMSI and BCBSMD have asserted the need to become part of a larger organization in order to effectively compete in an increasingly competitive health insurance market. They refer to increased competition from national for-profit insurance companies that are able to raise additional capital on the financial markets and reduce overhead by exerting downward pressure on suppliers and providers, which result in increased economies of scale. Through this combination of two non-profit entities, the companies propose to create a larger more efficient organization, which will, they assert, create similar economies of scale, and result in better service for the subscribers that live and work in their contiguous markets.

5. GHMSI currently markets branded and unbranded products.[2]

6. GHMSI and BCBSMD both currently own for-profit subsidiaries, which is permitted by the laws in both jurisdictions.

7. GHMSI currently sells branded health insurance products in the District of Columbia, parts of Northern Virginia and Prince George's and Montgomery Counties.

8. BCBSMD currently sells its branded health insurance products throughout the State of Maryland, with the exception of Prince George's and Montgomery Counties.

9. The proposed composition of the boards of directors of GHMSI, BCBSMD, and HOLDCO consists of interlocking boards of directors. As a result of the interlocking boards of directors, it is probable that conflicts of interests will result in the governance of the combined organization.

10. The Blue Cross Blue Shield National Association will give HOLDCO the right to use the Blue Cross Blue Shield trademark. GHMSI and BCBSMD will become controlled affiliates (for trademark purposes) of HOLDCO, which will enable GHMSI and BCBSMD to market Blue Cross Blue Shield products throughout the combined market area.

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[2] The term "branded products" refers to health care insurance products that are offered by a Blue Cross Blue Shield plan bearing the trademark issued by the Blue Cross Blue Shield National Association. Currently, GHMSI and other Blue Cross Blue Shield plans sell "unbranded" health care insurance products (products that do not bear the Blue Cross Blue Shield brand) through their subsidiaries outside of the exclusive licensing area granted by the Blue Cross Blue Shield National Association.

11. After the transaction is approved, GHMSI and BCBSMD intend to choose existing health insurance products offered by each organization and market them throughout the combined jurisdiction under a unified marketing force.

12. Premiums generated by insurance products sold in GHMSI's current market area will accrue to GHMSI's books. However, premium taxes will not accrue to the District of Columbia on GHMSI's products sold outside of the District of Columbia.[3]

13. GHMSI has made a Scott Hart Rodino filing with the Justice Department and the Federal Trade Commission for the purpose of informing them of the proposed business combination and its potential effect on competition in each market. The Justice Department failed to raise any objections to the merger during the time permitted by statute for doing so.

14. In addition to becoming a unified marketing force, the companies anticipate that they will be able to reduce their combined overheads by creating other efficiencies. Such changes may include one claims department, one underwriting department, one customer service department, and one general counsel's office.

15. GHMSI retained the brokerage firm of Goldman Sachs to render an opinion regarding how the Proposed Transaction would effect GHMSI's creditworthiness. After examining the transaction, Goldman Sachs opined that the Proposed Transaction would not have a negative impact on GHMSI's creditworthiness.

16. The DISR retained the consulting firm of Deloitte & Touche to review the transaction and to advise the DISR on its opinion of the proposed business combination.

17. During its review, Deloitte & Touche interviewed employees of GHMSI and BCBSMD regarding the Proposed Transaction, reviewed marketing information, and financial records, and other documents to obtain an understanding of the business combination, and whether its stated goals could reasonably be obtained.

18. Based on their review, Deloitte & Touche opined that the proposed business combination was reasonable and that the proposed efficiencies and financial projections could be obtained if the venture was successful. However, Deloitte & Touche stated that certain critical information, such as a combined business plan, combined marketing information, and combined reimbursement rate data was unavailable. Accordingly, Deloitte & Touche made recommendations, in its final report, that it stated should be made conditions for the approval of the transaction.

19. The proposed business combination will result in the restructuring of management, substantial changes in operations, particularly in the area of marketing insurance products, and the companies' contractual relationships with health care providers.

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[3] Premium taxes are paid to the jurisdiction where the risk insured is located. For example, GHMSI currently pays premium taxes to the State of Maryland on products it sells in Prince George's and Montgomery Counties.

20. Even though the GHMSI and BCBSMD will retain their separate corporate existence, once the transaction is approved and the business combination plan has been implemented, it will be difficult to separate GHMSI from BCBSMD due to, for example, intercompany transfers of assets and the joint purchases of equipment.

21. Some highly compensated GHMSI executives are parties to employment agreements that provide severance pay as a result of a "change in condition".

22. GHMSI provides an "open enrollment" plan to the residents of the District of Columbia.

23. GHMSI currently employs a substantial number of employees in the District of Columbia and such employment may be affected by the Proposed Transaction.

24. In the event of a future conversion to a for-profit institution, a pre-business combination picture of GHMSI's assets, revenues, market share, reserve and surplus levels, and other financial information will assist DISR and OCC in the determination of what, if any, assets should be set-aside for charitable purposes and the value of such assets.

Analysis and Conclusions

Recent conversions of non-profit corporations have resulted in "charitable set-asides" of substantial value. The conversion issue has been addressed in no less than ten states. See generally, Statement of Community Catalyst, 11/4/97, p. 3-4; DISR # 102. The largest one of these set-asides amounted to $3.2 billion in California. Id.

Accordingly, the DISR has considered the issue of whether or not a "conversion" would be triggered by the Proposed Transaction. If it were, the Proposed Transaction arguably could not be approved in its current form because a charitable set-aside or other trust obligation would have to be imposed. Because the issue of a "charitable set-aside" is central to the analysis of the entire Proposed Transaction, we will consider it first.

Issues Considered

1. Does the Proposed Transaction Constitute a "Conversion"?

The D.C. Medical Services Act establishes the obligations of a non-profit hospital and medical services corporation in the event that it converts to for-profit status. D.C. Code Ann. §§ 1, 35-4715 and 35-4716. However, the Act does not define what constitutes a "conversion". When a "conversion" occurs depends upon the facts and circumstances of each individual case. A conversion has been defined as follows:

> A conversion takes place when a non-profit institution, such as a hospital, insurance company, or managed care company, changes its status, merges with a for-profit company, or restructures and becomes a for-profit company. A fundamental change in the character of an institution takes place as a result of a conversion.

A Manual on the Conversion of Non-Profit Healthcare Organizations Into For-Profit Corporations, Consumers Unions/Community Catalyst (1997), p. 7.

More specifically, conversions generally can be categorized into one of five types: (1) asset sales, (2) merger of a "charity" into a for-profit entity, (3) a "drop down" conversion, in which the charity contributes assets and liabilities to a newly-formed, for-profit wholly-owned subsidiary, (4) a "conversion in place", in which the exempt organization converts into a for-profit organization and (5) a "joint venture" conversion, in which the exempt organization is converted to for-profit status, buys a portion of its assets, and a new, charitable entity receives the cash value of the assets sold. Lawrence E. Singer, "The Conversion Conundrum: The State and Federal Response to Hospitals' Changes in Charitable Status", American Journal of Law and Medicine (Vol. XXIII, Nos. 2 & 3, 1977), 232-233.

The Proposed Transaction does not directly fit into any of these five categories. No new for-profit entity is proposed to be created, and no sale of assets is proposed to be made to an existing for-profit entity. Nonetheless, the question remains as to whether such a "fundamental change in the character" of GHMSI will occur as a result of the Proposed Transaction that it can be deemed to be a "conversion".

It is the Commissioner's view that such a "fundamental change" cannot happen unless either of the following occurs: (1) the corporate structure of the "charitable" entity is altered such that its "charitable" purpose cannot be implemented or (2) control over the "charitable entity" is so significantly altered that, even though it may appear to be a "charitable" entity, the control of its assets and operation has been altered so significantly that its assets are not utilized for its "charitable" purpose. It is the Commissioner's conclusion that neither of the above will occur as a result of the Proposed Transaction.

First, the changes to GHMSI's corporate structure do not trigger a "conversion". The record is replete with testimony and written submissions by witnesses on behalf of GHMSI and Deloitte & Touche that a corporate merger will not occur as a result of the Proposed Transaction. E.g, DISR # 9, p. 11. An alternative point of view was presented, but the Commissioner found these arguments to be unpersuasive. Both GHMSI and BCBSMD will survive in tact as corporations with the same corporate purpose subject to the same regulatory duties and constraints.

GHMSI's federal charter has been amended to permit a single class of members, and HOLDCO will be the single controlling member for both GHMSI and BCBSMD. Nonetheless,

GHMSI's amended charter will continue to declare it to be a "charitable and benevolent institution" which will continue to be operated for the benefit of its certificate holders. See GHMSI Charter, 53 Stat. 1412.

The parent of GHMSI and BCBSMD (HOLDCO) will be chartered as a Maryland non-profit corporation. HOLDCO will be restricted, pursuant to the terms of this Order in certain respects for the purpose of preventing its status as the parent of two "non-profit" institutions (GHMSI and BCBSMD) from effecting a "conversion". First, the articles of incorporation of HOLDCO will be ordered to include a provision requiring the protection of the non-profit assets of GHMSI and BCBSMD. Accordingly, any action by the Board of Trustees of HOLDCO contrary to this duty would constitute not only an *ultra vires* act, but also a breach of fiduciary duty. Second, HOLDCO will be required to be licensed both as a Maryland non-profit health service plan[4] and as a District of Columbia hospital and medical services corporation. These two requirements will extend the regulatory oversight and control of DISR and MIA to monitor and, if necessary, intervene regulatorily to make certain that these duties are fulfilled.

Accordingly, while the business structure of GHMSI and BCBSMD may have been changed by the establishment of an upstream holding company, the "charitable and benevolent" nature of those two organizations has not been altered. Moreover, the regulatory authority has been established to enforce, if necessary, these obligations of the board of trustees.

The second set of circumstances referenced above, which has also been sometimes referred to as a "rolling conversion", is more problematic. The Fair Care Foundation ("Fair Care"), an opponent of the Proposed Transaction, has asserted that one of its fundamental elements -- the creation of an upstream non-profit holding company which will be the sole member of both GHMSI and BCBSMD -- constitutes a "change of control over GHMSI", which triggers a conversion. Fair Care Foundation's Reply Memo. of Law in Support of its Pet. to Intervene, p.9, DISR # 133. This change in the "power to control", Fair Care asserts, either triggers a "conversion" or at least places "GHMSI's charitable assets... at grave risk". Id. at 9-10. The Commissioner disagrees.

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[4] A Maryland non-profit health service plan is subject to strict scrutiny of its investments and its acquisition of affiliates or subsidiaries. For example, it is required to submit a statement of proposed action to the MIA 60 days prior to the effective date of the proposed action, and the Commissioner is obliged to either approve or disapprove the proposed action. The plan may not, absent the MIA's approval:

> (i) create, acquire, or invest in an affiliate or a subsidiary in order to control the affiliate or a subsidiary;
> (ii) alter the structure, organization, purpose, or ownership of the plan or an affiliate or a subsidiary of the corporation;
> (iii) make an investment exceeding $500,000; or
> (iv) make an investment in an affiliate or a subsidiary.

Maryland Ins. Code Ann. § 14-133(c) (1977).

The Proposed Transaction, as approved, will permit HOLDCO to be established as the single voting member of GHMSI and BCBSMD. Both Blue Cross/Blue Shield plans will continue to operate as non-profit subsidiaries. The initial capitalization of HOLDCO will only be $500,000 -- 2/3 of which will be provided by BCBSMD and 1/3 by GHMSI. The initial Board of Trustees of HOLDCO will reflect the same relative positions (BCBSMD will appoint 12 directors and GHMSI will appoint 6). Significant corporate actions such as any conversion, merger, change of control, equity infusion, change in principal executives, or incurrence of debt will require the affirmative vote of at least 80% of the total number of directors.

Of particular concern to opponents of the Proposed Transaction, e.g., Fair Care and Consumer Federation of America, are the provisions for the transfer of assets between BCBSMD, GHMSI, and HOLDCO. The Intercompany Agreement establishes the terms under which such intercompany transfers could occur. Intercompany Agreement p. 1-6, DISR # 2. In brief, asset transfers could occur in the event that the capital reserves of one of the companies or their subsidiaries should fall below regulatory reserve requirements; if one of the companies is unable to pay member claims; if either company is unable to pay legally enforceable obligation; and, under certain circumstances, for "discretionary" reasons. Id. Such "discretionary" transfers would be restricted by the requirement of obtaining increasing levels of approval commencing with the approval of the CEO of the transferring company for transfers less than $1 million progressing to the approval of the Board of Directors of a transferring company and HOLDCO for transfers in excess of $5 million. Id. These funding transfer provisions were also of substantial concern to DISR and MIA.

Present insurance regulatory authority allows DISR the ability to examine the financial health and market conduct practices of any insurer under its jurisdiction. The D.C. Medical Services Act will impose, when GHMSI becomes licensed, certain duties and obligations that are tailored to address the regulation of a hospital and medical services corporation. See generally, D.C. Code Ann. § 35-4701 et seq. More critically, the HCS Act provides the explicit authority to review intercompany transactions and to require them to be "fair and reasonable". D.C. Code Ann. § 35-3706. The HCS Act specifically provides that any intercompany sale, purchase, exchange, loan, or extension of credit, guarantees or investments that exceed or are equal to 3% of the insurer's admitted assets must be filed for approval by DISR. D.C. Code Ann. § 35-3706(a)(2).[5] DISR also has the authority to require the insurer or its affiliates to produce its books and records and to examine any such affiliates to determine compliance with the law. D.C. Code Ann. § 35-3707(a).

While the broad authority of the DISR to regulate insurers within his jurisdiction and the specific constraints of the HCS Act have, under most circumstances, proven to be adequate to prevent improper intercompany transfers, DISR, in cooperation with MIA, has decided to supplement those regulatory capabilities with the additional constraints contained in this Order. While the precise language of the terms and undertakings of the Order speak for themselves, they can be very briefly summarized as follows: (1) GHMSI will not be permitted to deviate from its Charter as a "charitable and benevolent institution"; (2) GHMSI will provide the information

[5] § 35-3706 provides that DISR has 30 days in which to consider the Proposed Transaction and to disapprove it within such time.

necessary according to any qualified financial consultant to establish a valuation and will continue to provide such relevant information; (3) GHMSI and BCBSMD shall remain separate corporations; (4) GHMSI shall not alter its financial, accounting, legal or tax reporting; (5) GHMSI will substantially maintain its existing level of surplus and reserves; (6) GHMSI will notify DISR of any transfer of $500,000 or more and obtain prior approval of any transfer that is not the subject of a previously approved cost allocation agreement or a mandatory transfer that does not reduce required surplus or reserves (these obligations are supplemental to others contained in other legal requirements); (7) all transfers will be adequately documented and characterized as indebtedness or "reasonable consideration"; (8) GHMSI shall provide notice of any pledging, collateralizing, securitizing or otherwise encumbering any asset of $2 million or more and shall obtain prior approval for any such action regarding an asset of $5 million or more; (9) HOLDCO's charter is required to expressly set forth its duty to safeguard the non-profit nature of GHMSI; (10) the Boards of Trustees of HOLDCO, BCBSMD and GHMSI shall be restructured to minimize interlocking director conflicts; (11) GHMSI will notify DISR of any joint venture purchase with HOLDCO and/or BCBSMD of an asset of $500,000 or more and shall obtain prior approval for participation in any such joint venture regarding an asset of $1 million or more; (12) the executive compensation contracts of GHMSI shall be altered to modify the severance pay due to highly compensated executives due to a "change of control"; (13) both GHMSI and BCBSMD shall be required to be licensed in the District of Columbia and HOLDCO shall be licensed as a Maryland non-profit health service plan by MIA and as a hospital and medical services corporation by DISR; (14) both GHMSI and BCBSMD shall submit a business plan for review by DISR; (15) federal tax advantages associated with accumulated net operating losses will remain with GHMSI; (16) open enrollment shall be continued by GHMSI , BCBSMD and HOLDCO; (17) GHMSI and BCBSMD will cooperate in an effort to standardize classification of information required for statutory accounting; (18) GHMSI will cooperate in an examination by DISR of fee structures of products; (19) GHMSI will endeavor to maintain the current number of employees with attention to their residency in the District of Columbia; (20) GHMSI will cooperate in a market conduct examination; (21) GHMSI, BCBSMD and HOLDCO are prohibited from converting to for-profit status for three years unless otherwise authorized to do so by DISR; (22) GHMSI shall execute cost sharing agreements, which will be subject to regulatory review and approval; (23) a post closing report must be filed; (24) all corporate documents amended pursuant to this Order must be refiled; (25) the transaction is subject to further orders as required; (26) the Order may be subject to further modification; and (27) GHMSI, BCBSMD and HOLDCO shall continue to be subject to the jurisdiction of DISR pursuant to the HCS Act for the purposes of implementing the terms of this Order and the employing of experts necessary for such purpose.

The conditions and undertakings contained in this Order will allow GHMSI to proceed with the Proposed Transaction and to gain the benefits of the "synergies" of a larger market and operational economies of scale, without freeing GHMSI, BCBSMD and HOLDCO from reasonable regulatory constraints. GHMSI and BCBSMD will remain as non-profit corporations, with all of the attendant benefits and duties. In particular, the licensing requirement for HOLDCO imposed by the Order bring HOLDCO within the regulatory authority of both DISR and MIA and impose upon HOLDCO the obligations contained in the Maryland Non-Profit Health Service Plan Act and the D.C. Medical Services Act, as relevant. It is our opinion that the history of GHMSI

and BCBSMD in a less regulated environment, see supra pp. 1-2, and the obligations resulting from their non-profit status render these regulatory restrictions fair not only from the perspective of GHMSI and BCBSMD, but also from the perspective of their certificate holders and the general public, as well.

In sum, it is our conclusion that the restraints imposed by the Intercompany Agreement, the present District of Columbia law and, in particular, the HCS Act and the D.C. Medical Services Act, and the terms of this Order are sufficiently stringent to prevent the occurrence of a "rolling conversion". Therefore, we conclude that a "conversion" will not occur if the Proposed Transaction is approved. Further, GHMSI's assets will not be "at risk".

A final related question is whether or not GHMSI is a "charity" with charitable set-aside obligations. GHMSI has taken the position that it is not such an entity. Substantial testimony was presented by Fair Care and others holding the opposite view.

The determination of "charitable status" is dependent upon a variety of factors: (1) the plain language of the organization's charter, (2) the history of its activities in the public interest, (3) the government's treatment of the organization in the past, and (4) the degree to which the courts and regulators have found other similarly situated organizations to be "charities". Testimony of John Pomeranz, Harrison Institute for Public Law, p. 4; DISR # 103. However, the focus of the hearings before the DISR was whether or not the Proposed Transaction would qualify for approval under the HCS Act. The focus was not the charitable status of GHMSI.

Having determined that the Proposed Transaction is not a "conversion" and that the assets of GHMSI are not "at risk", the issue of whether or not GHMSI is a "charity" does not need to be determined at this time. When, and if, a conversion should occur or be proposed, the issue will become ripe for determination.

2. If the Proposed Transaction is Approved, will GHMSI be able to "Satisfy the Requirements for the Issuance of a License to Write the Lines of Insurance for which it is Presently Licensed"?

There is no reason to believe that after the Proposed Transaction is consummated that GHMSI will be unable to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed. As a corporate entity, GHMSI will remain the same with the exception that its sole member will be HOLDCO. GHMSI will remain subject to the regulatory purview of DISR. In fact, it is the belief of GHMSI that it will be better able to "write the lines of insurance for which it is presently licensed" because it will be better able to take advantage of more efficient management and utilization of capital. E.g., Tr. 9/8/97 pp. 31-34.

3. If the Proposed Transaction is Approved, will it "Substantially Lessen Competition in Insurance in the District or Tend to Create a Monopoly"?

Due to concern regarding a potential for violation of the federal antitrust laws, GHMSI and BCBSMD did not prepare the kind of joint marketing and operational plans that might have

been anticipated. E.g., Tr. 9/9/97 pp. 77-84; GHMSI Responses 11/18/97, attachments I, J, K; DISR #137. Each Blues organization did its own research and, in some instances, coordinated through a "messenger model" by the utilization of an independent third party. Id. As a result, the hearings and requests for information to GHMSI did not produce a unified business plan showing the potential anticompetitive impact, if any.

Nonetheless, substantial information was obtained from GHMSI which summarized the reasons why GHMSI believes that there will not be an anticompetitive impact. See, e.g., GHMSI Responses 11/18/97, attachments I, J, K; DISR # 137. The analysis of the competitive impact suggested by § 35-3704(d)(2) was performed by GHMSI. It indicates that the standard of presumptive antitrust violation would not occur as a result of the Proposed Transaction. Id. at Exhibit K.

It is noteworthy (although in no way dispositive) that GHMSI and BCBSMD made a pre-merger notification filing with the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission pursuant to 15 U.S.C. § 18(a), which did not result in any further action by either federal agency. This, at least, establishes a presumption that the Proposed Transaction will not have sufficient anticompetitive impact to trigger the provisions of either the Sherman Antitrust Act, 15 U.S.C. §§ 1 and 2, or the Clayton Antitrust Act, 15 U.S.C. § 18.

DISR believes that the healthcare market for the District of Columbia is not overly concentrated and will not become more concentrated after the Proposed Transaction occurs. GHMSI and BCBSMD do not now compete in the D.C. market because BCBSMD has been prohibited from doing so.

Nonetheless, in order to make certain that an anticompetitive impact does not occur, the Order requires: (1) BCBSMD and GHMSI to prepare and file for review a business plan, (2) GHMSI to cooperate in a private pricing review, (3) GHMSI to participate in a market conduct review, (4) GHMSI and BCBSMD products to be approved, (5) the licensing of HOLDCO, and (6) the continuing jurisdiction of the HCS Act to make certain that the terms of the Order are monitored and enforced. These obligations, as well as others, will permit DISR to monitor and, if necessary, prevent any anticompetitive impact.

4. If the Proposed Transaction is Approved, will the Financial Stability of GHMSI be Jeopardized by the Financial Condition of HOLDCO or Will the Interests of Policyholders be Prejudiced?

A review of the record indicates that there is no reason to believe that the financial stability of GHMSI will be jeopardized by the financial condition of HOLDCO or that the interests of policyholders will be prejudiced. The Proposed Transaction has been examined in great detail by the financial advisor to DISR, Deloitte & Touche, and by the advisor to the MIA, KPMG Peat Marwick. In addition, BCBSMD's financial advisor, Bear Stearns & Co., MD Tr. 9/4/97 pp. 51-52, and GHMSI's financial advisor, Goldman, Sachs & Co., Tr. 9/9/97 p. 11, examined the Proposed Transaction. Each of these financial experts arrived at the same

conclusion, namely, that the Proposed Transaction did not pose a financial hazard to either GHMSI or BCBSMD.

One of the motivating factors behind the Proposed Transaction is the improvement of the financial stability of GHMSI due to the increased efficiencies and access to capital that is promised by the Proposed Transaction. Of course, the Intercompany Agreement allows capital to flow both to GHMSI from BCBSMD and from GHMSI to BCBSMD. However, the restrictions contained in this Order in conjunction with those contained in existing statutes and regulations enable DISR to monitor and to prevent, if necessary, any outflow of capital that would jeopardize the financial stability of GHMSI or be contrary to the interests of policyholders.

5. If the Proposed Transaction is Approved, will a "Material Change" be made in the Business or Corporate Structure or Management of GHMSI that would be "Unfair and Unreasonable to Policyholders" and "Not in the Public Interest"?

There is more than ample evidence that a "material change" will be made in the business or corporate structure of GHMSI. While the corporate integrity of GHMSI will remain and its non-profit function as a "charitable and benevolent" corporation will remain, it will have one controlling member, namely, HOLDCO. While the management of GHMSI will remain in place, the management at HOLDCO will reflect the dominant position of BCBSMD because the CEO will be William Jews (the present Chairman, CEO of BCBSMD) and the CFO will be Larry Glasscock (the present President and CEO of GHMSI).

This raises the issue of whether a foundation has been laid for the conclusion the Proposed Transaction will be "in the public interest". We believe that, if the Proposed Transaction is effectively implemented and if it results in the benefits projected by GHMSI and BCBSMD, it will be. There was substantial testimony regarding the significant competition in the health insurance industry and the need for marketwide operation. E.g. Tr. 9/8/97 p.28. While the National BCBS Association has for historical reasons divided the Washington, D.C.-Northern Virginia-Maryland market into two markets (one served by GHMSI and the other served by BCBSMD), there is no longer an economic reason for doing so. Advances in communication technology, changes in commuting and employment patterns, and substantial changes in the healthcare industry now lead to the inevitable conclusion that economies of scale can be obtained by having an integrated healthcare delivery arrangement for the territory previously covered by BCBSMD and GHMSI. Moreover, while either GHMSI or BCBSMD could affiliate with a national health insurer or healthcare company, we believe that it is in the best interests of the citizens of the District of Columbia to have a health insurer that is locally controlled. In addition, it is our opinion that it is beneficial to continue to have a health service plan that is non-profit.

These conclusions were supported by a variety of witnesses. Deloitte & Touche testified to the financial and operational benefits that will accrue to GHMSI. Deloitte & Touche Report pp. 1-18, DISR #93. Witnesses for GHMSI, naturally, testified at length regarding the intended benefits of the Proposed Transaction. E.g., Tr. 9/8/97 pp. 16-70. In addition, DISR received numerous letters from the public supporting various aspects of the Proposed Transaction. E.g., DISR # 87, 88, 89, 92, 109, 110, 111, 112, 115, 127, 131, 135.

On the other hand, there were vocal opponents of the of the Proposed Transaction, e.g., Fair Care and Consumer Federation of America. It is noteworthy, however, that at least two public interest organizations, Community Catalyst and the Harrison Institute for Public Law, did not oppose the Proposed Transaction, but rather concentrated on the necessity of including adequate safeguards in the Order to protect consumers' interests and, in particular, the assets of BCBSMD and GHMSI in the event that a conversion to a for-profit entity occurs in the future. See, generally, testimony of John Pomeranz, DISR # 103, Testimony of Community Catalyst, DISR #102.

While it has been argued that these changes will be "unfair and unreasonable to policyholders" and "not in the public interest", we do not find that any of the proposed changes would fit this description. Fair Care has argued that the Proposed Transaction would be "unfair and unreasonable" because "GHMSI has provided poor service to its policyholders". Fair Care Reply Memo., p. 7-8, DISR # 133. Fair Care introduced some anecdotal evidence to support this point. However, the approval of the Proposed Transaction will not have any impact upon the quality of service that has been rendered in the past. On the other hand, the close scrutiny to which GHMSI will be subjected as a result of the Proposed Transaction and the market conduct examination which will occur as a result of the Proposed Transaction will put DISR in the position to take remedial action on this subject if any is required. Fair Care also asserted that "the assets of GHMSI would be controlled by a Maryland Corporation and may not be used for the benefit of GHMSI policyholders". Id. at 8. While BCBSMD will maintain a dominant position in HOLDCO, the transfer of assets of GHMSI will be controlled by the provisions of the Intercompany Agreement, the HCS Act and, most importantly, this Order. Any transfer of assets from GHMSI will be reviewed by DISR with the intention that any such transfer shall be for the benefit of GHMSI policyholders. Fair Care also argues that the "few restrictions in the agreements regarding the transfer of assets between GHMSI, HOLDCO and BCBSMD are wholly inadequate". Id. We agree that in the absence of other restrictions, the restrictions in the agreements would be inadequate. However, as noted throughout this Decision and Order, there are sufficient restrictions contained in the law, regulations and this Order.

Fair Care has also asserted that the Proposed Transaction is "not in the public interest" for a variety of reasons. Id. The concern regarding the potential conflicts of interests among directors of GHMSI, BCBSMD and HOLDCO has been addressed by the requirement in the Order that provides for a board that has independent directors. Fair Care asserts that the "charitable assets of GHMSI are not protected". Id. However, the Order requires not only that a methodology for valuation of assets be established, but also that the charter of HOLDCO shall be amended to expressly set forth its obligation to protect the assets of BCBSMD and GHMSI and to preserve the "charitable and benevolent" non-profit status of GHMSI for the benefit of its certificate holders.

Fair Care argues that GHMSI has disclaimed its charitable and benevolent nature. However, GHMSI's "charitable and benevolent" status is reinforced by this Order. As noted supra, p. 12, the issue of the legal ramifications of GHMSI's status will need to be determined by a court of law with the issue properly before it. It would be premature as part of this proceeding

to attempt to make such a determination. Nonetheless, DISR will monitor to make certain that GHMSI does not deviate from the "charitable and benevolent" purpose referenced in its charter.

Fair Care also argues that the "transfer of control of charitable assets from a charitable and benevolent organization (GHMSI) to one that is not (HOLDCO) is contrary to the public interest". Id. While the membership of GHMSI has been transferred to HOLDCO, no assets of GHMSI have yet been transferred anywhere. Any such transfer will have to be in conformity with the agreements, the law and regulations, and the provisions of this Order. Only when, and if, such transfers are proposed can the determination be made whether or not they are consistent with GHMSI's charter and in the public interest.

Fair Care also argues that the Proposed Transaction "may be a first step towards a conversion to for-profit status". Id. This argument is premature. The Proposed Transaction does not expressly indicate that it will result in a conversion. In the event that such a proposal should be made, DISR and MIA will deal with it at that time.

Finally, Fair Care argues that the Proposed Transaction is "illegal and ineffective because the corporation specifically created by Congress for certain purposes (GHMSI) may not cede control of itself to a state corporation, and ... a chartered corporation may not transfer the performance of its public duties". Id. at 8-9. A premise of this Order is that none of the public duties of GHMSI have been transferred. Moreover, Congress specifically passed legislation, H.R. 3027, which permitted the alteration of the GHMSI charter.

Therefore, even though GHMSI's business structure will change, GHMSI's management, corporate integrity, and guiding purposes as a non-profit corporation will remain the same. In addition, the legal and regulatory oversight provided by existing District of Columbia law in conjunction with the duties, obligations and authorities imposed by this Order will provide the opportunity to DISR to make certain that both the structure and operation of GHMSI continues to be both fair and reasonable to policyholders and in the public interest.

6. If the Proposed Transaction is Approved, will the "Competence, Experience, and Integrity" of Management Meet the Standard of Being "in the Interest of Policyholders... or of the Public"?

Evidence was presented regarding the "competence, experience, and integrity "of GHMSI management. Tr. 11/9/97 pp. 65-66; DISR #2, attachment 3. The management of GHMSI, which will stay in place, is well known to DISR. In addition, the management of BCBSMD is well known to MIA. Further, the BCBSMD management participated at various stages of the hearings. No evidence or testimony was introduced that would give DISR any reason to question the "competence, experience, and integrity" of GHMSI management.

7. If the Proposed Transaction is Approved, Will it Be "Likely to be Hazardous or Prejudicial to the Insurance-Buying Public".

We conclude that the Proposed Transaction will not be "likely to be hazardous or prejudicial to the insurance buying public". This conclusion is based on the information presented and submitted to the record in conjunction with the fact that any proposed business plan will be subject to review by DISR, and DISR has the regulatory authority under existing law and this Order to prevent any such action that could reasonably be predicted to be hazardous or prejudicial to the insurance buying public.

It has been asserted by Fair Care that the Proposed Transaction may be "hazardous or prejudicial" because (1) "the national results of mergers and combinations involving Blue Cross and Blue Shield plans have been alleged, by the Kentucky Attorney General and others, to include increased premiums, worse service, and blatant deception" Id. at 8; and (2) the "transaction costs" involved in achieving the merger far outweigh any benefits. Fair Care Reply Memo., p. 8, DISR # 133. No evidence other than conclusory allegations and hearsay representations were made regarding the results of other Blue Cross and Blue Shield combinations. There is nothing in the record to indicate that "increased premiums" and "worse service" will occur or that "blatant deception" has occurred. In regard to "transaction costs", there is no evidence in the record that the costs incurred in the Proposed Transaction are excessive in relation to the benefits which presumptively will occur. DISR receives financial information quarterly from GHMSI and will continue to examine it closely for this purpose, as well as others.

Conclusions of Law

After having considered all of the testimony and all of the documents submitted for the record, it is our conclusion that the Proposed Transaction does not violate any one of the six standards set forth in D.C. Code Ann. § 35-3703(g) and, accordingly, the Proposed Transaction is suitable for approval subject to the conditions and undertakings set forth in the Order.

ORDER

It is therefore ORDERED that the proposed Business Combination Agreement between Group Hospitalization and Medical Services, Inc. ("GHMSI") and Blue Cross/Blue Shield of Maryland, Inc. ("BCBSMD") pursuant to the Holding Company Systems Act ("HCS Act"), D.C. Code Ann. § 3701, et seq. be, and is hereby, authorized and approved subject to the satisfaction of the following conditions and undertakings; each of which shall be deemed to be supplementary to, and not in derogation of, existing applicable statutes, regulations and orders:

CONDITIONS AND UNDERTAKINGS:

1. GHMSI shall continue to be bound by, and to conduct its affairs pursuant to, the requirements contained in its federal charter as a "charitable and benevolent institution", unless and until authority to deviate from such provisions is granted by the United States Congress. In

the event the United States Congress considers granting, or actually grants, such a deviation or otherwise permits any change in GHMSI's federal charter, GHMSI shall notify the DISR and the Office of Corporation Counsel ("OCC") in writing as soon as it is aware that Congress is considering such a change, and as to how said change will bear upon its status as a "charitable and benevolent institution".

2. GHMSI shall retain at its expense a financial consultant to advise the DISR as to the specific information needed now, and on an on-going basis, for the purpose of determining a valuation of GHMSI. GHMSI shall submit said information to the DISR within thirty (30) days of the final determination of such information by the aforementioned financial consultant. Such information at a minimum will include the following: (1) the number of current GHMSI policyholders, (2) the number of GHMSI providers in its network, (3) information regarding premiums generated per policyholder, (4) current and historical levels of surplus and reserves, (5) policyholder contracts, (6) provider contracts, (7) current and historical audited financial statements, (8) historical, current and projected revenues, (9) current and historical and projected market value of significant assets and investments, (10) actual claim reserve run-off data, (11) current and historical financial information regarding its presently owned and previously owned subsidiaries, (12) current and historical income tax returns, and (13) any records or other information recommended by a financial consultant needed to perform a valuation of GHMSI and its subsidiaries.

3. GHMSI and BCBSMD shall remain separate corporations for legal, financial, accounting, income tax, and insurance regulatory purposes.

4. As required for insurance regulatory purposes, GHMSI shall not, absent written approval of DISR, change its current financial, accounting or tax reporting methodologies, or corporate status.

5. GHMSI shall maintain its existing level of surplus and reserves, as of the effective date of the business combination. Should those reserves be reduced by three percent (3%) for any reason, GHMSI shall provide the DISR with notification of such change within ten (10) days of GHMSI's determining such change in reserves. In the event that GHMSI's reserves are reduced by five percent (5%) or more over any three (3) year period, GHMSI shall provide the DISR with notification of such change within ten (10) days of GHMSI's determining such change in reserves.

6. All transfers by or among BCBSMD, GHMSI, HOLDCO or any other entity within the holding company system shall be subject to D.C. Code Ann. § 35-3706 and the terms of the transfers must be "fair and reasonable." The parties shall amend the Intercompany Agreement to reflect this requirement. All transfers of assets by GHMSI, BCBSMD or HOLDCO or its subsidiaries in excess of $500,000 are subject to the prior approval of the Commissioner as follows:

(a) *Cost Allocations* - Cost allocation agreements, service contracts, management, rental, and similar agreements must be approved by the Commissioner before

implementation. In the event that the payments under these agreements exceed the amounts set forth in D.C. Code Ann. § 35-3706, the transaction is subject to the notification and approval requirements of § 35-3706.

(b) *Mandatory Transfers* - The Commissioner shall receive contemporaneous notice of any transfers for capital reserves, claims payments and other legally enforceable obligations as defined in the Intercompany Agreement. Such transfers must be submitted to the Commissioner for review under § 35-3706 and must meet the terms of the Intercompany Agreement. No transfer will be made if the transfer would cause the entity making the transfer to fall below the statutory surplus or reserve requirements. Transfers that are considered to be investments in a subsidiary or affiliate where the investment exceeds $500,000 shall be subject to all applicable law including the approval requirement set forth in MD Ins. Code Ann. § 14-133.

(c) *Discretionary Funding* - Any other transfers which exceed $500,000 shall be approved in advance and must be demonstrated to meet all the requirements of all applicable law, including that the transaction be fair and reasonable, be fully documented and be consistent with customary practice.

This condition shall remain in effect until further order of the DISR and shall not be in derogation of any duties or obligations imposed upon GHMSI by the Holding Company System Act, or any other applicable law, regulation or order.

7. All transfers of money, promissory notes, investments, equipment or the purchase thereof, accounts or other assets among GHMSI, BCBSMD, and HOLDCO, or any of their subsidiaries now in existence or to be created shall be conditioned upon proper recordation on the financial and accounting records of GHMSI, BCBSMD, and HOLDCO, or any of their respective subsidiaries now in existence or to be created. In addition, said transfers shall be given in exchange for a note or other evidence of legal indebtedness, and be recorded as an asset of the transferring company and a liability of the transferee company, unless adequate and reasonable consideration for the transfer has been obtained and documented by both the transferring and the transferee companies.

8. GHMSI, BCBSMD and HOLDCO or any other affiliated company now in existence or to be created shall be prohibited from pledging, collateralizing, securitizing or otherwise encumbering the assets, including income from premiums, unless (1) the DISR is notified of any such action affecting an asset of Two Million Dollars ($2,000,000.00) or more

during any one (1) calendar year and (2) no such encumbering shall occur on any asset valued at Five Million Dollars ($5,000,000.00) or more without prior written approval by the DISR.

9. HOLDCO shall amend its articles of incorporation to expressly set forth an obligation to safeguard the assets of GHMSI and BCBSMD and to preserve the non-profit status of GHMSI in light of its Charter which provides that "this corporation is hereby declared to be a charitable and benevolent institution".

10. The Board of Directors of GHMSI, BCBSMD and HOLDCO shall be restructured so as to (a) minimize interlocking directors by ensuring that no less than two members of the Board of Directors of each Board are "outside" directors and not on the Board of any subsidiary or affiliate of either BCBSMD, GHMSI or HOLDCO, and (b) ensure that no officer or employee of GHMSI, BCBSMD or HOLDCO is on either Board. Such structure for the Boards of Directors for the three organizations shall remain in effect until approval to alter such structure is obtained from the DISR.

11. GHMSI shall not purchase or participate in any joint venture with HOLDCO, BCBSMD, or any of their affiliates to purchase any asset with a value of One Million Dollars ($1,000,000.00) or more without obtaining prior written approval from the DISR. For any such participation in excess of Five Hundred Thousand Dollars ($500,000.00), GHMSI shall notify the DISR in writing to provide the DISR with information regarding (1) the cost of the asset purchased, including all related expenses, (2) the reasons for the purchase, (3) the utilization of the asset, (4) how title to the asset will be held, and (5) a detailed cost allocation plan regarding how the cost of the asset will be shared among the affiliated companies.

12. GHMSI shall alter the executive compensation contracts with any GHMSI executive having a right to obtain severance pay pursuant to a "change in control" provision. All such contracts shall be amended by the assumption of the obligations of such contracts by HOLDCO and shall provide that any severance pay will be funded by the parties in the same proportion as the initial capitalization of HOLDCO should the "change in control" provision be exercised. No payment under such contracts may be made until GHMSI and BCBSMD (a) retains an independent consultant to offer an opinion as to the reasonableness of the contracts, including an analysis of whether the contracts are consistent with similar contracts in similar nonprofit settings; (b) the contracts and the consultant's report are submitted to the DISR and the MIA for review. The contracts will be deemed approved and may be implemented unless, within 60 days of the date the contract is submitted, either Commissioner determines that the contracts are unreasonable and exceed industry standards for similar contracts. In addition, in the event that a GHMSI executive exercises his or her "change in control" provision and receives any amount of compensation therefrom, said executive, personally or through a business he or she owns, controls, or is otherwise affiliated, shall not be rehired, retained or be permitted to receive any form of compensation from GHMSI, BCBSMD, HOLDCO, or any of their subsidiaries now in existence or to be created in the future.

13. GHMSI and BCBSMD shall be required to be licensed in the District of Columbia by DISR. HOLDCO shall be licensed as a Maryland Nonprofit Health Service Plan, Md. Ins.

Code Ann. § 14-101, et seq., by the Maryland Insurance Administration ("MIA") and as a Hospital and Medical Services Corporation, D.C. Code Ann. § 35-4701, et seq., by the DISR. Duplicates of any filings, documentation, or information provided to MIA by HOLDCO as a Nonprofit Health Service Plan shall be provided contemporaneously to DISR.

14. Both GHMSI and BCBSMD shall file a business plan for review by DISR regarding programs, marketing, operations, and protections of consumers in regard to market conduct abuse and the risk of prospective financial loss caused by the Business Combination.

15. GHMSI shall ensure that only GHMSI and its subscribers will benefit from the federal tax advantages associated with its accumulated net operating losses.

16. GHMSI, BCBSMD, and HOLDCO shall design and file an open enrollment plan for review by DISR which will provide no less open enrollment to the District of Columbia than in any jurisdiction in which GHMSI and BCBSMD, are, or will become, licensed.

17. GHMSI and BCBSMD shall cooperate in, and provide information relevant to, an effort by DISR and MIA to establish identical classifications of information on all statutory annual statements.

18. GHMSI shall cooperate in an examination by DISR and provide information regarding fee structures and provider reimbursements of products marketed in the District of Columbia.

19. GHMSI will (1) employ no less than the number of employees presently employed in the District of Columbia as of December 1, 1997 and (2) maintain the ratio of D.C. residents to all employees in the District of Columbia as of December 1, 1997. To the extent that the number or residency ratio of D.C. employees deviates from that standard, such deviation must be fully justified by the Board of Trustees using prudent business judgment to DISR.

20. GHMSI, BCBSMD and HOLDCO shall cooperate in, and provide information relevant to, a market conduct examination to commence within three months of the date of this Order.

21. GHMSI, BCBSMD and HOLDCO are prohibited from converting to for-profit status for three years commencing on the date of this Order unless authorized to do so by DISR and such other governmental entities as may be required.

22. BCBSMD and GHMSI shall execute specific cost sharing and management agreements addressing specific shared costs such as income taxes, employee salaries and benefits, insurance and accompanying costs. The agreement should also include specific intercompany billing methods and settlement procedures.

23. Within 120 days of closing, BCBSMD shall file a post-closing report detailing the integration of products, services and administrative functions, including actual and projected cost savings as well as timetables for total integration.

24. BCBSMD, HOLDCO and GHMSI shall amend and refile any Articles of Incorporation, By-laws, agreements, contracts or other documents which must be redrafted in order to comply with this Opinion and Order.

25. This transaction is subject to further orders as the circumstances require.

26. This Order is subject to further modification or amendment and further review either sua sponte or on petition of BCBSMD, HOLDCO or GHMSI.

27. GHMSI, BCBSMD and HOLDCO shall continue to be subject to the jurisdiction of DISR pursuant to the provisions of the HCS Act, for purposes of implementing the terms of this Order, and the employing of experts necessary for such purpose, until further Order of DISR.

Patrick E. Kelly
Interim Commissioner of Insurance

Dated this 23rd day of December, 1997.

DISTRICT OF COLUMBIA
DEPARTMENT OF INSURANCE AND SECURITIES REGULATION

IN THE MATTER OF

APPLICATION OF HEALTH CARE SERVICE CORPORATION TO ACQUIRE CONTROL OF AMERICAN CAPITAL LIFE INSURANCE COMPANY	:	**Case Number A-HC-97-02**

On or about October 30, 1997, Health Care Service Corporation ("Applicant") submitted a Form A filing pursuant to D.C. Code Section 35-3703 to acquire control of American Capital Life Insurance Company ("American"), an insurance company domiciled in the District of Columbia. Based upon the representations made in the Form A filing, the Commissioner makes the following findings;

1. The requirements and procedures for approval of mergers or acquisitions of domestic insurance companies are set forth in Section 35-3703 of the District of Columbia Code.

2. Applicant proposes to purchase all of the issued and outstanding shares of Medical Life Insurance Company, from Mutual Holding Company, an Ohio corporation which is wholly owned by Medical Mutual of Ohio (Medical Mutual"). Medical Life Insurance Company has a 98.8489% interest in American, a District of Columbia domiciled insurance company. The purchase price will be $95,000,000. Medical Mutual received a fairness opinion from an investment banking firm that the consideration is fair, from a financial point of view, to Medical Mutual.

3. American has underwritten no insurance business since January 1996, and currently meets the minimum capital and surplus requirements of the District Columbia.

4. The proposed transaction was reviewed pursuant to Section 35-3703 of the District of Columbia Code.

5. The application to supported by the required documentation, either attached to the application or on file at the D.C. Department of Insurance and Securities Regulation.

6. The facts presented in this application support a determination of exempting the Commissioner from holding a public hearing on this transaction in accordance with Section 35-3703 (h)(2) of the District of Columbia Code.

IT IS THEREFORE ORDERED that the application to acquire control of American Capital Life Insurance Company be and hereby is approved.

Dated 12/19/97

Patrick E. Kelly
Interim Commissioner of Insurance

SEALED: