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IN THE SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
CIVIL DIVISION

DISTRICT OF COLUMBIA, a municipal corporation, 441 4th Street, N.W. Washington, DC 20001, Plaintiff, v. GROUP HOSPITALIZATION AND MEDICAL SERVICES, INC., 840 First Street, N.E. Washington, DC 20065, and CAREFIRST, INC., 10455 Mill Run Circle Owings Mills, MD 21117, Defendants.	)	Civil Action No. 0004562-08

COMPLAINT FOR DECLARATORY RELIEF,
ORDER OF REHABILITATION, AND OTHER EQUITABLE RELIEF

Plaintiff, the District of Columbia (the "District"), by its Attorney General, alleges:

1. The District files this Complaint against Defendant Group Hospitalization and Medical Services, Inc. ("GHMSI") and Defendant CareFirst, Inc. ("CareFirst") for declaratory relief, an order of rehabilitation, and other equitable relief to remedy actions by Defendants that are contrary to GHMSI's legal obligations as a charitable and benevolent institution. These actions include using GHMSI's revenues to build up a level of surplus that exceeds the level required for any legitimate charitable or nonprofit purpose. In this case, the Attorney General represents the public interest in GHMSI using

its revenues and surplus for nonprofit purposes and consistently with its charitable mission to promote public health.

Jurisdiction

2. The Court has jurisdiction over the subject matter of this case pursuant to D.C. Official Code § 11-921(a)(6) and § 31-1310. The Court has personal jurisdiction over GHMSI pursuant to D.C. Official Code § 13-422, and over CareFirst pursuant to D.C. Official Code § 13-423(a)(1) and (a)(2).

Parties

3. The District, a municipal corporation empowered to sue and be sued, is the local government for the territory constituting the permanent seat of the government of the United States. Plaintiff brings this action, through its Attorney General, pursuant to the District's statutory authority to rehabilitate insurers, D.C. Official Code § 31-1310, and the Attorney General's common law authority to enforce charitable trusts, *see* D.C. Official Code § 44-601(5).

4. GHMSI, a federally chartered, non-stock, non-profit corporation headquartered and domiciled in the District of Columbia, is licensed and regulated by the District as a Hospital and Medical Services Corporation under D.C. Code § 31-3501 *et seq*. *See* Pub. L. No. 103-127, §§ 138(a) and (b)(1), 107 Stat. 1336 (1993). GHMSI's primary business is selling health insurance and administering health plans in the District of Columbia, as well as in Maryland and Northern Virginia. The majority of premium revenue generated by GHMSI is from its health insurance and health plan business in the District of Columbia.

5. CareFirst, a Maryland-based, non-profit holding company, is licensed and regulated by the District as a Hospital and Medical Services Corporation under D.C. Code § 31-3501 *et seq*. Since 1997 CareFirst has been the sole voting member of GHMSI and, exercising both corporate control and contractual managerial authority, has controlled and managed GHMSI's activities, including the activities that are the subject of this Complaint. Both GHMSI and CareFirst currently do business as CareFirst BlueCross BlueShield.

GHMSI's Powers and Purpose

6. Since 1984, GHMSI has been "authorized and empowered" by its Charter

> (a) to enter into contracts with individuals or groups of individuals to provide for hospitalization and medical care of such individuals, upon payment of specified rates or premiums, and to issue to such individuals appropriate certificates evidencing such contracts; (b) to enter into contracts with hospitals and other providers for the care and treatment of such individuals, in accordance with the terms of such certificates; (c) to cooperate, consolidate, or contract with individuals, groups, or organizations interested in promoting and safeguarding the public health; and (d) to engage in any lawful business that is incidental to or supportive of the business and affairs of this corporation.

Pub. L. No. 395, § 2, 53 Stat. 1412 (1939); Pub. L. 98-493, § 2, 98 Stat. 2272 (1984).

7. At all times since its creation in 1939, GHMSI has been "declared" by its Charter "to be a charitable and benevolent institution" that "shall not be conducted for profit, but shall be conducted for the benefit of [its] certificate holders." Pub. L. No. 395, §§ 3, 8, 53 Stat. 1412 (1939).

8. Under the aforementioned Charter provisions, GHMSI's corporate purpose is a charitable one: to promote public health, primarily through the provision of nonprofit health plan services for the benefit of its certificate holders, *i.e.* subscribers. This charitable purpose requires GHMSI to treat the promotion of public health as its

bottom-line mission and to pursue business goals – such as generation of operating profits, enhancement of company value, accumulation and maintenance of surplus, and compensation of executives – solely as means of advancing this mission.

Defendants' Course of Conduct

9. Soon after CareFirst assumed control of GHMSI in 1997, the pursuit of profitable business and the building of asset value became GHMSI's bottom-line goals. As the largest CareFirst affiliate, GHMSI was an integral part of CareFirst's 1999 Strategic Plan, which sought "Geographic Dominance by 2003 with revenue of $8 to $11 billion, market share of 3 times the next biggest competitor, and total capital of $1.5 to $1.7 billion, at least $700 million of which is for acquisitions."

10. As part of this plan, CareFirst sought to discontinue its role as "insurer of last resort" and to shift its business from "unprofitable segments" to more profitable ones. For example, during 2000-2001, when it was merging its for-profit health plan FreeState into a GHMSI subsidiary, CareFirst decided that it needed to "re-underwrite" its FreeState subscribers, which resulted in thousands of Maryland and District of Columbia subscribers not qualifying for the new coverage due to health problems they had developed while they were insured by FreeState. Instead of offering these less-healthy individuals coverage that was comparable to the HMO coverage they had as FreeState subscribers, CareFirst offered them indemnity policies in an open-enrollment program with high deductibles.

11. CareFirst's focus on profits culminated in an unsuccessful attempt in 2002-2003 to convert itself and GHMSI, as well as GHMSI's affiliates, into for-profit companies, which were to merge with the for-profit health insurer WellPoint Health

Networks, Inc. Although the primary stated rationale for the proposed for-profit conversion was to provide CareFirst with improved access to capital needed for future growth, CareFirst failed to give more than passing consideration to other growth strategies – such as seeking to merge with another nonprofit health insurer – that would have avoided the need to convert CareFirst and GHMSI into for-profit companies. Indeed, in evaluating their options, CareFirst and GHMSI placed little or no value on preserving their charitable and nonprofit status and missions, while giving special attention to proposals that were likely to produce large payouts to CareFirst executives. The attempted for-profit conversion was abandoned only after it was disapproved by the Maryland Insurance Commissioner on March 5, 2003.

12. Under CareFirst's management and control, GHMSI achieved dramatic growth in capital without ever formally converting into a for-profit company. From 1998 to 2003, GHMSI's total adjusted risk-based capital – or "surplus" – increased each year, growing from $159 million at year-end 1998 to $392 million by year-end 2003, and reaching $501 million at year-end 2004.

13. Based on a standard established by the National Association of Insurance Commissioners, state insurance regulators typically expect an insurer to maintain a total adjusted risk-based capital ("TAC") that is at least 200 percent of its authorized control level ("ACL") risk-based capital. The Blue Cross and Blue Shield Association ("BCBSA") has set a more conservative standard, requiring a TAC risk-based capital that is at least 375 percent of ACL. At year-end 2003, GHMSI's TAC risk-based capital was equal to 787 percent of ACL – more than two times the BCBSA standard. At least by that point, no legitimate charitable or non-profit purpose could have been served by

further increases to GHMSI's ratio of TAC risk-based capital to ACL. Yet, one year later, at year-end 2004, GHMSI's TAC risk-based capital had grown to 951 percent of ACL.

14. As it pursued strategic growth in surplus that far exceeded whatever it might need to support its charitable, public benefit purposes, GHMSI disavowed even having a public benefit mission. In a legal analysis prepared by its counsel and submitted to the District's Department of Insurance, Securities and Banking on March 24, 2005, GHMSI stated that its "mission remains, as it has always been, to operate for the benefits [sic] of its subscribers, not for the benefit of the public at large."

Defendants Are Urged to Return to Their Charitable and Nonprofit Purposes

15. From early 2003 to late 2005, Defendants were repeatedly put on notice – by two Maryland Insurance Commissioners, an independent public advocacy organization, the District's insurance regulators, and the District's Attorney General – that they needed to change course and return to their charitable and nonprofit missions.

16. Maryland Insurance Commissioner Steven B. Larsen, in a March 5, 2003 Report ("Larsen Report") accompanying and supporting his Order disapproving CareFirst's proposed for-profit conversion, set forth the following conclusions:

> From 1997 to the present, CareFirst management retreated from, and ultimately abandoned, its mission . . . and assumed all the operating characteristic[s] and corporate goals and mission of a for-profit company.
>
> The Board did not question the action by management to abandon the corporate mission and took no action to prevent it.
>
> Other regional nonprofit BlueCross/ BlueShield plans have succeeded financially and accumulated strong surplus levels and also continued to pursue a "public benefit mission" of serving vulnerable populations of insureds and subsidizing products to increase affordability.

> The Board took no action to determine how other nonprofit plans were able to continue as financially strong nonprofits while pursuing a public benefit mission [while] CareFirst management was abandoning its mission to provide insurance at least cost and expense.

Larsen Report at 111.

17. Maryland Insurance Commissioner Alfred W. Redmer, Jr., in a July 8, 2003 Legislative Report ("Redmer Report") addressing whether the factual findings and legal conclusions in the Larsen Report supported "probable cause to believe" that statutory violations had occurred, concluded:

> [CareFirst's] withdrawal from markets that represent the most vulnerable and poorly served segments of the population and the lack of consideration of its nonprofit mission in adopting a strategic plan for the company make a prima facie case that the company was operated for profit.

Redmer Report at 36. Noting that "the revocation or suspension of CareFirst's certificate of authority would serve no useful purpose and would be harmful to the public interest," Commissioner Redmer decided to issue an Order assessing a monetary penalty based on CareFirst having "embarked upon a declared course of corporate conduct that is in direct violation of a clear statutory mandate" not to be operated for profit. *Id.* at 37.

18. The DC Appleseed Center for Law and Justice, an independent non-profit advocacy organization, issued a Report ("Appleseed Report") in December 2004 concluding that "GHMSI has not been meeting [its] charitable obligation to citizens of the National Capital area":

> [I]n order to meet its charitable obligation under its charter, GHMSI could and should be spending approximately $50 million currently and, in 2008, on the order of $100 million per year on community activities, and it is capable of doing so without evident risk to its competitive viability or its financial soundness. And yet . . . during 2004 it plans to spend only about $1 million in meeting that charitable obligation.

"CareFirst: Meeting Its Charitable Obligation to Citizens of the National Capital Area" at I-10 (Dec. 2004). The Report's conclusions were supported by an attached legal analysis prepared as a pro bono project by the law firm of Covington & Burling LLP and an attached economic study prepared by the firm Mathematica Policy Research, Inc. According to the economic study, even if GHMSI were to allocate two percent of its gross premium revenue for community benefit programs from 2004 to 2008, its projected surplus would likely continue at between two-and-a-half and four times the minimum level that insurance regulators typically expect insurers to maintain. *Id.* at III-44, III-51.

19. The District's Department of Insurance, Securities, and Banking issued a Report ("DISB Report") on May 15, 2005, stating its belief that "[b]ased on its financial health, including its significant surplus and net income level, and the breadth of its operations in the District, . . . GHMSI should be engaging in charitable activity significantly beyond its current activities." DISB Report at 19. After noting that there was insufficient evidence in the record "to establish a maximum level of surplus" for GHMSI, the Department concluded:

> Based on the evidence before the Department, it appears that GHMSI may reduce its surplus level without negatively impacting its financial strength and viability, and the Department believes that could be achieved by increasing financial contributions to organizations, activities, or joint efforts that will advance the public health in the District of Columbia.

Id. at 21.

20. The Office of the Attorney General for the District of Columbia made public, on or before October 3, 2005, two legal memoranda by the Attorney General regarding GHMSI's "charitable obligation." The first Attorney General memorandum, dated March 4, 2005, concluded, in part, that GHMSI "cannot fulfill [its charitable and

benevolent] mission simply by allocating a specified percentage of premiums or earnings to distinctly 'charitable' activities. Rather, GHMSI is to devote its entire operation to serving, directly or indirectly, the purposes for which it was chartered." Among the examples cited of "conduct that would appear to contravene GHMSI's charitable purposes" was "[s]eeking to increase GHMSI's profits or asset value without due regard for the effect on the quality, benefits, affordability, or accessibility of GHMSI's health plans." The memorandum also included examples of permissible uses of excess surplus, such as "[i]mproving the overall quality or benefits of its health plans for subscribers without increasing rates," "[i]ncreasing the accessibility of its health plans for new and existing subscribers by providing discounts for subscribers with limited income," and "[s]upporting the efforts of other charitable organizations to promote health in GHMSI's service area."

21. The second Attorney General memorandum, dated August 4, 2005, clarified that a "charitable health insurer" like GHMSI "would be acting contrary to its charitable obligation if it made the accumulation of 'surplus' an end in itself, or sought to accumulate surplus for a purpose that was not reasonably related to the company's public health mission." The memorandum concluded that "[u]ntil GHMSI acknowledges its obligations as a 'charitable and benevolent institution' to operate for the benefit of the public, one cannot presume that its corporate decisions are based on a board determination as to how best to fulfill the corporation's charitable purposes."

Defendants' Continued Focus on Profits and Surplus

22. Rather than heeding regulators' warnings regarding the need to refocus its attention on charitable and nonprofit purposes, CareFirst has continued to make profit generation the most important factor in calculating financial incentives for its president and CEO. As of 2006, the president and CEO's annual incentive plan assigned 15 percent weights to both "net income" and "underwriting gain," and his long-term incentive plan relied on a combination of growth in the number of contracts and a measure of return on capital.

23. Meanwhile, Defendants have still not acknowledged that GHMSI has an enforceable obligation, as a charitable and beneficial institution, to promote public health. In the fall of 2007, CareFirst's Interim President and CEO went so far as to state:

> The many meaningful investments CareFirst makes to improve the health of the residents of the Nation's Capital is [sic] not done out of any legal obligation to do so, but because we are committed to being a good corporate citizen and to fulfilling our mission to serve the community. Mandating financial targets for such voluntary good works conflicts with the tenets of [GHMSI's] Federal charter.

Letter from David D. Wolf to The Honorable Mary M. Cheh, D.C. Councilmember (Oct. 10, 2007).

24. Despite being on notice that continuing to maintain an excessive surplus – at the expense of its service to the public – would be viewed by regulators and the public as inconsistent with its charitable mission, GHMSI continued during 2005-2007 to build its surplus, which reached $561 million at year-end 2005, $663 million at year-end 2006, and $754 million at year-end 2007. Moreover, GHMSI's ratio of TAC risk-based capital to ACL remained stubbornly high: 893 percent at year-end 2005, 955 percent at year-end 2006, and 916 percent at year-end 2007. Simply by holding the ratio of TAC risk-based

capital to ACL steady at the year-end 2003 level of 787 percent – which by year-end 2007 would have allowed a surplus of $648 million instead of the actual surplus of $754 million – GHMSI would have freed up more than $100 million in additional funding for the promotion of public health.

25. In 2005 CareFirst launched its CareFirst Commitment Initiatives, which CareFirst claimed included $35 million in "rate relief" for GHMSI customers plus about $4 million in other benefits for the GHMSI service area. In each of the next two years, the CareFirst Commitment Initiatives – including initiatives unrelated to GHMSI – totaled about $9 million. By contrast, from year-end 2004 – when GHMSI's TAC risk-based capital was already at 951 percent of ACL – to year-end 2007, GHMSI's surplus grew by $252.5 million.

26. Absent regulatory or judicial intervention compelling GHMSI to rededicate itself to nonprofit purposes and to its charitable mission of promoting public health, GHMSI is unlikely to cease building and maintaining its surplus at the expense of its obligations to serve the public.

Count I

(Willful Violation of Charter)

27. The District repeats and realleges Paragraphs 1 through 26 as if set forth fully in this paragraph.

28. Defendants have, within the previous four years, willfully violated GHMSI's charter by operating GHMSI for other than nonprofit purposes and contrary to its mission as a charitable and benevolent institution, providing grounds for rehabilitation pursuant to D.C. Official Code § 31-1310(9).

Count II

(Breach of Charitable Trust)

29. The District repeats and realleges Paragraphs 1 through 26 as if set forth fully in this paragraph.

30. As a charitable corporation, GHMSI's assets are subject under the common law to a charitable trust limiting their use to GHMSI's charitable purposes.

31. By using GHMSI's assets inconsistently with its charitable purposes, Defendants are in breach of the charitable trust applicable to these assets.

Prayer for Relief

WHEREFORE, the District requests that this Court:

a. Declare that Defendants have violated GHMSI's charter and breached the charitable trust applicable to GHMSI's assets;

b. Enjoin Defendants from further violations of GHMSI's charter and from further breaches of the charitable trust applicable to GHMSI's assets;

c. Pursuant to D.C. Official Code § 31-1310(9), issue an order authorizing the Commissioner for the District's Department of Insurance Securities and Banking to rehabilitate GHMSI and rededicate the company's operations and surplus to nonprofit purposes and to its charitable, public health mission;

d. Appoint a Special Master to assist the Court in overseeing the rehabilitation of GHMSI and the rededication of GHMSI's operations and surplus to nonprofit purposes and to its charitable, public health mission;

e. Award the District its costs, including reasonable attorney's fees; and

f. Order such other additional relief as the Court deems appropriate.

Respectfully submitted,

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