



June 4, 2008

The Honorable Virgil Smith, Chair
House Insurance Committee
Michigan House of Representatives
686 House Office Building
P.O. Box 30014
Lansing, MI 48909-7514

Dear Chairman Smith:

RE: P.A. 350 Violations

Your June 2, 2008, letter concerning the multiple potential violations of P.A. 350 by Blue Cross has come to my attention and requires immediate response. In your letter, you referred to a May 22, 2008, letter from Commissioner Ross concerning those violations. It appears that you have relied on the Commissioner's letter to reach the conclusion that the violations do not require further attention by the Legislature, or that no violations took place. For reasons of which you may not yet be aware, both conclusions are plainly wrong, and will lead to bad policy decisions for Michigan citizens.

Although I have known Commissioner Ross for years and have confidence in his abilities and judgment, there is no escaping that the analysis and conclusions in his letter are wholly inadequate to address the questions that should have been asked affecting the legislative proposals to expand the mission of BCBSM and the Accident Fund. In fairness to the Commissioner, I am confident he would have provided a different response if the question(s) had better reflected the problems that have resulted from BCBSM's course of action.

Here are a couple of the correct questions to ask and answer:

Does the Nonprofit Health Care Corporation Reform Act (the "Act") provide Blue Cross Blue Shield of Michigan ("BCBSM") the legal authority to expend subscriber funds for capital contributions to its for-profit subsidiaries in order to support the subsidiaries' operation and expansion?

Does the Act provide BCBSM the legal authority to own or control worker's compensation insurers other than the insurer formed pursuant to legislation adopted in 1993 specifically permitting the acquisition of the state accident fund's assets and liabilities?

Put simply, the answer to both of the above questions is clearly "No." And, although you couched your original question to Commissioner Ross under the provisions of Section 207(1)(x)(vi) of PA 350, no responsible analysis can be limited to that subparagraph. In his letter to you, the Commissioner himself cautioned you that he believes BCBSM's authority to operate the Accident Fund is broad – "as long as it keeps within the boundaries of PA 350 and the Insurance Code." Since a complete analysis goes beyond the scope of this letter, I will briefly summarize some of the additional provisions to which Commissioner Ross may have been referring:

- Section 207(1)(x) provides that BCBSM may "establish, own, and operate a domestic stock insurance company only for the purpose of acquiring, owning, and operating the state accident fund. . . ." Section 207(1)(o) provides that BCBSM is prohibited from transactions that would result in its "owning or controlling 10% or more of the voting securities" of for-profit insurers (other than the Accident Fund) "unless the transaction satisfies chapter 13 of the insurance code. . . and the insurer acquired is only authorized to sell disability insurance as defined under section 606 of the insurance code. . . ." (Disability insurance as defined in section 606 does NOT include workers' compensation insurance.)

Notwithstanding these provisions and the other statutory limitations on BCBSM's activities, BCBSM now controls multiple for-profit stock companies in Michigan, Wisconsin and California.

- Section 207 (1)(x)(v)&(vi) provide that "Health care corporation and subscriber funds are used only for the acquisition from the state of Michigan of the assets and liabilities of the state accident fund [and] Health care corporation and subscriber funds are not used to operate or subsidize in any way the insurer. . . ."

Notwithstanding these provisions and the other statutory limitations on BCBSM's activities, BCBSM has used corporate and subscriber funds to operate or subsidize its for-profit insurers – including the down-streaming of \$125,000,000.00 to the Accident Fund during 2007. Ironically, these funds were apparently used to acquire a California for-profit insurer resulting in what appears to be the most recent violation of the provisions outlined above.

As you can see from these brief examples, these are complex and weighty issues that cannot be resolved by simply interpreting one statutory subparagraph of a lengthy, complex statute. The stakes are quite high. If the legislature chooses to proceed toward the enactment of the proposed

The Honorable Virgil Smith, Chair
House Insurance Committee
Michigan House of Representatives
June 4, 2008
Page Three

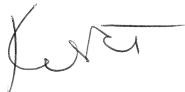
expansions, it would be rewarding apparent lawlessness and sanctioning the continued diversion of subscriber funds and the attendant escalation of subscriber fees. At the same time, the legislature would further disadvantage the many tax-paying, jobs-providing insurers who would be forced to compete in new ways with BCBSM – a non-profit, tax-exempt, monopoly. That does not sound like prudent public policy for a state experiencing the grave economic challenges that Michigan faces today.

As I testified in your committee last year, proposed expansions of BCBSM are anti-market and anti-consumer. They would serve only to expand a monopoly, reduce competition and increase consumer burdens. For those reasons, it is important that you and Commissioner Ross more closely and thoroughly review the P. A. 350 violations we have brought to your attention.

Please let me know if you have any questions about my legal conclusions, or if you would like to meet with me to discuss them. You may rest assured that we are communicating with other members of the House and Senate about our concerns, and that we are still stinging from the inattention to these issues we experienced in committee last year. However, we remain hopeful that you are interested in good policy – not just politics – and that this letter helps open the lines of communication.

In light of his current investigation into these matters, we are also providing a copy of this letter to the Attorney General.

Sincerely,



Kurt D. Gallinger
Chairman

C: Commissioner Ken Ross
The Honorable Joe Hune
The Honorable Andy Dillon
The Honorable Craig DeRoche
The Honorable Mike Bishop
The Honorable Buzz Thomas
The Honorable Tom George
The Honorable Alan Sanborn
Attorney General Mike Cox