June 8, 2015

DMHC Meeting on the Acquisition of Care1st Health Plan by Blue Shield of California
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Good afternoon. Thank you Anna for your remarks, and thank you to the DMHC for the opportunity to speak today.

This afternoon, I will speak about why we are proposing to acquire Care1st and how this transaction is a good thing for Californians.

I also want to take this opportunity to address several issues relating to Blue Shield's not-for-profit mission and history that have come up in recent months.

In a nutshell, here is why Blue Shield of California is proposing to acquire Care1st and why it is good for California. Blue Shield is a not-for-profit company, proposing to acquire Care1st at a fair market price in order to fulfill our mission, and in the process convert it from a for-profit company to a not-for-profit.

Blue Shield's acquisition of Care1st is by far the best option for Californians because it gives the Care1st organization its best chance to systematically improve quality and affordability, expand its reach to serve more Californians, and keep jobs and revenue in California.

Allow me to go into more detail on each of the four parts of that statement:

First, Blue Shield is a not-for-profit company. Specifically, Blue Shield is a nonprofit mutual benefit corporation and will we remain so. That is a fact that I will elaborate on later.

Second, we are proposing to acquire Care1st at a fair market price. To help demonstrate this point, please consider the following. Houlihan Lokey Capital Markets, the leading provider of acquisition fairness opinions, gave its opinion that the purchase price was fair to Blue Shield. Anthem and United have completed acquisitions of similar companies recently and, relatively speaking, Blue Shield's purchase price of Care1st is lower based on standard benchmarks, including on a per member and percentage of revenue basis.

Also, Anna told you about the auction process that Care1st ran with extensive interest from many bidders. For any of you that have ever tried to buy a house in California, you are well aware of the fact that any number of so-called "experts" can tell you what a property should be worth, but what ultimately determines its worth is what others are willing to bid for it. Given that Blue Shield was selected despite not having the highest bid, it is a safe assumption that we could not have acquired Care1st at a lower price.

Third, this transaction furthers our mission, which is to ensure all Californians have access to high quality health care at an affordable price. What that means to me in practical terms is that we are here to transform a dysfunctional health care system that is bankrupting us into one that is worthy of our family and friends and sustainably affordable. We use this mission as a guide for all our decisions, including the decision to acquire Care1st. Completing this acquisition will better position us to fulfill our mission for multiple reasons that I would like to expand upon.

Twelve million Californians – or 1 in 3 – get insurance coverage through Medi-Cal and Blue Shield currently serves none of them. In order to walk the talk on our mission to increase access for all Californians, we need to start serving this population.

Fundamental to creating a system "worthy of our family and friends" is bringing health care into the digital age. Blue Shield has made major investments in technology over multiple years to accomplish this goal. The most visible of these investments has been the launch of the California Integrated Data Exchange, or Cal INDEX, which is integrating electronic records from hospitals, physicians and others to establish a real time, secure, digital health record for clinicians and consumers. It is our intention after this acquisition is completed to have Care1st and its beneficiaries take advantage of these technology investments and thereby improve the quality of care.

Blue Shield is considered a leader in developing provider partnerships, also referred to as Accountable Care Organizations, or "ACOs." Independent analysts have found our ACOs to have saved substantial money and improved quality measures such as reducing inpatient re-admission rates. Our ACOs achieve these results by rewarding health care providers for working collaboratively and focusing on delivering patients the right care in the right clinical setting. It is our intention to work closely with Care1st to figure out how we can form provider partnerships that will improve both the quality and efficiency of care provided to Medi-Cal beneficiaries.

Acquiring Care1st right now is by far the best way for Blue Shield to enter Medi-Cal.

It is far better than trying to enter on our own, because with this acquisition we get a management team and employees who have extensive experience with the Medi-Cal program. It is also better than other potential acquisitions because of the terrific cultural and values fit we feel exists between the two organizations. And finally right now is better than any other time because our own large, multi-year technology project will soon be completed and we can leverage it to improve and expand Care1st's wonderful operating model.

And fourth, in the process of acquiring Care1st we will convert the company from for-profit to not-for-profit. Since we made the pledge to voluntarily cap our net income at 2% in 2011, we have given back $560 million to customers and the community. When we convert Care1st to not-for-profit, their results will be included in the company-wide 2% pledge.

For the past five years, we have averaged contributing 15% of our income – which amounts to over $30 million per year – to the Blue Shield of California Foundation. Our Foundation is one of the largest private contributors to California's community clinics, is the largest private funder of domestic violence programs in California, and was honored as the most impactful corporate Foundation in the country last month by the National Committee for Responsive Philanthropy. We base our contributions to the Foundation on our income and therefore, if we complete the Care1st acquisition, expand our revenue, and earn 2% income, it will ultimately increase our contributions to the Foundation.

Now I'd like to speak about why this transaction is good for California. First, it will systematically improve the quality and affordability of care for Californians with the fewest economic resources, and often the greatest health needs. Care1st has done a wonderful job serving its mainly Medi-Cal beneficiaries, however, they do not have the size or resources to make the technology investments required to materially improve care in the future. However, they can and will take advantage of the investments we've made to do exactly that. In addition to technology, Care1st will be able to tap our experience creating ACOs to develop appropriate Medi-Cal provider partnerships to improve care.

As a result of the transaction, Care1st will also be able to expand its reach to serve more Californians. Because of their current size and financial position, Care1st is unlikely to meaningfully expand its geographic reach in California quickly if they remain independent. However, by leaning on our state-wide infrastructure and capabilities, Care1st is far better positioned to expand quickly to other geographic areas and serve more Californians than they would otherwise.

And importantly, Blue Shield will keep jobs and revenue in California.

Nearly every other logical acquirer has its headquarters and Medicaid operations outside the state and would most likely pursue "synergies" that would mean a major loss of jobs from California to another location. Whereas, Blue Shield is new to Medi-Cal and will be relying on the Care1st leadership team and employees to make the acquisition a success.

Similarly, companies headquartered out-of-state tend to make major capital decisions at the corporate level which leaves it an open question as to whether Care1st profits will remain in – and be re-invested in – California. There are no such questions whatsoever with Blue Shield of California, and as I already mentioned, our overall profits will remain voluntarily capped with a substantial portion of those earnings going to our Foundation.

Before I conclude, I think it is important that I address and correct some open items that have been circulating recently about Blue Shield, including our status as a not-for-profit, and the issue of tax exemption. We have heard from some people who feel that Blue Shield's assets belong to the general public because they consider Blue Shield to be a charity, or because Blue Shield has been tax exempt. The fact is that there are different kinds of nonprofit corporations in California. Some are charities, and others are not. Some are tax exempt, and others are not. Some people who are concerned about this transaction are confused about these differences.

So let me clear a few things up.

Blue Shield was formed during the Great Depression by physicians who wanted to help people who couldn't afford to pay for health care. These physicians started a voluntary prepaid health services plan, and charged people $2.50 a month to join. It wasn't funded by the government, or by charitable donations, and it never has been.

Blue Shield was formed as a nonprofit mutual benefit corporation. The law says that this kind of nonprofit is not allowed to be a public charity, and Blue Shield is not and never was a public charity.

So how did Blue Shield get a state tax exemption? There are lots of nonprofits that are tax exempt that are not public charities. For example, trade associations, civic organizations and other health plans like Inter Valley Health Plan and Delta Dental are all tax exempt, but none of them are public charities. Like Blue Shield, many of these are social welfare organizations, organized for the benefit of their members. The tax law provides an exemption for social welfare organizations. Blue Shield's social welfare mission is to ensure quality, affordable care for all Californians, or as I've put it today: to create a health care system worthy of our family and friends and sustainably affordable. It is a great mission, we are proud of it, it will bring great benefit to the public when we fulfill it, but it does not make us a public charity.

Blue Shield of California is not exempt from federal taxes and fees. Our 2014 tax bill was some $440 million excluding state income tax. By the way, for anyone keeping track, that means even with a state tax exemption, Blue Shield is paying a much higher effective tax rate than most for-profit companies. If we are ultimately unsuccessful in maintaining our state income tax exemption, that bill will increase by $26 million per year. The Franchise Tax Board audit and all of the correspondence and interactions associated with it are 100%, solely dedicated to answer that one question: what will Blue Shield's tax bill be?

Now, I'd like to comment on the latest issues raised in the news over the weekend. Blue Shield's bylaws say that if the company ceased to do business and dissolved, any money that remains after the repayment of debts would be distributed to members. That's what we've told everyone, consistently, because it's true. Tax laws do not prohibit this; they only impact whether taxes are due. And they don't impact the fact that we are a nonprofit mutual benefit corporation, or the fact that we are not a charity.

Finally, we are and will remain not-for-profit. We are not converting to for-profit status. No one is going to make us convert to for-profit status.

Any talk about this possibility is a figment of someone's imagination and should be treated in the same fashion as speculation regarding sightings of Bigfoot, the Loch Ness Monster and the tooth fairy. We are and will remain a not-for-profit. Period.

Next, I want to address transaction-related financial incentives: No payments will be made to any Blue Shield executives or anyone else at Blue Shield in connection with the transaction. No Blue Shield director, executive, or employee owns stock in Care1st or has any other financial interest in the transaction.

The transaction price: The purchase price is $1.2 billion. Not $1.25 billion as has been widely reported.

And also, the transaction structure: Blue Shield is buying Care1st through a new subsidiary company Blue Shield created specifically for this purpose, currently called Cumulus

Holding Company. Cumulus is also a not-for-profit mutual benefit corporation with the identical mission and board of directors as Blue Shield and is completely controlled by Blue Shield. This structure does not result in any special tax benefits. The reason for this structure is that it simplifies the transaction and provides flexibility. For example, while this public meeting is all about the California business, Care1st also has business in Arizona and Texas – states where Blue Shield of California does not operate today. Using a holding company helps keep these businesses separate from our existing businesses.

In summary, Blue Shield of California is a not-for-profit company, proposing to acquire Care1st at a fair market price in order to further our mission and in the process convert a for-profit company to not-for-profit.

To reiterate, having Blue Shield acquire Care1st is by far the best option for Californians because it gives the Care1st organization its best chance to systematically improve quality and affordability, expand its reach to serve more Californians, and keep jobs and revenue in California.

I had the distinct pleasure of meeting with the Care1st Board of directors after we reached agreement to acquire them. They are a wonderful and diverse group of people who care deeply about their members, their employees and the impressive company they created from scratch. As Anna said earlier, at that meeting, one of their Board members asked me to "take care of their baby." I made a solemn pledge to them on that day and I make that same pledge to all of you now, that if this transaction is approved, we will in fact take great care of this wonderful company.

Thank you.