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Brackbill, Robert

From: Brackbill, Robert
Sent: Tuesday, March 13, 2012 1:31 PM
To: 'jack.stover@bipc.com'
Subject: UPE/Highmark Form A Filing: Letter from Deputy Commissioner Johnson
Attachments: 120313StoverLtr(Public).pdf

Mr. Stover,

Please see the attached correspondence from Deputy Commissioner Steve Johnson.

Robert E. Brackbill, Jr. | PIR | Chief, Company Licensing Division
Pennsylvania Insurance Department
1345 Strawberry Square | Harrisburg, PA 17120
Phone: 717.783.2143 | Fax: 717.787.8557
E-mail: rbrackbill@pa.gov
www.insurance.pa.gov | www.chipcoverspakids.com



March 13, 2012

Jack M. Stover, Esquire
Buchanan Ingersoll & Rooney PC
One South Market Square
213 Market Street, 3rd Floor
Harrisburg, PA 17101-2121

RE: UPE's February 21, 2012, February 27, 2012
and February 29, 2012 Responses to Pennsylvania Insurance
Department's January 9, 2012 Information Request Regarding
the Application of UPE for Approval of the Acquisition
of Control of Highmark, Inc. and its Pennsylvania
Domiciled Insurance Subsidiaries

Dear Mr. Stover:

The Pennsylvania Insurance Department (the "Department") has made a preliminary review of UPE's February 21, 2012, February 27, 2012 and February 29, 2012 responses to the Department's January 9, 2012 Information Request (the "1/9/12 Request").

The purpose of this letter is to review a number of specific issues. However, the fact that certain issues are contained in this letter does not diminish the priority or necessity of UPE responding to the other requests set forth in the 1/9/12 Request.

Request 2.1.4 - Rights and Remedies Available to Highmark for any Breach or Default.

A. Request 2.1.4 provides:

"Provide a full and complete analysis of the rights and remedies available to Highmark for any breach or default under the Affiliation Agreement or any other agreement between Highmark and any WPAHS Entity both before and after completion of the Transaction, and a description of any reserves, funds or escrows providing security for such obligations."

B. The response is incomplete as it does not fully answer Request 2.1.4.

C. The following action is required:

D. Kindly provide a certification to the Department as follows:

“UPE certifies that (1) other than the provisions of the Affiliation Agreement reviewed in its response to Request 2.1.4, there are no other rights and remedies available to Highmark for any breach or default under the Affiliation Agreement both before and after completion of the Transaction; (2) other than the Affiliation Agreement, there are no other agreements between Highmark and any WPAHS Entity [or describe any such agreements and any rights and remedies available to Highmark for any breach or default under those agreements or under the Affiliation Agreement both before and after completion of the Transaction]; and (3) there are no reserves, funds or escrows designated to provide security for Highmark with respect to any breach or default any right or remedy under the Affiliation Agreement or any other agreement.”

Request 2.1.5 - Risks that any Highmark and/or Highmark Affiliates will be Subject to any WPAHS Entities' Claims, Debts or Obligations.

A. “UPE understands that” is not a direct and complete answer to the Request.

B. Section 2.1.5 provides:

(1) “Provide an analysis of the risks that any assets, properties or reserves of Highmark or the Highmark Affiliates will be subject to any claims, debts or obligations of the WPAHS Entities, together with the methods or approaches by which such risks are being mitigated.”

(2) In response to Section 2.1.5, UPE concludes that neither Highmark, UPE, nor UPE Provider Sub will become liable for the pension obligations of WPAHS. Specifically, it stated:

“Similarly, Highmark, UPE and UPE Provider Sub will not become liable for the pension obligations of the WPAHS Entities in that the structure of the transaction assures that Highmark, UPE and UPE Provider Sub will not become part of the same “controlled group” as defined under Treasury Regulation § 1.414(c)(5) and as referenced in Section 4001(a)(14) of ERISA and PBGC Reg. § 4001.3. More specifically, the required level of common control that must exist before controlled group liability will attach is not present in the Transaction in that less than 80% of the

Board of Directors of WPAHS will be controlled by UPE
(see Treasury Regulation § 1414(c)(5)(b)).”

(3) While the foregoing analysis addresses the board composition, it does not address: (i) the effect that the reserved powers under Section 3.3(b) of the Amended and Restated Bylaws of WPAHS will have on the conclusion as to controlled group status, including, without limitation, the authority of UPE, as the Ultimate Parent, to approve the election by the Board of WPAHS of the Chief Executive Officer, Chief Financial Officer, Treasurer and Secretary of WPAHS; and (ii) whether the pension plan is a single employer or multiemployer plan.

(4) The following action is required:

Kindly review these issues and advise the Department how the reserved powers affect the analysis and whether each plan is a single or multiemployer pension plan.

C. In response to Section 2.1.5, UPE further concludes that neither Highmark, UPE nor UPE Provider Sub will be liable for the long-term, tax-exempt bond debt of the WPAHS Entities, as defined in 1/9/12 Request.

(1) Specifically, it stated:

“In this same regard, Highmark, UPE and UPE Provider Sub will not become liable for the long term, tax-exempt bond debt of the WPAHS parties in that Highmark and the UPE Parties will not be added as members of the WPAHS Obligated Group. There is no provision in the WPAHS Bond Documents that requires that any member, parent or affiliate of WPAHS be added as members of the WPAHS Obligated Group.”

(2) While the foregoing conclusion is based upon the parties not contractually becoming part of the WPAHS obligated group, the analysis is limited to the contractual obligations and ignores any other applicable legal theory that may give rise to liability, including a theory based upon the effect of the current factual relationship, contribution of funds and steps now being implemented toward affiliation between the WPAHS Entities, UPE, UPE Provider Sub and Highmark.

D. The following action is required:

Kindly provide an analysis of the issues raised in C (2) above .

Request 2.2.1 – Change of Control.

A. Request 2.2.1 provides:

“Except for reserved powers specifically described in Exhibit F to the Affiliation Agreement, provide a full description of any contracts, arrangements or understandings with respect to any membership interest, investment interest or other interest by which UPE Controls or has a right to Control any of Highmark, Highmark Affiliate, WPAHS, or WPAHS Affiliate in which the Applicant, its Affiliates or any Person listed in Item 3 of the Form A is involved (or is expected to be involved in the future), including but not limited to transfer of any interest, joint venture, loan or option arrangement, puts or calls, guarantees of loans, guarantees against loss, or guarantees of profits, division of losses or profits, or the giving or withholding of proxies. The description shall identify the Person with whom such contracts, arrangements or understandings have been entered into.”

B. The response appears to be limited to “indirect interests in Highmark Affiliates.” The Request requires a response “. . . with respect to any membership interest, investment interest or other interest by which UPE Controls or has a right to Control any of Highmark, Highmark Affiliate, WPAHS, or WPAHS Affiliate in which the Applicant, its Affiliates or any Person listed in Item 3 of the Form A is involved (or is expected to be involved in the future). . . .”

C. The following action is required:

Kindly provide a full response so that the Department may evaluate this in connection with its review of the Form A filing.

Request 2.3.1 - Tax-Exempt Bond Documents.

A. Request 2.3.1 provides:

“Provide full and complete copies of the Master Indenture and the WPAHS Tax-Exempt Bond documents.”

B. The following action is required:

In addition to the material submitted in the response received dated February 21, 2012 (UPE-0000001 to UPE-0002995), kindly provide:

- (1) Documentation of the following outstanding indebtedness: Floating Rate Restructuring Certificates; Series 2006A/2006B Revenue Notes; and any outstanding mortgage loans.

- (2) Documentation for or a certification that there are no outstanding Financial Product Payments (hedge agreements) or investment agreements relating to proceeds of the Bonds.
- (3) A certification that the proposed indebtedness resulting from the Transaction together with existing indebtedness will not cause WPAHS to violate its debt service coverage ratio (DSC) covenant. The DSC ratio technical default minimum is 1.10x (if it is below 1.10, an Independent Consultant must be employed) and, in any event, the DSC ratio can be no less than 1.0x. In addition, certify that WPAHS is now in compliance with the DSC ratio and what DSC ratio is projected to exist after the addition of the Subordinated Debt.
- (4) An explanation as to how the indebtedness contemplated by the Affiliation Agreement will comply with the requirements for the incurrence of additional indebtedness under the Master Trust Indenture (MTI). Will the debt be “expressly subordinated” in accordance with the terms of the MTI, or how it will otherwise satisfy the requirements of section 3.05 of the MTI?

Request 2.4.3.8 - Consideration.

A. Request 2.4.3.8 provides:

“If any of the funds or other consideration (collectively, the “Consideration”) used or to be used by any of Applicant or Highmark and WPAHS Entity in effecting, consummating or performing the Transaction (no matter how described in the Affiliation Agreement or other document) is represented or is to be represented by funds or other property borrowed or otherwise obtained for the purpose of acquiring or holding any interest in any Highmark and WPAHS Entity, furnish a description of the transaction relating thereto, the names of the parties thereto, the relationship, if any, between the borrower and the lender, the amounts borrowed or to be borrowed, and copies of all agreements, promissory notes and security arrangements related thereto.”

B. “UPE understands that” is not a direct and complete response to the Request.

C. The following action is required:

Kindly provide a certification to the Department as follows: “[UPE][Highmark] certifies that UPE’s response to Request 2.4.3.8 is complete and that no Consideration (as defined in the Request) used or to be used by any of Applicant or Highmark and WPAHS Entity in effecting, consummating or performing the Transaction (no matter how described in the Affiliation Agreement or other document) is represented or is to be represented by funds or other property

borrowed or otherwise obtained for the purpose of acquiring or holding any interest in any Highmark and WPAHS Entity.

Request 3.2-3.2.5 – Governmental Filings.

A. Request 3.2 provides:

“For each governmental, regulatory, corporate and/or contractual notices, filings, consents and/or approvals that are or reasonably may be required for or in connection with the Transaction provide:”

B. The following action is required:

Kindly provide the following certification “UPE certifies that its response to Requests 3.2 and 3.3 provides the requested information with respect to all governmental, regulatory, corporate and/or contractual notices, filings, consents and/or approvals that are or reasonably may be required for or in connection with the Transaction.”

Request 3.4.1. – Hart/Scott/Rodino.

A. Request 3.4.1 provides:

“3.4.1 Representatives of Highmark have informed the Department that no Hart/Scott/Rodino filing needs to be made or will be made by the Applicant and/or any Highmark and WPAHS Entity in connection with the Transaction. Provide a full and complete copy of any analysis, opinion or other document prepared by or for the Applicant or any Highmark and WPAHS Entity regarding the necessity for the making of a Hart/Scott/Rodino filing in connection with the Transaction.”

B. The response to Request 3.4.1 is limited to correspondence between counsel for Highmark, Debra H. Dermody, and Michael Verne of the Federal Trade Commission’s Premerger Notification Office.

(1) Ms. Dermody’s included e-mail to Mr. Verne was written on June 23, 2011, more than three months before the Affiliation Agreement between Highmark and WPAHS was signed on October 31, 2011.

(2) In her e-mail, Ms. Dermody summarizes the Highmark/WPAHS affiliation and states: “Each of the existing entities will consolidate their entire operations into the newly-created nonprofits.” This appears to refer to UPE and UPE Provider Sub.

(a) As the transaction summarized in the Form A filing is described as an “affiliation” and not a “consolidation”, kindly advise how the

description of the transaction in Ms. Dermody's e-mail applies to the Form A filing.

- (b) If Highmark views this as a consolidation, kindly provide an analysis of the effect of this being considered a consolidation under the WPAHS tax exempt bond documents.
- (3) Also in her e-mail, Ms. Dermody states: "Although A [referring to Highmark] does appoint the initial board, that board must be controlled by independent directors and then will become self-perpetuating. Accordingly, it appears that the exemption should be available."
 - (a) Does this statement only apply to UPE?
 - (b) If so, kindly describe the effect of the changes in the WPAHS Entity boards and the reserved powers in UPE and UPE Provider Sub on this analysis.
- C. In addition, UPE's response fails to include "a full and complete copy of any analysis, opinion or other document. . .regarding the necessity for the making of a Hart/Scott/Rodino filing. . . ." or a certification that no such analysis, opinion or other document exists.
- D. The following action is required:

Kindly respond to the questions posed in this request and supplement the current filing as necessary so that UPE makes a full response to Request 3.4.1.

Request 3.6 – Notices.

- A. Request 3.6 provides:

"List all notices, filings, consents and/or approvals needed by or from the National Blue Cross Blue Shield Association ("BCBSA") or other Blue Cross licensing body with respect to the Transaction." and Request (3.6.1) ("3.6.1 For each such notice, filing, consent or approval, provide the information required by Section 3.2 above."
- B. "UPE understands that" is not a direct and complete answer to the Request.
- C. The following action is required:

Kindly provide a certification to the Department as follows: "[UPE][Highmark] certifies that UPE's response to Request 3.6 lists all notices, filings, consents and/or approvals needed by or from BCBSA or other Blue Cross licensing boding with respect to the transaction."

Request 4.3.13.1 – Credit Rating.

A. Request 4.3.13.1 provides:

“Discuss any changes in credit rating or outlook for Highmark, any Highmark Affiliate, WPAHS and/or WPAHS Affiliate related to the Transaction.”

B. The response may be incomplete.

C. The following action is required:

Kindly supply missing information, if any, and provide a certification to the Department as follows: “[UPE][Highmark] certifies that UPE’s responses to Request 4.3.13 provides a full and complete copy of any materials submitted to credit rating agencies by any Highmark and WPAHS Entity related to the Transaction.”

Request 4.3.15 – Tax Opinions.

A. Request 4.3.15 provides:

“Provide a full and complete copy of any tax opinions or analyses of taxation issues concerning the Transaction that have been or will be obtained.”

B. The response appears to be incomplete as it only relates to UPE and Highmark

C. The following action is required:

- (1) Kindly provide confirmation is needed that no other Highmark and WPAHS Entity (defined in the January 9, 2012 PID Information Request as: “. . . Highmark, all Highmark Affiliates, WPAHS, and all WPAHS Affiliates) has obtained or anticipates obtaining any tax opinion in connection with the transaction.
- (2) In addition, Section 8.9 of the Affiliation Agreement requires Highmark and UPE parties, as a condition to closing, to have received reasonable assurances concerning the tax-exempt status of the WPAHS parties. Section 8.10 of the Affiliation Agreement requires Highmark and the UPE parties, as a condition to closing, to have received assurances regarding the tax-exempt status of the Ultimate Parent Entity and the provider subsidiaries. Kindly describe what reasonable assurances are contemplated to be requested and whether an opinion is to be obtained. If an opinion is to be obtained, provide a copy of the opinion or a draft of the opinion as soon as it is available.

Request 4.1.4 - Adequacy of Capital and Liquidity

A. Request 4.1.4. provides:

“Provide an analysis for Highmark and each Highmark Affiliate of the adequacy of capital and liquidity so as to meet relevant requirements.”

B. “UPE understands that” is not a direct and complete answer to the Request.

C. The following action is required:

Kindly provide a certification to the Department that the response to Request 4.1.4 is a complete response to the Request.

Request 4.1.4.1- Capital and Liquidity Assumptions

A. Request 4.1.4.1 provides:

“In connection with such analysis, describe the assumptions underlying the analysis and the reasonableness of such assumptions.”

B. “UPE understands that” is not a direct and complete answer to the Request.

C. The following action is required:

Kindly provide a certification to the Department that the response to Request 4.1.4.1 is a complete response to the Request.

Request 4.4.1 – Claims.

A. Request 4.4.1 provides:

“Identify and provide a description of any claims against any Highmark and WPAHS Entity by any Highmark and WPAHS Entity that are being, have been or will be settled or resolved in connection with the Transaction or since the execution of the June 28, 2011 term sheet between Highmark and WPAHS.”

B. The following action is required:

Kindly provide a certification to the Department that the litigation described in UPE’s response to Request 4.4.1 includes all claims against any Highmark and WPAHS Entity by any Highmark and WPAHS Entity that are being, have been or

will be settled or resolved in connection with the Transaction or since the execution of the June 28, 2011 term sheet between Highmark and WPAHS.

Request 4.6.2 – Advantages and Disadvantages.

A. Request 4.6.2 provides:

“Explain the advantages and disadvantages of the Transaction for members, subscribers, enrollees, policy holders, hospital providers, other health care providers, pharmacies and other affected persons.”

B. The response is incomplete as it only refers to advantages from the transaction.

C. The following action is required:

(1) Kindly provide a full response to this Request so that the Department may evaluate this in connection with its review of the Form A filing. Kindly describe potential disadvantages (including risks) to each Highmark and WPAHS Entity.

(2) If UPE’s contention is that there are no disadvantages (including risks) from the Transaction to any Highmark and WPAHS Entity, kindly provide a certification to the Department that UPE, Highmark and WPAHS are aware of no potential disadvantages (including risks) from implementing the Transaction and that neither the Highmark or WPAHS Boards were presented with, discussed or were aware of any potential disadvantages (including risks) resulting from proceeding, implementing or carrying out the Transaction.

Request 4.6.14 – Target Range for Surplus

A. Request 4.6.14 provides:

“Discuss the anticipated target range for the surplus levels of Highmark and each Highmark Affiliate for the next five years, expressed in both dollars and RBC ratio, and include discussion of whether that target range is optimal for policyholders and subscribers.”

B. “UPE understands that” is not a direct and complete answer to the Request.

C. No “discussion of whether [the] target range is optimal for policyholders and subscribers” has been included. Note that the RBC target ranges are used by the Department for determining whether there is excess surplus. Being within a target range does not necessarily mean that the target range obtained is optimal for policyholders and subscribers.

- D. The following action is required:

Kindly provide a discussion of whether the target range is optimal for policyholders and subscribers and provide a certification that the response to Request 4.6.14 is complete.

Request 5.1.1.1 – Formation Documents.

- A. Request 5.1.1.1 provides:

“Articles of incorporation or other formation document, except for those entities for which such documents have been provided. Identify the entities for which such documents have been provided and where such documents are located in the Form A filing and accompanying material.”

- B. The following action is required:

Kindly provide a certification to the Department that all information requested in Request 5.1.1.1 has now been supplied.

Request 5.1.1.9 – Membership Interest.

- A. Request 5.1.1.9 provides:

“To the extent not disclosed in the Form A filing and accompanying material, provide a full and complete listing of each class of membership interests in each of Highmark, Highmark Affiliate, WPAHS and WPAHS Affiliate, summarize any rights of Control with respect to each such class, and refer to the agreement or document to which such right of Control relates. If disclosed in the Form A filing and accompanying material, identify where such disclosure is located in the Form A filing and accompanying material.”

- B. The following action is required:

Kindly provide responses regarding WPAHS and WPAHS Affiliates and certify to the Department that the response to UPE is complete.

Responses Limited to Only UPE or Highmark.

- A. In many cases, in addition to those earlier noted, UPE provides its response only as it relates to Highmark or UPE without addressing the application of the issues to the WPAHS Entities as required by the 1/9/12 Request including Requests 3.2.5, 3.4.3, 3.6, 3.7, 3.8, 4.2.15, 4.3.13.1, 4.3.15, 4.3.16, 4.3.17, 4.3.18, 5.1.3, 5.1.1.4, 5.15, 5.2.1, 5.2.2, 5.2.4, 5.3.1 and 6.3. By way of illustration, but without limitation to the foregoing matters, the discussion below illustrates some of these responses that fail to address the application to the WPAHS Entities:

B. Request 5.1.3 – Most Favored Nations

(1) Section 5.1.3 provides:

“Explain the current or anticipated use by or among one or more Highmark and WPAHS Entities of “most favored nation” clauses or similar provision (“MFN’s”), whether or not currently used, in any contract by or among one or more Highmark and WPAHS Entities, including, but not limited to, provider and/or health care services payment or reimbursement contracts. Provide samples of MFN language used in existing provider or other agreements. Explain the impact of the Transaction on existing or contemplated MFN agreements.”

(2) While the response to Section 5.1.3 addresses the use of MFN clauses for Highmark Affiliates, as defined in the 1/9/12 Request, it does not address: (i) whether and to what extent any WPAHS Entities are subject to MFN clauses in their contractual relationships; and (ii) what effect such clauses, if any, are anticipated to have as a result with reimbursement or payment rates contemplated to be negotiated by any WPAHS Affiliate with Highmark and Highmark Affiliates.

(3) The following action is required:

Kindly provide: (i) an analysis of the WPAHS Affiliates’ MFN arrangements in accordance with (2) above; and (ii) if these MFN arrangements exist and are contemplated to have any effect, a discussion of how those rates effects are addressed in the financial projections provided by the WPAHS Entities to the Department.

C. Request 4.3.16 Litigation

(1) Request 4.3.16 provides:

“For all matters where liability of any Highmark and WPAHS Entity is claimed to be in excess of \$1,000,000 or where injunctive relief is sought, file a schedule of all documents produced by the Highmark and/or Highmark Affiliates in discovery in such matters.”

(2) The response may be incomplete as it includes only information regarding Highmark, not the WPAHS Entities.

No Affirmative Statement Provided.

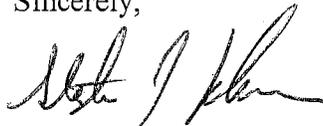
- A. In many responses, UPE either states that "UPE understands" or provides other qualifying language when providing information in response to 1/9/12 Request, including, without limitation, Request Sections 2.1.5, 2.4.3.8 and 3.6.
- B. The following action is required:

UPE must make affirmative statements to the Department as if such statements were provided in the Form A pursuant to Section 1402 of the Act (40 PS § 941.1402).

Please be advised that the Department reserves the right to request additional information and documentation, above and beyond the requests set forth in the 1/9/12 Request and in this letter, based on its continued review of the Form A filings, including UPE's February 21st, 27th and 29th responses and additional responses to be made by UPE. These requests are continuing requests and Applicants should promptly update their responses as soon as new information becomes available.

As UPE has requested expedited treatment of the filing, the Department requests that you respond to this letter on or before March 27, 2012.

Sincerely,



Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation