

# MORRIS, NICHOLS, ARSHT & TUNNELL LLP

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January 14, 2011

**VIA E-MAIL**  
**& FIRST-CLASS MAIL**

The Honorable Battle R. Robinson  
104 W. Market Street  
Georgetown, DE 19947

Re: Proposed Affiliation of BCBSD, Inc. with Highmark Inc.

Dear Judge Robinson:

In accordance with the Scheduling Order entered by Your Honor on January 5, 2010, we write to inform you of the position of our client, the Delaware Department of Insurance (the "Department"), regarding the applications of those interested in being determined a "party in interest" to this proceeding. We understand that only the application of Jo Ann Fields, M.D. (attached hereto as Exhibit 1) remains active<sup>1</sup> and, as such, we only address her application in this letter.

The Department opposes the application of Dr. Fields for status as a "party in interest" in the current affiliation proceeding because she does not satisfy the minimal standard required of a "party in interest." Even if Dr. Fields had met this standard, her interests as a policyholder and as a member of the public are adequately and more appropriately represented by the Department and ultimately the Insurance Commissioner in this proceeding.<sup>2</sup>

The Pre-Hearing Order, dated October 20, 2010 (attached as Exhibit 2), which governs this proceeding, requires an applicant to show "that such person has a significant pecuniary interest in the proceeding, which interest is not adequately represented by an existing party, and the protection of which

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<sup>1</sup> The Department received communications from two other potential applicants for status as a "party in interest," but we understand that these applicants do not plan to pursue their applications further.

<sup>2</sup> We note that pursuant to paragraph 4 of the October 20, 2010 Prehearing Order in this matter that the Delaware Attorney General is already a party to this proceeding.

otherwise will be impaired or impeded unless such person is admitted as a Party” to be determined a “party in interest.”

The same Pre-Hearing Order also carefully defines the scope of the Hearing Officer’s review in this proceeding: “to determine whether the Commissioner should approve the affiliation of BCBSD, Inc. with Highmark Inc. by applying the “the specific criteria for approving or disapproving a change of control of a Delaware domestic insurer found at 18 *Del. C.* § 5003(d)(1).” Section 5003(d)(1) contains six specific criteria, three of which are relevant here:

c. The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, *or prejudice the interest of its policyholders*;

d. The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, 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*;

e. 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 and of the public* to permit the merger or other acquisition of control; or

18 *Del. C.* 5003(d)(1)c.-e. (emphasis added). *See also* Pre-Hearing Order on Request of Physicians Health Services of Delaware, Ltd. To Intervene as a Party in Interest at 2, *In re Proposed Affiliation of BCBSD, Inc. with CareFirst, Inc.* (Sept. 7, 1999) (Docket No. 99-09) (attached as Exhibit 3) (noting, in a similar proceeding, that the scope of review is “carefully circumscribed”).

Dr. Fields appears to seek status as a “party in interest” to the affiliation as a “customer” and presumably, a policyholder with BCBSD, Inc. She also seeks to represent the “public.” She cites a “financial stake” in the proposed transaction as a “customer” who is “vulnerable to above average rate increases” in “the individual and small group market.”

Dr. Fields has failed to offer any evidence that any pecuniary interest she may have in this proposed affiliation is “significant” – the standard established by the Pre-Hearing Order, dated October 20, 2010. Status as a mere policyholder is not enough to support designation as a formal party. *See, e.g.,* Order on Pre-Hearing Motions at 3, *In re Proposed Acquisition of Royal Indemnity Company et al. by Arrowpoint Capital Corp. and Arrowpoint Capital, LLC*, (Dec. 20, 2006) (Docket No. 313) (attached as Exhibit 4) (in a recent “Form A” proceeding under 18 *Del. C.* § 5003, the Hearing Officer denied the applications of several large policyholders with “significant” interests because “some distinct, substantial interest beyond that as a policyholder should be required as a basis for entitlement to party status” under 18 *Del. C.* 5003(d)(2)).<sup>3</sup>

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<sup>3</sup> The denial of formal party status to large policyholders with “significant” financial interests under 18 *Del. C.* § 5003(d)(2)’s arguably more inclusive standard than the standard applicable here –

The Honorable Battle R. Robinson

January 14, 2011

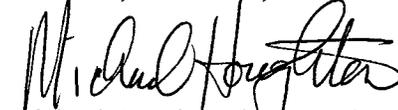
Page 3

Regardless of the pecuniary interest Dr. Fields may suggest she has, her interests as a customer and policyholder of BCBSD, Inc., as well as that of “the public,” are already adequately represented by the Department and the Commissioner in this proceeding – and all other similar proceedings – in the application of the 18 *Del. C.* 5003(d)(1)c.-e. criteria noted above. “In Delaware, as in most states, the Insurance Commissioner is charged with the responsibility of providing [regulatory] scrutiny and assessing risk to *Delaware policyholders by enforcing the laws and regulations with their best interests in mind.*” *In re Proposed Affiliation of BCBSD, Inc. with CareFirst, Inc.*, 2004 Del. Super. LEXIS 333, at \*53 (emphasis added) (attached as Exhibit 5); *see also* Order on Pre-Hearing Motions at 3, *In re Proposed Acquisition of Royal Indemnity Company et al. by Arrowpoint Capital Corp. and Arrowpoint Capital, LLC*, (Dec. 20, 2006) (Docket No. 313) (attached as Exhibit 4) (“protection of policyholders is the paramount objective of Delaware’s body of insurance regulation” and “the protection of policyholders is thus the primary function of the Commissioner”).<sup>4</sup>

For the foregoing reasons, Dr. Fields’ application should be denied. Despite not obtaining party status, Dr. Fields may, of course, pursuant to paragraph 5 of the October 20, 2010 Pre-Hearing Order, nevertheless “appear at the hearing and present testimony in aid of the inquiry” being undertaken by the Department and others in this proceeding.

Respectfully,

MORRIS, NICHOLS, ARSHT & TUNNELL, LLP



Michael Houghton (No. 2179)

Leslie A. Polizoti (No. 4299)

Brenda R. Mayrack (No. 5253)

*Attorneys for the Delaware Department of Insurance*

MH/BRM/ss

Enclosures

cc: Jo Ann Fields, M.D. (via email, facsimile and First Class Mail)  
See Attached Service List

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(. . . continued)

“significant pecuniary interest” – argues for an individual’s interest as a policyholder in this proceeding to be found to be similarly insufficient for status as a “party in interest.”

<sup>4</sup> The presence of the Delaware Attorney General as a party to this proceeding only further evidences that the interest of the public will be diligently represented in this matter.

## SERVICE LIST

<p>The Honorable Battle R. Robinson 104 W. Market Street Georgetown, DE 19947 Phone: 302.856.2248 <i>Hearing Officer</i></p> <p>and</p> <p>GianClaudio Finizio, Esquire Bayard, P.A. 222 Delaware Avenue, Suite 900 P.O. Box 25130 Wilmington, DE 19801 Phone: (302) 429-4240 Fax: (302) 658-6395 Email: <a href="mailto:gfinizio@bayardlaw.com">gfinizio@bayardlaw.com</a> <i>Counsel to Hearing Officer Robinson</i></p>	<p>Timothy P. Mullaney, Sr., Esquire Delaware Department of Justice P.O. Box 1227 Dover, DE 19901 Phone: 302.577.8341 Fax: 302.577.6499 Email: <a href="mailto:Tim.Mullaney@state.de.us">Tim.Mullaney@state.de.us</a></p> <p>and</p> <p>Ian R. McConnell, Esquire Delaware Department of Justice Carvel State Office Bldg 820 N. French Street Wilmington, DE 19801 Phone: 302.577.8533 Fax: 302.577.6499 Email: <a href="mailto:ian.mcconnel@state.de.us">ian.mcconnel@state.de.us</a></p>
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*Counsel for Delaware Dept. of Insurance*

# **EXHIBIT 1**

JO ANN FIELDS, M.D.  
P.O. Box 615, 2 EAST HIGH STREET • FELTON, DELAWARE 19943  
TEL: 302-284-1169 • FAX: 302-284-8827

December 28, 2010

Linda Sizemore  
Director of Company Regulation  
Delaware Department of Insurance  
841 Silver Lake Boulevard  
Dover, Delaware 19904

Dear Ms. Sizemore:

I request to be party to the review of the proposed affiliation between Blue Cross Blue Shield of Delaware (BCBSD) and Highmark, Inc. As a customer of BCBSD I have a financial stake. I purchase my health insurance from BCBS in the individual and small group market where I am particularly vulnerable to above average rate increases.

In fact, when my policy renewed in July 2010 I had a 13% rate increase. I wrote to the Department of Insurance and later filed a FOIA request with the Department of Insurance to get an explanation for the rate increase. I was told in a letter dated 8/10/10 from Deputy Insurance Commissioner, Gene Reed, that this information is "private commercial information" and "is proprietary and deemed non-public and not subject to disclosure by FOIA request." It seems to me that BCBSD is not a totally private organization. It is a not-for-profit plan and as I understand it has a charter with the state to provide not-for-profit health insurance coverage to the people of Delaware.

I believe that the affiliation review process is a good opportunity for the state to write into the affiliation agreement certain guarantees that BCBSD and Highmark will open up their records to a more rigorous rate review process by the Insurance Commissioner and also allow public review and comment. I believe that my participation will help to achieve that goal.

In particular I would pursue three basic issues:

- 1) If one goal of the affiliation is to achieve operating efficiencies for the two companies, how will those efficiencies translate into lower rates for customers and how will customers know?
- 2) As part of the affiliation agreement, BCBSD and Highmark should agree to a process by which rate increases will be subject to public review and comment.
- 3) I believe the Department of Insurance has recently received a \$1 million grant to implement a new health insurance rate review process. The affiliation review process would be a good opportunity for the Insurance Commissioner to present her department's progress on that grant by explaining how she could conduct a rate review using BCBSD/Highmark as a specific example.

I am fully aware that the technical and legal issues here are beyond my understanding. But the customers and the public deserve some assurance that their interests are being represented.

Thank you for your consideration.

Sincerely,

*Jo Ann Fields, MD*  
Jo Ann Fields, MD

*Sent to:*  
*Linda Sizemore by email and hand delivered*  
*David Swartz by email and US mail*  
*Michael Haughton by email and US mail*  
*Frederick Campbell by email and US mail*  
*Timothy Mullany by email and US mail*

# **EXHIBIT 2**

**BEFORE THE INSURANCE COMMISSIONER**  
**FOR THE STATE OF DELAWARE**

In Re: The proposed affiliation of                    )  
BCBSD, INC., doing business as                    )           Docket No.  
Blue Cross Blue Shield of Delaware,            )  
with HIGHMARK INC.                                 )

**PRE-HEARING ORDER**

WHEREAS, the above parties have filed with the Delaware Department of Insurance (the "Department") a proposed plan to affiliate; and

WHEREAS, said proposed affiliation raises issues within the jurisdiction of this Department that require investigation pursuant to Chapter 3, Title 18, Delaware Code; and

WHEREAS, on notice, a public hearing will be conducted hereafter;

NOW, THEREFORE, preliminary to such hearing in this case, it is hereby ORDERED that:

1. A Hearing Officer (the "Hearing Officer") will be appointed and a hearing in this matter will be conducted pursuant to an inquiry initiated by the Delaware Insurance Commissioner (the "Commissioner") under the provisions of 18 *Del. C.* § 317, *et seq.* The conduct of the hearing is governed generally under the provisions of 29 *Del. C.* § 10101 *et seq.*, except as the same are in conflict with the provisions of Chapter 3 of Title 18 (*see e.g.*, 18 *Del. C.* § 326).

2. Highmark Inc. ("Highmark"), a Pennsylvania nonprofit corporation, shall be liable for the reasonable and necessary expenses of the Hearing, Hearing Officer, and Delaware Insurance Department including such outside counsel and experts as deemed necessary. The Hearing Officer shall hear and resolve disputes relating to such expenses.

3. The parties in interest hereto (each, a "Party" and together, the "Parties") are presently the Department; BCBSD, Inc. ("BCBSD"), a nonprofit health service corporation regulated by the Department under the provisions of Chapter 63 of Title 18; and Highmark. By virtue of becoming a Party, Highmark has submitted itself to the jurisdiction of the Department in this matter for the purposes of: (i) acknowledging its agreement that the Commissioner shall have the authority to make a determination in accordance with the terms and conditions of this Order as to whether Highmark's proposed affiliation with BCBSD should be approved; and (ii) establishing the terms and conditions under which a public hearing in this matter will be conducted and under which the Commissioner shall issue an order approving or disapproving the affiliation.

4. The Department, Highmark and BCBSD agree that the Attorney General of the State of Delaware, representing the State in its capacity as *parens patriae*, is also a Party. The Attorney General's participation in this proceeding is without prejudice to any separate rights the Attorney General may possess and may elect to pursue in other venues which are otherwise available, as a matter of law. Any additional Parties shall be admitted by application to the Hearing Officer upon a hearing, at which the present Parties may be heard and approval by separate order based upon a showing that such person has a significant pecuniary interest in the proceeding, which interest is not adequately represented by an existing Party, and the protection of which otherwise will be impaired or impeded unless such person is admitted as a Party. The Department shall cause to be published in at least two newspapers of general, daily circulation in the State of Delaware for five (5) consecutive days, not later than twenty (20) days prior to the application deadline for such purpose set by the Hearing Officer, a notice of the opportunity to seek joinder as a Party to this proceeding.

5. Upon notification by the Department that its examination and review of the proposed transaction is complete, the Hearing Officer shall set a date for a public hearing on the merits of the proposed affiliation at the Department's offices in Dover (unless another place is designated by the Hearing Officer). The date to be set by the Hearing Officer shall be within thirty (30) days following the deadline set by the Hearing Officer for completion of all submissions from the Parties. Any person, whether or not a Party, may appear at the hearing and present testimony in aid of the inquiry; provided, however, that the Hearing Officer shall have the right to limit any testimony which the Hearing Officer determines is unduly repetitive, plainly irrelevant, immaterial or privileged. The Department shall cause to be published in at least two newspapers of general, daily circulation in the State of Delaware for five (5) consecutive days, not later than twenty (20) days prior to the hearing date, a notice of the date, time and place of the hearing and the right of persons to appear and testify.

6. Up to and including five (5) business days prior to the hearing, any person may make written submissions to be considered by the Hearing Officer. Documents which for ease of reference summarize, excerpt, or reformat materials previously submitted to the Hearing Officer, or documents requested to be submitted by a Party, may be submitted at the hearing or during such period subsequent to the hearing as the record remains open pursuant to Paragraph 11 of this Order. BCBSD and Highmark shall, at a minimum, submit those responses and documents as would be required for a "Form A" filing pursuant to Chapter 50, Title 18 Delaware Code.

7. The Parties shall have the right at the hearing to: (i) be represented by counsel; (ii) summon and examine witnesses identified to the Hearing Officer; (iii) submit evidence in written form; (iv) cross examine witnesses called by other Parties; and (v) present written and/or oral argument.

8. The purpose of the hearing is to determine whether the Commissioner should approve the affiliation of BCBSD with Highmark. In making such determination, the Hearing Officer shall apply the specific criteria for approving or disapproving a change of control of a Delaware domestic insurer found at 18 *Del. C.* § 5003(d)(1), and the Parties consent to these criteria being employed in this matter. Any testimony or documentary evidence which the Hearing Officer determines does not address a matter within the scope of the hearing is subject to exclusion by the Hearing Officer.

9. Any authorized discovery of a Party by another Party shall be conducted during the document submission period prior to the hearing, and shall be subject to the prior approval and supervision of the Hearing Officer.

10. Documentary evidence submitted into the record by any Party prior to, at or subsequent to the hearing shall be deemed to be a "public record" within the meaning of 29 *Del. C.* § 10002(g) and any applicable regulations, unless the Hearing Officer shall determine otherwise upon the application of any Party. Upon motion of a Party, and thereafter by order of the Hearing Officer, those documents considered by the Hearing Officer as part of the hearing record which are deemed to be documents which are not "public records" pursuant to applicable law shall be identified by title and date in a document filed herein.

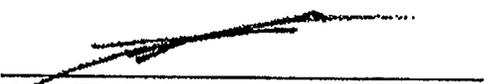
11. The testimony at the hearing shall be transcribed with the costs of transcription to be borne by Highmark. The hearing record shall remain open following the conclusion of the hearing for a term to be set by the Hearing Officer, so that any Party may submit such additional documentation relevant to the scope of the hearing as the Hearing Officer may authorize at the conclusion of the hearing. Within twenty (20) days following the date of closing the record, the Hearing Officer shall submit a summary of the evidence, recommended findings of fact,

recommended conclusions of law, and a recommended decision in the form of a proposed order to the Commissioner pursuant to 29 Del. C. § 10126. Such proposed order may include such proposed conditions to which the recommended approval of the transaction should be subject if the Commissioner should approve it.

12. To the extent permitted by law, the Hearing Officer may supplement this Order with such other orders as may be required or useful in the administration of this proceeding.

13. The present Parties, by their counsel, shall acknowledge receipt of and their assent to this Order by signing, dating and returning a copy to the Department.

SO ORDERED this 20th day of October, 2010

  
\_\_\_\_\_  
Karen Weldin Stewart, CIR-ML  
Insurance Commissioner  
of the State of Delaware

CONSENTED TO:

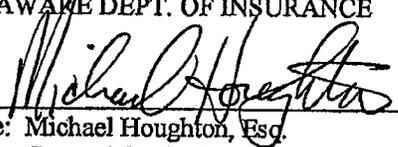
BCBSD, Inc.

By:   
\_\_\_\_\_  
Name: David S. Swayze, Esq.  
Title: Counsel for BCBSD, Inc.  
Date: \_\_\_\_\_

HIGHMARK INC.

By: \_\_\_\_\_  
Name: Frederick K. Campbell, Esq.  
Title: Counsel for Highmark Inc.  
Date: \_\_\_\_\_

DELAWARE DEPT. OF INSURANCE

By:   
\_\_\_\_\_  
Name: Michael Houghton, Esq.  
Title: Counsel for the Department  
Date: 11/01/10

DELAWARE DEPARTMENT OF JUSTICE

By: \_\_\_\_\_  
Name: Timothy Mullaney, Esq.  
Title: Director, Consumer Protection &  
Fraud Division  
Date: \_\_\_\_\_

recommended conclusions of law, and a recommended decision in the form of a proposed order to the Commissioner pursuant to 29 Del. C. § 10126. Such proposed order may include such proposed conditions to which the recommended approval of the transaction should be subject if the Commissioner should approve it.

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Karen Weldin Stewart, CIR-ML  
Insurance Commissioner  
of the State of Delaware

CONSENTED TO:

BCBSD, Inc.

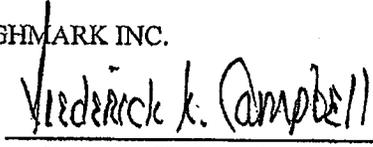
DELAWARE DEPT. OF INSURANCE

By: \_\_\_\_\_  
Name: David S. Swayze, Esq.  
Title: Counsel for BCBSD, Inc.  
Date: \_\_\_\_\_

By: \_\_\_\_\_  
Name: Michael Houghton, Esq.  
Title: Counsel for the Department  
Date: \_\_\_\_\_

HIGHMARK INC.

DELAWARE DEPARTMENT OF JUSTICE

By:   
\_\_\_\_\_  
Name: Frederick K. Campbell, Esq.  
Title: Counsel for Highmark Inc.  
Date: 10/21/10

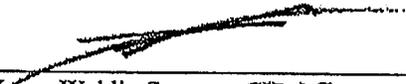
By: \_\_\_\_\_  
Name: Timothy Mullaney, Esq.  
Title: Director, Consumer Protection &  
Fraud Division  
Date: \_\_\_\_\_

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SO ORDERED this 20th day of October, 2010

  
\_\_\_\_\_  
Karen Weldin Stewart, CIR-ML  
Insurance Commissioner  
of the State of Delaware

CONSENTED TO:

BCBSD, Inc.

By: \_\_\_\_\_  
Name: David S. Swayze, Esq.  
Title: Counsel for BCBSD, Inc.  
Date: \_\_\_\_\_

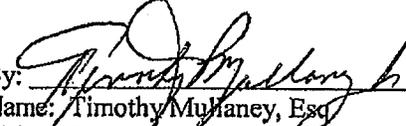
DELAWARE DEPT. OF INSURANCE

By: \_\_\_\_\_  
Name: Michael Houghton, Esq.  
Title: Counsel for the Department  
Date: \_\_\_\_\_

HIGHMARK INC.

By: \_\_\_\_\_  
Name: Frederick K. Campbell, Esq.  
Title: Counsel for Highmark Inc.  
Date: \_\_\_\_\_

DELAWARE DEPARTMENT OF JUSTICE

By:   
\_\_\_\_\_  
Name: Timothy Mulhane, Esq.  
Title: Director, Consumer Protection &  
Fraud Division  
Date: 10/26/10

# **EXHIBIT 3**

BEFORE THE INSURANCE COMMISSIONER  
IN AND FOR THE STATE OF DELAWARE

IN RE: Proposed Affiliation of BCBSD, :  
INC., D/B/A Blue Cross and : Docket No. 99-09  
Blue Shield of Delaware, :  
with CareFirst, Inc. :

**PRE-HEARING ORDER ON REQUEST OF  
PHYSICIANS HEALTH SERVICES OF DELAWARE, LTD.  
TO INTERVENE AS A PARTY IN INTEREST**

By letter from its attorney dated April 28, 1999 Physicians Health Services of Delaware, Ltd., ("PHS") request that it be considered a "party in interest" in the above-captioned matter. By further letter of August 18, 1999 counsel requests party in interest status for two individual physician members of PHS who are policyholders of and have contracts with Blue Cross Blue Shield of Delaware ("BCBSD").

As hearing officer, I have reviewed these written submittals on behalf of PHS and the two individual physicians, as well as written responses objecting to the interventions. A hearing on the requests was held on August 23, 1999 at which I denied the requests of PHS and the two physicians for party status. This written order memorializes the ruling.

The request of the two physicians for party status is denied because it was not timely. The published notice of the proceedings established a deadline of April 30, 1999 to apply for party status. Two such requests were filed prior to that date. However, the two physicians did not seek to intervene until August 18, 1999, three and one half months after the deadline imposed by the Commissioner and after a hearing date has been set. This belated request must be denied.

With respect to the application of PHS the hearing officer found that PHS failed to show a sufficient, immediate interest in the subject matter of the proceedings to support its application for party status, for the reasons discussed below.

Under the Insurance Commissioner's ("Commissioner") Pre-Hearing Order ("Order"), only those persons with a "substantial pecuniary interest" in the proceeding may intervene as "parties in interest." (Such persons are distinguished from "interested persons" who are given leave to appear at the hearing and offer testimony.) The Order also carefully circumscribes the purposes of the proceedings as being threefold: whether the proposed affiliation of BCBSD and CareFirst 1) violates Delaware law, 2) threatens the capital adequacy of BCBSD or 3) adversely affects BCBSD policyholders. Because the hearing officer is directly to apply the standards contain in Ch. 50 of Title 18 of the Delaware Code, the inquiry must necessarily touch on the effect the affiliation may have on competition among health care insurers in the State.

A review of PHS's application shows that it fails to meet the standards set out in the Commissioner's order. While the nature of PHS's business and its current activities are not entirely clear from the record, PHS acknowledges that it has no existing contracts with BCBSD. It asserts, however, that it may have such contracts in the future. This showing is simply insufficient to established a "significant pecuniary interest" as required by the Order and PHS's assertion of a possible contractual relationship in the future is speculative and does not support the direct claim or right required for party status.

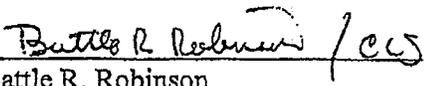
PHS also asserts, however, that a number of physicians who are shareholders in and/or members of PHS have existing contracts with BCBSD. Further, they may wish to have such contracts in the future. PHS asserts that physicians will be at a disadvantage in negotiating contracts with the larger entity which will result from the affiliation.

Even if I assume that a contractual relationship between BCBSD and physician members/shareholders of PHS gives PHS a sufficient interest to seek party status, I conclude that issues related to the negotiations and implementation of provider-contracts are not directly involved

in the subject matter of the current proceeding. The fundamental issue before the Delaware Insurance Commissioner is the capital adequacy of a health insurance provider of this State. That inquiry simply does not encompass a review of the provider's relationship with individual physicians. While the capital adequacy of BCBSD certainly impacts upon physicians - as it does numerous others who do business with it - that appears to be a more general interest shared by many rather than a specific pecuniary interest of PHS and its shareholders and members.

It also appears that neither PHS nor its shareholders/members have a specific or direct interest in the scope of the other two inquiries before the Commissioner: whether the affiliation comports with the Delaware law and whether it adversely affects policy holders. In both of these issues PHS and its shareholder/members can assert only a general interests, an interest which can be adequately protected by the Attorney General and by its ability to appear and testify at the hearing. Similarly, PHS is not a competitor of BCBSD and so lacks any direct or substantial pecuniary interest that such status might confer under the Order.

For these reasons I have denied PHS's request to intervene as a party in interest. It may, however, participate in the hearing as an "interested party" where its views and concerns may be heard and considered.

  
Battle R. Robinson  
Hearing Officer

Date: September 7, 1999

# **EXHIBIT 4**

THE INSURANCE DEPARTMENT OF THE STATE OF DELAWARE

IN THE MATTER OF:

The Proposed Acquisition of Royal Indemnity )  
Company, a Delaware domiciled )  
property/casualty insurance company, Security )  
Insurance Company of Hartford, a Delaware )  
Domiciled property/casualty insurance company, )  
Guaranty National Insurance Company, a ) Docket No. 313  
Delaware domiciled property/casualty insurance )  
Company, and Royal Surplus Lines Insurance )  
Company, a Delaware domiciled )  
property/casualty insurance company, by )  
Arrowpoint Capital Corp., a Delaware )  
Corporation, and Arrowpoint Capital, LLC, a )  
Delaware limited liability company )

**ORDER ON PRE-HEARING MOTIONS**

1. This proceeding involves a proposed transaction (the “Royal US Acquisition”) in which Arrowpoint Capital Corp. and Arrowpoint Capital LLC (the “Applicants”) would acquire the partnership interests in Arrowpoint General Partnership (the “Partnership”). The Partnership owns 100% of the common stock of Royal & SunAlliance USA, Inc. (“RSA USA”), which in turn indirectly owns 100% of the common stock of four Delaware domestic insurers (the “Insurers”), including Royal Indemnity Corporation (“Royal Indemnity”). As a result, the Royal US Acquisition requires the approval of the Commissioner of Insurance of the State of Delaware (the “Commissioner”) pursuant to 18 *Del.C.* §5003 (“Section 5003”).

2. Current directors, officers and certain employees of RSA USA are the beneficial owners of the Applicants. The proposed Royal US Acquisition, in substance, would result in the transfer of ownership and control of the Insurers from The Royal & Sun Alliance Insurance Group plc (“RSA plc”) to the Applicants.

3. In proceedings in this matter prior to the appointment of the undersigned as Hearing Officer, various persons (identified collectively as “the Moving Policyholders”) who assert significant claims or potential claims as holders of insurance policies issued by the Insurers submitted a variety of requests for pre-hearing relief. Specifically:

a. The following Moving Policyholders seek to be accorded the status of formal parties to this proceeding (a number of these persons have also explicitly sought leave to take discovery, and such requests will be treated as ancillary to, and subsumed within, their applications for status as parties): General Motors Corporation (“GM”); DaimlerChrysler Corporation (“DC”); The Student Loan Corporation (“SLC”); Federal-Mogul Corporation (“F-M”); MBIA Insurance Corporation (“MBIA”); Wells Fargo Bank, as trustee (“WF”); World

Trade Center Properties, LLC, Silverstein Properties Inc., Silverstein WTC Mgmt. Co. LLC 2, 2 World Trade Center LLC, 4 World Trade Center LLC, and 5 World Trade Center LLC (collectively "WTC"); The Port Authority of New York and New Jersey and 1 World Trade Center LLC (collectively "Port Authority"); and Westfield WTC LLC, Westfield WTC Holding LLC, Westfield Corporation Inc. and Westfield America, Inc. (collectively "Westfield").

b. Several Moving Policyholders (GM, DC, SLC, MBIA, WF, Port Authority and Westfield) seek continuance of the hearing in this matter in order to permit discovery on matters asserted to be related to the issues in this proceeding. In particular, GM seeks a continuance of 120 days from the time of completion of the Form A filing in this matter, in significant part for the purpose of having this proceeding informed by the disposition of certain of the issues in its litigation against Royal Indemnity in the Circuit Court of Oakland County, Michigan (the "Michigan litigation").

c. WTC has also moved for the appointment of an independent actuary for the purpose of evaluating whether the Insurers have adequately reserved for the claims (pending and potential) against them. WTC has also sought leave to submit the Declaration of Prof. David F. Babbel and Hon. Robert E. Wilcox, MAAA (the "Babbel/Wilcox Declaration").

4. The Moving Policyholders have submitted an array of speaking motions and letter memoranda in support of their various applications, and the Applicants and the Delaware Department of Insurance ("DID") have responded in kind. Counsel for these participants submitted additional oral comments on the various applications at a two and a half hour telephonic pre-hearing status conference on December 14, 2006 (the "December 14 Status Conference").

5. The recitation of background and reasons for the determinations embodied in this Order is necessarily truncated and preliminary, and is not intended to set forth final determinations of either fact or law that will control the disposition of the matter upon final public hearing. As recited more formally below, however, and for the reasons recited briefly below, WTC's application for leave to submit the Babbel/Wilcox Declaration is granted, but the other applications of the Moving Policyholders are denied.

6. Not surprisingly in light of the sophistication of their counsel, the Moving Policyholders support their various motions with a superficially compelling array of legal authorities and appeals to practical and policy concerns. Their legal arguments in support of their motions for party status center on Section 5003(d)(2), specifically its provision that in connection with the public hearing on a matter such as this, "any person ... whose interest may be affected thereby shall have the right to present evidence, examine and cross-examine witnesses, and offer oral and written arguments and in connection therewith shall be entitled to conduct discovery proceedings in the same manner as is presently allowed in the Superior Court of this State." Because of their status as holders of policies issued by the Insurers (policies that involve upwards of hundreds of millions of dollars), the Moving Policyholders maintain that they have an "interest" that "may be affected" by this proceeding, and they therefore have a statutory right to "conduct discovery proceedings" and "present evidence, examine and cross-examine witnesses" as if this were an action pending in the Superior Court.

7. This statutory argument does not adequately take into account competing statutory provisions and objectives:

a. Section 5003(d)(2) also requires that the public hearing “be held within 30 days after the [Form A] is filed,” and that the hearing occur upon as little as “7 days’ notice to such other persons [other than “the person filing the statement”] as may be designated by the Commissioner.” The statute does not clearly explain how the Commissioner could satisfy the 30-day hearing deadline and still afford persons with an “interest” in the matter the right to take discovery as under the Rules of the Superior Court. What is clear, however, is that Section 5003 contemplates a relatively expedited proceeding for action on applications for approval of a change of control of a Delaware domestic insurer. An expansive view of this sort of proceeding as an adversarial forum equivalent to ordinary civil litigation undermines that clear statutory policy of expedition. This consideration militates against allowing intervention in this proceeding on a basis that is more liberal than the standard generally applicable to intervention in civil actions in the Superior Court (*see* Superior Court Civil Rule 24(a)(2), denying intervention as of right if the applicant’s interest is adequately represented by existing parties).

b. The term “interest” as used in Section 5003(d)(2) is not defined by statute or case law, and is by no means self-defining. It should therefore be construed in a manner consistent with the governing statutory objectives and regulatory framework. All agree that the protection of policyholders is the paramount objective of Delaware’s body of insurance regulation. And with regard to the regulatory framework, it is clear that “[i]n Delaware, as in most states, the Insurance Commissioner is charged with the responsibility of providing [ ] scrutiny and assessing risk to Delaware policyholders by enforcing the laws and regulations with their best interests in mind.” *In the Matter of Proposed Affiliation of BCBSD, Inc.*, 2004 Del. Super. LEXIS 333, \*53 (Oct. 4, 2004). The protection of policyholders is thus the primary function of the Commissioner. The statutes do not place responsibility for protecting policyholders in the realm of private enforcement through litigation or an equivalent process. Therefore, in the absence of substantial evidence that the Commissioner – through his general investigative and supervisory powers, and through the conduct of this hearing process – is incapable of discharging his statutory obligation to review change of control transactions to determine whether they “prejudice the interest of [ ] policyholders” (Section 5003(d)(3)(c)), some distinct, substantial interest beyond that as a policyholder should be required as a basis for entitlement to party status in proceedings under Section 5003. However significant their interests as policyholders may be, none of the Moving Policyholders has articulated and demonstrated such a distinct “interest” of the sort that would justify their intervention as parties in this matter.

8. With regard to practical and policy concerns, however, the Moving Policyholders urge that the proposed Royal US Acquisition is a conflict transaction (in light of the equity interest of current management in the acquiring entities), and therefore requires regulatory oversight in a manner that cannot be, and is not being, applied by the DID in this matter. In essence, the Moving Policyholders maintain that regulatory oversight will be deficient as a matter of law in the absence of an adversarial process (involving discovery and cross-examination, as in litigation) or at least some independent alternative (such as the appointment of

an independent actuary) to test the adequacy of the proposed Royal US Acquisition from the perspective of protecting the Insurers' policyholders.

9. The Moving Policyholders, however, have not demonstrated (at least at this point) that the Commissioner and this proceeding are incapable of protecting the policyholders' interests in the absence of their intervention and conduct of adversarial proceedings in this matter:

a. Preliminarily, the Moving Policyholders have not demonstrated that the proposed Royal US Acquisition is tainted by unique or unusual conflicts of interest. In conflict transactions generally, the primary concern is that directors and officers will use their control to structure a transaction to favor themselves at the expense of their corporation and its stockholders. In view of that sort of concern, the party meriting protection here would be RSA plc, the seller in the transaction. There is no substantiated conflict, however, between RSA's directors and officers, on one hand, and the Insurers' policyholders, on the other: to the contrary, it is at least equally plausible that the directors and officers would be anxious to extract as much from RSA plc as possible in the proposed transaction for the benefit of the Insurers (and, indirectly, for the benefit of their policyholders), since the more financially secure the Insurers become under the transaction, the more profit and job security the directors and officers might be able to achieve in the long run. To be sure, WTC suggests that management of the Insurers (like any equity holder of a domestic insurer) will have an incentive to minimize payouts to policyholders, unmitigated by any countervailing reputational incentive to promote the writing of additional policies. While that suggested incentive may be one that should be taken into account in evaluating the proposed Royal US Acquisition at the public hearing in this matter, it is not one that is sufficiently concrete at this stage to require a determination that the DID is incapable of effectively representing policyholder interests in evaluating the proposed transaction (even without the proposed transaction, and while under the ultimate control of RSA plc, the Insurers already seem to have had no lack of zeal to minimize claims brought by GM, DC, MBIA and WTC).

b. The Moving Policyholders question the efficacy of the DID's review of the proposed Royal US Acquisition, asserting that in evaluating the Insurers' financial condition and reserves, the DID has not directly contacted any of the Moving Policyholders to obtain their input in assessing the appropriate amounts to reserve on claims that they assert. The Moving Policyholders, however, point to nothing in any statute, rule or case precedent that requires that the DID's assessment of the Insurers' reserves must include an invitation to claimants to present evidence and argument concerning their respective claims.

c. The Commissioner's powers with respect to this proceeding, moreover, by no means exhaust his authority to protect policyholder interests. GM expresses particular concern, for example, that the proposed Royal US Acquisition would grant "management insiders the opportunity to extract millions of dollars from the acquired companies to the detriment of the policyholders." (Docket #15 at 3). Even disregarding the limitations on distributions by the Insurers established in the proposed Royal US Acquisition, however, GM's stated concern is significantly addressed by statutes that would require the Insurers to give notice to the DID of proposals to declare and pay dividends to the Insurers' owners (*see* 18 *Del. C.* §5004(e),

§5005(b)), and that require the DID to periodically examine the financial condition of domestic insurers (*see* 18 *Del. C.* §§318 *et seq.*).

10. Denial of the Moving Policyholders' applications for party status does not deny them a meaningful opportunity to call attention to their concerns about the proposed Royal US Acquisition. They have not squarely contended that such denial would unconstitutionally deprive them of due process of law, and any such contention would lack merit. *See LaFarge v. Cmwlth. of Pa., Ins. Dep't.*, 735 A.2d 74, 78 (Pa. 1999) (in proceeding on insurer's proposal to place asbestos and environmental liabilities in a separate operating entity, notice and opportunity to comment "were adequate to satisfy the requirements of due process," and the "imposition of additional procedures such as sworn testimony, cross-examination, a full stenographic record, and opportunity to submit briefs would entail extensive delay [and] would not materially enhance the interests of [policyholders]"). In this proceeding, the Moving Policyholders have had and will have significant opportunities to present their concerns. They have already submitted comments that will surely need to be addressed in connection with the public hearing in this matter. The Babbel/Wilcox Declaration, for example, raises a number of significant questions (*e.g.*, about the scope of and responsibility for unfunded pension obligations) that the Applicants and the DID should address in regard to the statutorily required evaluation of the effect of the proposed transaction on the Applicants' financial condition and the Insurers' financial stability. It can be expected that the Moving Policyholders will submit still more comments on the proposed transaction, and those comments should inform the outcome of this proceeding.

11. The Moving Policyholders' requests for continuance become largely moot once it is determined that they will not have party status in this matter and therefore will not be entitled to conduct discovery. GM suggests an independent reason, however, why a continuance would be appropriate, so it is necessary to address that reason here. GM's suggestion is that the hearing in this matter should await the outcome of proceedings in the Michigan litigation, since the trial in that litigation, scheduled to begin in February 2007, could soon result in a trial court-level resolution of Royal Indemnity's liability to GM on substantial policy claims, and that the adequacy of the Insurers' reserves would become clearer with the benefit of such a resolution. There are at least two reasons, however, to reject this suggestion as a predicate for an extended continuance here. First, it is not a foregone conclusion that developments in the Michigan litigation will occur as promptly as GM expects: damages issues may be bifurcated and deferred, as Royal Indemnity is seeking, or proceedings may be delayed for any number of other reasons inherent in the litigation process. Second, and more importantly, the previously mentioned statutory policy of expedition counsels against even a limited stay of this administrative proceeding in favor of civil litigation pending elsewhere.

12. With respect to WTC's application for the appointment of an independent actuary, the Applicants raise the threshold question of whether the Hearing Officer in a proceeding of this sort has the statutory authority to require such an appointment. WTC points out that in the proceeding involved in *LaFarge, supra*, the Pennsylvania Insurance Department engaged an independent actuary, and that under Section 5003(d)(3) the Commissioner may retain actuaries "not otherwise part of the Commissioner's staff as may be reasonably necessary to assist the Commissioner in reviewing the proposed acquisition of control." The question of the Hearing

Officer's authority to require the appointment of an independent actuary may be academic in any event, since WTC is surely correct in asserting, alternatively, that the Hearing Officer could at least recommend that the Commissioner appoint an independent actuary. For reasons previously set forth, however, the application for an order requiring or recommending the appointment of an independent actuary will be denied. Any lack of a report by such an actuary may be taken into account in evaluating the application for approval of the proposed Royal US Acquisition. In the meantime, however, there is no factual basis for a determination at this stage of the proceedings that the DID's evaluation to date suffers from some debilitating disqualification or inadequacy (see paragraph 7b, above).

13. For similar reasons, it is inappropriate to enter any direction to the Applicants or to the DID with respect to the content of the Applicants' Form A filing in this matter. The determination of the completeness of that filing is the responsibility of the DID. Whether that filing is a sufficient basis for approval of the proposed Royal US Acquisition is a different question, one that is to be addressed at the public hearing in this proceeding.

**IN CONSIDERATION OF WHICH,**

- A. WTC's motion for leave to submit the Babel/Wilcox Declaration is **granted**;
- B. The various motions for party status, for discovery, for continuance and for appointment of an independent actuary are **denied**;
- C. Notwithstanding such denial, the materials previously submitted by the Moving Policyholders, including the Babel/Wilcox Declaration, will be considered as written comments on the proposed Royal US Acquisition, and such materials need not be resubmitted for purposes of such consideration, and the Moving Policyholders may submit additional written comment and argument in accordance with procedures to be established for the public hearing in this matter.

/s/ Lawrence A. Hamermesh  
Prof. Lawrence A. Hamermesh  
Hearing Officer

December 20, 2006

# **EXHIBIT 5**



LEXSEE 2004 DEL SUPER LEXIS 333

**IN THE MATTER OF: PROPOSED AFFILIATION OF BCBSD, INC., d/b/a BLUE  
CROSS AND BLUE SHIELD OF DELAWARE, WITH CAREFIRST, INC.,**

**C.A. No. 04A-07-004-JRS**

**SUPERIOR COURT OF DELAWARE, NEW CASTLE**

*2004 Del. Super. LEXIS 333*

**September 10, 2004, Submitted  
October 4, 2004, Decided**

**NOTICE:**

[\*1] THIS OPINION HAS NOT BEEN RE-  
LEASED FOR PUBLICATION. UNTIL RELEASED,  
IT IS SUBJECT TO REVISION OR WITHDRAWAL.

**SUBSEQUENT HISTORY:** Affirmed by *Carefirst, Inc.*  
*v. Williams*, 2004 Del. LEXIS 583 (Del., Dec. 17, 2004)

**PRIOR HISTORY:** Upon Appeal from the Decision  
and Amended Order of the Insurance Commissioner  
Dated June 30, 2004.

**DISPOSITION:** AFFIRMED

**COUNSEL:** Attorneys for Appellant, CareFirst, Inc.: W.  
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ware.

Attorney for the Delaware [\*2] Department of Justice:  
Marsha Kramarck, Esquire, Department of Justice, Wil-  
mington, Delaware.

**JUDGES:** Joseph R. Slight, III, Judge.

**OPINION BY:** Joseph R. Slight, III

**OPINION**

**MEMORANDUM OPINION**

**SLIGHTS, J.**

**I.**

In this appeal from a decision of the Delaware In-  
surance Commissioner ("the Commissioner" or "the  
Delaware Commissioner"), the Court addresses the scope  
of the Commissioner's authority to consider and approve  
a unique structural affiliation between two non-profit  
health service plans, the appellant, CareFirst, Inc.  
("CareFirst") and one of the appellees, Blue Cross and  
Blue Shield of Delaware, Inc. ("BCBSD"). The affilia-  
tion created by the parties and submitted to the Commis-  
sioner for approval resulted in a transaction not specifi-  
cally addressed, and perhaps not even contemplated by,  
the statutory scheme that regulates the health insurance  
industry in Delaware. The Commissioner approved the  
affiliation in March, 2000. By order dated June 30, 2004,

the Commissioner withdrew her approval after concluding that recently enacted legislation in Maryland rendered the affiliation no longer in the best interests of BCBSD or its Delaware subscribers.

CareFirst now argues that [\*3] the Commissioner lacked the authority to approve the affiliation in 2000 and lacked the authority subsequently to withdraw her approval in 2004. According to CareFirst, neither act was within the Commissioner's statutorily prescribed power. CareFirst also argues that even if the Commissioner was authorized to approve and then disapprove of the affiliation, her decision to order the disaffiliation of BCBSD and CareFirst was not supported by substantial evidence.

For the reasons that follow, the Court finds that the Commissioner was authorized both to approve the affiliation with conditions and subsequently to withdraw that approval when a dramatic change in circumstances compelled her to do so. In addition, the Court is satisfied that the Commissioner's decision to order disaffiliation is supported by substantial evidence. Accordingly, the decision must be **AFFIRMED**.

## II.

### A. The Parties

The parties to this appeal are the appellant, CareFirst, and the appellees, the Delaware Department of Insurance (the "Department"), the Delaware Department of Justice, and BCBSD. CareFirst is a non-profit Maryland corporation regulated as a health service plan under the Maryland [\*4] Insurance Code. CareFirst operates as a holding company that originally was formed by an affiliation between CareFirst of Maryland, Inc. ("CFMD") and Group Hospitalization and Medical Services, Inc. ("GHMSI"), two non-profit subsidiaries that provide Blue Cross and Blue Shield services in the State of Maryland and the District of Columbia, respectively.<sup>1</sup> BCBSD is a non-profit Delaware corporation regulated as a health service corporation under the Delaware Insurance Code.<sup>2</sup> The Commissioner is the "chief officer" of the Department and is charged with regulatory responsibility over domestic and foreign "insurers" as provided by the Delaware Insurance Code.<sup>3</sup>

<sup>1</sup> D.I. 12, B-8, 9.

<sup>2</sup> See *DEL. CODE ANN. tit.18, §§ 102, 310* (1999). Title 18 of the Delaware Code Annotated of 1974 shall hereinafter be referred to as the "Delaware Insurance Code."

<sup>3</sup> *Id.*

### B. The 1998 Affiliation Agreement

On December 23, 1998, CareFirst and BCBSD executed an Affiliation Agreement (the "Agreement") to capitalize [\*5] on marketing and administrative synergies between the two companies and to allow BCBSD to remain competitive and economically viable through its relationship with the larger and more resourceful CareFirst.<sup>4</sup> Prior to entering into the Agreement, the BCBSD board conducted extensive due diligence on CareFirst, the CareFirst Board and its management. BCBSD felt comfortable at the time of the Affiliation that CareFirst was a company focused on fiscal discipline and market competitiveness, that it understood and would respect the unique Delaware market, and that it shared BCBSD's vision for the future.<sup>5</sup>

<sup>4</sup> D.I. 12, B-10.

<sup>5</sup> D.I. 12, B-169, Tr. at 86.

Under the Agreement, CareFirst would become the sole member of BCBSD, as well as the primary licensee for use of the Blue Cross and Blue Shield service trademarks (the "Marks") in Delaware. BCBSD would become an affiliate of CareFirst and would maintain "controlled affiliate" licenses to use the Marks in Delaware. CareFirst paid no consideration for either its [\*6] membership interest in BCBSD or the primary licenses for use of the Marks in Delaware. The Agreement required BCBSD and CareFirst to amend their respective charters and bylaws to implement this unique affiliated structure. Despite the structural changes, BCBSD remained a locally-controlled entity with its own Delaware-based board of directors.<sup>6</sup>

<sup>6</sup> This was accomplished through amendments to the BCBSD and CareFirst charters that prevented CareFirst from electing anyone to the BCBSD board of directors except those persons nominated by the BCBSD board. D.I. 12, B-310, 335.

The Agreement contemplated three classes of CareFirst directors comprised in total of twenty-one members, including six "Class I Directors" from the District of Columbia affiliate, twelve "Class II Directors" from the Maryland affiliate, and three "Class III Directors" from the Delaware affiliate. Under the Agreement, each class of directors maintained the exclusive right to elect or remove any director within its class.<sup>7</sup> Moreover, the size [\*7] of the CareFirst Board could not be changed without the approval of each class of directors, and the existence and powers of the separate classes of directors or members could not be altered in any manner, directly or indirectly, without the consent of the potentially affected class of directors.<sup>8</sup>

<sup>7</sup> D.I. 12, B-336-37.

8 D.I. 14, Ex. B, Affiliation Agreement, App. B § 3(b).

### C. The 2000 Affiliation Order

In 1999, BCBSD and CareFirst requested approval of the Agreement from the Commissioner under Chapters 3 and 50 of the Delaware Insurance Code. The parties believed this approval to be necessary and in concert submitted themselves and the Affiliation they had constructed to the jurisdiction of the Commissioner.<sup>9</sup> Even though it was understood by all concerned that the Affiliation was not a "change in control" transaction or merger of the companies, the parties agreed that the provisions of the Delaware Insurance Code relating to such transactions may provide helpful guidance to the Commissioner [\*8] as she considered the unique transaction they had submitted to her for approval.<sup>10</sup>

9 D.I. 12, B-1.

10 D.I. 12, B-11.

In October 1999, a public hearing was held on the matter before the Honorable Battle R. Robinson, the Hearing Officer appointed by the Commissioner to consider the transaction in the first instance. Three months later, on January 4, 2000, the Hearing Officer issued her findings and conclusions in which she recommended approval of the Affiliation with several conditions. On March 20, 2000, the Commissioner issued her Order in which she adopted most of the Hearing Officer's recommendations as conditions to her approval of the Affiliation (the "Affiliation Order").<sup>11</sup> The following conditions, to which the parties agreed, are relevant here:

. CareFirst and BCBSD must comply with the provisions of 18 Del. C. Ch. 50, and CareFirst must further agree to the "general supervisory authority" of the Commissioner pursuant to 18 Del. C. Ch. 3.<sup>12</sup>

. The CareFirst and BCBSD boards of [\*9] directors must be restructured to comply with the terms of the draft amended certificates of incorporation and bylaws submitted for approval by the parties. Any change in the corporate structure of either CareFirst or BCBSD "must receive prior approval of the [Department]."<sup>13</sup>

. Certain transfers of assets are now subject to the prior approval of the Commissioner.<sup>14</sup>

. CareFirst and BCBSD must maintain their separate corporate identities for

legal, financial, accounting, tax, and insurance regulatory purposes.<sup>15</sup>

. BCBSD must maintain its not-for-profit status for at least two years from the date the Affiliation becomes effective. Thereafter, it may not convert to for-profit status without the approval of the Commissioner.<sup>16</sup>

. Any change in the corporate structure of CareFirst or any of the affiliates which is required to be filed with another regulator must also simultaneously be filed with the Department.<sup>17</sup>

. The conditions to the approval of the Affiliation are "subject to further order as circumstances may require." The Hearing Officer's Report and Affiliation Order "are subject to further modification or amendment or further review either sua [\*10] sponte by the Commissioner or by motion of a party."<sup>18</sup>

11 The Commissioner modified and augmented some of the Hearing Officer's proposed conditions to "strengthen and give more specificity" to the Department's ability to oversee and regulate the future activities of the parties, and to "better assure that no substantial alteration of BCBSD health services as currently provided in Delaware can occur absent prior notice and approval of the Insurance Commissioner and the Attorney General." D.I. 12, B-3.

12 D.I. 12, B-58 at P 3.

13 D.I. 12, B-58 at P 4.

14 D.I. 12, B-58 at P 5.

15 D.I. 12, B-58 at P 1.

16 D.I. 12, B-60 at P 9.

17 D.I. 12, B-61 at P 10.

18 D.I. 12, B-62 at P 19.

After the Affiliation was approved by the Commissioner, the parties continued to deliver services to BCBSD subscribers in accordance with the terms of the Agreement and the Affiliation Order. By all accounts, the Affiliation has been and continues to be a success.

### D. The Maryland Legislation

[\*11] In response to growing concerns of the Maryland Insurance Commissioner ("the Maryland Commissioner") regarding a perceived change in the focus and direction of CareFirst, on May 22, 2003, the Maryland

General Assembly enacted legislation addressing the regulation of nonprofit health service plans incorporated in or licensed by the State of Maryland (the "Maryland Legislation").<sup>19</sup> The Maryland legislators made no secret of the fact that the Maryland Legislation targeted CareFirst and its affiliates.<sup>20</sup> Several features of the Maryland Legislation, effective June 6, 2003, altered the Affiliation, including provisions that:

. Prohibited an acquisition or conversion of CareFirst to a for-profit corporation for a period of five years, and allowed that any decision to convert thereafter may be vetoed by any three members of CareFirst's Board of Directors;

. Changed the membership of the CareFirst Board by causing the removal and replacement of all twelve Class II Directors by July 1, 2004, irrespective of their current term limit status, without approval by Delaware or District of Columbia regulators;

. Provided that five of the new Class II directors on the CareFirst [\*12] Board would be nominated by a committee designated by the Maryland General Assembly and the Governor by December 31, 2003, and that the remaining seven Class II directors would be selected by the previously elected Class II directors from a special pool of applicants determined by the nominating committee to meet the minimum qualifications established by the Maryland Legislation;

. Reduced the term of a CareFirst director to two years and limited total service to six years (down from nine);

. Limited compensation of CareFirst directors to \$ 12,000 per calendar year and \$ 15,000 per year for Board or Committee Chairs;

. Required CareFirst directors to adhere to a newly stated non-profit mission;

. Sanctioned CareFirst directors if they strayed from the non-profit mission;

. Expanded the number of CareFirst directors from twenty-one to twenty-three by adding two non-voting members to the CareFirst Board, one to be appointed by the Speaker of the Maryland House of Delegates and the other to be appointed by the President of the Maryland Senate;

. Identified six categories of CareFirst and BCBSD management decisions that must now be approved by the CareFirst [\*13] Board or by delegation to one of its committees; and

. Authorized the creation of an oversight committee of Maryland government appointees to examine and evaluate CareFirst.<sup>21</sup>

19 On November 20, 2001, CareFirst entered into an agreement with WellPoint Health Networks, Inc. whereby CareFirst and its affiliates, including BCBSD, would be acquired by WellPoint and converted to for-profit status. In March, 2003, the Maryland Commissioner declined to approve the transaction and criticized CareFirst's management and Board for not respecting CareFirst's nonprofit mission, for failing to seek and consider material information relevant to the decision to convert, for approving large bonuses and permanent roles for management, and for conducting a flawed bidding process. D.I. 12, B-436.

20 D.I. 10, Ex. 7 at 6-7; Ex. 8 at 8-9; Ex. 19 at 7.

21 The Maryland Legislation triggered a flurry of litigation among the Blue Cross and Blue Shield Association and the State of Maryland. The litigation resulted in an Order and Consent Judgment in the United States District Court for the District of Maryland. This consent order purportedly modified the Maryland Legislation in several respects, including its provisions regarding the composition of the CareFirst board. D.I. 12, B-505-08. In 2004, the Maryland General Assembly passed an amendment to the Maryland Legislation intended, *inter alia*, to make clear that the statute applied only to insurers actually conducting business in Maryland. D.I. 12, B-535-36.

**[\*14] E. The Commissioner's Standstill Order, Rule to Show Cause and the Administrative Services and Business Affiliation Agreement**

In response to the Maryland Legislation, citing her concern that the new law would adversely affect BCBSD and its Delaware subscribers, the Commissioner issued a so-called "Standstill Order" on April 10, 2003, in which she prohibited BCBSD or CareFirst from changing their charters, bylaws or the composition of their Boards of Directors without the Commissioner's prior written approval.<sup>22</sup> Subsequently, on May 22, 2003, the Commis-

sioner issued a Rule to Show Cause requiring the parties to demonstrate why: (1) the Maryland Legislation would not contravene the Affiliation Order, (2) the Affiliation Order should not be terminated, (3) BCBSD's participation in the Affiliation should not be withdrawn, (4) any assets, licenses, authorities, or the like yielded by BCBSD to CareFirst should not be returned, and (5) any other and necessary Order should not be entered protecting the rights of Delaware citizens to the full benefits offered prior to the Affiliation Order.

22 D.I. 12, B-516.

[\*15] To address the Commissioner's concerns, in the Fall of 2003, BCBSD and CareFirst proposed to modify the Affiliation by adopting an Administrative Services and Business Affiliation Agreement (the "ASBAA"). The ASBAA provided for: (1) the restoration of majority membership of BCBSD to the BCBSD Board of Directors; (2) an ongoing business relationship between BCBSD and CareFirst; (3) continued oversight by the Commissioner; and (4) the surrender of the primary licenses to use the Marks in Delaware by CareFirst back to BCBSD. In November 2003, CareFirst and BCBSD submitted the ASBAA to the Delaware and Maryland Insurance Commissioners for approval. On December 1, 2003, after receiving evidence from the parties, the Delaware Commissioner approved the ASBAA on the condition that it be consummated by December 31, 2003.

For his part, the Maryland Commissioner withheld approval and notified the parties by letter dated December 23, 2003, that the ASBAA was "disapproved, as submitted, pending my further review." As of this writing, the Court is not aware of the Maryland Commissioner's decision regarding the ASBAA.<sup>23</sup>

23 See Footnote 76, *infra*.

[\*16] Because CareFirst and BCBSD did not obtain approval from the necessary Maryland authorities, they failed to close the ASBAA by the December 31, 2003 deadline set by the Delaware Commissioner. Consequently, the Commissioner convened hearings on March 9 and April 15, 2004 to receive evidence concerning whether the Affiliation Order had been violated by the Maryland Legislation and, if so, what the appropriate remedy for any such violation might be.

#### F. The Commissioner's June 30, 2004 Decision and Amended Order

As a result of her hearings, the Commissioner issued a Decision and Amended Order on June 30, 2004, in which she found several violations of the Affiliation Order arising from the Maryland Legislation. Specifically, the Commissioner found that the Maryland Legislation:

. placed a significantly different Board, with significantly different goals, objectives and responsibilities, in control of CareFirst and that there is a substantial risk that this new majority will govern CareFirst in a manner that is inconsistent with the present long term objectives of the BCBSD Board;<sup>24</sup>

. granted to the Maryland-controlled CareFirst Board new, specific and detailed authority [\*17] to oversee the management of the affiliates, including indirectly BCBSD, that did not exist at the time of the review and approval of the Affiliation;<sup>25</sup>

. created a non-profit mission that causes CareFirst to be governed, managed and operated in a way that does not give first priority to its financial fitness and is not consistent with the character of CareFirst as it existed when the Affiliation with BCBSD was approved, and provided for sanctions against individual board members for straying from this mission;<sup>26</sup>

. created a five-year acquisition moratorium which, when coupled with the statutory non-profit mission of CareFirst, effectively precludes BCBSD from being acquired by a third party at least through May 22, 2008, and very likely for the indefinite future thereafter, notwithstanding that such an acquisition might be in the best interests of BCBSD and its subscribers.<sup>27</sup>

24 D.I. 12, B-157.

25 D.I. 12, B-157-58.

26 D.I. 12, B-158-59.

27 D.I. 12, B-159-60.

The Commissioner's [\*18] Order required that CareFirst and BCBSD take all steps necessary to return CareFirst's membership in BCBSD to the BCBSD Board of Directors, and to cause CareFirst to surrender its rights to use the Marks in Delaware. Nevertheless, the Order permits the parties to preserve their Affiliation on a contractual basis if they desire, subject to the Commissioner's approval.<sup>28</sup>

28 Both CareFirst and BCBSD have indicated that they would be willing to remain contractually affiliated.

CareFirst timely filed its notice of appeal from the Commissioner's June 30, 2004 Order on July 16, 2004. Thereafter, the parties stipulated, and the Court agreed, to address this appeal on an expedited basis and, in the meantime, to enter a stay of the Commissioner's June 30 Order.

### III.

CareFirst argues that the Delaware Commissioner exceeded her authority in several respects during the proceedings before the Department. First, CareFirst contends that, because the Delaware Insurance Code does not expressly address the role of the [\*19] Commissioner in the context of an Affiliation like the one created here, the Commissioner lacks the authority either conditionally to approve the Affiliation or subsequently to vacate that approval. Alternatively, CareFirst argues that even if the Commissioner had the authority to order disaffiliation, she had no authority to order CareFirst and BSBSD into a particular business relationship, such as the ASBAA. Finally, CareFirst alleges that the Commissioner had no authority to determine whether there was a breach of the Agreement because that is a question for a court, not an administrative agency, to decide.

Next, CareFirst argues that the Commissioner's June 2004 Order is not supported by substantial evidence. Specifically, CareFirst contends that the record lacks substantial evidence to support the Commissioner's finding that the Affiliation Order caused a change in the structure of the CareFirst Board and thereby violated her Affiliation Order. In this regard, CareFirst observes that Class II directors have always been authorized by the CareFirst charter and bylaws to elect and remove Class II directors. The CareFirst corporate documents also allow the Board to take all steps [\*20] necessary to comply with applicable laws. Thus, the steps taken to elect twelve new Class II directors in compliance with the Maryland Legislation were proper and consistent with the structure approved by the Delaware Commissioner in her Affiliation Order.

CareFirst also argues that the addition of the two nonvoting directors does not violate the Affiliation Order because the CareFirst charter expressly allows that the size of the Board may be increased or decreased, in accordance with the procedure set forth therein.<sup>29</sup> This provision was in the corporate documents approved by the Commissioner.<sup>30</sup> Moreover, because the two additional directors are nonvoting, their addition to the CareFirst Board did not alter the voting balance or otherwise change the "structure" of the Board.

29 D.I. 12, B-336.

30 *Id.*

As to the remedy imposed by the Commissioner, CareFirst contends that she acted arbitrarily and abused her discretion by ordering the disaffiliation prior to allowing the Maryland Commissioner to [\*21] consider and act upon the proposed ASBAA. According to CareFirst, the ASBAA has been approved by all necessary parties in Delaware, provides answers to all of the Delaware Commissioner's concerns regarding the Maryland Legislation, and certainly provides a less drastic remedy than disaffiliation.

Finally, CareFirst argues that the Commissioner's decision was based upon unsupported speculation that the Maryland Legislation "might put BCBSD and its subscribers at risk," a conclusion directly at odds with the overall success that CareFirst and the Affiliation have continued to enjoy both before and after the Maryland Legislation was enacted.

Both BCBSD and the Department take issue with CareFirst's position on the extent of the Commissioner's authority.<sup>31</sup> They contend that the Commissioner was operating properly under the broad grant of authority given to her by the Delaware Insurance Code when she approved the Affiliation and later when she vacated her Affiliation Order. They also argue that CareFirst should not be permitted to challenge the Commissioner's authority now because CareFirst affirmatively assented to her Affiliation Order when it was entered including each of the conditions [\*22] imposed.

31 While BCBSD did not brief the issue of the Commissioner's authority, BCBSD indicates that it agrees with and has adopted the Department's position.

As to the merits of the Commissioner's decision, both BCBSD and the Department maintain that, at a minimum, there is substantial evidence that a gross change of circumstances occurred as a result of the Maryland Legislation that would enable the Commissioner to respond in her capacity as chief administrator and regulator. Alternatively, there is substantial evidence to support the Commissioner's conclusion that specific conditions of the Affiliation Order were violated. Additionally, they argue that the remedy was appropriate because the Commissioner was responding to a real threat of harm to Delaware subscribers and tailored the remedy to allow the parties to continue their relationship through a contractual relationship, rather than a structural one, if they both desired.

These contentions raise two issues for the Court to decide: (i) whether the Commissioner [\*23] had the au-

thority conditionally to enter the Affiliation Order and subsequently to vacate that Order and, if so; (ii) whether the Commissioner's decision to vacate her Affiliation Order and order disaffiliation was supported by substantial evidence.

#### IV.

This Court has appellate jurisdiction over this matter pursuant to *Section 10142 of the Administrative Procedures Act*.<sup>32</sup> In exercising its jurisdiction, the Court's review is limited to determining whether the Commissioner's findings are supported by substantial evidence, whether they are free from legal error, and whether they are the product of an orderly and logical deductive process.<sup>33</sup> "Substantial evidence" means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.<sup>34</sup> In making the determination of whether substantial evidence supports the administrative findings, the Court does not weigh the evidence, determine questions of credibility, or make its own factual findings; it merely determines if the evidence is legally adequate to support the agency's factual findings.<sup>35</sup>

32 *DEL. CODE ANN. tit. 29, § 10142(a)*(2003) ("Any party against whom a case decision has been decided may appeal such decision to the [Superior] Court. ").

[\*24]

33 *In the Matter of Surcharge Classification 0133 by the Delaware Compensation Rating Bureau, Inc.*, 655 A.2d 295, 299 (Del. Super. Ct. 1994), citing *Kreshtool v. Delmarva Power and Light Co.*, 310 A.2d 649, 652 (Del. Super. Ct. 1973) ("Reversal is warranted if the administrative agency exercises its power arbitrarily, or committed an error of law, or made findings of fact insupportable by substantial evidence. ").

34 *Canyon Construction v. Williams*, 2003 Del. Super. LEXIS 89, 2003 WL 1387137 at \*1 (Del. Super.).

35 *Id.*; *DEL. CODE ANN. tit. 29, § 10142(d)*(2003).

#### V.

##### A. The Challenge To The Commissioner's Authority

Before determining whether the Commissioner's decision was supported by substantial evidence, the Court must first address the legal question of whether the Commissioner was authorized conditionally to approve the Affiliation between CareFirst and BCBSD and also whether she was authorized subsequently to vacate that order. For the reasons that follow, the Court concludes she was authorized to do both.

##### 1. The Commissioner's Authority [\*25] Conditionally to Approve the Affiliation

Chapter 3 of the Delaware Insurance Code outlines the Commissioner's general authority. It provides, in part, that "the Commissioner shall enforce and execute the duties imposed by this title" and ". . . shall have the powers and authority expressly vested by or reasonably implied from this title."<sup>36</sup> This broad grant of authority allows the Commissioner to do all that is "reasonably necessary" to execute her powers and duties.<sup>37</sup> In addition to this broad grant of statutory authority, the Delaware Insurance Code addresses specific instances in which the Commissioner may exercise her regulatory powers. For instance, at Chapter 50, the Insurance Code grants the Commissioner express authority to approve mergers and change-of-control transactions involving Delaware insurers.<sup>38</sup> When evaluating a merger or change-of-control transaction, the Commissioner must strictly apply the criteria set forth in *Section 5003 (d)(1)* and must approve the proposed transaction unless she determines that the transaction would implicate any of the concerns identified in the statute.<sup>39</sup>

36 *DEL. CODE ANN. tit. 18, § 310(a),(b)* (1999).

[\*26]

37 *Dep't of Correction v. Worsham*, 638 A.2d 1104, 1107 (Del. 1994) ("An expressed grant of legislative power to an agency carries with it the authority to do all that is reasonably necessary to execute that power."); *Atlantis I Condo. Ass'n v. Bryson*, 403 A.2d 711, 713 (Del. 1979)(same); see *State Farm Mut. Auto. Ins. Co. v. Hale*, 297 A.2d 416, 418 (Del. Ch. 1972)(same).

38 See *DEL. CODE ANN. tit. 18, § 5003(a)*(1999).

39 See *DEL. CODE ANN. tit. 18, § 5003(d)(1)*(1999) ("*Section 5003*"): "*Approval by Commissioner: Hearings*. -- (1) The Commissioner shall approve any merger or other acquisition of control referred to in subsection (a) of this section unless, after a public hearing thereon, the Commissioner finds that [the transaction will implicate any of the following enumerated concerns. . . .]"(emphasis added). See also *Dakota Nat'l Ins. Co. v. Comm'r of Ins.*, 79 N.D. 97, 54 N.W.2d 745, 748 (N.D. 1952) ("Giving this [mandatory] language its ordinary meaning, it seems clear to us that the exercise of discretion by the Commissioner of Insurance is limited to a determination of whether an insurance company has complied with the statutes and that when such a company has complied with all of the statutory prerequisites, it is the Commissioner's duty to issue a certificate that it has so complied. ").

[\*27] Under the Affiliation Order, CareFirst would become the sole member of BCBSD, as well as the primary licensee for use of the Marks in Delaware. BCBSD would become an affiliate of CareFirst and maintain "controlled affiliate" licenses to use the Marks in Delaware. CareFirst paid no consideration for either the transfer of the membership interest in BCBSD or the transfer of the primary licenses for use of the Marks in Delaware. Although the Agreement required BCBSD and CareFirst to amend their respective charters and bylaws to implement this structure, BCBSD remained a locally-controlled entity with its own local board of directors. There was no merger or change-of-control effected by the Affiliation. By its terms, then, *Section 5003* does not apply to the Affiliation. And the Delaware Insurance Code does not otherwise address the unique transaction undertaken by BCBSD and CareFirst here.

Notwithstanding the absence of a specific statutory grant of authority, CareFirst and BCBSD went to the Commissioner with the Agreement because they perceived a need to seek regulatory approval of the Affiliation in keeping with the broad authority of the Commissioner as set forth in Chapter 3.<sup>40</sup> [\*28] Moreover, in apparent recognition of the unique nature of this arrangement, the parties agreed that the *Section 5003* criteria could guide the designated hearing officer, and later the Commissioner, through the approval process,<sup>41</sup> even if the statutory criteria were not the only factors to be applied in the analysis.<sup>42</sup> In accordance with this understanding, the Hearing Officer applied the *Section 5003* criteria to the proposed Affiliation, found that the concerns identified in the statute were not implicated by the Affiliation, and recommended approval of the Affiliation with several conditions.<sup>43</sup> The Commissioner adopted most of the Hearing Officer's recommendations and included them in her Order as conditions to her approval of the Affiliation.<sup>44</sup>

40 D.I.12, B-1.

41 D.I. 12, B-11.

42 *But see Blood Serv. Plan Ins. v. Williams*, 186 So.2d 33, 38 (Fla. Dist. Ct. App. 1966)("Although the [State Insurance] Commissioner is accorded reasonable latitude of discretion in determining whether the requirements of the statute have been complied with, he is not authorized nor empowered to impose additional conditions and requirements as a prerequisite to granting a certificate of authority under the statute."); *Dakota Nat'l Ins. Co.*, 54 N.W.2d at 748 (stating that the Commissioner must limit his inquiry to whether the company has complied with the statute); *New Hampshire-Vermont Hospitalization Serv v. Whaland*, 114 N.H. 92, 315 A.2d 191, 194-95 (N.H. 1974)(stating absent statutory

authority, "Insurance Commissioner does not have supervisory powers over the composition of the board of medical service corporations.").

[\*29]

43 D.I. 12, B-53-57.

44 D.I. 12, B-3, 58-62.

CareFirst now argues that the Commissioner lacked the authority conditionally to approve the Affiliation because the applicable statutory scheme does not specifically authorize her to do so. While the Court agrees that the *Section 5003* criteria normally should be applied strictly and unconditionally when the transaction involves a merger or change of control, no such limitations confine the Commissioner's review of a hybrid transaction, such as the Affiliation at issue here, particularly when the parties in concert subject themselves to the Commissioner's authority and make no effort to seek boundaries upon her review.

Given the nature of the transaction under review and the understanding of the parties, the Commissioner was free to scrutinize the proposed transaction in accordance with criteria she deemed appropriate, and to place conditions upon her approval of the Agreement, so long as the process she employed comported with the *Administrative Procedures Act* and basic notions of due process.<sup>45</sup> Neither party has suggested that the Commissioner [\*30] strayed from either precept. Indeed, after the Hearing Officer issued her recommendations, either party had the right to take exception to her findings under the *Administrative Procedures Act*, even on the issue of authority, but neither party chose to exercise that right.<sup>46</sup> When the Commissioner issued her Order approving the Affiliation, the parties could have appealed that Order, but again, did not.<sup>47</sup> Consequently, neither party can be heard to challenge her authority to approve the Affiliation now. It is simply too late.

45 *See generally* LEE R. RUSS, ET AL., *COUCH ON INSURANCE* § 2:10 (3d ed. 1997)("The insurance commission or other regulatory body must exercise its jurisdiction in a matter which conforms to the concepts of due process of law imposed by federal and state constitutions.").

46 *See DEL. CODE ANN. tit. 29, § 10126(b)*(1999)("When the proposed order is submitted to the agency, a copy shall be delivered to each of the other parties who shall have 20 days to submit in writing to the agency exceptions, comments and arguments respecting the proposed order.").

47 D.I. 12, B-1. The Commissioner's Order approving the Affiliation was a final, not an interlocutory order. Because her Order was final, ei-

ther party could have taken an appeal from it in accordance with the applicable rules. See Del. Super. Ct. Civ. R 72; *Quaker Hill Place v. Saville*, 523 A.2d 947 (Del. Super. Ct. 1987)(an order must be final before it is subject to review).

[\*31] The Commissioner's authority to approve the Affiliation does not derive solely from the parties' agreement to submit the matter to her. Her authority to review the Agreement is a logical extension of her implied powers under Chapter 3 of the Delaware Insurance Code.<sup>48</sup> As Commissioner, she is charged with evaluating mergers and other change-of-control transactions involving Delaware insurers to ensure that the combination will not be harmful or prejudicial to the interests of Delaware subscribers. Given this express authority, it is logical that the Commissioner, through her implied powers, is authorized to evaluate this Affiliation because the potential for injury to Delaware subscribers is equally as real.<sup>49</sup>

48 *Retail Liquor Dealers Ass'n of Delaware v. Delaware Alcoholic Beverage Control Commn.*, 1980 Del. Ch. LEXIS 461, 1980 WL 273545 at \*3 (Del. Ch.) ("When an agency is vested with a broad range of discretionary powers it is likely that the General Assembly intended to vest implied authority in such agency to do that which is incidental, implied, necessary and proper in light of the objective sought to be gained and in light of the express powers granted.").

[\*32]

49 See LEE R. RUSS, ET AL., *supra* note 45, § 2:8("The authority granted the regulatory body entails a duty to exercise a broad surveillance over the operations of insurance companies with a view to instituting procedures and recommending changes which might prevent or reduce the likelihood of unsuccessful ventures.").

## 2. The Commissioner's Authority to Vacate Her Prior Order

Next, CareFirst contends that because nothing in Chapter 3 or Chapter 50 of the Delaware Insurance Code expressly permits the Commissioner to vacate her prior Order, she must be prohibited from doing so. Although CareFirst correctly observes that the Delaware Insurance Code does not expressly permit the Commissioner to vacate her Affiliation Order, this fact should come as no surprise given that the Delaware Insurance Code did not expressly authorize her to enter the Order in the first place. The Court already has determined that the broad grant of statutory authority to the Commissioner empowered her to act when she was requested by the parties to review and approve the Affiliation. Now the Court [\*33]

must consider whether this same authority empowered her to act when confronted with a potential violation of the letter and/or spirit of her Affiliation Order.

It is well recognized that courts have the inherent power to vacate their judgments or orders when justice requires.<sup>50</sup> This inherent power exists within administrative agencies as well. An administrative agency performing its regulatory functions has the inherent power to grant a rehearing or otherwise to reconsider a previous decision, even absent specific statutory authority.<sup>51</sup>

50 *Lyons v. Delaware Liquor Com.*, 44 Del. 304, 5 *Terry* 304, 58 A.2d 889, 895 (Del. Gen. Sess. 1948)("It is an inherent power of Courts of record to vacate their judgements or orders under proper circumstances, within a limited period after rendition.").

51 See *Henry*, 293 A.2d at 581("In Delaware, a public body exercising judicial functions inherently has the power, even without statutory authority, to reopen and reconsider a decision until it loses jurisdiction."). See also E.H. Schopler, Annotation, *Power of Administrative Agency to Reopen and Reconsider Final Decision As Affected By Lack of Specific Statutory Authority*, 73 A.L.R. 2d. 939 §§ 2, 3 (2004)("Some of the authorities proceed on the theory that administrative agencies, like courts, have the inherent or implied power to reconsider final decisions still under their control, and that such power necessarily follows from their powers to decide.").

[\*34] CareFirst argues that the Commissioner's jurisdiction over the Affiliation expired after the time to take an appeal of her Affiliation Order had passed. Consequently, her power to vacate the Affiliation Order also had expired. This argument ignores the fact that the Commissioner expressly retained jurisdiction to review the Order and to modify it either *sua sponte* or by motion of either BCBSD or CareFirst.<sup>52</sup> As previously stated, CareFirst did not challenge the imposition of this condition or, for that matter, any of the other conditions imposed by the Commissioner. Instead, CareFirst accepted the Commissioner's conditions and has been operating under these conditions for the four years that have passed since its Affiliation with BCBSD was approved. Once again, CareFirst's challenge to the Commissioner's authority comes too late.

52 D.I. 12, B-62 at P 19: "These conditions are subject to further order as circumstances may require. These Findings and Recommendations and the Commissioner's Order are subject to further modification or amendment or further review ei-

ther *sua sponte* by the Commissioner or by motion of a party."

[\*35] Because the Commissioner, as an administrator and regulator, has the inherent authority to reconsider a prior decision, and because she expressly retained jurisdiction over the Affiliation in her original Affiliation Order, the Court finds that she likewise had the authority to vacate her Affiliation Order. The Court next considers whether her exercise of that authority was proper in this case.

#### B. The Commissioner's Decision Was Supported By Substantial Evidence

To determine *vel non* the Commissioner properly exercised her authority, the Court must consider whether her findings that the Affiliation Order was violated and that disaffiliation was the appropriate remedy were supported by substantial evidence. The Court will consider these issues *seriatim*.

##### 1. The Violation of the Affiliation Order

The Department argues that regardless of whether the Maryland Legislation violated any of the specific conditions of the Affiliation Order, as the "chief officer" of the Department, the Commissioner is vested with the authority continuously to examine the Affiliation to ensure that the letter and spirit of the Agreement and Affiliation Order remain in tact. The Court agrees. [\*36] At the time she approved the Affiliation, the Commissioner made specific findings that the transaction would benefit Delaware subscribers.<sup>53</sup> She made these findings based upon a thorough understanding of the goals of the Affiliation and of the regulatory environment in which it would operate. This understanding was a predicate of her approval of the transaction. When the conditions that form the bases of her approval change, the Commissioner must be empowered to withdraw her approval if she finds that the changes render the Affiliation no longer in the best interest of Delaware subscribers. This is what regulators do. And this is precisely what the Commissioner did here. Her findings in this regard were amply supported by substantial evidence.

53 D.I. 12, B-1, B-5.

The gross effect of the Maryland Legislation was substantially to enhance the oversight role of the Maryland General Assembly in CareFirst's day-to-day operations.<sup>54</sup> The Maryland legislators injected themselves into CareFirst by directing a dramatic [\*37] change in the CareFirst corporate structure and, in turn, a dramatic change in CareFirst's focus and priorities. First, the Maryland General Assembly reshaped the CareFirst Board of Directors by directly appointing two new mem-

bers and by changing the requisite qualifications of Class II directors.<sup>55</sup> Then the Maryland General Assembly unceremoniously "sacked" each and every Class II director and replaced them with directors hand-picked by the legislators or their designees.<sup>56</sup> The General Assembly also created an "oversight committee" to advance the interests of Maryland's uninsured population by ensuring, *inter alia*, that "policies and processes are in effect to assess and improve the quality of health insurance products to [Maryland] subscribers and certificate holders."<sup>57</sup>

54 D.I.12, B-169, Tr. at 84-85: "Second, the legislation requires routine management decisions made by CareFirst or any affiliate or subsidiary of CareFirst to be pushed up to the CareFirst board or a board committee for approval. These are decisions that are not limited to policy but involve substantial operations and, in effect, have board members without the expertise of their officers having to pass on actions not traditionally coming to board attention." *See also* D.I. 12, B-482 (Maryland Legislation appoints two new directors chosen by Maryland legislators); D.I. 12, B-505 (Maryland Legislation replaces all Class II directors).

[\*38]

55 D.I. 12, B-169, Tr. at 89: "The CareFirst board now has two nonvoting members serving at the pleasure of the Maryland Senate and House of Delegates, whose apparent function appears to be to report board communications and actions back to the Maryland House and Senate leadership." *See Disney v. Walt Disney Co.*, 857 A.2d 444, 2004 Del. Ch. LEXIS 120, 2004 WL 1776688 at \*3 (Del. Ch.) (noting that "the private communications among or deliberations" of a board of directors are generally private and not subject to public disclosure.).

56 D.I. 12, B-169, Tr. at 85, 88. "Fourth, the legislation, and the way it has been modified by Court order, causes the Maryland members' removal and replacement within a year. And that applies to every one of the twelve Maryland directors on the CareFirst board, which constitute an absolute majority of the whole board, 12 out of 21." . . . "No less serious is the restructuring of CareFirst governance. By July 1, all the Maryland directors of CareFirst, constituting a majority of the whole board, will be replaced by persons who, in all likelihood, will have no personal understanding whatever of the history of CareFirst, its affiliates, or the challenges they face. These new directors, five of whom were picked by the State of Maryland, with the rest coming from a limited pool of applicants screened by the State

of Maryland, will take office under increased responsibilities and liabilities including the threat of sanction for engaging in a so called "unsound and unsafe" practice if they fail to demonstrate a commitment to the ambiguous and legislatively ill-defined nonprofit mission' of CareFirst."

[\*39]

57 See D.I. 12, B-473, (Maryland Legislation creates new non-profit mission); D.I. 12, B-483 (Maryland Legislation creates oversight committee).

To ensure compliance with this new corporate direction, the Maryland General Assembly provided the Maryland Commissioner with the authority to sanction CareFirst directors individually for non compliance.<sup>58</sup> Specifically, the Maryland Legislation provided that CareFirst directors who engaged in "unsound or unsafe business practices" would be subject to sanctions, including possible removal.<sup>59</sup>

58 D.I. 12, B-169, Tr. at 88. "These new directors . . . will take office under increased responsibilities and liabilities, including the threat of sanction for engaging in a so-called "unsound and safe" practice if they fail to demonstrate a commitment to the ambiguous and legislatively ill-defined non-profit mission' of CareFirst."

59 D.I. 12, B-487 (Maryland Legislation provides for sanctioning of CareFirst directors who engage in unsound or unsafe business practices, defined generally as any practice that does not advance the newly adopted non-profit mission of CareFirst.).

[\*40] In its opening brief, CareFirst evoked the image of a family when describing the Affiliation, claiming that the Affiliation brought BCBSD into the "CareFirst family" to join GHMSI and CFMD.<sup>60</sup> In most functional families, parents do their best to treat their children equally; they avoid, if at all possible, making decisions that will favor one child to the detriment of another. Here, the passage of the Maryland Legislation affected the "CareFirst family" in a manner that required the CareFirst Board to act first in the best interest of the Maryland child, even if such actions are detrimental to the other CareFirst children. As a result, CareFirst no longer was the same Affiliation partner that the Commissioner evaluated when she approved the Affiliation. Under these circumstances, even in the absence of a violation of any specific condition of the Affiliation Order, the Commissioner's decision to vacate her Affiliation Order on the basis of the dramatic change in the environment in which the Affiliation was to operate constituted a proper exercise of her regulatory authority and was supported by substantial evidence.<sup>61</sup>

60 D.I. 9, CareFirst Br. at 3.

[\*41]

61 CareFirst overstates the effects of the 2004 amendments to the Maryland Legislation. (D.I. 12, B-535-36). While it is true that these amendments clarified that the Maryland Legislation would directly apply only to those insurers that conduct business in Maryland, the amendments do nothing to lessen the indirect impact of the new law on the Delaware affiliate. By making CareFirst focus on its Maryland subscribers under threat of sanction, the Maryland Legislation altered the environment in which the Affiliation operated to the real potential detriment of Delaware subscribers.

Even assuming *arguendo* that the Commissioner was required to find a specific violation of her Affiliation Order before she could vacate it, the record is replete with evidence that the Maryland Legislation violated her Order in a manner that authorized her to act. The violations go to the very structure of this so-called "structural affiliation" and are matters that the Commissioner made clear from the outset of the parties' relationship she would not countenance. Specifically, the Maryland Legislation caused a significant [\*42] restructuring of the CareFirst Board of Directors without the prior approval of the Commissioner in violation of the Affiliation Order.<sup>62</sup>

62 D.I. 12, B-58 at P 4: "The Boards of Care-First and BCBSD shall be restructured, to the extent necessary, to (i) comply with the terms of the draft amended Certificates or Incorporation and By-Laws of the two companies . . . Any change in this structure must receive prior approval of the Insurance Department."

In recognition of the Commissioner's directive that all "structural" changes to the CareFirst Board be pre-approved by the Department, the parties focused their presentations in the written submissions and at oral argument on what is, and what is not, a "structural" change to the Board. Having now reviewed the by-laws and certificates of incorporation submitted to the Commissioner for review as part of the approval process, and having considered the effect of the Maryland Legislation on the CareFirst Board, the Court is satisfied that the following mandates of the [\*43] new law caused changes in the "structure" of the CareFirst Board in violation of the express provisions of the Affiliation Order:<sup>63</sup>

. The mandated replacement of the Class II directors with directors selected by the Maryland General As-

**sembly or its designees:** The CareFirst Articles of Incorporation state that all classes of CareFirst directors had the right to approve changes in board membership within their respective classes. <sup>64</sup> The Maryland Legislation took this right from the Class II directors and placed it in the hands of the Maryland legislature. <sup>65</sup> This is contrary to the express text of CareFirst's charter, as specifically approved by the Commissioner, and no change to this text was submitted to the Commissioner for approval. <sup>66</sup>

**. The mandated increase in the size of the CareFirst Board from twenty-one to twenty-three:** The new board members were appointed by, and presumably accountable to, the Maryland General Assembly. To effect this increase, the Maryland Legislation required a change in the CareFirst charter that was not submitted for prior approval by the Commissioner. <sup>67</sup>

**. The mandated change in the requisite qualifications of the [\*44] Class II directors:** CareFirst chose to outline the qualifications of its directors in its Bylaws. <sup>68</sup> Now the qualifications of the twelve replacement directors are outlined by the Maryland Legislation as enforced by the statutorily created nominating committee. <sup>69</sup> This structural change was not approved by the Commissioner.

**. The mandated change in the term of CareFirst Board members from three years to two years and reduction of the total number of years each member may serve from nine to six:** These changes require modification of the CareFirst charter and neither change was submitted for approval by the Commissioner. <sup>70</sup>

<sup>63</sup> The structure of both the CareFirst and BCBSD boards, as approved by the Commissioner, were outlined in the corporate documents submitted to the Commissioner for review. The term "structure" as it appears in the Affiliation Order does not refer to the composition of the boards -- the Commissioner did not intend to direct that CareFirst or BCBSD elect particular in-

dividuals to their respective boards of directors. The parties were free to elect whomever they wished to serve so long as they complied with the process for doing so set forth in the corporate documents approved as part of the Affiliation Order. The structure of each board that the Commissioner addressed in her Affiliation Order included the number of directors, the classes of directors, the qualifications of directors, and the manner of selection of directors, all matters governed by the CareFirst and BCBSD charters and bylaws.

[\*45]

<sup>64</sup> D.I. 12, B-336, 37: "During the Initial Period and the Second Period, (I) each class of Members has the exclusive right to elect or remove any Director of the corresponding class by a majority vote of the Members of that class . . ."

<sup>65</sup> CareFirst argues that the fact that it replaced the Class II directors in accord with the Maryland Legislation cannot be deemed a violation of the Affiliation Order because the corporate documents submitted to the Commissioner for review provided that "the composition of the Board shall comply with the requirements of *Section 14-115 of the Maryland Insurance Code* (as the same may be amended from time to time)[.]." This argument misses the mark. While it is true that CareFirst's corporate documents contemplated possible changes in the law, the Commissioner made clear her requirement that any proposed change in the structure of the CareFirst or BCBSD boards must be presented to her for approval. She made no exception for changes in structure required by a change in law; her order requiring prior approval was unconditional. No such prior approval was obtained here.

<sup>66</sup> D.I. 12, B-58 at P 4.

<sup>67</sup> D.I. 12, B-336: "The number of Directors of the Corporation shall be twenty-one (21), which number may be increased or decreased in the manner provided for in this Charter and in the Bylaws of the Corporation, but shall never be less than the minimum number permitted by the laws of the State of Maryland now or hereafter in force . . ."

[\*46]

<sup>68</sup> D.I. 12, B-313, Article 2 § 2.

<sup>69</sup> D.I. 12, B-505-508.

<sup>70</sup> D.I. 12, B-485.

All of the changes to the CareFirst Board mandated by the Maryland Legislation modified CareFirst's charter and/or bylaws. As such, these changes are structural; they alter the basic corporate documents upon which the Commissioner approved the Affiliation. The Commissioner required that any structural change receive her

prior approval. Neither CareFirst nor the Maryland legislature saw fit to seek this approval prior to effecting these structural changes to the CareFirst Board. This failure constitutes a clear violation of the Commissioner's Affiliation Order.<sup>71</sup>

71 The Delaware General Corporation Law supports the notion that the changes mandated by the Maryland Legislation required structural changes to the CareFirst board: "The number of directors shall be fixed by, or in a manner provided in, the by-laws, unless the certificate of incorporation fixes the number of directors, in which case a change in the number shall be made only by amendment of the certificate." See *DEL. CODE ANN. tit. 8, § 141(b)*(2001). Section 141(b) also provides that the qualifications for directors may be included in the certificate of incorporation or bylaws. See *DEL. CODE ANN. tit. 8, § 141(b)*(2001). In this case, CareFirst placed such qualifications in its bylaws. As such, the right to amend the qualifications for Class II directors rested with the members of the board entitled to vote to change such qualifications -- the then-existing Class II board members. See *DEL. CODE ANN. tit. 8, § 109(a)*(2001). D.I. 12, B-310-11.

[\*47] In addition to these structural changes to the CareFirst Board, the Maryland Legislation also imposed upon CareFirst a newly formulated non-profit mission statement that the Delaware Commissioner concluded may require CareFirst to remain in product lines that could jeopardize its financial fitness.<sup>72</sup> This finding, supported by substantial evidence in the record, violated the Affiliation Order by "causing CareFirst to be governed, managed, and appointed in a way that does not give first priority to its financial safety and soundness [which] is not consistent with the type of company CareFirst was when BCBSD sought Affiliation, and at the time [the Commissioner] reviewed and approved the Affiliation."<sup>73</sup> Moreover, the mandated sanctions for failing to advance CareFirst's newly-stated non-profit mission arguably impact the ability of the CareFirst board to discharge its collective duty of care and/or loyalty to its affiliates by compelling it to act in a manner that is either inconsistent with the best interest of all affiliates or inconsistent with the interests of some affiliates to the benefit of others.

72 The shift in the CareFirst mission was in response to Maryland's concerns that CareFirst was focusing its efforts on more financially rewarding markets. These concerns were expressed in the Maryland Commissioner's July 8, 2003 report, in which he observed: "The Conversion Report pro-

vides examples of business decisions made by CareFirst that were consistent with its declared intent to operate for profit. As noted in Section IV, CareFirst withdrew from the Medicaid and Medicare markets and from the SAAC program on the ground that those programs were not profitable, without exploring alternative means of supplying those markets or subsidizing those products while maintaining the corporation's fiscal soundness. And, most significantly, the Conversion Report concludes that CareFirst gave no real consideration to its nonprofit mission in developing its strategic plan of conversion and acquisition. Indeed, when considering how to broaden its market and expand its access to capital, CareFirst dismissed an affiliation with Highmark out of hand, simply because it was a non-profit entity. The 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." D.I. 12, B-550.

[\*48]

73 D.I. 12, B-158.

Finally, the Commissioner concluded that the five-year acquisition moratorium imposed upon CareFirst by the Maryland Legislation violated the Affiliation Order by indirectly imposing a similar moratorium on an acquisition of BCBSD as long as the structural affiliation remains in tact.<sup>74</sup> This conclusion was supported by substantial evidence that has not been meaningfully controverted by CareFirst.<sup>75</sup>

74 D.I. 12, B-159.

75 D.I. 12, B-169, Tr. at 91: "Let me also emphasize again the importance we attach to the five-year moratorium on the acquisition of CareFirst. As you know, the boards of all four of the CareFirst, all three of the CareFirst operating companies determined that a merger of CareFirst into WellPoint was in the best interest of the companies and their subscribers. This transaction was, unwisely in our judgment, disapproved by the Maryland Insurance Commissioner, and the Maryland legislation now forecloses a similar transaction by CareFirst for five years. Although this section of the legislation does not directly apply to [BCBSD], nevertheless, as long as [BCBSD] is structurally affiliated with CareFirst, it will not be able to be acquired in a WellPoint-type transaction, even though our board might again determine, as the experts have opined and should, that is in our subscribers' best interest."

[\*49] Having now concluded that the Maryland Legislation changed the conditions precedent upon which the Commissioner based her approval of the Affiliation, and that the Maryland Legislation violated several express provisions of the Affiliation Order, the Court now turns to the question of whether disaffiliation as ordered by the Commissioner was an appropriate remedy.

## 2. The Commissioner Framed An Appropriate Remedy

CareFirst argues that disaffiliation is not the proper remedy in this case because it need only receive the Maryland Commissioner's approval of the ASBAA in order to preserve the relationship with BCBSD in a manner that addresses the Delaware Commissioner's concerns while, at the same time, allows the parties to continue a mutually beneficial partnership. Disaffiliation, on the other hand, effectively requires both parties to walk away from the relationship in the absence of regulatory approval in Maryland.

Notably, the ASBAA contractually binds BCBSD to affiliate with CareFirst and requires that CareFirst return its membership in BCBSD and the Marks to BCBSD. The Commissioner's June 30, 2004 Order, on the other hand, does not *require* BCBSD to affiliate; it simply [\*50] *permits* the affiliation to continue on a contractual basis if both parties agree. As a practical matter, however, BCBSD will not affiliate with CareFirst, either contractually or otherwise, unless and until CareFirst obtains regulatory approval for the affiliation in Maryland. Thus, while the Department and BCBSD suggest that the Commissioner's June 30 Order offered some middle ground by allowing the parties to affiliate contractually if they desired, for the reasons just stated, this "middle ground" offers little comfort to CareFirst because, as of this writing, Maryland still has not passed on the ASBAA.<sup>76</sup>

<sup>76</sup> On September 27, 2004, CareFirst requested this Court to delay the issuance of its decision in this case because CareFirst has received word that the Maryland Commissioner will be rendering a decision on the ASBAA within the next several days. The Court advised the parties on October 1, 2004 that it would be issuing its decision on October 4, 2004 by close of business. At 12:22 p.m. on October 4, the Court received from CareFirst a fax transmission that appears, at first glance, to be a copy of the long-awaited decision of the Maryland Commissioner on the proposed ASBAA. The transmission was not accompanied by any request for relief. The Court has not read the Maryland Commissioner's opinion. And,

given the length of the Maryland Commissioner's delay, the Court cannot justify a purposeful delay in its decision-making (a process completed prior to the receipt of the Maryland Insurance Commissioner's opinion) particularly when the parties have stipulated to expedite this appeal rather than litigate CareFirst's application to stay the Commissioner's Order.

[\*51] CareFirst's challenge to the remedy imposed by the Commissioner is, in essence, a challenge to her assessment of the risks posed by the Maryland Legislation and her effort to address those risks. Before undertaking to consider the Commissioner's decision in this regard, the Court takes this opportunity to emphasize two critical features of its limited standard of review. First, the Court notes that it is obliged to take due account of the experience and specialized competence of the agency and of the purposes of the law under which the agency has acted.<sup>77</sup> Second, when determining whether the administrator's decision is supported by substantial evidence, the Court must be mindful that substantial evidence is "more than a scintilla but less than a preponderance" of the evidence supplied by the parties in the appellate record.<sup>78</sup> If the decision is supported by substantial evidence, then the agency's findings "must be accepted even though the Court may have reached a different conclusion if presented with the evidence in the first instance."<sup>79</sup>

<sup>77</sup> *DEL. CODE ANN. tit. 29, § 10142(d)(2003)*("The Court, when factual determinations are at issue, shall take due account of the experience and specialized competence of the agency and of the purposes of the basic law under which the agency has acted. The Court's review, in the absence of actual fraud, shall be limited to a determination of whether the agency's decision was supported by substantial evidence on the record before the agency.").

[\*52]

<sup>78</sup> *Electric Hose and Rubber Co. and Dravo Corp. v. Nai*, 2004 Del. Super. LEXIS 35, 2004 WL 304356 at \*5 (Del. Super.).

<sup>79</sup> *Patterson v. Super Dog Pet Food, Co.*, 2004 Del. Super. LEXIS 260, 2004 WL 1790128 at \*2 (Del. Super.).

Here, the Commissioner determined that the most effective remedy to protect the interests of the Delaware provider, BCBSD, and Delaware subscribers, was to order the disaffiliation of CareFirst and BCBSD. After hearing all of the evidence in this matter, the Commissioner concluded that there were a number of risks to the continued ability of CareFirst to provide services to Delaware subscribers if the structural Affiliation was

allowed to continue. She concluded that the change in the regulatory environment in which CareFirst now must operate in Maryland threatens the financial fitness of CareFirst and limits its ability to act in the best interests of its Delaware affiliate. Given the importance of CareFirst's role in providing services to Delaware subscribers, the Commissioner determined that the risk of future harm was substantial enough to require her to act now.<sup>80</sup>

80 D.I. 12, B-162: "If the financial condition of CareFirst deteriorates as a result of the changes in its mission and governance, it may be too late at that time to disentangle a structurally affiliated BCBSD from CareFirst before irreparable damage to the financial condition or reputation of BSBSD occurs. Real damage to the Affiliation has been done and action must be taken now."

[\*53] The insurance industry is highly regulated.<sup>81</sup> Health insurance, in particular, has received, and likely will continue to receive, even more regulatory scrutiny.<sup>82</sup> In Delaware, as in most states, the Insurance Commissioner is charged with the responsibility of providing this scrutiny and assessing risk to Delaware policyholders by enforcing the laws and regulations with their best interests in mind. The barometer by which she measures risk is calibrated by her experience. The Court concurs with her assessment of risk here. There is substantial evidence that the Maryland Legislation has created a new environment in which the Affiliation must now operate that will emphasize the interests of Maryland subscribers to

the potential detriment of Delaware subscribers. The Court rejects the notion that the Commissioner must wait for the Affiliation to suffer actual harm before she acts. When the continued health insurance coverage of Delaware subscribers is potentially in jeopardy, the Commissioner acts properly when she takes reasonable measures to prevent the unacceptable result of interrupted coverage from ever happening. Her decision in this regard was the product of "an orderly and [\*54] logical deductive process" and was supported by substantial evidence, both standards necessarily animated by her regulatory expertise.

81 Lee R. Russ, Et Al., *supra* note 45, § 2:1, ("The insurance industry is subjected to a substantial amount of governmental regulation, since insurance is widely recognized to be a business that affects the public interest, rendering it a proper subject of regulation and control by the state through the police power.")

82 *Id.*

## VI.

Based on the foregoing, the decision of the Delaware Insurance Commissioner is **AFFIRMED**.

**IT IS SO ORDERED.**

Judge Joseph R. Slights, III