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Gabriel Ravel
Deputy Director, General Counsel
Department of Managed Health Care
980 9th Street, Suite 500
Sacramento, California 95814

Dear Mr. Ravel:

A key issue in the Department of Managed Health Care's review of Blue Shield of California's acquisition of Care1st Health Plan is the question of what is Blue Shield's duty, or charitable trust obligation, to the community. In a letter to you dated April 20, 2015, which I recently obtained through a Public Records Act request, Blue Shield General Counsel Seth Jacobs presents an argument to support Blue Shield's claim that it has no charitable trust obligation. The argument has a number of flaws, which I plan to detail in a forthcoming letter.

My reason for writing now is to alert you that a key point Mr. Jacobs makes in his letter contradicts what Blue Shield told the Franchise Tax Board during the recent audit of its tax-exemption.

In his letter to you Mr. Jacobs writes that Blue Shield, as a mutual benefit corporation, may distribute assets upon dissolution to its members. The authority to do this, he argues, materially distinguishes Blue Shield from nonprofits that have a charitable trust obligation since such nonprofits are barred by law from providing private gain to any person.

At the outset, it is critical to recognize the fundamental difference between charitable nonprofit (public benefit) corporations and non-charitable nonprofit (mutual benefit) corporations. With respect to the former, California law expressly requires that they be "not organized for the private gain of any person" and be "organized for public or charitable purposes." (Cal. Corp. Code §5130). In contrast, mutual benefit corporations—like Blue Shield—may be organized "to engage in any lawful act or activity, other than credit union business, for which a corporation may be organized under such law." (Cal. Corp. Code §7130). Moreover, upon dissolution, mutual benefit corporations may make distributions of gains, profits or dividends to any member (Cal. Corp. Code §7141), while such distributions are barred as "private gain" and expressly prohibited under the Nonprofit Public Benefit Corporation Law (Cal. Corp. Code §5410).

In responding to issues raised by the FTB, Blue Shield said the opposite—that it could *not* distribute assets upon dissolution to any private person because, as a social welfare organization, it was legally prohibited from doing so.

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This particular point was a significant issue in the FTB's audit. California law provides that in order for a nonprofit to be tax-exempt as a social welfare organization, as Blue Shield was, its assets must be irrevocably dedicated to social welfare purposes. This includes a requirement that the organization's articles of incorporation provide that upon dissolution the assets of the organization would be distributed to another organization operated for charitable or social welfare purposes.

The FTB pointed to the lack of such a clause in Blue Shield's articles of incorporation and the provision in its bylaws providing for the distribution of its assets to its enrollees upon dissolution as evidence of noncompliance with this requirement.

In its response, Blue Shield noted that its articles of incorporation include a provision designating social welfare promotion as the specific purpose of the corporation and prohibiting any activities not in furtherance of the corporation's purpose. Blue Shield went on to argue that since federal law, which on this topic is incorporated into California law, prohibits social welfare organizations from making distributions to private persons, Blue Shield's articles of incorporation effectively include the required dissolution provision.

In a nutshell, Blue Shield, in defense of its social welfare tax exemption, assured the FTB that its organizational structure obligates it to benefit society and prohibits it from distributing private gains. Now, as it seeks to fend off the imposition of any public benefit requirement by the DMHC in connection with its proposed acquisition, Blue Shield maintains that its organizational structure authorizes the distribution of private gains and that this precludes any obligation to benefit the public.

Since Blue Shield has in their possession their written exchange with the FTB, there's an easy way to determine exactly how much what Blue Shield told them differs from what they are telling you. Blue Shield should publicly release their written communications with the FTB, including the audit findings.

If Blue Shield won't do so voluntarily, the DMHC should demand the records since they contain information material to an issue at the heart of the DMHC's review of the proposed acquisition. Once obtained, the records should be made public since they relate to a matter of legitimate public interest and contain no business secrets.

Thank you for your consideration.

Sincerely,

Michael Johnson
Former Public Policy Director, Blue Shield of California

Cc: Jozel L. Brunett, Legal Division Chief Counsel, Franchise Tax Board