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REED & DAVIDSON

ATTORNEYS AT LAW
520 SOUTH GRAND AVENUE
SUITE 700
LOS ANGELES, CALIFORNIA 90071-2845
TELEPHONE (213) 624-6200
FACSIMILE (213) 623-1692
WWW.POLITICALLAW.COM

DANA W. REED
CARY DAVIDSON
JAMES A. SIVESIND
JEFFREY E. LANGAN
RONDI J. WALSH
IRA D. GLASKY
FLORA S. YIN

OF COUNSEL
BRADLEY W. HERTZ

OTHER OFFICES
ORANGE COUNTY
(714) 641-1666
SACRAMENTO
(916) 447-1688

Supplement to AOR 1999-39

FAX COVER SHEET

To:	Jonathan Levin (202) 219-0130
Of:	Federal Election Commission
From:	James A. Sivesind
Client/Matter:	91
Date:	January 21, 2000

DOCUMENTS	NUMBER OF PAGES*
Letter regarding WellPoint	9

Original will NOT follow.

COMMENTS: **See attached.**

*** NOT COUNTING COVER SHEET. IF YOU DO NOT RECEIVE ALL PAGES, PLEASE TELEPHONE US IMMEDIATELY AT (213) 624-6200.**

REED & DAVIDSON
ATTORNEYS AT LAW
550 SOUTH GRAND AVENUE
SUITE 700
LOS ANGELES, CALIFORNIA 90071-2665
TELEPHONE (213) 624-6200
FACSIMILE (213) 623-1692
WWW.POLITICALLAW.COM

DANA W. REED
GARY DAVIDSON
JAMES A. SIVESIND
JEFFREY E. LANGAN
IRA D. GLASKY
FLORA R. YIN
OF COUNSEL
BRADLEY W. HERTZ

OTHER OFFICES
ORANGE COUNTY
(714) 641-1688
SACRAMENTO
(916) 447-1880

January 21, 2000

Mr. Jonathan Levin
Federal Election Commission
Office of General Counsel
999 E Street, N.W.
Washington, D.C. 20463

VIA FACSIMILE
ORIGINAL BY U.S. MAIL

Re: WellPoint Health Networks "WELLPAC"

Dear Mr. Levin:

This is a follow up to our telephone conversation on January 18, 2000, during which you requested additional information regarding WellPoint Health Networks Inc. ("WellPoint"). You asked us to compare the operations of WellPoint's Blue Cross subsidiaries and its UNICARE and other subsidiaries ("non-Blue Cross subsidiaries"). You also inquired about the Blue Cross and Blue Shield Association's ("BCBSA") ability to control WellPoint through provisions in the Blue Cross License Agreement ("License Agreement") and WellPoint's Certificate of Incorporation ("Charter") and Bylaws.

I. Operations of WellPoint's Blue Cross, UNICARE and Other Subsidiaries

A. Number of Subsidiaries and Members

WellPoint currently owns 18 operating subsidiaries and four holding companies.[1] Two (11 percent) of the operating subsidiaries do business under the Blue Cross name and mark, and 16 (89 percent) do business under the UNICARE, WellPoint or other names and marks.[2]

WellPoint has 7.2 million medical and 30.6 million specialty members. Approximately 5 million (69 percent) of the medical members are served by WellPoint's Blue Cross subsidiaries, while

[1] One subsidiary, UNICARE of Texas Health Plans, Inc., mentioned in our previous letter to the Federal Election Commission is in the process of being dissolved.

[2] The Blue Cross operating subsidiaries are BC Life & Health Insurance Company and Blue Cross of California. The non-Blue Cross operating subsidiaries are Affiliated Health Care, Inc.; AHI Healthcare Corporation; American Managing Company; Comprehensive Integrated Marketing Services; Cost Care, Inc.; National Capital Health Plan, Inc.; Professional Claim Services, Inc. (dba WellPoint Pharmacy Management); The Industry MSO, Inc.; Tristate Inc.; UNICARE Life & Health Insurance Company; UNICARE National Capital PPO, Inc.; UNICARE Service Co.; WellPoint Association Services Group, Inc.; WellPoint Behavioral Health, Inc.; WellPoint Dental Services, Inc.; and WellPoint Development Company, Inc.

2.2 million (31 percent) are served by the non-Blue Cross subsidiaries. Among the specialty members, 6.8 million (22 percent) are members of WellPoint's Blue Cross subsidiaries, and 23.7 million (78 percent) are members of the non-Blue Cross subsidiaries.

Since its incorporation, WellPoint has acquired a number of subsidiaries, and nearly all of the members that it gained through these mergers are now members of UNICARE or the other non-Blue Cross subsidiaries. For example, in 1996, WellPoint purchased the Life and Health Benefits Management Division of Massachusetts Mutual Life Insurance Company ("Mass Mutual"). As a result of this transaction, UNICARE acquired 3.4 million members, including 2.2 million specialty and 1.2 million medical members. Of these, 10,000 of the California medical members have been transferred to either Blue Cross of California ("BCC") or BC Life & Health Insurance Company ("BC Life") pursuant to Section 4 of the California Blue Cross License Addendum amended and restated as of June 12, 1998 ("License Addendum"). The remaining California medical members, who currently total 60,000, are expected to be transferred from UNICARE to BCC or BC Life by May 17, 2001. Thus, WellPoint's Blue Cross subsidiaries will eventually acquire up to 70,000 (2 percent) of the members originally transferred from Mass Mutual to UNICARE.

Another important acquisition was the 1997 purchase of John Hancock Mutual Life Insurance Company's group benefits division, which now conducts business under the UNICARE name.

In July 1998, WellPoint announced that it would acquire Cerulean Companies, Inc. ("Cerulean"), the parent of Blue Cross and Blue Shield of Georgia ("BCBS Georgia"). The Georgia Department of Insurance has not approved the merger because of certain pending shareholder litigation involving Cerulean. WellPoint and Cerulean recently agreed to extend their merger agreement to December 31, 2000. Nearly all of Cerulean's 1.7 million members are currently members of either BCBS Georgia or Cerulean's two other Blue Cross subsidiaries. Cerulean has one additional insurance agency subsidiary that is not a Blue Cross affiliate licensee.

Last month, WellPoint also agreed to purchase Rush Prudential Health Plans of Illinois. The transaction, which is awaiting regulatory approval, is expected to be completed in the first half of 2000. UNICARE will gain approximately 300,000 new medical members through this acquisition.

B. <u>Assets and Revenue</u>

The following chart shows WellPoint's total assets as of September 30, 1999 and revenues for the nine-month period ended September 30, 1999, and the corresponding assets and revenues attributable to WellPoint's Blue Cross and non-Blue Cross subsidiaries.

Period: January 1, 1999 to September 30, 1999			
	WellPoint and All Subsidiaries	WellPoint's Blue Cross Subsidiaries	WellPoint's Other Subsidiaries
Assets	$4,600,000,000	$2,800,000,000	$1,300,000,000
Premium revenue	$5,100,000,000	$4,200,000,000	$900,000,000
Management services	$300,000,000	$100,000,000	$180,000,000

C. Employees

WellPoint and its subsidiaries have approximately 10,529 employees. Currently, 6,174 (59 percent) of these employees work for WellPoint's Blue Cross subsidiaries, while 4,355 (41 percent) work for the non-Blue Cross subsidiaries.

II. BCBSA's Authority or Ability to Control WellPoint

WellPoint's Charter, Bylaws and License Agreement include various provisions that were adopted in order to prevent any special interest such as another health plan, a medical provider or the State of California from acquiring control or influence over WellPoint. The purpose of these provisions is not to give BCBSA control over WellPoint, but to ensure that WellPoint is diversely owned so that it will be responsive to the communities it serves.

WellPoint was originally incorporated as a wholly-owned subsidiary of Blue Cross of California, which at the time was the primary Blue Cross licensee in California. Between 1993 and 1996, BCC effectively disposed of its entire interest in WellPoint. In 1993, WellPoint sold 20 percent of its stock in a public offering. Three years later, BCC transferred the remaining 80 percent to the California HealthCare Foundation ("CHF"), and BCC was reorganized as a wholly-owned subsidiary of WellPoint. WellPoint then executed a primary Blue Cross license agreement, and BCC and BC Life entered into controlled affiliate license agreements with BCBSA.

Because CHF owned 80 percent of WellPoint immediately after WellPoint's May 1996 recapitalization, several provisions were included in the License Agreement and WellPoint's Charter and Bylaws in order to diminish CHF's ability to control WellPoint. [See License Addendum, p. 2]. Since no other shareholder held a significant interest in WellPoint, CHF's board of directors could otherwise have chosen all of WellPoint's directors and taken over the management of the corporation if these provisions had not been adopted. CHF has now disposed of all except 6.7 percent of its WellPoint stock, but it still holds more shares than any other noninstitutional shareholder.

Some requirements of the Charter, Bylaws and License Agreement are similar to the requirements imposed on WellPoint and other health plans by state statutes and regulations. For example, no shareholder may acquire 10 percent or more of WellPoint's shares without the consent of the affected Department of Insurance regulators. Furthermore, WellPoint is required to submit reports disclosing all shareholders who own five percent or more of the corporation's stock to the California Department of Corporations. In addition, WellPoint must comply with minimum capital requirements and customer service requirements determined by Departments of Insurance in California and other states.

You inquired specifically about the Charter, Bylaws, License Agreement and License Addendum provisions relating to the board of directors, stock transfers, and issuance of securities. These provisions are discussed below.

A. <u>Board of Directors</u>

1. <u>Number of Directors</u> [Bylaws Art. III, § 2]

The Bylaws provide that until CHF beneficially holds less than 5 percent of the voting power, the board of directors must consist of nine members divided into three groups with staggered three year terms. One-third of the directors are elected each year. There are currently seven directors on the board.

2. <u>Elections</u> [Agreement § 9(d)(iii); Addendum § 2.1(i); Bylaws Art. III, IV]

a. <u>WellPoint and BCC Designees</u>

As mentioned above, BCC was the sole shareholder of WellPoint until WellPoint went public in 1993. Initially, six directors were elected to WellPoint's board, and none of them were nominated or suggested by BCBSA. At the time of WellPoint's May 1996 recapitalization, there were eight directors, three of whom were nominated by BCC before it transferred its 80 percent interest in WellPoint to CHF. The remaining five directors were independently nominated by WellPoint. BCC selected its three designees through a secret ballot of the then-existing BCC directors, and WellPoint selected five designees who were existing WellPoint directors.

Since the recapitalization, one BCC designee and one WellPoint designee have resigned. The BCC designee was replaced by a new director who was suggested by the WellPoint management team, nominated by the Nominating Committee and approved by a unanimous vote of the entire board including the remaining BCC designees. This director is not a current or former director, officer or employee of BCC or BCBSA. The two other BCC designees have entered into agreements with the California Department of Corporations which prohibit them from serving on WellPoint's board of directors beyond April 2002 and April 2003.

The term "BCC designee" refers to any of the three initial directors nominated by BCC, or their direct or indirect replacements, regardless of how the replacements are nominated or elected. For example, if a BCC designee's term expires, and the WellPoint designees or the shareholders nominate a candidate for the position, the candidate automatically becomes a BCC designee if he or she wins the election. Thus, a BCC designee may be a director who was not nominated by or who does not represent the interests of BCC. BCC, a separately incorporated subsidiary of WellPoint, has its own board of directors, none of whom are BCC designees on WellPoint's board. The term "WellPoint designee" means any of the five initial directors nominated by WellPoint, or their direct or indirect replacements. The ninth seat on the board, which is currently vacant, has never been either a BCC designee or a WellPoint designee position.

Certain Bylaws sections described below appear to make certain decisions subject to a vote of or concurrence by the BCC designees. However, the three BCC designees have no ongoing relationship with BCC, and have never had any affiliation or connection with BCBSA. As discussed above, a BCC designee position may be filled by a director who was not chosen by and has no connection with BCC. In addition, BCBSA has no influence over either the BCC designees on WellPoint's board or BCC's directors. WellPoint, not BCBSA, controls BCC and its board of directors.

b. <u>Election of a Director After a Term Has Expired</u>

Under Article IV, Section 2 of the Bylaws, until CHF beneficially owns less than 5 percent of WellPoint's voting securities, WellPoint must have a Nominating Committee comprised of three independent directors. One member must be a BCC designee, and the other two must be non-BCC designees. In order for a nominee to be selected by the Nominating Committee, he or she must be approved by a majority of the Committee members. In addition, the BCC designee member may veto a nominee to replace a BCC designee on the board, and the two WellPoint designees may veto a nominee to replace a WellPoint designee. If the Nominating Committee is unable to choose a nominee, then a nominee may be selected by the board of directors.

When any director's term expires, either the Nominating Committee, the shareholders or, if the Nominating Committee fails to select a nominee, the board of directors of WellPoint may select nominees for the position. A nominee will be elected if he or she receives a plurality of the shareholders' votes at the annual meeting.

The License Agreement and Addendum provide that WellPoint may lose its Blue Cross License if a majority of its directors are not "independent directors.". If two-thirds of the existing independent directors approve of a new director, then he or she is characterized as an independent director. All of the initial directors elected to the board at the time of WellPoint's incorporation were deemed independent because they did not represent any special interests, such as the California HealthCare Foundation, health care providers or competitive health plans.

The board's decision regarding the independence of a new director does not affect the outcome of the shareholder election. If, for example, four of the board's seven current directors, who are all considered independent, are replaced by four non-independent directors, then WellPoint may lose its Blue Cross License, but the new directors will remain on the board. Moreover, the existing independent directors may at any time decide to recharacterize these new directors as independent directors.

c. Election of a Director to Fill a Vacancy

The Nominating Committee may nominate a candidate to fill a vacancy on the board of directors. A proposed nominee for a BCC designee position may be vetoed by the BCC designee on the Committee, and a proposed nominee for a WellPoint designee position may be vetoed by the two WellPoint designees.

After the Nominating Committee selects a nominee, the nominee may be elected by a majority of the BCC designees,[3] if a BCC designee position is vacant, or by a majority of the WellPoint designees, if a WellPoint designee position is vacant. Since the ninth position on the board is neither a WellPoint nor a BCC designee position, a candidate for that position only needs the approval of a majority of the entire board.

If the Nominating Committee is unable to select a nominee, then the full board of directors may nominate a candidate to fill the vacancy. However, a nominee for a BCC designee position is subject to the approval of a majority of BCC designees, and a nominee for a WellPoint designee position is subject to the approval of a majority of the WellPoint designees.

If the board does not fill a vacancy, then the shareholders may at any time nominate and elect a director to fill the vacancy. There are currently two vacancies on the board, so the shareholders may elect any two individuals to fill these vacancies.

The independent director requirement applies to directors who are elected to fill vacancies. Thus, if a new director who has not received the approval of two-thirds of the existing independent board members is elected, and, as a result of this election, the majority of the board is no longer independent, then WellPoint may lose its Blue Cross license.

3. Effect of Requirements Relating to the Board of Directors

The Bylaws and License Agreement provisions relating to the board of directors do not give BCBSA the authority or ability to direct or participate in the governance of WellPoint or to appoint the directors of WellPoint. Unlike the sponsoring organizations in Advisory Opinions

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[3] In practice, the Nominating Committee presents its nominee during a board meeting, and the nominee is elected by the entire board (including the BCC designees).

1986-42, 1987-21, 1988-37 and 1996-26, BCBSA has never been entitled to name any of WellPoint's directors.

Because they occupy three positions on the board, the BCC designees may be able to prevent a nominee selected by the WellPoint designees or the shareholders from obtaining the two-thirds board approval required for classification as an independent director. However, as discussed earlier, BCBSA has no relationship with any of the BCC designees on WellPoint's board. Further, the election of a director who is not "independent" would have no effect on the License Agreement so long as a majority of the board is comprised of independent directors. In order for WellPoint to jeopardize its Blue Cross license, it would have to replace four of its seven current directors with new directors without the approval of two-thirds of the board. If this situation occurs, then WellPoint may lose its Blue Cross License, but the election of the non-independent directors *will not* be void.

The following chart, which is continued on the next page, explains how the nomination and election procedures apply under various circumstances.

Situation	Nomination Process	Election	Decision Regarding the Director's Independence
A BCC director's term expires	• The shareholders may nominate candidates • A majority of the Nominating Committee members may nominate a candidate, subject to the BCC designee member's veto • If the Nominating Committee fails to select a nominee, a majority of the board's BCC designees may nominate a candidate	• The shareholders elect a director by a plurality of the votes cast	• The board, by a 2/3 vote of independent directors, may determine that a new director is independent. This vote has no bearing on the shareholders' election.
A WellPoint director's term expires	• The shareholders may nominate candidates • A majority of the Nominating Committee members may nominate a candidate, subject to the two WellPoint designee members' veto • If the Nominating Committee fails to select a nominee, a majority of the board's WellPoint designees may nominate a candidate	• The shareholders elect a director by a plurality of the votes cast	• The board, by a 2/3 vote of independent directors, may determine that a new director is independent

Situation	Nomination Process	Election	Decision Regarding the Director's Independence
A BCC designee's seat becomes vacant	• A majority of the Nominating Committee members may nominate a candidate, subject to the BCC designee member's veto • If the Nominating Committee fails to select a nominee, a majority of the board's BCC designees may nominate a candidate	• A nominee selected by the Nominating Committee or the board may be elected by a majority of the board's BCC designees • If the board does not fill the vacancy, shareholders may at any time nominate and elect a replacement	• The board, by a 2/3 vote of independent directors, may determine that a new director is independent
A WellPoint designee's seat becomes vacant	• A majority of the Nominating Committee members may nominate a candidate, subject to the two WellPoint designee members' veto • If the Nominating Committee fails to select a nominee, a majority of the board's WellPoint designees may nominate a candidate	• A nominee selected by the Nominating Committee or the board may be elected by a majority of the board's WellPoint designees • If the board does not fill the vacancy, shareholders may at any time nominate and elect a replacement	• The board, by a 2/3 vote of independent directors, may determine that a new director is independent
Any other seat becomes vacant	• A majority of the Nominating Committee members may nominate a candidate • If the Nominating Committee fails to select a nominee, a majority of the entire board may nominate a candidate	• A nominee selected by the Nominating Committee or the board may be elected by a majority of the entire board • If the board does not fill the vacancy, shareholders may at any time nominate and elect a replacement	• The board, by a 2/3 vote of independent directors, may determine that a new director is independent

B. <u>Transfers of Stock</u> [Charter Art. VII; Agreement § 9(d)(iii); Addendum § 2.1(f)]

Except for CHF, noninstitutional investors may not beneficially own stock representing 5 percent or more of the corporation's voting power, and institutional investors may not beneficially own stock representing 10 percent or more of the voting power. A transaction that causes the purchaser to exceed the ownership limit is void, and any shares in excess of the ownership limit are deemed transferred to an independent escrow agent. These restrictions are designed to prevent any investor from acquiring a significant interest in WellPoint or acquiring control of the company.

CHF currently owns 6.7 percent of WellPoint's common stock. We do not know when CHF will dispose of its remaining excess shares, but it has sold a portion of its shares every year. No other noninstitutional shareholder beneficially owns 5 percent or more of WellPoint's stock, and no institutional shareholder beneficially owns 10 percent or more of WellPoint's stock.

C. Issuance of Securities [Agreement § 9(d)(iv); Addendum § 2.6]

Under the License Agreement and Addendum, WellPoint may issue common stock having identical terms as its existing common stock and may issue non-voting, non-convertible debt securities. In addition, WellPoint may issue other types of securities if it provides 30-day prior notice to BCBSA. For example, in July 1999, WellPoint issued zero coupon convertible subordinated debentures. BCBSA may not prevent the issuance of the securities, but it retains the authority to determine how the securities will be counted against the stock ownership limits. The provisions in the License Agreement and Addendum are intended to prevent any entity from circumventing the stock ownership limit by acquiring a percentage of equity or convertible debt securities that could give the entity as much control over the corporation as the direct ownership of common stock.

We hope this letter addresses all of your questions. Please contact us if you need any additional information.

Sincerely,

James A. Sivesind

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