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AGENDA ITEM

For Meeting of: 2-17-00

FEB 10 2000

MEMORANDUM

TO: The Commission

THROUGH: James A. Pehrkon *JP*
Staff Director

FROM: Lawrence M. Noble *L*
General Counsel

N. Bradley Litchfield *NBL*
Associate General Counsel

Jonathan M. Levin *JL*
Senior Attorney

Subject: Draft AO 1999-39

Attached is a proposed draft of the subject advisory opinion. We request that this draft be placed on the agenda for February 17, 2000.

Attachment

1 **ADVISORY OPINION 1999-39**

2
3 **James A. Sivesind**
4 **Reed & Davidson**
5 **520 South Grand Avenue**
6 **Suite 700**
7 **Los Angeles, CA 90071-2645**

DRAFT

8
9 **Dear Mr. Sivesind:**

10 **This responds to your letters dated November 4 and December 10, 1999, and**
11 **January 21, 2000, on behalf of WellPoint Health Networks Political Action Committee**
12 **("WellPAC"), requesting an advisory opinion concerning the application of the Federal**
13 **Election Campaign Act of 1971, as amended ("the Act") and Commission regulations to**
14 **the question of its affiliation with Blue Cross and Blue Shield Association PAC**
15 **("BluePAC").**

16 **WellPAC is the separate segregated fund ("SSF") of WellPoint Health Networks,**
17 **Inc. ("WellPoint"). Until July 1996, WellPAC was known and operated as Blue Cross of**
18 **California PAC ("BCC PAC"), and Blue Cross of California ("BCC") was its reported**
19 **"parent" or connected organization. In 1990, the Commission issued an opinion**
20 **concluding that the Blue Cross and Blue Shield Association ("BCBSA") was affiliated**
21 **with each of its regular member plans, including BCC. Advisory Opinion 1990-22.**
22 **Consistent with that opinion, Blue PAC reported BCC PAC as an affiliated SSF.**
23 **Between 1993 and 1996, however, there was a corporate reorganization with respect to**
24 **BCC and WellPoint which resulted in WellPoint's ownership of BCC (described further**
25 **below). You assert that this reorganization and related changes warrant a conclusion by**
26 **the Commission that WellPAC is no longer affiliated with BluePAC. You ask the**
27 **Commission to conclude the same.**

28 ***Applicable statutory and regulatory provisions***

29 **The Act and Commission regulations provide that committees established by the**
30 **same corporation, person, or group of persons, including any parent, subsidiary, branch,**
31 **division, department, or local unit thereof are affiliated. 2 U.S.C. §441a(a)(5); 11 CFR**
32 **100.5(g)(2) and 110.3(a)(1)(ii). The regulations clarify the term "local unit," stating that**
33 **it may include, in appropriate cases, a franchisee or licensee. 11 CFR 100.5(g)(2) and**

1 110.3(a)(1)(ii). Contributions made to or by affiliated committees shall be considered to
2 have been made to or by a single committee and thus such committees share contribution
3 limits. 2 U.S.C. §441a(a)(5); 11 CFR 100.5(g)(2), 110.3(a)(1), and 110.3(a)(1)(ii). In
4 addition, a corporation may solicit contributions to its separate segregated fund ("SSF"),
5 from the restricted class (i.e., executive and administrative personnel and stockholder,
6 and the families thereof) of its subsidiaries or other affiliates. 2 U.S.C.
7 §441b(b)(4)(A)(i); 11 CFR 114.5(g)(1).

8 In the absence of certain automatically affiliated relationships such as a parent
9 corporation and its subsidiary, Commission regulations provide for an examination of
10 various factors in the context of an overall relationship to determine whether one
11 company is an affiliate of another and, hence, whether their respective SSFs are affiliated
12 with each other. 11 CFR 100.5(g)(4)(i) and (ii)(A)-(J), 11 CFR 110.3(a)(3)(i) and (ii)(A)-
13 (J). Included in these factors are (A) whether a sponsoring organization owns a
14 controlling interest in the voting stock or securities of another sponsoring organization;
15 (B) whether a sponsoring organization has the authority or ability to direct or participate
16 in the governance of another sponsoring organization through provisions of constitutions,
17 by-laws, contracts or other rules, or through formal or informal practices or procedures;
18 (C) whether a sponsoring organization has the authority or ability to hire, appoint, demote
19 or otherwise control the officers, or other decision-making employees of another
20 sponsoring organization; (E) whether a sponsoring organization has common or
21 overlapping officers or employees with another sponsoring organization which indicates a
22 formal or ongoing relationship between the organizations; (F) whether a sponsoring
23 organization has any members, officers, or employees who were members, officers, or
24 employees of another sponsoring organization which indicates a formal or ongoing
25 relationship or the creation of a successor entity; (G) whether a sponsoring organization
26 provides funds or goods in a significant amount or on an ongoing basis to another
27 sponsoring organization; (H) whether a sponsoring organization causes or arranges for
28 funds in a significant amount or on an ongoing basis to be provided to another sponsoring
29 organization; (I) whether a sponsoring organization had an active or significant role in the
30 formation of another sponsoring organization; and (J) whether the committees have

1 similar patterns of contributions which indicates a formal or ongoing relationship
2 between the committees. 11 CFR 110.3(a)(3)(ii)(A), (B), (C), (E), (F), (G), (H), (I), and
3 (J). The list of ten circumstantial factors set out at 11 CFR 110.3(a)(3)(ii) is not an
4 exclusive list, and other factors may be considered. See Advisory Opinion 1995-36.

5 ***Factual background***

6 WellPoint is a publicly traded, managed health care corporation with subsidiaries
7 that offer a variety of health care plans and specialty products such as preferred provider
8 organizations, pharmacy benefit management, and dental, behavioral health, and life
9 insurance. WellPoint's subsidiaries operate under the Blue Cross and UNICARE brand
10 names in California and under the UNICARE brand name in other States. WellPoint and
11 BCC have license agreements with BCBSA granting WellPoint, BCC, and Blue Cross
12 Life & Health Insurance Company ("BC Life") the exclusive use of the Blue Cross name
13 and marks in California; WellPoint has a primary license agreement with BCBSA, and
14 BCC and BC Life, wholly owned subsidiaries of WellPoint, have a "controlled affiliate"
15 license agreement with BCBSA. WellPoint subsidiaries provide medical plans and
16 specialty products under the UNICARE name to subscribers in all fifty States with offices
17 in thirteen States and the District of Columbia. UNICARE companies compete directly
18 with BCBSA licensees outside of California.

19 You briefly describe how WellPoint arrived at its present situation. BCC was
20 originally established in 1937 as a nonprofit public benefit corporation. Prior to 1993, the
21 organization that is now WellPoint was directed or controlled by BCC and operated
22 various medical, dental, and pharmacy plans which were Blue Cross licensees, with two
23 small non-licensee subsidiaries that focused on life insurance services. Between 1993
24 and 1996, BCC converted to a for-profit corporation, with a recapitalization that included
25 its merger with WellPoint, which was formerly one of its subsidiaries. As a result of this
26 reorganization, BCC became a wholly owned subsidiary of WellPoint.

27 Since 1993, WellPoint (as BCC and then as WellPoint) acquired other
28 subsidiaries that are not Blue Cross licensees. These include businesses that now operate
29 under the UNICARE brand name, such as various life, health, and group benefits
30 divisions of Massachusetts Mutual Life Insurance Company and John Hancock Mutual

1 Life Insurance Company, acquired in 1996 and 1997. In 1995, UNICARE became the
2 brand name for most of the WellPoint businesses operated outside of California.
3 WellPoint currently owns 18 operating subsidiaries and four holding companies. One
4 holding company owns the two operating subsidiaries that do business under the Blue
5 Cross mark and name in California (BCC and BC Life). Two of the holding companies
6 (UNICARE Specialty Services and UNICARE National Services), hold the remaining 16
7 operating companies, which do business under UNICARE, WellPoint, or other names
8 and marks. (The fourth holding company handles WellPoint's passive investments.)

9 WellPoint currently has 7.2 million "medical members" and 30.6 million
10 "specialty members." Approximately 5 million of the medical members and 6.8 million
11 of the specialty members are served by the Blue Cross subsidiaries. Approximately 2.2
12 million medical members and 23.7 million specialty members are served by the non-Blue
13 Cross subsidiaries. WellPoint has approximately 10,500 employees; 59 percent are
14 employed by the Blue Cross subsidiaries and 41 percent by the non-Blue Cross
15 subsidiaries. WellPoint has \$4.6 billion in assets, with \$2.8 billion held through the Blue
16 Cross subsidiaries and \$1.3 billion with the other subsidiaries. In the first three quarters
17 of 1999, approximately eighty percent of WellPoint's \$5.1 billion in premium revenue
18 came from the Blue Cross subsidiaries. Sixty percent of WellPoint's \$300 million in
19 management services revenues came from non-Blue Cross subsidiaries.¹

20 You present facts that tend to illustrate a lack of affiliation between WellPoint and
21 BCBSA, using the affiliation factors presented above. You note that BCBSA has no
22 ownership interest in WellPoint nor any common shareholders; BCBSA and its licensees
23 are not liable for the debts of another licensee; the person who is both Chairman/CEO of
24 WellPoint and BCC is the only WellPoint or BCC person on BCBSA's board and
25 constitutes the only board overlap that either WellPoint's seven member board or BCC's

¹ You note that WellPoint is currently planning on acquiring another BCBSA licensee, Cerulean Companies, Inc. ("Cerulean"), the parent company of Blue Cross and Blue Shield of Georgia, which has 1.7 million members, nearly all of whom are Blue Cross subscribers. The acquisition was approved by Cerulean shareholders in June 1999 but has not yet been approved by the Georgia Department of Insurance because of pending shareholder litigation involving Cerulean. Recently, WellPoint also agreed to purchase Rush Prudential Health Plans of Illinois, which consists of 300,000 medical members; it will become part of the UNICARE system.

1 three-member board has with BCBSA's 56 member board; and only three out of
2 WellPoint's 11,000 employees (a BCC vice president, BCC department director, and
3 BCC project manager) are former BCBSA employees. You acknowledge that, although
4 BCBSA provides limited administrative services to WellPoint (and to other licensees),
5 WellPoint compensates BCBSA for these services and for the use of the Blue Cross name
6 and mark, and thus such provision is merely part of an arms length transaction. You note
7 that BCBSA hires lobbyists to represent the association, but that WellPoint does not share
8 those lobbyists, has hired its own lobbyists, and does not rely on BCBSA for its lobbying
9 activities. Although WellPAC contributed \$5,000 to BluePAC in 1998 and in 1999, it
10 also regularly contributes to the political committees of other health care associations of
11 which WellPoint is a member. The two PACs do not consult with each other over
12 contributions and any occasional common recipient would result from both
13 organizations' interest in the same issues.² In contrast to the statement in Advisory
14 Opinion 1990-22 that BCBSA had a role in the formation of the member plans, inasmuch
15 as they need admission to BCBSA and a license in order to operate as a Blue Cross plan,
16 WellPoint was not formed for the sole purpose of operating the BCC plan and operates a
17 number of subsidiaries that are not affected by the license agreement. You also cite a
18 factor that is not specifically mentioned in the regulations, but has been discussed in
19 previous advisory opinions (Advisory Opinions 1996-42 and 1995-36). This factor is the
20 existence of direct competition between WellPoint subsidiaries and BCBSA member
21 plans.

22 Your letters and other documents submitted by you also present the linkages
23 between WellPoint and BCBSA. In order to maintain its licensee status with BCBSA,
24 WellPoint must adhere to certain membership standards and other conditions. You refer
25 to nine membership standards that are presently in effect and (with one exception) were
26 also applicable in 1992. In general, these standards require that WellPoint and all other
27 BCBSA member plans avoid control by non-member (of BCBSA) plans or by any special
28 interest group; demonstrate strong financial viability and responsive customer service

² You also note that neither company solicits PAC contributions from the executive and administrative personnel and stockholders of the other.

1 (including claims processing in all service areas); use the plan's best efforts in its service
2 area to promote the value of the BCBSA marks; and emphasize its independence from
3 BCBSA and other plans in its communications with customers and the public (e.g.,
4 identifying a plan as an "independent licensee" of BCBSA). One standard extant in 1992,
5 but no longer in effect, is the requirement that a member plan operate as a non-profit
6 entity.

7 There are other BCBSA requirements as to WellPoint's activities through
8 provisions of the licensing agreement (with addendum) and through related provisions of
9 WellPoint's charter and bylaws. For example, there are general provisions to ensure
10 compliance with the membership standards as to the financial health and protection of the
11 value of the Blue Cross licensed marks and name (e.g., non-assignability without
12 BCBSA's permission). Moreover, WellPoint incurs a heavy liability to BCBSA upon
13 termination of the license.

14 The license agreement, addendum, and governing documents also include various
15 provisions that were adopted in order to prevent any special interest such as another
16 health plan, a medical provider, or the State of California from acquiring control or
17 influence over WellPoint. You state that the purpose of these provisions is not to give
18 BCBSA control over WellPoint, but to ensure that WellPoint is diversely owned so that it
19 will be responsive to the community it serves. As part of the May 1996 reorganization of
20 BCC from parent to subsidiary of WellPoint, and the related conversion of both entities
21 into for-profit corporations, a charitable organization known as California Healthcare
22 Foundation ("CHF") purchased 80 percent of WellPoint's stock from BCC. Thus, there
23 are provisions that prevent any possibility of CHF control over WellPoint's Board. CHF
24 has now disposed of all except 6.7 percent of WellPoint's stock.

25 One of these measures is to preserve a line of succession from the membership of
26 the WellPoint board before the May 1996 reorganization until the present. That board
27 consisted of eight directors, three of whom were selected in a secret ballot by BCC's then
28 existing board members and five of whom were selected independently by WellPoint's
29 then existing board members. All of these eight directors were denoted as "independent"
30 directors because they did not represent CHF or any health care providers or competitive

1 health plans. The license addendum and bylaws provide that the board must consist of a
2 majority of those "independent" directors (who are named in the addendum) or their
3 successors, with three labeled as "BCC designees" and five as "WellPoint designees."³
4 These provisions, including the designation of BCC designees, may suggest an
5 institutional preservation of WellPoint as principally a Blue Cross company, but you
6 explain that these labels are limited in their significance. You explain that none of the
7 directors was selected by BCBSA, that the BCC designees have "no ongoing relationship
8 with BCC,"⁴ and that the BCC designees "have never had any affiliation or connection
9 with BCBSA." The directors are elected by the shareholders, or are selected by the other
10 directors in the event of a vacancy. A "successor" to a BCC designee is anyone
11 nominated by the board members or WellPoint shareholders to succeed a BCC designee
12 or successor, who then wins a shareholder election, or in the event of a vacancy of a BCC
13 designee or successor, anyone elected by the other BCC designees. The same principles
14 apply to successors to WellPoint designees.⁵ With respect to the need for successors of
15 "independent" board members, a successor is still either elected by the shareholders at the
16 end of a term or by the other eligible board members in the event of a vacancy. The
17 designation of "independent director" is accomplished merely by a vote of two-thirds of
18 the independent directors (then in office) to apply that label.⁶

³ Since May 1996, one BCC designee and one WellPoint designee have resigned. The BCC designee was succeeded by a new director who had been suggested by the WellPoint management team. The WellPoint designee has not been succeeded, and a ninth undesignated seat remains vacant.

⁴ In particular, you state that none of the BCC designees on WellPoint's board serve on BCC's board.

⁵ Until CHF beneficially owns less than five percent of WellPoint's stock, WellPoint must have a nominating committee comprised of three independent directors, consisting of one BCC designee and two non-BCC designees. Nominees are selected by a majority vote of the committee. The BCC designee may veto the nomination of a proposed BCC designee board member and each WellPoint designee has the same power with respect to a proposed WellPoint designee member. Such designees have no veto power over shareholder nominations, and, if the nominating committee fails to nominate a candidate, a majority of the BCC or WellPoint designees on the board may nominate a candidate for BCC or WellPoint designee respectively.

⁶ Other provisions of the licensing agreement, addendum, and articles of incorporation that are aimed at preventing control by a special interest state that no non-institutional investor may beneficially own stock representing five percent or more of the voting power in WellPoint, no institutional investor may own ten percent or more of such voting stock, and no investor may own any WellPoint securities which, in combination, amount to ownership of 20 percent or more. The excess stock owned by CHF is placed in a voting trust and not voted by CHF and any other investor's excess share would be placed under the control of a share escrow agent. In either situation, the excess is to be voted in proportion to the vote of shareholders that are not subject to such an agreement. (The articles of incorporation, in addressing the

1 Analysis

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3 As the facts above illustrate, the overall relationship of WellPoint and BCBSA
4 may be viewed from two different perspectives. First, there is the change in the
5 relationship of WellPoint's relationship with BCBSA as a result of the for-profit
6 conversion and WellPoint's resulting transformation into an entity with business
7 operations that extend well beyond those of Blue Cross. Presently, Blue Cross of
8 California and the Blue Cross businesses are not at the top of the company's structure but
9 are subsidiaries of WellPoint, which owns a substantial number of non-Blue Cross
10 businesses that operate, for the most part, as an entirely different insurance group.
11 Second, there are the continuing ties to BCBSA which affect to some extent the
12 membership of WellPoint's board and certain aspects of WellPoint's capitalization and
13 operations. Moreover, there is the continuing tie of BCC, a wholly-owned subsidiary of
14 WellPoint, to BCBSA as a "controlled affiliate" licensee.

15 Although the Commission acknowledged in Advisory Opinion 1990-22 that it is
16 difficult to directly compare BCBSA's relationship to its member plans with other
17 franchise or license arrangements addressed in past opinions, a comparison is useful and
18 relevant, particularly in view of the changing nature of the licensee. In past opinions, the
19 Commission has interpreted the affiliation provisions of the Act and regulations as
20 affiliating franchisees and licensees with a central franchising or licensing corporation
21 where one entity exercises pervasive supervision and direction over the daily operations
22 and business policies of another entity such as a franchisee. Advisory Opinion 1992-7
23 and 1985-7; see also Advisory Opinions 1988-46, 1979-38, 1978-61, and 1977-70. The
24 Commission has concluded that there was affiliation in those circumstances where the
25 franchisees conducted the relevant businesses solely under the supervision or service
26 marks of the central organization (for example, where an insurance agency was permitted
27 to sell only the insurance carrier's policies, or where franchisees providing tax
28 preparation services could provide such services only under the franchisor's name and
29 marks). See Advisory Opinions 1985-31 and 1992-7. You emphasize that WellPoint is

powers of share escrow agents, specifically require that WellPoint stock certificates refer to the five percent limitation as being designed to ensure compliance with the BCBSA license agreement.)

1 not required to conduct its health insurance, life insurance, and other related businesses
2 exclusively under the Blue Cross name, and conducts an extensive portion of its
3 businesses in those fields under the UNICARE name. Accordingly, WellPoint's
4 circumstances are more analogous to the situation presented in Advisory Opinion 1985-7
5 where the Commission concluded that affiliation did not exist between a malt beverage
6 brewing company and distributors that were granted exclusive territorial rights to market
7 its products, partly because of the ability of the distributor to market the products of other
8 brewers.

9 The change of WellPoint from a company that was primarily engaged in business
10 under the Blue Cross name, marks, and license arrangements to one with significantly
11 more varied operations provides the "context of the overall relationship" for the
12 examination of the affiliation factors. See 11 CFR 110.3(a)(3)(ii). Prior to the
13 transformation, with the Blue Cross operations dominating the company structure, the
14 BCBSA license arrangement was more pervasive in the operations of the company. Now
15 there is a very-different consideration; although there remain license agreements with
16 BCBSA, the Blue Cross operations are owned by WellPoint and are one segment of a
17 materially altered company structure that is significantly engaged in other activities not
18 related to BCBSA, which activities even involve some competition with BCBSA entities.

19 The effect of the license restrictions on matters addressed in the Commission
20 regulations appears to be outweighed by this competing consideration, particularly in
21 view of the fact that the effect of these restrictions is limited. The license restrictions on
22 the selection of WellPoint's board do not give BCBSA significant control over the
23 board's membership; BCBSA has had no role in the placing of individuals on the
24 WellPoint board, and your explanation indicates that the selection of successor board
25 members is under the practical control of the WellPoint board and shareholders.
26 Although there are general controls over the level of ownership or voting power for any
27 one investor, the principal object of these controls, CHF, currently holds just under 7
28 percent of WellPoint's stock, after having held 80 percent in 1996. Moreover, other facts
29 discussed above in relation to affiliation factors, including the lack of overlap of present
30 or former employees, the facts related to the provision of goods and services including

1 lobbying services, and the direct competition between WellPoint subsidiaries and
— 2 BCBSA member plans, support non-affiliation status between WellPoint and BCBSA.

3 The continued links of BCC to BCBSA do not change the foregoing analysis or
4 conclusions. Commission regulations provide for affiliation of a corporation with its
5 parent, subsidiaries, branches, divisions, and affiliates. 11 CFR 100.5(g)(2),
6 110.3(a)(1)(ii), and 114.5(g)(1). See, for example, Advisory Opinion 1982-18 which
7 permitted an SSF of a subsidiary corporation to solicit the executive and administrative
8 employees of its parent and of other first and second level subsidiaries of the parent (that
9 were not subsidiaries of the subsidiary corporation). Unlike WellPoint in its entirety,
10 BCC's operations are exclusively Blue Cross activities and not those of other insurance
11 companies. Notwithstanding this fact, the past affiliated relationship of BCBSA to BCC
12 was based on a license arrangement, not on any equity ownership of one by the other.
13 Such a license arrangement may lead to a conclusion of affiliation based on certain
14 aspects of control. As indicated above, however, the conversion of BCC, from a non-
15 profit parent company whose main point of external control was BCBSA to a for-profit
16 subsidiary subject to ownership and control by a well-diversified WellPoint, changes the
17 entire situation. The Commission concludes that WellPoint's equity ownership and
18 control of BCC supersedes any control held by BCBSA.

19 Based on the foregoing, the Commission concludes that WellPAC and Blue PAC
20 are no longer affiliated. Thus, they no longer share limits on the receipt and making of
21 contributions, and neither WellPoint nor BCBSA may solicit the restricted class of each
22 other's organization for PAC contributions. The Commission emphasizes, however, that
23 this opinion is based on the specific facts presented in connection with this request and
24 the Commission is not hereby making a determination as to the relationship between
25 BCBSA and any other BCBSA regular member plans.

