INSURANCE COMMISSIONER FOR THE STATE OF MARYLAND	*	**MARYLAND INSURANCE ADMINISTRATION**
v.	*	
CAREFIRST, INC.	*	**Case No.: MIA-2007-10-027**
and	*	
WILLIAM L. JEWS	*	

* * * * * * * * * * * * *

FINAL ORDER

This Final Order is entered pursuant to §§ 1-201, 2-108, 2-214, 14-124, and 14-139 of the Insurance Article of the Maryland Code and is effective as of the date on which it is entered. This order is based on the entire record of this case. The reasons for the order are set forth in the Statement of Reasons ("Statement") that accompanies and is filed with this order. That Statement is hereby adopted and incorporated by reference as if fully set forth herein. It is hereby **ORDERED** as follows:

1. The proposed action of the board of respondent CareFirst, Inc. ("CareFirst") to pay its former Chief Executive Officer, intervenor William L. Jews, the total sum of $17,970,162.00, following Mr. Jews' termination without cause (as defined in Mr. Jews' employment contract), is unlawful and contrary to § 14-139(c) of the Insurance Article. Section 14-139(c) limits lawful compensation at CareFirst to that which is "fair and reasonable. . . for work actually performed" for the benefit of CareFirst. As explained in the Statement, the proposed payment of nearly $18 million is not "fair

and reasonable" and the portion of that payment that represents continuation of Mr. Jews' base salary after November 1, 2008, is not "for work actually performed" for the benefit of CareFirst. Accordingly, CareFirst's proposal to make a nearly $18 million post-termination payment to Mr. Jews is hereby prohibited and CareFirst's approval of that payment is hereby vacated.

2. Consistent with § 14-139(c), CareFirst is authorized to approve and make a total post-termination payment to Mr. Jews and Mr. Jews is authorized to receive a total post-termination payment in the amount of $8,985,081.00. The amount remaining to be paid to Mr. Jews by CareFirst is $8,985,081.00 minus the amount that CareFirst has paid Mr. Jews since his termination (as of April 28, 2008, CareFirst had paid Mr. Jews $2,281,021.00 since his termination), plus interest calculated as provided in Mr. Jews' employment contract.

3. Within 15 days of the date of this order, CareFirst shall calculate the exact amount due to Mr. Jews, consistent with this order, and provide that calculation to counsel for Mr. Jews and to counsel for the Maryland Insurance Administration. If either of those parties objects to CareFirst's calculation, the objecting party shall give written notice of that objection to CareFirst no later than 10 days after receipt of CareFirst's calculation. Promptly thereafter, the parties shall meet and confer to seek to resolve the objection. Absent resolution following the parties' good faith efforts to resolve the matter, a written notice of objection shall be filed with the Insurance Commissioner (and served upon other counsel) within 7 days of counsel's

determination that the matter cannot be resolved. Such further and separate proceedings as may be appropriate will be scheduled to resolve the objection. Absent a timely objection to CareFirst's calculation, CareFirst is authorized and directed to make payment to Mr. Jews in accordance with this order as soon as practicable following the expiration of the time within which a written notice of objection may be submitted to CareFirst.

4. The parties' numerous proposed requests for findings of fact and conclusions of law (nearly 400 in total) have been considered carefully. The substance of the parties' principal requests are addressed (either granted or denied) in this Final Order and in the Statement that accompanies this order, albeit in a form and in language different from that used by the parties. All requests for findings of fact and conclusions of law not addressed specifically in this Final Order or in the Statement are hereby denied and overruled.

SO ORDERED and effective this 14th day of July 2008.

RALPH S. TYLER
Insurance Commissioner

APPEAL RIGHTS

A party to this hearing who is aggrieved by the Insurance Commissioner's decision may file an appeal in a Maryland Circuit Court within (30) days of the date of this order. Please also be aware that your appeal will not stay (or stop) the Commissioner's Order from taking effect. You must request the circuit court to enter a stay. Your request must be in writing filed with the court in the form of a motion. It is up to the circuit court to decide whether or not to grant your motion.

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* * * * * * * * * * * * *

STATEMENT OF REASONS
IN SUPPORT OF FINAL ORDER

Ralph S. Tyler
Insurance Commissioner
525 St. Paul Place
Baltimore, MD 21202
410-468-2090

July 14, 2008

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I. Introduction.

Based upon the entire record of this case and for the reasons set forth below, I find and conclude that the proposal of respondent CareFirst, Inc. ("CareFirst") to pay its former Chief Executive Officer, intervenor William L. Jews, the total sum of $17,970,162.00 (an amount almost seven time Mr. Jews' gross income from CareFirst in 2006, his last year of employment) following Mr. Jews' termination is unlawful. I further find and conclude that CareFirst is authorized to pay Mr. Jews and Mr. Jews is authorized to receive a total post-termination payment of $8,985,081.00 which is one-half of the amount which CareFirst proposed to pay. As of the start of the hearing in this case on April 28, 2008, CareFirst had paid Mr. Jews $2,281,021.00 since his termination. The total remaining amount to be paid Mr. Jews is $8,985,081.00 minus the amount paid since his termination, plus interest as provided for in Mr. Jews' employment contract.

An alternative to my determining the permissible payment amount would be to remand this matter to CareFirst for its board to determine a different and lawful amount. In the interest of closure and finality, it seems far preferable to determine now both the unlawfulness of the proposed payment as well as the lawful amount. This approach moves this matter toward conclusion. Mr. Jews was terminated about 20 months ago. In the interest of fairness to all parties, certainly including Mr. Jews, this matter needs to be resolved. A remand, by contrast, will further prolong the matter.

This order was preceded by extensive evidentiary proceedings and full legal briefing and argument. All parties filed both pre- and post-hearing legal memoranda, presented witnesses, and offered documentary evidence. Following the hearing, all parties submitted proposed findings of fact and conclusions of law. The evidentiary hearing in this case lasted approximately four and one-half days, followed by closing arguments on a separate day. The transcript of the evidentiary hearing (exclusive of closing arguments) is almost 1,400 pages long. A list of the ten witnesses who testified is attached as Exhibit 1. The parties submitted four thick binders of joint exhibits, containing in excess of 150 exhibits. CareFirst and the MIA each submitted additional binders of party sponsored exhibits and additional exhibits were offered and accepted during the course of the hearing.

The undersigned heard and considered all the evidence, has read more than once and considered carefully all of the written submissions, including the briefs and the proposed findings and conclusions, and has reviewed the entire record. This order is based on the entire record following a careful and thorough review of that entire record. The citations in this statement of reasons to particular testimony and exhibits are provided for ease of reference only and are not intended and are not to be construed as excluding reliance on other parts of the record.

II. <u>Overview of Principal Issues</u>.

In 2003, the Maryland General Assembly enacted § 14-139(c) of the Insurance Article.[1] That statute provides that an officer or director of a non-profit health plan [CareFirst] "<u>may only approve or receive</u> from the assets of the corporation <u>fair and</u>

[1] Unless otherwise noted, all statutory references are to the Insurance Article of the Maryland Annotated Code.

reasonable compensation in the form of salary, bonuses, or perquisites for work actually performed for the benefit of the corporation." (Emphases added.) The core issues in this case are (1) whether CareFirst's proposal to pay Mr. Jews nearly $18 million following Mr. Jews' termination as CareFirst's CEO violates § 14-139(c), and (2) if so, what amount of post-termination compensation is CareFirst authorized to pay Mr. Jews.

The framework for the analysis of these issues is CareFirst's special statutory mission. CareFirst is not just another private company, the board of which is more-or-less free to pay its CEO whatever it deems appropriate. Instead, CareFirst's mission is to "provide affordable and accessible health insurance." Section 14-102(c)(2). The General Assembly enacted § 14-139(c) because CareFirst had strayed from that mission. The record of this case establishes that CareFirst's proposal to pay Mr. Jews $18 million following his departure is contrary to CareFirst's mission and violates § 14-139(c).

CareFirst and Mr. Jews argue that Mr. Jews should receive the entire nearly $18 million. In their view, that entire sum was earned pursuant to a valid employment contract between the company and Mr. Jews, is "fair and reasonable" as measured by compensation paid to chief executive officers of organizations comparable to CareFirst, and is "for work actually performed" for the benefit of Care First.[2] The Maryland Insurance Administration ("MIA") argues to the contrary. The MIA's position is that the proposed $18 million post-termination payment is not "fair and reasonable" and that a

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[2] With different degrees of emphasis, CareFirst and Mr. Jews also make several separate legal arguments (addressed and rejected below) as to why § 14-139(c) is inapplicable in whole or in large measure to the proposed post-termination payment to Mr. Jews.

portion of the proposed payment is not "for work actually performed" for the benefit of CareFirst.

The preponderance of the evidence (with a few exceptions discussed below) supports CareFirst's and Mr. Jews' position that the components of the payment to Mr. Jews (*e.g.*, base salary and benefits) are comparable to that which chief executive officers at entities similar to CareFirst receive. There is, however, no evidence that the CareFirst board had any basis for determining that the total proposed post-termination payment is comparable to that which a chief executive officer at an entity similar to CareFirst would receive in the event of his/her termination.

The MIA takes a position at odds to that of CareFirst and Mr. Jews on the question of whether comparability is, by virtue of the statutes involved, tantamount to "fair and reasonable" or whether "fair and reasonable" under § 14-139(c) has a meaning separate and distinct from mere comparability under § 14-139(d). No court has addressed the question of whether "fair and reasonable" under § 14-139(c) is satisfied by showing "comparability" under § 14-139(d). The parties also differ on the question of whether the total $18 million post-termination compensation payment must meet the statutory standard of "fair and reasonable" or whether the analysis begins and ends with whether the component parts of Mr. Jews' compensation package are "fair and reasonable . . . for work actually performed." This, too, is a question of first impression.

Section 14-139(c) was enacted in 2003 as part of a comprehensive package of legislative reforms of CareFirst. These reforms included the adoption of provisions that added new members to the board of CareFirst, § 14-115(d), and provisions that required the board's compensation committee to study executive compensation and to develop compensation guidelines, § 14-139(d). The General Assembly enacted these reforms following disturbing revelations about CareFirst's conduct that emerged in the proceedings relating to the company's failed attempt to convert from a not-for-profit to a for-profit entity. The findings in those proceedings convinced the General Assembly that CareFirst had lost its way and was not acting consistent with its intended nonprofit mission. The General Assembly addressed this problem by mandating changes in the company's governance structure and in its compensation practices.

Despite the General Assembly's actions, CareFirst's post-2003 "new board" behaved like the company's predecessor boards with respect to the CEO's compensation. While the new board hired new compensation advisors and the relevant board committee reviewed the reports of those advisers, the board made few substantive changes. Indeed, the undisputed testimony of two members of the board's post-2003 compensation committee is that the committee never attempted to negotiate, or even considered negotiating, a different and less rich deal with Mr. Jews than the one he had entered into with a prior board. Without a new contract, the post-2003 board was committing itself to the terms agreed to by the earlier board. Those terms drove Mr. Jews' compensation, and did so without regard to the will of the General Assembly as expressed in § 14-139(c).

The post-2003 compensation committee's principal compensation consultant told the committee (and the board) that executives at other more-or-less comparable health plans were being paid large sums of money, sums comparable to the amounts being paid to Mr. Jews pursuant to his pre-2003 contract. As the chair of the compensation committee testified, the committee believed that its task of determining "fair and reasonable" compensation was completed once it determined that compensation at CareFirst was comparable to that at roughly similar entities. This conclusion was wrong.

Even as to comparability, however, there were serious gaps in the company's approach. <u>First</u>, neither the board nor its compensation committee established compensation guidelines as to termination payments. <u>Second</u>, neither the board nor its compensation committee did a comparability study to establish that the <u>total</u> proposed payment to Mr. Jews upon his termination ($18 million) is comparable to that which "nonprofit health service plans in the United States similar in size and scope to [CareFirst]" would pay in similar circumstances. <u>And third</u>, the consultant's report that the board received on executive severance practices, which did <u>not</u> benchmark total dollars, but merely examined contract provisions, was issued months after Mr. Jews was terminated. Plainly, therefore, that limited study played no role in the board's decision at the time of Mr. Jews' termination to pay him almost $18 million.

A central cause of the heated (to put it mildly) controversy surrounding CareFirst's proposed conversion to a for-profit entity was the regulatory, legislative, and public revulsion (and that is not too strong a word) at the prospect of CareFirst's executives, prominently including Mr. Jews, receiving huge payments if the transaction closed. After the Insurance Commissioner disapproved that transaction, the General Assembly enacted

§ 14-139(c). The General Assembly took this action because it wanted CareFirst to change its compensation practices. Acquiescing in the actions of the prior board, as the new board did, was not responsive to the will of the General Assembly.

As CareFirst's vigorous and effective advocacy in this case confirms, the current CareFirst board stands behind the proposed $18 million payment to Mr. Jews. CareFirst argues that the board's judgment is entitled to deference. As a general proposition of corporate law, there is no dispute that a corporate board's judgment on the issue of CEO compensation is entitled to deference. That rule is of limited, if any, applicability here, however, <u>precisely because the post-2003 board failed to exercise its judgment to restrain the CEO's compensation</u>. The post-2003 board abdicated its responsibility and, therefore, there is no board judgment to which to defer.

Further, the argument for deference, even assuming that the board made a judgment, is inconsistent with the Insurance Commissioner's duties and obligations under the Insurance Article. CareFirst is a unique entity that is subject to comprehensive regulatory oversight. *See* § 14-101, *et seq*. Section 14-139(d)(5), for example, grants the Insurance Commissioner authority to issue an order prohibiting the payment of "compensation [that] exceeds the amount authorized under the approved guidelines." Here, as noted, there are no "approved guidelines" as to total post-termination payments as the board never adopted any guidelines on this subject. The absence of those guidelines does not deny regulatory authority to prevent unreasonable compensation. More generally, the Insurance Commissioner has authority under § 2-108 to enforce all the provisions of the Insurance Article. That broad enforcement authority includes authority to enforce the important provisions of § 14-139(c). If the board's proposed action violates § 14-139(c), as it does, the invocation of general notions of deference will not save that unlawful act from regulatory correction.

CareFirst and Mr. Jews argue that this case should not be used to re-litigate the conversion debacle. Nothing in this order should be so construed. That does not mean, however, that the conversion transaction and its aftermath are irrelevant. Those events, including the regulatory and legislative responses to the attempted conversion, are the context within which § 14-139(c) was enacted and are undeniably part of Mr. Jews' CareFirst legacy.

III. The Statutory and Regulatory Framework.

The relevant statutory and regulatory framework involves § 14-139(c) and (d), statutory provisions that address directly the issue of executive compensation at CareFirst; the statutory scheme that establishes CareFirst and defines its special character and mission; and the Insurance Commissioner's statutory authority to enforce provisions of the Insurance Article.

A. Section 14-139 of the Insurance Article.

The General Assembly enacted § 14-139(c) and (d) in direct response to the 2003 *Order and Report of the Maryland Insurance Administration Regarding the Proposed Conversion of the CareFirst, Inc. to For-Profit Status and Acquisition by WellPoint Health Networks, Inc.*, MIA No. 2003-02-032 (March 5, 2003) (MIA Ex. 19B). The

Maryland General Assembly passed a comprehensive package of legislative reforms in response to the 250 page report by then Commissioner Larsen.

Section 14-139(c) states,

> A director, trustee, officer, executive, or employee of a corporation operating under this subtitle may only approve or receive from the assets of the corporation fair and reasonable compensation in the form of salary, bonuses, or perquisites for work actually performed for the benefit of the corporation.

Section 14-139(d) gives specific charges to the compensation committee of the board of directors and to the board:

> (d)(1) The compensation committee of the board shall:
>
> (i) identify nonprofit health service plans in the United States that are similar in size and scope to the nonprofit health service plan managed by the board; and
>
> (ii) develop proposed guidelines, for approval by the board:
>
> 1. for compensation, including salary, bonuses, and perquisites, of all officers and executives that is reasonable in comparison to compensation for officers and executives of similar nonprofit health service plans; and
>
> 2. for compensation for board members that is reasonable in comparison to compensation for board members of similar nonprofit health service plans.
>
> (2) The board shall review the proposed guidelines at least annually.
>
> (3) The board shall:
>
> (i) provide a copy of the approved guidelines:
>
> 1. to each officer and executive of the nonprofit health service plan;
>
> 2. to each candidate for an officer or executive position with the nonprofit health service plan;
>
> 3. to each board member of the nonprofit health service plan; and
>
> 4. on or before September 1, 2004, and annually thereafter, to the Commissioner; and
>
> (ii) adhere to the approved guidelines in compensating the officers, executives, and board members of the nonprofit health service plan.
>
> (4) On an annual basis, the Commissioner shall review:
>
> (i) the compensation paid by the nonprofit health service plan to each officer and executive; and

(ii) the base compensation and compensation for attendance at meetings paid by the nonprofit health service plan to board members.

(5) If the Commissioner finds that the compensation exceeds the amount authorized under the approved guidelines, the Commissioner shall issue an order prohibiting payment of the excess amount.

By its terms, § 14-139(c) prohibits the board from "approv[ing]" compensation in the form of salary, bonuses, or perquisites beyond that which is "fair and reasonable . . . for work actually performed." The statute also imposes a corollary duty on officers not to "receive" any compensation beyond that which is permitted by the statute. This deliberate "belt and suspenders approach" – a prohibition on the board's "approving" and a separate prohibition on the executive's "receiving" – makes clear how strongly the General Assembly felt about preventing excessive executive compensation at CareFirst.

Section 14-139(d) separately requires the board to develop annual guidelines for salary, bonuses, and perquisites that are "reasonable in comparison to compensation for officers and executives of similar nonprofit health service plans." CareFirst argues that if its "executive compensation is in line with that paid by similar not-for-profit health plans for similar work, then § 14-139(c) is satisfied." (CareFirst Pre-Hr'g Br. 30.) Mr. Jews joins in this position. By this view, if compensation is comparable, it is fair and reasonable. This conclusion is not supported by the statute, the legislative history, or common sense.

"The cardinal rule of statutory interpretation is to ascertain and effectuate the intent of the Legislature. Statutory construction begins with the plain language of the statute, and ordinary, popular understanding of the English language dictates interpretation of its terminology." *Bowen v. City of Annapolis,* 402 Md. 587, 613 (2007) (*quoting Kushell v. Dep't of Natural Res.,* 385 Md. 563, 576-78 (2005)). Legislation "must be read so that no word, clause, sentence, or phrase is rendered superfluous or nugatory." *James v. Bulter,* 378 Md. 683, 696 (2003). When the plain language is clear, there is no "need to resort to the various, and sometimes inconsistent, external rules of construction, for the Legislature is presumed to have meant what it said and said what it meant." *Tribbitt v. State*, 403 Md. 638, 646 (2008)(internal quotation omitted).

Limiting the definition of "fair and reasonable" to comparable, as CareFirst urges, ignores the structure and the plain language of the statute. By including both subsections (c) and (d), the General Assembly imposed two separate obligations. Only the board has obligations under § 14-139(d), while both the board and the officer (Mr. Jews) have obligations under § 14-139(c). <u>Section 14-139(c) bars Mr. Jews from receiving compensation other than that which is "fair and reasonable . . . for work actually performed" and this bar exists independent of the board's satisfaction (or not) of its duties either under § 14-139(c) or (d).</u> To read the statute as urged by CareFirst (*i.e.* subsection (c) means the same thing as subsection (d)) would render subsection (c) superfluous and would relieve CareFirst's officers of their independent duties under § 14-139(c).

If the board pays compensation in violation of its guidelines, "the Commissioner shall issue an order prohibiting payment of the excess amount." Section 14-139(d)(5). Such a violation is considered an unsound or unsafe business practice under § 14-116 and a violation of the board's statutory duty under § 14-115(c). Again, however, no provision of the statute suggests that a failure on the part of the board to meet its obligations under § 14-139(d) relieves the company's officers of their obligations under § 14-139(c). Nor does a failure on the part of the board deny the Insurance Commissioner authority to prohibit an officer of CareFirst from breaching his/her § 14-139(c) obligations.

The CareFirst board failed to develop guidelines as to total post-termination payment amounts. That board failure does not relieve Mr. Jews of his obligation under § 14-139(c) not to receive compensation beyond that which is "fair and reasonable. . . for work actually performed for the benefit of [CareFirst]." Again, this § 14-139(c) obligation is imposed on all directors, trustees, officers, executives, and employees, while § 14-139(d) imposes obligations only upon the board and its compensation committee.

The legislative history, "although unnecessary to consider because the plain language of the statute is unambiguous," does not support CareFirst's argument. *Tribbitt,* 403 Md. at 649. As CareFirst has pointed out, an early draft of the legislation contained what would have been only an amendment to § 14-115 to include language similar to current subsection (d). *House Bill 1179, First Reading*, at 13 (2003). But that is not the direction taken by the General Assembly. Instead, the General Assembly enacted a revision to § 14-139 that included both subsections (c) and (d).

The logical (or common sense) flaw in the contention that "comparable" equals and satisfies "fair and reasonable" is that it would authorize CareFirst to pay "comparable" compensation even when such compensation was demonstrably not "fair and reasonable." If, for example, a comparability study showed that CEOs at nonprofit health plans similar to CareFirst were being paid $20 million per year, CareFirst, by the logic that "comparable" equals "fair and reasonable," would be authorized to pay its CEO $20 million per year despite (1) the "fair and reasonable" limitation of § 14-139(c), (2) the impact on the company of paying a CEO at that level, and (3) the inconsistency between CareFirst's mandated statutory nonprofit mission and paying a CEO a salary of $20 million. The General Assembly never intended that absurd and unsound result. That, however, is a possible result if CareFirst's argument were accepted.

The proper interpretation of the relationship between § 14-139(c) and (d) is that each creates independent and distinct, albeit not unrelated, legal obligations. Compliance with § 14-139(d)'s comparability standard is necessary, but not sufficient to comply with § 14-139(c)'s requirement that compensation be "fair and reasonable...for work actually performed" for the benefit of CareFirst.

B. The special legal status, character, and obligations of CareFirst.

CareFirst is a unique health care insurer with a legally mandated nonprofit mission. CareFirst traces its roots to the Associated Hospital Service of Baltimore, which was formed as a nonprofit corporation by the General Assembly in 1937. Its mission was to operate a "nonprofit hospital service plan" at "minimum cost and expense" to its subscribers. *Laws of Maryland, Chapter 224* (1937). It became the Maryland Hospital Service, Inc. in 1947. In 1950, a group of physicians formed a nonprofit health plan called Maryland Medical Service, Inc. In 1973, these groups became Blue Cross of Maryland and Blue Shield of Maryland, respectively, and then consolidated in 1985.

CareFirst of Maryland, Inc. was created in 1997 though the combination of Blue Cross and Blue Shield of Maryland, Inc. and a federally chartered nonprofit, Group Hospitalization and Medical Services, Inc.

CareFirst is a "nonprofit health service plan" exempt from taxation and subject to extensive government regulation. Section 14-101, *et seq*. Its mission, as articulated by the General Assembly, includes "provid[ing] affordable and accessible health insurance" to its members. Section 14-102(c). The General Assembly directed that the primary function of members of CareFirst's board of directors is "ensuring that the corporation effectively carries out [its] nonprofit mission." Section 14-115(c)(3)(i). Board members and corporate officers must act in the best interest of the company and in furtherance of its statutory mission. Sections 14-115(c); 14-115.1(b).

The General Assembly reaffirmed CareFirst's long standing nonprofit mission through the 2003 reform legislation. A significant part of this legislation deals with the issue of controlling executive compensation. Sections 14-115.1(b)(2); 14-116; 14-139(c)-(d). This legislation was adopted in response to the corporation's attempts to convert from a nonprofit to a for-profit business.

C. The Insurance Commissioner's enforcement authority.

The Insurance Commissioner has authority under § 2-108 to enforce all provisions of the Insurance Article. This authority extends to the "authority expressly conferred on the Commissioner by or reasonably implied from [the Insurance Article]." Section 2-108(1). This broad authority includes authority to enforce all statutory provisions relating to CareFirst's obligations to satisfy its nonprofit mission and with respect to executive compensation. The Commissioner has similarly broad authority to "conduct any investigation or hearing" necessary to enforce subtitle 1 of Title 14 (relating to nonprofit health service plans). Section 14-124(a).

IV. <u>Findings of Fact</u>.

The following facts, all of which were proven by at least a preponderance of the evidence (as many of the relevant facts in this case are undisputed), are hereby found to be true and provide the basis for the conclusions reached in this order.

A. Mr. Jews' employment and compensation at CareFirst.

1. Mr. Jews is hired at BlueCross.

After holding a number of senior and very responsible positions in the health care field, Mr. Jews was recruited in 1993 to become the president and CEO of the entity then known as BlueCross and BlueShield of Maryland ("BlueCross"), which is now CareFirst. CareFirst holds a certificate of authority to operate in the state.

In 1993, Mr. Jews and BlueCross entered into a three year employment agreement. (J. Ex. 20.) That contract provided that Mr. Jews would receive an annual base salary of $379,000.00 plus bonuses (a minimum of $75,000.00 the first year, plus eligibility for an addition $50,000.00), plus other benefits. Mr. Jews' 1993 contract was modified and extended several times. (J. Exs. 21-27.) On November 23, 2003, *i.e.*, after the effective date of § 14-139(c), the CareFirst board again extended Mr. Jews' contract. (J. Ex. 26, letter from board chair to Mr. Jews advising Mr. Jews of the board's determination to extend his contract.)

Mr. Jews' annual salary increased substantially over the 13 years he was CEO (1993-2006). By the time of Mr. Jews' termination in November 2006, his annual base salary was approximately $1 million, plus substantial bonuses. His total gross income in 2006 was more than $2.5 million. In the years 2001-2006, Mr. Jews' total annual gross income ranged from $2.5 million to in excess of $3 million. (J. Ex. 125 at 2.)

2. *Mr. Jews' record at CareFirst.*

By all relevant measures, including customer service and financial performance, BlueCross was in bad shape when Mr. Jews started as its CEO. There is no dispute that the company's performance improved dramatically while Mr. Jews was CEO. Mr. Jews deserves and has received substantial credit for this improvement. Mr. Jews was compensated well for the progress that the company made under his leadership. *See* § IV.A. 3, *infra*.

Without diminishing in the slightest Mr. Jews' accomplishments while CEO, his record of executive leadership was a decidedly mixed one. He cannot fairly receive credit (as he deserves and as CareFirst gives him and as Mr. Jews claims) for the many accomplishments and improvements at CareFirst during his 13 years as CEO and simultaneously avoid responsibility for the enormous troubles and public wrath visited upon the company during those years. As CEO, Mr. Jews gets a large share of responsibility for both the good and the bad.

The event that casts a long shadow over Mr. Jews' tenure is the attempted conversion of CareFirst to a for-profit entity. Mr. Jews asserts that he pursued that transaction with the knowledge and support of the board and, therefore, he should not shoulder responsibility for the transaction's rejection. As CEO, Mr. Jews cannot escape accountability for the failure of a major corporate strategic initiative of which he was the champion. Similarly, Mr. Jews cannot escape accountability for the public and political firestorm which surrounded and followed the attempted transaction. As the chief executive officer, Mr. Jews was the captain of the CareFirst ship.

The Insurance Commissioner rejected CareFirst's proposal to convert to a for-profit entity and be acquired by WellPoint Health Networks, Inc. (MIA Ex. 19A.) The Commissioner's reasons are detailed at great length in his report on the conversion (MIA Ex. 19B) and only a few key points require mention here. Among the Insurance Commissioner's reasons was the huge bonuses that CareFirst executives, including Mr. Jews, would receive if the transaction closed. (MIA Ex. 19B at 128-133.) The applicable section of the Commissioner's report is titled "the role of money in the decision to convert and select partner." (MIA Ex. 19B at 128.) The Commissioner found as a fact that "the bonuses became <u>nothing more than a ransom</u> that had to be paid by an Acquiror . . ." *Id.* at 133 (emphasis added). The overreaching demands of CareFirst's executives, including Mr. Jews, was a major failure on Mr. Jews' watch. (MIA Ex. 19B at 133, testimony of WellPoint's CEO: "Mr. Schaefer made clear that it was only through the agreement to pay the executive bonuses that WellPoint would be granted the privilege of purchasing CareFirst"; *id.*, "he described the bonuses as a take it or leave it proposition, meaning that without the payment of the bonuses the deal could not be consummated.")

The General Assembly endorsed these and other findings of the Insurance Commissioner when it enacted reform legislation in 2003. Chapter 356 of the Laws of 2003 includes a series of "whereas" clauses that refer directly to the conversion proceedings and the Insurance Commissioner's rejection of the attempted conversion. (J. Ex. 145.) Of direct relevance here is the following: "WHEREAS, the Insurance Commissioner found that the management of CareFirst sought, and the Board of Directors approved, large bonuses and permanent roles for current management in the combined company and these bonuses created incentives that conflicted with the nonprofit mission of CareFirst." (J. Ex. 146, Ch. 357, Laws of 2003.)

Similarly relevant in completing the picture of Mr. Jews' tenure at CareFirst is the established fact that under his leadership the company strayed significantly from its statutory nonprofit, public purpose mission. This deviation from its statutorily mandated mission was another of the findings in the Insurance Commissioner's report rejecting the WellPoint transaction. (MIA Ex. 19B at 95-103; *id.* at 95, "analysis of CareFirst's decision to abandon its nonprofit mission.") Again, the General Assembly endorsed these findings when it enacted the 2003 reform legislation. (J. Ex. 145, Ch. 356, Laws of 2003, "WHEREAS, the Insurance Commissioner found that the management and Board of Directors of CareFirst did not view their nonprofit mission as restraining or guiding their business activities."); (J. Ex. 146, Ch. 357, Laws of 2003 noting that CareFirst had exited certain markets "resulting in over 6,000 individuals losing their health insurance.")

The extent to which the company strayed from its mission is detailed separately in a lengthy report to the General Assembly in 2003 by the Insurance Commissioner who followed the Commissioner who rejected the conversion transaction. (MIA Ex. 23 at 35-38; *id.* at 36, "The Conversion Report notes that the Chief Executive Officer and the Chairman of the Board declared that the corporation would be operated for-profit. Those declarations, alone, are sufficient to find a probable violation of the Insurance Article in the operation of CareFirst.") The Commissioner found that CareFirst's "withdrawal from markets that represent [provide coverage for] the most vulnerable and poorly served segments of the population <u>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</u>." (MIA Ex. 23 at 36 (emphasis added).) Failure to consider its nonprofit mission is about as severe a charge as the Insurance Commissioner could level at CareFirst given that pursuit of that mission is the company's reason for being. *See* § 14-402(c) (identifying the elements of the nonprofit mission of CareFirst); § 14-102(d) (CareFirst shall develop "goals, objectives, and strategies" to carry out its statutory mission).

While not admitting to the allegations in the Commissioner's Legislative Report, in September 2005, CareFirst did enter into a Consent Order with the Insurance Commissioner to resolve the issues in the report. (MIA Ex. 25.) In that Consent Order, CareFirst agreed to "make equal payments totaling $225,000.00 to MEDBANK of Maryland, the Maryland Mental Health Association of Maryland, and the Maryland Association of County Health Officers . . ." *Id.* at 10.

In sum, Mr. Jews' tenure was marked by both great success and great failure. He was a mixed blessing for CareFirst and the public it is to serve.

3. *Mr. Jews' compensation while employed at CareFirst.*

For the last six years of Mr. Jews' employment at CareFirst, 2001-2006, his annual gross income was as follows:

2001 - $2,703,144.68

2002 - $2,775,477.58

2003 – $3,034,332.76

2004 - $2,933,717.45

2005 - $2,518,835.08

2006 - $2,576,499.62

(J. Ex. 125 at 2.) <u>Thus, over these six years, Mr. Jews was paid in excess of $16.5 million</u>. This sum does not include more than $1.6 million of deferred payment under the company's Long Term Incentive Plan.

The components of Mr. Jews' annual compensation were base salary, incentive bonus payments (both annual and long term incentive bonuses), fringes, and a gross up to cover taxes on some of the fringe benefits. For example, his total compensation in 2005, the last full year of Mr. Jews' employment at CareFirst, exceeded $2.5 million and was comprised of the following elements:

Base salary - $975,000.00

Annual Incentive - $915,744.00

Long Term Incentive - $733,811.00

Less deferred portion of long term incentive – ($220,143.00)

Fringes and gross up - $114,423.08

Total gross income - $2,518,835.08

(J. Ex. 125.)

Mr. Jews' compensation <u>while employed</u> is of direct relevance to the issues in this case as that compensation establishes that he was compensated extremely well along the way. Part of the analysis of the company's plan to pay Mr. Jews almost $18 million upon his termination must include reference to the very substantial prior payments that Mr. Jews received. This is <u>not</u> a case where a large payment at termination can be explained, let alone justified, on the ground that it is compensation for a previously underpaid employee. Mr. Jews was paid well; he was not underpaid.

The undeniable fact is that executive compensation during the Jews Era was a matter of central, if not obsessive, concern at CareFirst. The compensation cornucopia that is Mr. Jews' contract is remarkable for its extent, variety, and richness. (J. Ex. 22; 125.) This rich cornucopia was provided to the CEO of a state chartered not–for–profit health plan designed and intended to advance the mission of providing access to affordable health insurance. This obsession with executive compensation is confirmed by the central (and inappropriate) place that executive bonuses played in the doomed conversion transaction.

There was considerable testimony regarding the design, implementation, and complexities of CareFirst's compensation system, particularly the company's Annual Incentive Plan ("AIP") and its Long Term Incentive Plan ("LTIP"). It is unnecessary to go into the details of those plans here. It is sufficient for present purposes to note and to find as facts that (1) CareFirst had elaborate incentive plans and (2) those plans gave considerable weight to the financial performance of the company. Neither proposition is in dispute.

One of CareFirst's post-2003 compensation advisers, Professor Brian Hall of the Harvard Business School, expressed concern about the weight given to the company's financial goals. In notes of Professor Hall's meeting with the company's executive compensation committee in June 2004, the following observations are attributed to Professor Hall: "All of CareFirst's documents on executive performance measures – particularly the long term incentive plan – are weighed primarily to sets of financial goals. This requires a good look to see if the measures being used reflect all the goals of the Company." (J. Ex. 69 at 2.)

CareFirst did not call Professor Hall as a witness to elicit his opinion on the question of whether paying Mr. Jews $18 million upon his termination was "fair and reasonable" or consistent with the company's mission. In fact, CareFirst now seeks to put some distance between itself and Professor Hall's observations. Professor Hall's observations are, however, persuasive for many reasons not the least of which is he was the only adviser hired and consulted by the board or its compensation committee who made a serious effort to evaluate CareFirst's compensation system in the context of the company's nonprofit mission.

CareFirst must, of course, be concerned about financial performance and that concern is properly a part of the company's compensation structure. CareFirst is in the insurance business and must be solvent to pay claims and must have a surplus to manage unexpected changes in the market and to improve its infrastructure. That said, the evidence in this case establishes, as Professor Hall observed, CareFirst's performance measures were "weighted primarily to sets of financial goals." The evidence further establishes that CareFirst's emphasis on financial performance was at the expense of attention to its public purpose mission. This lack of balance is evident, for example, in the company's effort under Mr. Jews' leadership to increase the company's profitability to improve its attractiveness as an acquisition by a for-profit entity and is, as well, entirely consistent with the company's "lack of consideration of its nonprofit mission in adopting a strategic plan." (MIA Ex. 23 at 6.)

4. Mr. Jews' mixed record of performance did not hurt his compensation.

As detailed above, Mr. Jews was compensated well as CareFirst's CEO. The finding made in this section – a finding for which there is overwhelming evidence (to say nothing of a preponderance of evidence) – is how the problems at CareFirst, problems for which Mr. Jews as the CEO bears significant responsibility, did not hurt Mr. Jews' compensation.

The post-2003 board, the board in place following the disaster that was the failed conversion transaction, was unwilling to broach the subject of changing Mr. Jews' contract. The testimony of board member Mr. Michael Kelly is that the post-2003 board did not even conduct a review of Mr. Jews' performance in connection with the events that were the impetus for the 2003 reform legislation. (Hr'g Tr. 1010:16-1011:2; 1011:6-8, "the board, I think, [it] is fair to say was incapable of having that type of discussion at that time.") Unable to review Mr. Jews' performance in connection with the conversion transaction, the board similarly did not attempt to negotiate a different and less rich employment contract with Mr. Jews. (Hr'g Tr. 1016:6-19.) Mr. Wayne Rogers, another board member went a step further and testified that neither the CareFirst board nor a representative of the board so much as "consider[ed] renegotiating" Mr. Jews' employment contract. (Hr'g Tr. 1215:7-13.) That contract was, of course, the principal driver of Mr. Jews' compensation.

Mr. Jews testified as to the lack of substantive difference between the actions of the pre-2003 and the post-2003 boards. (Hr'g Tr. 1389:3-19, "I was more pleased that the result of that [the activities of the post-2003 board] ended up being the same result as the other board had come to.") In fact, Mr. Jews testified that until the hearing in this case he had no understanding that the compensation review of the post-2003 board was in response to the new statute. (Hr'g Tr. 1389:20-1390:3.) Sadly, Mr. Jews' perception that post-2003 that it was all just business as usual is accurate.

One of the most remarkable pieces of testimony in this case is Mr. Kelly's response to the question of whether the post-2003 board, at the outset of its tenure, reviewed Mr. Jews' prior performance:

> The witness [Mr. Michael Kelly]: The answer is no. And, yes, in terms of the number of very emotional statements about [the] quality of the Maryland legislator (sic) [should read "legislature"].
>
> *   *   *   *   *
>
> The witness: [These statements about the legislature were] not altogether positive . . . .

(Hr'g Tr. 1010:16 – 1011:5.)

This testimony demonstrates that the board had little understanding of its role or obligations, starting with its obligations to the General Assembly. Rather than evaluating the CEO, this board of a specially chartered nonprofit health insurer spent time, according to the chair of the compensation committee, complaining about the "quality" of the Maryland legislature. Those complainants are notable both for their arrogance and their irrelevance because, to state the obvious, the General Assembly directs the CareFirst board, not *vice versa*.

There is some evidence, specifically testimony from Mr. Kelly, and argument from CareFirst's counsel about post-2003 divisions within the board and the former board members' resentment of the "intrusion" of the General Assembly by, for example, adding new board members to the board. This evidence and argument were offered by way of attempted explanation for the board's undeniable failure to take a firmer hand in its dealings with the CEO and his compensation. Even accepting as true this proffered factual explanation for the board's inaction, it does not change the board's legal obligations. The board's anger, if that is what it was, at the General Assembly for "interfering" in CareFirst's business does not relieve the board of its obligation to follow the law as the General Assembly enacts it. Anger is not a recognized defense to defiance of the law. Further, as is discussed below in the "conclusions of law" section, the board's default (whatever the reasons for that default) cannot go unaddressed and warrants regulatory correction.

Remarkably, the undisputed facts are that a majority of the compensation committee (and ultimately the full board) determined that Mr. Jews <u>should be rewarded</u> for "hold[ing] the company and the leadership together during a difficult year [2003] in terms of negative press and legislative action against CareFirst by the Maryland General Assembly." (J. Ex. 66a.) Rather than being held responsible, let alone blamed, for leading the company to the very brink of disaster, Mr. Jews was rewarded for "hold[ing] the company and leadership together." That is an exceedingly odd incentive system, a system analogous to decorating an infantry officer for managing a hasty retreat while not examining the officer's strategic blunders which made the retreat necessary.

The compensation committee of the CareFirst board reviewed Mr. Jews' performance in 2003 and determined that "no increase to the CEO's base pay of $975,000.00 is appropriate at this time," <u>but</u> that he should receive "a 50% increase over the non-discretionary payout of $717,868.00, *i.e.*, a performance adjustment of 150% to the annual incentive payout, bringing a total annual incentive payout to the CEO of $1,076,802.00." (J. Ex. 66a.) Two committee members, Mr. Kelly and Mr. Merson, dissented from the recommendation to increase the incentive payout. (Hr'g Tr. 992:21-993:16, testimony of Mr. Kelly, "we [Mr. Merson and I] disagreed quite profoundly" that things had gone very well in 2003.) While the minutes of the full board reflect that it adopted both of the committee's recommendations, *i.e.* not to increase Mr. Jews' base pay while increasing to 150% his non-discretionary payout (J. Ex. 68 at 4), Mr. Jews' base salary for 2004 was, in fact, increased from $960,576.95 in 2003 to $1,012,500.00 in 2004 (J. Ex. 125 at 2).

In sum, Mr. Jews prospered despite the company's woes. The board did not hold Mr. Jews accountable for those woes; instead, at least some board members found it relevant and productive to complain about the General Assembly; Mr. Jews' compensation was not diminished as a result of the company's deep problems; and in 2003 and 2004, in the immediate aftermath of the conversion debacle, Mr. Jews received his highest level of compensation in his final six years of employment ($3,034,332.76 in 2003 and $2,933,717.45 in 2004). (J. Ex. 125 at 2.)

5. Mr. Jews is terminated.

In late October 2006, Mr. Jews was asked to meet with the chairman of the CareFirst board, Mr. Merson, and another board member, John Colmers. (Hr'g

Tr.1337:7-16.)[3] Mr. Jews testified that he was then told that "the board had made a decision that it was time to make a change" in CEO leadership. (Hr'g Tr.1337:20-21.) Mr. Jews further testified that he was told that the board's action was precipitated by the "residual impact," including [negative] newspaper articles about the company. (Hr'g Tr.1337:21-1338:13.) Following that meeting, Mr. Jews made a written appeal to Mr. Merson dated October 31, 2006. (J. Ex. 28.) In his appeal, Mr. Jews stated his desire to avoid termination and to remain as the CEO or, at a minimum, to delay his departure until March 31, 2007. *Id.*

The board rejected Mr. Jews' plea. On November 1, 2006, the CareFirst board "determined it to be in the best interest of the Corporation to terminate William L. Jews as the Chief Executive Officer and President of the Corporation" and, accordingly, terminated him on that date "without cause" as that term is defined in Mr. Jews' contract. (J. Ex. 29.) While the termination was "without cause" as a matter of law, the board had solid reasons for its action. The board's reasons, as expressed by the chairs of the Maryland and District of Columbia companies and as stated in the minutes, were Mr. Jews' performance "over the last several years," "the lack of leadership the CEO has displayed," "several specific instances where insufficient information has been provided to the Board regarding significant projects," and Mr. Jews' inability to lead the new effort

[3] The hearing transcript states that he was asked to meet with Mr. Merson and "John Holman." The reference to "Holman" is a transcription error. The undisputed testimony is that Mr. Jews met with Mr. Merson and Mr. Colmers.

to establish new partnerships "because of the failure of the WellPoint transaction." (J. Ex. 29.) The minutes continue:

> The Chairs of each of the Boards [of the Maryland and District of Columbia companies] then summarized their concerns with the CEO's performance over the last several years and all stressed the lack of leadership the CEO has displayed which is becoming more crucial as the companies embark on a new vision and long-term strategic plan. The Chairs also discussed several specific instances where insufficient information had been provided to the Board regarding significant projects. The Board, in those instances, needed to take action on its own to gather the information which in turn led to changes in direction and in the final decisions being made. The chairs also expressed a concern that as the company begins to look at the potential for new partnerships, the current CEO is incapable of leading that effort because of the failure of the WellPoint transaction.

Id.

As board member Mr. Kelly testified, the above-quoted paragraph is a "responsible summary" of the board's reasons for terminating Mr. Jews. (Hr'g Tr. 996: 3-7.) Mr. Kelly amplified on that summary and testified that "post-2003 he [Mr. Jews] didn't seem to have a vision for the company that accommodated the variety of tensions that we faced both internally and externally." (Hr'g Tr. 996: 10-13.) Mr. Kelly agreed that "there was a lack of leadership by the CEO." (Hr'g Tr. 997: 13-15.)

It is noteworthy that the first mentioned reason for the board's action terminating Mr. Jews was "concerns with the CEO's performance <u>over the last several years</u>." (J. Ex. 29 (emphasis added).) This board concern was not reflected in the board's passive *status quo* treatment of Mr. Jews "over the last several years" by, for example, the board's failure to evaluate his performance in connection with the conversion transaction; the board's failure to attempt to negotiate a new contract with Mr. Jews; and the board's failure to restrain, instead of increasing, Mr. Jews' compensation.

In summary, the facts regarding Mr. Jews' tenure as CareFirst's CEO, all proven by a preponderance of the evidence, are that Mr. Jews served for 13 years as the CEO of CareFirst (or its predecessor); his tenure was marked by numerous substantial successes and also by some substantial and highly public failures; Mr. Jews was compensated very well over the years of his employment; the very substantial failures at the company during Mr. Jews' tenure did not hurt Mr. Jews' compensation; for three years, the post-2003 board took a "hands off" *status quo* approach in its dealings with Mr. Jews, his contract, and his compensation; the post-2003 board did not, for example, evaluate Mr. Jews' performance in connection with the events that pushed the company to the brink; the post-2003 board never even considered negotiating a new contract with him; in 2006, Mr. Jews was terminated, against his wishes, "without cause" as defined in his employment contract; and the board had substantial and documented reasons for terminating Mr. Jews and those reasons related to his performance over several years, including his management style, specifically his failure to keep the board informed, his lack of vision for the company, and his inability to lead the company as it looked for new strategic partnerships.

B. CareFirst's proposed payment to Mr. Jews upon termination.

The facts are not in dispute as to (1) the post-termination amounts allegedly due to Mr. Jews under his contract, (2) the amounts actually paid to Mr. Jews since his termination up to April 28, 2008 (the start of the hearings in this case), and (3) the difference between (1) and (2), which is the amount unpaid as of April 28, 2008, excluding interest. The parties agree that the contract terms as applied to the facts call for CareFirst to pay Mr. Jews a total of $17,970,162.00. The parties further agree that between November 1, 2006, the date of Mr. Jews' termination, and April 28, 2008, Mr. Jews received $2,281,021.00, leaving an unpaid amount of $15,689,141.00. (J. Ex. 125.)

The largest single component of Mr. Jews' post-termination payments involves payments under the company's Supplemental Employee Retirement Plan ("SERP"). The proposed SERP payment is in excess of $9.7 million, none of which has yet been paid. Other significant components of the company's proposed payment to Mr. Jews are continuation for three years of his base salary (total $2,925,500.00 of which $1,451,250.00 had been paid as of April 28, 2008); payment of outstanding grants under the Long Term Incentive Plan ($1,150,000.00 none of which has yet been paid); and deferred LTIP payments ($2,437,712.00 none of which has yet been paid). There are, as well, relatively modest (by comparison) amounts for continuation of benefits for three years ($191,011.00); payment for unused leave ($61,875.00); and benefits under employee benefit plans ($684,537.00 all of which have been paid). (J. Ex. 125.)

C. The comparability of compensation paid Mr. Jews and that paid to executives at similar entities.

Section 14-139(d)(1) directs CareFirst's board to identify nonprofit health service plans in the United States "similar in size and scope" to CareFirst and to develop compensation guidelines for compensation of CareFirst executives that compensates them on a basis "that is reasonable in comparison to compensation for officers and executives of similar nonprofit health service plans." The board developed compensation guidelines following the enactment of § 14-139(d) (J. Ex. 45) and, indeed, the Board had guidelines prior to the enactment of that statute (J. Ex. 44). <u>The board did not develop guidelines as to termination payments</u>.

The post-2003 board engaged a new compensation consultant, the firm of Price Waterhouse Coopers ("PWC"), and specifically Mr. Scott Olsen of that firm, to identify companies comparable to CareFirst and to do a study of the compensation policies at those companies and to compare them to CareFirst. (J. Ex. 90B.) Mr. Olsen testified that CareFirst's annual incentive plan was comparable to that used by entities similar to CareFirst. (Hr'g Tr. 764:6-20; 766:4-14.) Mr. Olsen testified to the same effect with respect to the company's long term incentive plan. (Hr'g Tr. 767:17-769:6; 781:6-20.) Mr. Olsen also testified that CareFirst's supplemental retirement plan was comparable to that used at similar entities. (Hr'g Tr. 790:1-12.) Similar testimony was provided by Mr. Christopher McGee of Mercer Universal Consulting. (Hr'g Tr. 1032:14-1105:4; J. Ex. 110.) Mr. McGee was not a consultant to CareFirst, but a testifying expert hired by counsel for CareFirst.

As of Mr. Jews' termination on November 1, 2006, PWC had not issued its report on comparable SERP practices and PWC did not do so until March 2007, long after Mr. Jews' involuntary exit. That belated report does not purport to compare post-termination payments. Rather, the report (titled "Severance and SERP Practices in the Not-for-Profit

BlueCross BlueShield Health Insurance Industry Survey") is an analysis of the comparability of contract terms as they relate to severance and SERP provisions. (J. Ex. 109).

The proposed SERP payment to Mr. Jews of $9.7 million is more than 50% of the entire proposed post-termination payment. When the CareFirst board decided on or about November 1, 2006, that it would pay that substantial sum to Mr. Jews, it had no basis for deciding that the terms of its SERP were comparable to those of similar entities (as PWC had yet to do its report on that subject) and the board had no basis for deciding that the compensation was "fair and reasonable" (as no report on that subject was ever prepared).

Mr. Olsen took a series of not altogether consistent positions on the feasibility of doing a study that compares SERP or total post-termination payments to similar payments to executives of companies similar to CareFirst. When he was first asked if it was "feasible" to do an analysis of "the total amount of what a severance package would be," he responded "[w]ell, I think it is feasible," and then he went on to qualify his answer by saying that "it's important to characterize what you want to benchmark in terms of determining the feasibility." (Hr'g Tr. 790:13 – 792:4.) A few pages later, Mr. Olsen testified that "it is relatively difficult to benchmark that [total SERP payments] against the same competitive set." (Hr'g Tr. 794:6 – 8.) He then testified that "I don't believe it's practical to benchmark it [the entire post-termination package] against competitive practice." (Hr'g Tr. 795:20 – 796:1.) And finally, despite the stated impracticality of doing a comparative study of the total post-termination payments and, indeed, having never prepared such a report for the CareFirst board, Mr. Olsen, when asked directly, expressed the view that the proposed $18 million payment to Mr. Jews is "a big number, [but] it does appear to be consistent with competitive practice." (Hr'g Tr. 918:8-9.) This opinion was offered without a factual basis.

CareFirst's evidence on comparability was challenged on limited points. The MIA challenged the notion that the proposed payment of a year of base salary for a year beyond the contractual two year non-compete restriction that applied to Mr. Jews (for a total of three years of post-termination salary) was typical in the industry. (Hr'g Tr. 514:2–515:9; 516:21–519:12; 520:21–521:7.) The evidentiary basis for this objection was the PWC study. (J. Ex. 109; Hr'g Tr. 515: 3-16.) The MIA also objected to the third year payment because it was beyond the term of the non-compete and, therefore, "not for work actually performed." (Hr'g Tr. 516:9–13.) MIA also found the continuation of perquisites and the tax gross up payments "to be totally out of line" with industry practice. (Hr'g Tr. 533:1–536:3.)

The preponderance of the evidence supports the MIA's position that payment of the third year of post-termination base salary and the continuation of perquisites and the tax gross up payments are <u>not</u> "fair and reasonable" as they are <u>not</u> comparable to payments received by CEO's at entities similar to CareFirst. The MIA's position on the lack of comparability of these aspects of Mr. Jew's compensation is strengthened by the MIA's sound critique of the small sample size used by PWC to do its comparability analysis, particularly because the validity of that small sample was skewed by PWC's inclusion of CareFirst itself in the sample. To a large degree, PWC was simply comparing CareFirst to itself to reach the conclusion that CareFirst was "comparable."

Nevertheless, the preponderance of the evidence supports a finding that, in the main, the elements of the post-termination package are comparable to the compensation arrangements at entities similar to CareFirst. That is, however, the start of the analysis, not the end. Moreover, the board had no basis for its decision at the time of Mr. Jews' termination that paying Mr. Jews nearly $18 million was lawful.

D. Note on compensation consultants.

The testimony of the chair of the CareFirst board's compensation committee, Mr. Kelly, showed that the committee and the board relied heavily on the advice and reports of hired compensation consultants. Because CareFirst may continue this practice, a few cautionary observations are appropriate. (These comments are unrelated to CareFirst's counsel's hiring of such consultants as experts in this or any future case.)

Compensation consultants, even if they are from prominent firms, are no substitute for the board's duty to meet its fiduciary and statutory obligations. It is the board that has these legal responsibilities. The board cannot avoid its obligations by hiding behind a consultant or his report. Corporate compensation consultants are hired by corporate boards or management. The corporate compensation consulting business involves telling boards and management that executives in corporations make lots of money and, therefore, it is both permissible and perhaps even necessary for the consultant's current client to pay its executives similarly large salaries, bonuses, and perquisites. The methodology of the compensation consulting business fosters a perverse group think: others have jumped over the cliff, so you can (perhaps should) do likewise. There is no evidence in this case that compensation consultants restrain executive compensation.

V. Conclusions of Law.

A. The Insurance Commissioner is authorized and, indeed, required to determine whether the proposed post-termination payment to Mr. Jews is lawful.

CareFirst argues that deference is due to the judgment of the CareFirst board in approving a nearly $18 million post-termination payment to Mr. Jews and, accordingly, the board's decision to make that payment should not be disturbed. (CareFirst's Post-Hr'g Br. 4-6.) There are multiple defects in this argument. First, as a matter of fact, the board defaulted in its obligation to control the CEO's compensation. As detailed above, the post-2003 board did not evaluate Mr. Jews' performance in connection with the conversion debacle; the board did not attempt to negotiate a new contract with Mr. Jews; the board increased Mr. Jews' incentive compensation in the aftermath of the rejection of the conversion transaction; the board never developed post-termination compensation guidelines; and the board never did a comparability or other fact-based study to determine that the total proposed post-termination payment to Mr. Jews was "fair and reasonable." The exercise of regulatory oversight in this case does not, therefore, involve an invasion of the board's prerogative because the board abdicated its responsibility.

Case law in a variety of contexts recognizes that it is proper for regulatory or judicial authority to step in where, as here, there is a failure on the part of the legally responsible party to meet its responsibilities. *See, e.g., Adventist Health Care, Inc. v. Maryland Health Care Comm'n,* 392 Md. 103, 129 (2006) (Health Care Commission has authority to review hospital's decision regarding the relocation of an exiting cardiac surgery program); *Swann v. Charlotte-Mecklenburg Bd. of Ed.*, 402 U.S. 1, 15 (1971) (when school authorities fail in their affirmative obligations under school desegregation laws, judicial authority may be invoked); *U.S. v. Pan American World Airways, Inc.*, 371 U.S. 296, 311-12 (1963) (Civil Aeronautics Board has power to review discretionary decisions regarding a company's business practices); *Federal Maritime Bd. v. Isbrandtsen*, 356 U.S. 481, 491-92 (1958) (federal regulators have the authority to prohibit contractual agreement among and between members of industry that stifle competition of carriers).

The alternative to regulatory action in this case (or in any case in which the regulated entity fails to meet its obligations) would allow inaction to become the final word. Failure to act would become "the law" even if, as here, the actual law, as enacted by the General Assembly, required action. No principle of corporate or other law supports the notion that CareFirst's failures to act repeal §§ 14-139(c) and (d).

The Insurance Article authorizes regulatory action to assure that the goals of insurance regulation are met. The Commissioner's authority includes authority that is "reasonably implied" from the Insurance Article to regulate the insurance industry.

Section 2-108(1). The Commissioner has the authority, for example, to conduct investigations "necessary to fulfill the purpose" of the Insurance Article, § 2-108(4), and the Commissioner may examine the affairs of an insurer "whenever [he] considers it advisable." Section 2-205(a). With respect to nonprofit health service plans, the Commissioner has the authority to "conduct any investigation or hearing" necessary to enforce subtitle 1 of Title 14, § 14-124(a), and he has the same powers with respect to nonprofit health service plans "as are granted to the Commissioner under Titles 2 [General Provision] and 4 [Requirements for Insurers] of this article with respect to <u>any other activity</u> regulated under this article." Section 14-124(a)(2) (emphasis added).

In 2003, the General Assembly made the regulation of executive compensation at CareFirst a prominent part of Maryland's overall insurance regulatory scheme. The company's board was charged with the affirmative duty to approve only "fair and reasonable" executive compensation (§ 14-139(c)) and the board was charged with the affirmative duty to develop and implement compensation guidelines (§ 14-139(d)). The board never developed guidelines on termination payments and had no factual basis for determining that an $18 million post-termination payment was "fair and reasonable."

Even if the board had met all of its responsibilities (which it did not), that would not immunize the board's judgment from regulatory scrutiny. The decision of the Court of Appeals in *Insurance Comm'r v. Prop. and Cas. Ins. Guar. Corp.*, 313 Md. 518 (1988) is instructive. There, the Property and Casualty Insurance Guaranty Corporation ("PCIGC") argued that the determination and denial of claims falls within the sole discretion of an insurance company. *Id.* at 523. PCIGC argued that the Commissioner did not have the authority to order it to make payments to an insured because in doing so the Commissioner would be substituting his judgment for that of the insurance company. *Id.* PCIGC argued it had "exclusive authority, independent of the Insurance Commissioner," over whether to pay personal injury protection ("PIP") benefits to claimants whose PIP carrier was insolvent. *Id.* CareFirst's present argument echoes the argument made by PCIGC:

> While recognizing that the Commissioner possessed express statutory authority with respect to some limited segments of its operations...he had no authority, express or implied, to <u>insinuate himself in or substitute his judgment</u> for that of the corporation in the matter of claim denials. PCIGC thus contended that its decision not to pay the PIP claims was wholly beyond the reach of the Commissioner's authority.

Id. (emphasis added).

While the Court of Appeals recognized that the Insurance Code does not expressly confer upon the Commissioner the power to order PCIGC to pay claims, the Court found that the Insurance Code, viewed as a whole, empowered the "Commissioner to order an insurance company or an entity acting in place of an insurance company like PCIGC, to pay an entire class of disputed claims." *Id.* at 526. The Court thus recognized that the Commissioner has the duty to "substitute his judgment" for that of the decision-makers when the regulated entity fails to meet its obligations. So, too, here.

CareFirst's present "deference to the board" argument is simply a repackaging of the "business judgment" argument that the company offered (without success) in the conversion proceedings. Insurance Commissioner Larsen answered that argument with great effectiveness in the conversion report and that answer is hereby incorporated by reference. (MIA Ex. 19B at 70-72.) A central point of Commissioner Larsen's answer is that the "business judgment" rule cannot be used to deny or negate regulatory authority. That point applies fully here.

As a matter of law, the Commissioner has authority and, indeed, the obligation to review the proposed post-termination payment to Mr. Jews. Further, if that payment is found to be contrary to law, the Commissioner is authorized and obligated to act to correct that unlawful act.

B. The determination of what constitutes "fair and reasonable" compensation depends upon the facts and circumstances of the case.

As explained above in Section III.A, the "fair and reasonable" requirement of § 14-139(c) is not met merely by showing that the compensation is "comparable" under § 14-139(d); as a matter of law, mere comparability, which largely does exist here at least as to the components of Mr. Jews' compensation package, is not sufficient to satisfy the "fair and reasonable" standard of § 14-139(c). The earlier discussion and conclusion on this point are adopted and here incorporated by reference.

The terms "fair and reasonable" are used commonly in statutes and contracts because they have commonly accepted meanings. "Fair" means "marked by impartiality and honesty; free from self-interest, prejudice, or favoritism." *Merriam Webster Dictionary Online* (2008), http://www.merriam-webster.com/dictionary. "Reasonable" means "being in accordance with reason; not extreme or excessive; moderate, fair. *Id.*

Courts have held consistently that a determination regarding whether something is "fair and reasonable" is a finding of fact. *Independent Distributors, Inc. v. Katz,* 99 Md.App. 441, 457 (1994).

Whether a transaction is fair and reasonable "'is basically a factual determination and the lower court's findings will not be disturbed unless clearly erroneous.'" *Katz,* 99 Md. App. at 457 (*quoting Cummings v. United Artists Theatre Circuit, Inc.*, 237 Md. 1, 26 (1964)). The factual finding of "fair and reasonable" must be made based upon the "peculiar facts and circumstances in each particular case...these facts and circumstances vary so widely that each corporate tub must more or less stand upon its own bottom." *Miller Mfg. Co. v. C.I.R,* 149 F.2d 421, 423 (4th Cir. 1945).

The individual-specific, fact-specific nature of the determination that compensation is (or is not) "fair and reasonable" is confirmed by the testimony of CareFirst's principal compensation consultant, Mr. Olsen. Mr. Olsen testified as to the difficulty, near impossibility in his view, of doing a comparability study as to total post-termination payments and total SERP payments. This testimony is quoted above in Section IV.C. The reason for this difficulty, as Mr. Olsen testified and as CareFirst argued in its closing, is the variety of individual fact situations. "Fair and reasonable" is a question of fact because each case is different.

The undisputed fact is that CareFirst did not do a study that purports to show that the total proposed payment to Mr. Jews is comparable to what a CEO at a similar entity would receive in the event of a similar termination. Whatever the difficulties in doing such a study, it was not done. Mr. Olsen's unsubstantiated opinion that the proposed payment "appear[s] to be consistent with competitive practice" is not a study and provides no factual basis to uphold a payment of $18 million. As noted, the CareFirst board had no "comparability analysis" to support its decision to approve a payment of $18 million.

CareFirst urges that the reasonableness standard applied in making a determination under § 162(a)(1) of the Internal Revenue Code should be applied in making the determination under § 14-139(c). Section 162(a)(1) refers only to "reasonable compensation" and not to what is "fair and reasonable." Nevertheless, the cases interpreting § 162(a)(1) refute, rather than support, CareFirst's position. The § 162(a)(1) cases require consideration of a wide range of factors when determining reasonableness. Deference to a board's decision is only one aspect of a multi-faceted inquiry. The Tax Court applies "a number of factors, none entitled to any specified weight relative to another." *Exacto Spring Corp. v. C.I.R.* 196 F.3d 833, 834 -835 (7th Cir. 1999).

In the case of *Mayson Mfg. Co. v. C.I.R.,* 178 F.2d 115 (6th Cir. 1950), relied upon by CareFirst, the court emphasized the multi-faceted nature of a reasonableness determination. The court did not defer blindly to the company's determination, but rather included the presumption that the company's conclusion regarding compensation was reasonable as one consideration among many. The court noted that a wide range of factors need to be considered:

> Although every case of this kind must stand upon its own facts and circumstances, it is well settled that several basic factors should be considered by the Court in reaching its decision in any particular case. Such factors include the employee's qualifications; the nature, extent and scope of the employee's work; the size and complexities of the business; a comparison of salaries paid with the gross income and the net income; the prevailing general economic conditions; comparison of salaries with distributions to stockholders; the prevailing rates of compensation for comparable positions in comparable concerns; the salary policy of the taxpayer as to all employees; and in the case of small corporations with a limited number of officers the amount of compensation paid to the particular employee in previous years. The action of the Board of Directors of a corporation in voting salaries for any given period is entitled to the presumption that such salaries are reasonable and proper.

Mayson, 178 F.2d at 119. The tax cases underscore the wide scope of a reasonableness determination.

CareFirst has argued that separating "fair and reasonable" from "comparable" creates a problem of standardless review. This argument is wrong. Similarly expansive terms are used throughout the Insurance Article and in other contexts (including in the constitution as the term "due process" illustrates). The Legislature has delegated to the Insurance Commissioner authority to make judgments by applying broad statutory language.

For decades, courts have upheld broad legislative grants of discretionary authority to administrative agencies. *See, e.g., Lichter v. U.S.,* 334 U.S. 742 (1948) (allowed statutory standard of "excessive profits"); *Fed. Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591 (1944) (upheld statutory standard of "just and reasonable"); *Yakus v. U. S.,* 321 U.S. 414 (1944) (sustained a statutory standard of "generally fair and equitable" for administrative agency power to fix commodity prices). Likewise, the Maryland Court of

Appeals has upheld wide latitude in granting discretion to administrative agencies. *Christ by Christ v. Maryland Dep't of Natural Res.*, 335 Md. 427, 445 (1994); *Dep't of Transp. v. Armacost,* 311 Md. 64, 85 (1987); *Dep't of Nat. Res. v. Linchester,* 274 Md. 211, 220 (1975); *accord McDaniel v. American Honda Fin. Corp.*, 400 Md. 75, 91-92 (2007).

Attached and incorporated by reference is Exhibit 2, which contains examples of broad discretionary terms in the Insurance Article. The examples listed in Exhibit 2 are no less broad than "fair and reasonable" and no less valid.

In sum, the four closely related conclusions of law are (1) "fair and reasonable" under § 14-139(c) is a legal requirement independent of comparability; (2) § 14-139(c) imposes substantive legal obligations on CareFirst's board and on its officers and directors; (3) the substantive obligations of § 14-139(c) are not met merely by satisfying the procedural obligations of § 14-139(d) (not all of which were met here in any event); (4) the determination of whether proposed compensation is "fair and reasonable" is a question of fact; and (5) that factual determination must be based on the unique facts and circumstances of each case.

C. The determination of whether compensation is "for work actually performed" depends on the facts.

In addition to requiring that compensation be "fair and reasonable," § 14-139(c) requires that the compensation be "for work actually performed for the benefit of the corporation [CareFirst]." The determination whether compensation is "for work actually performed" is, like the determination of "fair and reasonable" compensation, a question of fact. That question of fact must be decided based on the particular facts of the case.

Here, CareFirst proposes to compensate Mr. Jews for three years beyond the date of his termination, and the last of those years is <u>after</u> the expiration of the Mr. Jews' contractual non-compete restriction. The factual issue to be decided regarding "for work actually performed" is whether the continuation of Mr. Jews' compensation for three years beyond termination (about two-thirds of which has been paid already) is "for work actually performed for the benefit of" CareFirst.

There is, in all candor, a certain facial and logical inconsistency between post-termination payments (other than perhaps deferred payments) and the legal requirement that compensation be paid only "for work actually performed" for the benefit of CareFirst. An employer (CareFirst, in this instance) receives no benefit from any post-termination payment and such a payment is not "for work actually performed" because a terminated employee is, by definition, no longer performing any work. This approach is too facile, however, because there is no evidence that the General Assembly intended to outlaw in its entirety the common practice of paying post-termination compensation.

Paying a year's base salary following the expiration of a contractual non-compete restriction is, however, a different matter. As a matter of fact, the compensation proposed to be paid to Mr. Jews after the expiration of the non-compete restriction (*i.e.*, the third year) is not "for work actually performed for the benefit of" CareFirst because CareFirst receives no benefit by continuing compensation beyond the expiration of the non-compete restriction. Accordingly, CareFirst is barred from approving and Mr. Jews is barred from receiving the continuation of Mr. Jews' salary for a period longer than the non-compete restriction.

D. The total proposed $18 million payment to Mr. Jews must satisfy the "fair and reasonable" standard.

As a matter of law, the total proposed payment to Mr. Jews (and not merely the components of the package) must satisfy the statutory "fair and reasonable" standard. This is the only conclusion that honors the plain words of the statute. The board only has authority to "approve" and Mr. Jews' only has authority to "receive" compensation that is "fair and reasonable." These obligations lose meaning if the "fair and reasonable" analysis is not applied to the entire proposed payment. Limiting the analysis to the parts while ignoring the sum of the parts is an exercise in regulatory blindness and makes no sense. More fundamentally, it is an approach contrary to the words of the statute and, therefore, contrary to the will of the General Assembly.

In this case, Mr. Jews' total package is comprised of a number of components. Those components include continuation of base salary, unpaid annual and long term incentive payments, deferred long term incentive payments, and the payment under the company's supplemental retirement plan. (J. Ex. 125.) To look at each of these components in isolation and without reference to their combined effect (a total of nearly $18 million) would miss the compensation forest by focusing on each tree. That irrational approach is not consistent with the statutory text.

E. The total proposed $18 million payment to Mr. Jews is not "fair and reasonable" and a portion of it is not for work actually performed for the benefit" of CareFirst.

Based upon all the facts and circumstances of this case, including the factual findings set forth above in Section IV and the statutes that set forth CareFirst's nonprofit mission, all which are incorporated by reference, the only possible conclusion is that paying Mr. Jews nearly $18 million is not "fair and reasonable." In addition, paying him one year of post-termination salary beyond the expiration of his non-compete obligation is not "for work actually performed" for the benefit of CareFirst.

These conclusions are based on the entire record of this case. The relevant facts of record include, but expressly are not limited to, the public interest; the fact of CareFirst's nonprofit mission; the facts relating to the company's deviation from its statutory mission while under the leadership of Mr. Jews; the facts relating to Mr. Jews very substantial compensation while employed; the facts that (a) some of the proposed post-termination payment is not comparable to that which CEO's of similar entities receive and (b) a portion of the proposed compensation is not "for work actually performed" for the benefit of CareFirst; the fact that CareFirst's CEO's compensation should be aligned with the company's mission; and the fact that the board failed to act (as described previously) to restrain the CEO's compensation.

With all of those factors in mind, there is simply no denying that $18 million is an enormous and legally inappropriate sum of money for CareFirst to pay its former CEO. Even at Mr. Jews' compensation rate, <u>the proposed post-termination payment is nearly</u>

seven times his 2006 gross compensation ($17,970,162.00 divided by $2,576,499.00 equals 6.97). (J. Ex. 125.) Eighteen million dollars, seven times his final year's total compensation, is simply too much money to be drained out of this nonprofit company. Eighteen million dollars is not a "fair and reasonable" sum for a nonprofit health plan to pay to its former CEO. In light of all the facts, $18 million is just too much.

The purpose of insurance regulation is consumer protection in the public interest. The public interest is not served by walking away from the established facts of this case and saying that there is nothing that can be done. There is something that can be done. The General Assembly took care to provide the tool (§ 14-139(c)) so that something could be done. The General Assembly enacted § 14-139(c) because it was concerned that CareFirst might offend again in the area of executive compensation. When the CareFirst board approved a post-termination payment of $18 million, the past proved to be prologue. That payment cannot stand because it is not in the public interest because it is not "fair and reasonable."

Highly relevant are the facts and the law regarding the special status and obligations of CareFirst. By law, CareFirst's mission is to "provide affordable and accessible health insurance"; "assist and support public and private health care initiatives for individuals without health insurance"; "promote the integration of a health care system that meets the needs of all the residents of the jurisdictions in which the nonprofit health service plan operates." Section 14-102(c). This is a noble mission, and this mission is not advanced by paying $18 million to its departing CEO.

Executive compensation in many for-profit companies in the United States is seemingly unrestrained, but there is little pretense, let alone a legal requirement, that these companies exist for a public purpose. As has been reported in the media and documented in proxy statements, CEO's of private companies often lead their companies into trouble and still receive huge sums. This approach to allocation of resources is not appropriate for CareFirst, which is, as a matter of law and as a matter of mission, fundamentally different than a for-profit company.

The facts relating to Mr. Jews' tenure at CareFirst are obviously relevant and have been covered sufficiently above and that prior discussion is incorporated by reference. The facts relating to the board's inaction are no less relevant. As discussed, the board holds a special statutory responsibility not to "approve" compensation other than that which is "fair and reasonable." Whether it was reluctance to confront Mr. Jews on the issue of compensation or fear of triggering the anger of other board members, or some other reason, the evidence is clear that the "new board" was not engaged in the task of restraining the CEO's compensation. The new board acted as though it was powerless to do anything, notwithstanding the clear direction that the General Assembly provided. Instead, as discussed above, the new board <u>increased</u> Mr. Jews' compensation in the aftermath of the collapse of the conversion transaction.

If the conclusion of this case were a determination that the $18 million payment is "fair and reasonable," that determination would be a ratification of the board's inaction and passivity. That would be exactly the wrong message to send to the board (to say nothing of the public). The General Assembly directed CareFirst to reform and, yes, restrain its CEO compensation practices. The board ignored that direction and, instead, groused about the "quality" of the Maryland General Assembly.

As noted above, CareFirst receives no benefit whatsoever from continuing Mr. Jews' compensation beyond the expiration of his non-compete restriction; therefore, the proposed payment of compensation for the year starting November 1, 2008, is disallowed.

VI. Conclusions of Law Regarding Defenses of CareFirst and Mr. Jews.

In addition to arguing that Mr. Jews should receive the proposed $18 million payment, CareFirst and Mr. Jews raise three separate arguments by way of partial or full defense. Those arguments are answered in this section.

A. CareFirst's prior disclosure to the MIA of Mr. Jews' termination payment.

The evidence is undisputed that CareFirst, acting through Mr. Kelly, chair of the board's compensation committee, disclosed to the MIA in 2004 the estimated anticipated payment to Mr. Jews if he were terminated without cause. This was commendable. That prior disclosure coupled with the MIA's failure then to take any action in response do not, however, establish some sort of waiver or estoppel or other legally effective bar that impedes the present proceeding. CareFirst raised the fact of its prior disclosure, and fairly so, without asserting that the MIA has waived its rights or that the government can be estopped. (Hr'g Tr. 1456:9-11.) The point is addressed here to eliminate any doubt as to the lack of legal relevance of this prior disclosure.

The whole issue of Mr. Jews' post-termination compensation was not ripe until he was terminated. There was simply nothing for the MIA or the Insurance Commissioner to do unless and until CareFirst actually made a determination that it was going to terminate Mr. Jews and pay him $18 million. Those events did not occur until on or shortly after November 1, 2006. Prior to that, the matter of Mr. Jews' termination was entirely hypothetical. That is, CareFirst might pay Mr. Jews about $18 million if he were terminated and that termination were without cause, but he would not paid that amount if he were not terminated or if he were terminated for cause. Again, while CareFirst's prior disclosure was commendable and such conduct is strongly encouraged, that prior disclosure has no impact on the propriety, the timeliness, or the scope of these proceedings.

B. Retroactive application of § 14-139(c).

From the outset of this case, Mr. Jews has argued that it violates both the Maryland and the United States Constitutions to apply § 14-139(c) to his contract because the contract predates the statute. CareFirst has adopted this argument, but without great enthusiasm. The contention that this proceeding constitutes an unconstitutional retroactive application of a statute to defeat vested contractual rights is refuted by the facts and is wrong as a matter of law.

1. Both CareFirst and Mr. Jews acted consistently and repeatedly on the basis that § 14-139(c) did apply to Mr. Jews' termination compensation.

CareFirst does not join Mr. Jews in asserting that there was no reason to believe (prior to the MIA's assertion of jurisdiction here) that § 14-139(c) would apply to Mr. Jews' contract. Were CareFirst to make such an assertion, it would be refuted by its undisputed conduct.

For example, as noted above, CareFirst takes pride in the fact that it disclosed to the Insurance Commissioner in 2004 the potential payout to Mr. Jews if he were terminated without cause and how, in CareFirst's view, that payout comported with § 14-139(c). (Hr'g Tr. 966:14-969:20; 1020:13-14). The fact of that disclosure is inconsistent with any assertion that § 14-139(c) does not apply to Mr. Jews' contract. Another example is the letter that Mr. Kelly, the chair of the board's compensation committee, sent to the Insurance Commissioner on September 1, 2004, regarding the company's new compensation guidelines. (J. Ex. 104). In that letter, Mr. Kelly quoted the 2003 reform legislation; he does not claim in that letter (or in any communication with the MIA or even in this case) that § 14-139(c) does not apply to the CEO's compensation.

Mr. Jews, in contrast to CareFirst, insists that he had every belief that his contract "was in full force and that this new law was not applicable." (Hr'g Tr. 1388:6-7.) This testimony is not credible and is refuted by overwhelming contrary evidence. Mr. Kelly, for example, testified that Mr. Jews "was extremely familiar with" the new law and that

Mr. Jews was "absolutely" aware of it and that Mr. Kelly "would guess" that Mr. Jews understood that the law applied to Mr. Jews' contract. (Hr'g Tr. 1021:3 – 13.)

The clearest refutation of Mr. Jews' testimony on the asserted inapplicability of § 14-139(c) is found in the minutes of the board and its compensation committee. The board and the committee discussed repeatedly the company's new obligations under the post-2003 legislation. (J. Exs. 60a, 61a, 62a, compensation committee minutes of November 20, 2003, "The Compensation Committee continued our review of current Executive Compensation practices as they relate to the MD legislation and the company's revised mission.") The minutes reflect that Mr. Jews was present at all of these meetings. There is no indication in these minutes or elsewhere (except in his testimony in this case) of Mr. Jews' saying, in substance, "this is an interesting discussion, but, of course, it has no applicability to me or to my contract." Mr. Jews' contemporaneous silence is far more persuasive than is his contrary hearing testimony.

The reports that the compensation committee received from its compensation consultants also refute Mr. Jews' testimony. The Hay Report (J. Ex. 45) and the PWC Report (J. Ex. 90B) do not carve out the CEO's compensation from their analysis. Mr. Jews does not assert that he was unaware of these reports. Again, there is no evidence of Mr. Jews' speaking up and asserting, as he now does, that § 14-139(c) was inapplicable to him.

The evidence is overwhelming that Mr. Jews took a very active interest in executive compensation matters (consider, for example, the potential bonuses to be paid to CareFirst executives, including Mr. Jews, if the WellPoint transaction closed) and that he was present at numerous meetings of the compensation committee and the minutes of full board meetings, following the enactment of § 14-139(c), at which compensation was discussed with direct reference to the new statute. <u>None of the minutes of all of those meetings reflect a single occasion on which Mr. Jews, any committee or board member, or any consultant so much as suggested that § 14-139(c) was inapplicable to Mr. Jews' contract</u>.

The preponderance of the evidence establishes that both CareFirst and Mr. Jews acted with full knowledge of § 14-139(c) and consistent with the view that § 14-139(c) applied to Mr. Jews' contract. That factual finding does not resolve fully the constitutional objection to applying § 14-139(c) to Mr. Jews' contract. It does, however, resolve that part of the objection premised on any notion of reasonable reliance or surprise. Mr. Jews had no basis for relying – and, in fact, he did not rely – on the notion that his contract was unaffected by § 14-139(c). Mr. Jews knew to the contrary.

2. *Mr. Jews' contract was extended after § 14-139(c) was enacted; therefore, applying § 14-139(c) to that contract does not involve a retroactive application of the statute.*

Section 14-139(c) was enacted as an emergency measure effective immediately upon its passage and signing by the Governor. Chapter 356, 2003 Laws of Maryland, which contained what is now codified as § 14-139(c), became effective May 22, 2003. (J. Ex. 145.) The CareFirst board extended Mr. Jews' employment contract on November 20, 2003, months <u>after</u> § 14-139(c) became effective. (J. Ex. 26.) Following the enactment of § 14-139(c) (and even prior to extending Mr. Jews' contract), the minutes of the compensation committee and the full board reflect consideration of executive compensation in light of the new statute. (J. Exs. 60a, 61a.)

The legally effective employment contract between CareFirst and Mr. Jews was entered into when the board extended his contract on November 20, 2003. Applying § 14-139(c) to that contract is not unlawful retroactive application because it is not retroactive at all. Section 14-139(c) was the law in effect when the contract was extended and that is the contract to which § 14-139(c) applies. The application of § 14-139(c) is lawful and prospective.

Parties to a contract are charged with knowledge of the law and "'all applicable or relevant laws must be read into the agreement of the parties just as if expressly provided by them, except where a contrary intention is evident.'" *Lema v. Bank of America, N.A.*, 375 Md. 625, 645 (2003) (*quoting Wright v. Commercial & Sav. Bank,* 297 Md. 148, 153 (1983)). When, as here, a contractual agreement is renewed or amended, the applicable laws passed between the time of the original contract and the renewal or amendment become part of the renewed or amended agreement. *State Dep't of Gen. Services v. Roger E. Holtman & Assoc., Ltd.* 296 Md. 403, 411 (1983) (extension of earlier contract between architect and State was separate contract, legally independent of earlier agreements and subject to new sovereign immunity law); *Maryland Med. Serv., Inc. v. Carver*, 238 Md. 466, 486 (1965) (statute requiring that health plan subscriber reimbursement for chiropodial service did not impair contractual rights, as statute applied only to contracts entered into or renewed subsequent to statute's effective date).

The General Assembly is not without power, however, to enact a retroactive statute affecting contractual relationships at CareFirst. Had it done so here, that action would be lawful as the Attorney General's analysis of this issue makes clear (Jt. Ex. 144). That analysis is hereby incorporated by reference.

The assertion that applying § 14-139(c) to Mr. Jews' contract is unconstitutional is rejected.

C. ERISA preemption.

CareFirst argues and Mr. Jews joins in the argument that the federal Employment Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1001 *et seq*. preempts, in very large measure, the application of § 14-139(c) to the post-termination compensation proposed to be paid to Mr. Jews. In fact, CareFirst asserts that ERISA preemption puts "roughly 90%" of the proposed payment to Mr. Jews beyond the reach of § 14-139(c). (CareFirst's Pre-Hr'g Br. 51.) This truly stunning argument would mean, if it were true (which it is not), that the Maryland General Assembly in 2003 was largely wasting its time in enacting § 14-193(c). In Mr. Jews' case, this preemption argument would mean, by CareFirst's calculation, that about $16.1 million of the proposed $17.97 million payment would escape state law scrutiny.

CareFirst makes no attempt to square it present contention that "roughly 90%" of Mr. Jews' post-termination compensation escapes state scrutiny with its earlier conduct (in which it takes pride) of disclosing to the MIA in 2004 the likely total payment to Mr. Jews if he were terminated without cause. Significantly, CareFirst's 2004 disclosure was not accompanied by a statement that "we are telling you about Mr. Jews' potential post-termination even though, as a matter of federal law, there is nothing you can do about roughly 90% of it." Furthermore, there is nothing in the extensive record of this case indicating that CareFirst (or Mr. Jews) raised the ERISA issue when the legislation was being considered by the General Assembly.

Congress enacted ERISA "to promote the interests of employees and their beneficiaries in employee benefit plans." *Shaw v. Delta Air Lines, Inc.,* 463 U.S. 85, 90 (1983). Specifically, ERISA requires plans to provide participants with plan information; provides fiduciary responsibilities; requires plans to establish a grievance and appeals procedures; and gives participants the right to sue for benefits and breaches of fiduciary duty. 29 U.S.C. 1001 *et seq.*

Congress included a broad federal preemption provision in ERISA to eliminate "the threat of conflicting or inconsistent State and local regulation of employee benefit plans." *Shaw,* 463 U.S. at 99. ERISA establishes as an area of exclusive federal concern the subject of every state law that 'relate[s] to' an employee benefit plan governed by ERISA." *FMC Corp. v. Holliday,* 498 U.S. 52, 58 (1990). However, preemption is not without limits. Courts "'...presume that Congress did not intend to preempt areas of traditional state regulation.'" *WSB Elec., Inc. v. Curry,* 88 F.3d 788, 791 (9th Cir. 1996) (*quoting Metropolitan Life Ins. Co. v. Massachusetts,* 471 U.S. 724, 740 (1985)). As the Fourth Circuit has noted recently,

> Although the phrase "relates to" has an expansive connotation, ERISA's preemptive scope is not unlimited, for "[i]f 'relate to' were taken to extend to the furthest stretch of its indeterminacy, then for all practical purposes pre-emption would never run its course, for really, universally, relations stop nowhere." *N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.,* 514 U.S. 645, 655, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995) (internal quotation marks omitted). Thus, as the Supreme Court has instructed, courts must go "beyond the unhelpful text ... and look instead to the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive." *Id.* at 656, 115 S.Ct. 1671.

Great-West Life & Annuity Ins. Co. v. Info. Systems & Networks Corp., 523 F.3d 266, 270 (4th Cir. 2008).

A law "relates to" an employee benefit plan "if it has a connection with or reference to such a plan." *Shaw v. Delta Air Lines, Inc.,* 463 U.S. 85, 96-97 (1983) (emphasis added). The Ninth Circuit has converted this definition into a "simplified test" for answering the "relates to" question.

> Is the state telling employers how to write their ERISA plans, or conditioning some requirement on how they write their ERISA plans? Or is it telling them that regardless of how they write their ERISA plans, they must do something else outside and independently of the ERISA plans? If the latter ... there is no preemption.

Curry, 88 F.3d at 795-96.

In the instant case, there is no preemption because § 14-139(c) makes no reference to an employee benefit plan and it is not connected with an ERISA plan. Section 14-139(c) does not "directly regulat[e] or effectively mandat[e] some element of the structure or administration of employers' ERISA plans." *Retail Industry Leaders Ass' v.*

Fielder, 475 F.3d 180, 192-93 (4th Cir. 2007). A state law, like § 14-139(c), that at most has only an indirect impact upon an ERISA plan is not preempted. *Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 658 (1995); *Fielder*, 475 F.3d at 193.

The plain language of § 14-139(c) makes clear that it is directed at and controls matters of corporate governance, as distinguished from "relating to" an employee benefit plan. By its terms, § 14-139(c) imposes restrictions on what the CareFirst board may "approve" and what its officers and others (here, Mr. Jews) may "receive." ERISA preempts state law in connection with employee benefit plans, not state corporate governance laws, and § 14-139 involves the latter.

Matters of corporate governance, most particularly the governance of nonprofit health plans (CareFirst), are uniquely the province of state law and do not "relate to" employee benefit plans. The comprehensive set of state laws regarding the formation, powers, and regulation of corporations are found in the Corporations and Associations Article of the Maryland Code, §§1-101 *et seq*. The laws relating to the duties, powers and obligations of nonprofit health plans are found in the Insurance Article, §§ 14-101 *et seq*. Section 14-139(c) fits squarely within this state law framework of corporate governance.

Importantly, CareFirst concedes that corporate governance is the central concern of § 14-139. (CareFirst's Post-Hr'g Br. 81, "The Commissioner asks whether the central concern of § 14-139 is corporate governance, as distinguished from dictating the terms of employee pensions or benefits. CareFirst believes that this is an accurate statement, which is also consistent with the broad-based governance changes throughout the 2003 reform legislation.") Mr. Jews adopts CareFirst's arguments in general and there is no indication that Mr. Jews does not join in CareFirst's concession. (Jews Post-Hr'g Br. 2, n.1; 4, n.3.)

Section § 14-139 is not touched, let alone preempted, by ERISA as ERISA preempts only "state laws insofar as they now or hereafter relate to any employee benefit plan," *see* 29 U.S.C. § 1144(a), and § 14-139 is not such a law. Section 14-139 "relates to" the governance of a unique and thoroughly regulated state law entity (CareFirst).

VII. Scope of Final Order and Impact other CareFirst Executives.

CareFirst has argued that setting aside the proposed post-termination payment to Mr. Jews would upset the compensation arrangements of other CareFirst executives and harm CareFirst's executive recruitment and retention efforts. These concerns are dramatically overblown. As noted previously, "fair and reasonable" is a person-specific, fact-specific determination. By definition, therefore, a determination of what is not "fair and reasonable" to pay CareFirst's former CEO is of little relevance to the compensation paid or proposed to be paid to others. The facts of each case are different.

Mr. Jews was the CEO. The factual analysis of "fair and reasonable" compensation for the CEO, including the board's special role in establishing the CEO's compensation, is unique and unlike that of any other executive. The same is true for the factual analysis of whether the compensation is "for work actually performed."

As for recruitment and retention, there is simply no evidence that the existence of § 14-139(c), including the potential that it would be applied to reduce post-termination compensation, has had an adverse impact on CareFirst's efforts. In fact, the evidence is directly to the contrary. That evidence is the company's success in attracting a highly qualified new CEO, Mr. Burrell, who entered into an employment contract with CareFirst fully aware of § 14-139.

Having said that the order in this case does not touch the compensation arrangements of others, the company would be well advised to review those arrangements to satisfy itself that compensation is "fair and reasonable," in addition to being "comparable," and further to assure itself that all proposed post-termination payments are "fair and reasonable." In addition, CareFirst should develop promptly post-termination compensation guidelines.

VIII. <u>The Lawful Post-Termination Payment to Mr. Jews.</u>

The ultimate question in this case is what amount of post-termination compensation is appropriate and permissible in light of (1) all the facts of the case and (2) the requirements of § 14-139(c). In deciding this ultimate question, consideration must be given to the entire record, including CareFirst's nonprofit mission and purpose; Mr. Jews 13 years as CEO; the company's accomplishments during those years (as well as its failures); the fact that Mr. Jews has a contract, albeit one that is subject to all legal requirements, including § 14-139(c); the fact that a substantial portion of the proposed post-termination compensation ($2.43 million) is for earned, but deferred, long term incentive payments (J. Ex. 125); the fact that Mr. Jews was compensated very well over the years he was CEO (earning, for example $16.5 million over the last six years); and the fact that as of November 1, 2008, Mr. Jews' right to seek other employment, including employment with a company that is a competitor of CareFirst will be unrestricted.

Taking the above-summarized facts into account, as well as all of the facts in the entire record, and with considerable hesitation because of the enormity of the sum, I conclude that the total permissible post-termination payment that CareFirst is authorized to approve and pay and that Mr. Jews is authorized to receive is one-half the amount that CareFirst proposed to pay, $8,985,081.00.

This total sum of nearly $9 million is almost 3.5 times Mr. Jews' 2006 compensation and is more than 3.5 times his 2005 compensation. Nearly $9 million is substantially more than the sum of continuation of his base salary for two years (about $2 million) payment of his entire deferred LTIP ($2.43 million), payment of all benefits under employee benefit plans (about $686,000.00), payment of his entire target AIP for his final year of employment ($731,250.00), payment of all unpaid base salary ($11,250.00), continuation of health benefits ($22,875.00), and payment for unused leave ($61,875.00). A payment of nearly $9 million will more than compensate Mr. Jews for all of those items, and, in addition, pay him about one-third of the proposed $9.77 million SERP payment. A total payment of nearly $9 million, is admittedly, 50% less than the $18 million that CareFirst proposed to pay, but it creates no hardship for the recipient.

As of April 28, 2008, the start of the hearing in this case, CareFirst had paid Mr. Jews $2,281,021.00 in post-termination compensation. The amount remaining to be paid to Mr. Jews, consistent with the Final Order entered here, is $8,985,081.00 minus the total post-termination compensation that CareFirst has paid (which presumably now exceeds the amount paid as of April 28, 2008, by virtue of CareFirst's continuing to pay Mr. Jews his base salary), plus interest, as provided in Mr. Jews' employment contract.

The decision in this case upholds the positions of the MIA that the proposed $18 million payment is not "fair and reasonable" and that a portion of the proposed payment is not "for work actually performed" for the benefit of CareFirst. The decision does not, however, adopt the MIA's proposed reduction in Mr. Jews' post-termination compensation nor does this decision rely on the methodology of the MIA's expert witness, Mr. Schmalbeck.

Based on the entire record and the application of the law to that record, the "liability question" of whether CareFirst is authorized to approve and whether Mr. Jews is authorized to receive a post-termination payment of $18 million is answered in the negative as the MIA urges. The question of remedy – that is, what post termination payment is legally permissible? – is a question for the Insurance Commissioner to decide and that decision is constrained by the facts and the law, but not by any position of a party. *See* §§ 2-108, 2-214.

"[T]he breadth of agency discretion is, if anything, at [its] zenith when the action assailed relates primarily not to the issue of ascertaining whether conduct violates the statute, or regulations, but rather to the fashioning of ... remedies and sanctions." *American Telephone and Telegraph Co. v. F.C.C.,* 454 F.3d 329, 334 (D.C. Cir. 2006) (*quoting, Niagara Mohawk Power Corp. v. Fed. Power Comm'n,* 379 F.2d 153, 159 (D.C.Cir.1967)); *see Atlantic Refining Co. v. F.T.C.*, 381 U.S. 357, 367-368 (1965) (FTC's authority includes developing solutions to complex problems within the area of regulatory expertise and the Court's function is limited to determining whether is founded in the record and is consistent with law); *accord, Marzullo v. Kahl,* 366 Md. 158, 172, (2001) ("[D]egree of deference should often be accorded the position of the administrative agency" in determining validity of legal conclusions when interpreting agency ordinances and regulations.).

IX. Rulings on Parties' Requested Findings of Fact and Conclusions of Law.

The parties submitted extensive requested proposed findings of fact and conclusions of law. The MIA submitted a total of 133 proposed findings of fact and conclusions of law. CareFirst submitted a total of 236 proposed findings and rulings. Mr. Jews adopts CareFirst's proposed findings and proposed 24 additional findings. This already lengthy statement of reasons would be far, far longer and less intelligible were it structured to respond individually to the parties' nearly 400 requests.

The substance of all the parties' principal requests is answered (either granted or denied) in this statement of reasons, albeit in form and language different than that proposed by the parties. For all purposes, including any judicial review of the order in this case, each and every request for a finding of fact or a conclusion of law submitted by any party that is not covered by this statement is hereby **DENIED** and shall be treated as addressed and specifically **DENIED**.

X. Conclusion.

A Final Order, consistent with this statement of reasons, is entered simultaneously.

July 14, 2008

RALPH S. TYLER
Insurance Commissioner

Exhibit 1

Witnesses in order in which they testified:

Richard Schmalbeck

Elizabeth (Beth) Sammis

William Stack

Scott Olsen

Michael Kelly

Christopher McGee

Constance Foster

Lawrence Mirel

Wayne Rogers

William L. Jews

Exhibit 2

Examples of Discretionary Terms in Insurance Article

The Insurance Article contains many provisions that grant the Commissioner broad discretionary authority and contain arguably vague or subjective language. The following examples are illustrative only and this list is far from exclusive.

For example, the Commissioner is charged with the responsibility of determining if various insurance rates are "excessive, inadequate or unfairly discriminatory." Sections 11-201(a)(1); 11-208(a); 11-302(a)(1); 11-306(b); § 11-307(d)(1); 11-402(b)-(c). In setting insurance rates, the Commissioner must consider "all relevant factors within and outside the State." Sections 11-205(c)(8); 11-306(c)(7); 14-126(b)((3)(ii)(5). The Commissioner has the authority to waive the standard provision required for insurance or annuity contracts as long as he "finds that the provision is unnecessary to protect the insured or is inconsistent with the purposes of the policy." Section 12-102 (b)(1).

See also § 2-205(a)(1) (examinations of insurers are to be held, "[w]henever the Commissioner considers it advisable."); § 2-206 (examination of producers is to be held, "[w]hen advisable to determine compliance with this article"); § 2-210(a)(1)("the Commissioner may hold hearings that the Commissioner considers necessary for any purpose under this article"); § 2-215(h)(3)(vi) (Court may reverse or modify a decision of the Commissioner that was "arbitrary and capricious."); § 7-106(c) (Commissioner can determine if disclosure of otherwise confidential corporate acquisitions information is in the public interest); § 7-306(b)(7) (Commissioner must disapprove an acquisition of "the interests of the domestic insurer's policyholders and stockholders might otherwise be prejudiced, impaired or not properly protected"); § 8-464(a)(6) (Commissioner shall issue an injunction against a Fraternal Benefit Society if it "is conducting its insurance business in a manner hazardous to its members, creditors, the public, or the business"); § 10-214(a) (Commissioner may require licensee to provide information he "considers necessary about business methods, policies, contracts, or transactions of the licensee"); § 11-218(b)(3) (rating organizations "shall provide rating services without discrimination to its members"); § 11-218(b)(4)(i) (subscriber may request Commissioner to review reasonableness of rating agency's denial of application); § 11-219(g)(2) (Commissioner may grant permission to entity to file rates if doing so is "in the public interest"); § 11-225(a)(2) (Commissioner may make an examination of an advisory organization whenever he "considers it expedient"); § 11-227 ("Commissioner may adopt reasonable rules and regulations necessary to carry out the purposes of this subtitle"); § 11-314(d)(2) (Commission shall hold a hearing if he finds that "application is made in good faith and sets forth on its face grounds that reasonably justify a hearing"); § 11-333(b)(2) (Commissioner may issue an order to a rating organization if "Commissioner finds that an activity or practice is unfair, unreasonable, or otherwise inconsistent" with the law); § 12-205(b) (Commissioner shall "adopt reasonable regulations establishing minimum benefits or coverages necessary to meet the needs of insureds"); § 14-124(a) ("Commissioner may conduct any investigation or hearing that... [he] considers necessary to enforce" the law); § 14-405(b)(14) (for an application for certificate of authority, Commissioner may request "any other information that ...[he] requires"); § 14-411(a) (Commissioner must be given "reasonably free access" to dental plan's business records.); § 16-603(b) (Commissioner may require "appropriate" policy provisions for variable life insurance policies); § 17-301 (b)(3)(i) (group life insurance policy "shall contain a nonforfeiture provision that in the opinion of the Commissioner is equitable to the insured and the policyholder").