

STATE OF NORTH DAKOTA
BEFORE THE INSURANCE COMMISSIONER

**In the Matter of the Form D
Application of Noridian Mutual
Insurance Company.**

)
)
)
)
)

**FINDINGS OF FACT,
CONCLUSIONS OF LAW, AND
ORDER**

FILE NO. CO-15-576

INTRODUCTION

On November 9, 2015, a statement known as a Form D Application (“Form D”) was filed with the North Dakota Insurance Commissioner (“Commissioner”) by Noridian Mutual Insurance Company, dba Blue Cross Blue Shield of North Dakota (“NMIC”), pursuant to N.D.C.C. ch. 26.1-10. NMIC submits the following three requests within the Form D for the Commissioner to consider: (1) to approve the NMIC Settlement Payment Guarantee Agreement with the State of Maryland; (2) to approve a NMIC capital contribution to Noridian Healthcare Solutions, LLC, (“NHS”) in the amount of up to \$18,250,000; and (3) to approve an intercompany agreement between NMIC and NHS.

After considering and reviewing all the documents, instruments, and materials filed in this matter, the Commissioner makes the following Findings of Fact, Conclusions of Law, and Order.

FINDINGS OF FACT

NMIC Background

1. NMIC is a nonprofit mutual insurance company organized under North Dakota law and is headquartered in Fargo, North Dakota. NMIC transacts health

insurance business in North Dakota and has been authorized to do so since 1943.

2. NMIC is governed by a Board of Directors and is in good standing with the North Dakota Insurance Department (“Department”). NMIC employs approximately 1,000 people in North Dakota.

3. NMIC holds a 100 percent ownership interest in NHS, making NHS a wholly owned subsidiary of NMIC and a member of NMIC’s insurance holding company system.

NHS Background

4. NHS is a limited liability company formed in 2002 under Delaware law and is headquartered in Fargo, North Dakota. NHS primarily provides administrative services to government agencies and private businesses. NHS employs approximately 1,700 people, including over 1,000 people in North Dakota.

5. In order to remain in line with federal organizational conflict of interest rules that became applicable to Medicare contractors in 2002, NHS must maintain operational independence from NMIC.

Form D Filing

6. On November 9, 2015, NMIC by and through its Associate General Counsel, Dale Shook, filed a statement known as a Form D statement with the Commissioner pursuant to N.D.C.C. § 26.1-10-05. The Form D statement along with supplemental information provided by NMIC at the request of the Department provides the information required by N.D.C.C. § 26.1-10-05.

NHS and the Maryland Health Insurance Exchange

7. NHS submitted a bid to serve as the prime contractor for the development

of the Maryland Health Insurance Exchange (“MDHIX”) on December 19, 2011, and was awarded the contract on February 21, 2012. The contract required NHS and its subcontractors to develop and implement the first phase of the MDHIX by October 1, 2013.

8. As a part of the contract with Maryland, NHS was obligated to provide a \$10,000,000 performance bond. The full amount of that bond was guaranteed by NMIC.

9. The MDHIX system created by NHS and its subcontractors encountered severe and persistent technical problems upon going live on October 1, 2013. The partial MDHIX released on October 1 immediately crashed and lacked critical capabilities necessary to provide acceptable functionality. The system was unstable, error-prone, and inadequate as a MDHIX platform. Many users complained they could not complete the shopping experience, select health plans, or enroll in Medicaid. Other users who had avoided frozen screens and believed they had successfully completed the enrollment process later learned that internal system errors prevented their enrollment data from being successfully transmitted to the Medicaid program or private insurance carriers. NHS was able to resolve hundreds of defects; however, the pace at which NHS was able to resolve defects could not keep up with the pace at which new defects were identified. NHS was ultimately unable to deliver all of the remaining functionality that was required under the contract.

10. In February 2014, prime contractor responsibilities were transitioned away from NHS and to another party. An analysis done by the party replacing NHS as lead contractor concluded the MDHIX system was deeply flawed, that remediating the system would take over 12 months and cost more than \$66 million, and that the

resulting product would likely still not meet the MDHIX's needs or provide a stable and sustainable system. It was further determined that because of the system's inability to provide a single source of truth and other fundamental architectural and design flaws that no attempt should be made at remediating the system developed by NHS and its subcontractors. Maryland ultimately decided to completely jettison the system developed by the NHS group in its entirety and replace it with technology used by the Connecticut Health Insurance Exchange.

11. After prime contractor responsibilities were removed from NHS, Maryland advised NHS of several legal claims it could assert against NHS in relation to NHS's failed attempt to develop the MDHIX. Several months of negotiations between NHS and Maryland followed. Maryland asserted its damage claim was in excess of \$100,000,000 and outlined a basis for that calculation.

12. In July 2015, NHS and Maryland reached a final settlement of their claims against each other, resulting in a Settlement Agreement between Maryland and NHS. Due to NHS's financial position, Maryland required that NMIC provide a settlement payment guarantee to NHS's financial obligations to Maryland. As is more fully outlined below, NMIC has agreed to provide this settlement payment guarantee. This settlement payment guarantee is subject to approval by the Commissioner.

**Terms of the Settlement Agreement Between NHS and the
Maryland Health Benefits Exchange**

13. Pursuant to the terms of the Settlement Agreement, NHS is required to make payments to the Maryland Health Benefits Exchange totaling \$45,000,000. The amount of \$20,000,000 is due upon the agreement becoming effective and the

remaining \$25,000,000 is payable over five equal yearly installments of \$5,000,000, without interest.

14. In return for making this payment, NHS will receive a complete release from Maryland and the Maryland Health Benefits Exchange, including a joint tortfeasor release to protect NHS from potential contribution claims by NHS subcontractors if Maryland obtains a tort judgment against any of them separately.

15. The Board of Directors of NHS and NMIC have each unanimously approved the Settlement Agreement.

16. The settlement amount (\$45,000,000) is less than half of what Maryland would seek from NHS and potentially attempt to seek from NMIC in any litigation.

17. The Settlement Agreement is subject to multiple conditions which must all be satisfied or waived before the Settlement Agreement becomes effective. The first of these conditions is Maryland must receive federal approval of the Settlement Agreement by the Maryland United States Attorney (USAO) and the federal Department of Health and Human Services' Centers for Medicare and Medicaid Services (HHS/CMS). The second condition is NHS must be satisfied it has received adequate assurance from the USAO, HHS/CMS, and the HHS Inspector General (HHS/OIG) that none of those entities have a present intent of proceeding with claims against NHS arising out of the MDHIX project. These two conditions were satisfied as of November 6, 2015. The final condition is approval from the North Dakota Insurance Commissioner of NMIC's participation in the settlement between NHS and Maryland.

18. Legal counsel for the Department has concluded that NHS, and potentially NMIC, are exposed to joint tortfeasor claims by other subcontractors on the MDHIX

Project. If Maryland sues the other contractors in tort, they could assert a claim against NHS and potentially against NMIC asserting that tortious action by NHS or NMIC contributed to any harm established by Maryland. The Settlement Agreement contains a joint tortfeasor release which NHS could assert in response to any potential claims. The Settlement Agreement also provides protection for NMIC by way of a judgment reduction mechanism from any potential contribution claims lodged against it by any NHS subcontractors successfully sued by Maryland.

Request to Approve the NMIC Settlement Payment Guarantee Agreement

19. NMIC requests approval of a Settlement Payment Guarantee Agreement between NMIC and the State of Maryland. As set forth in the Settlement Payment Guarantee Agreement, NMIC has agreed to guarantee timely payment of NHS's upfront \$20,000,000 obligation and each of the first four \$5,000,000 annual installments for a total initial guarantee amount of \$40,000,000. Additionally, NMIC has agreed to guarantee the final \$5,000,000 if at the due date of that payment, NHS continues to hold the Jurisdiction E and F Medicare contracts that it currently holds at substantially the same revenue levels, or has replaced those contracts with others that generate substantially the same revenue levels, or has replaced those contracts with others that generate substantially the same revenue during the year the final annual payment is due.

20. Pursuant to the terms of the Settlement Payment Guarantee Agreement, in exchange for providing the guarantee, NMIC receives a full release from the state and the Maryland Health Benefits Exchange, including a release of any claims against the \$10,000,000 performance bond guaranteed by NMIC. Maryland has also agreed to

protect NMIC by way of a judgment reduction mechanism from any potential contribution claims lodged against it by any NHS subcontractors successfully sued by Maryland.

21. NMIC's Board of Directors has unanimously approved the Settlement Payment Guarantee Agreement.

22. The Settlement Payment Guarantee Agreement is subject to the same conditions as the Settlement Agreement. Like the Settlement Agreement, the first two conditions for the Settlement Payment Guarantee Agreement were satisfied as of November 6, 2015. The final condition is approval from the North Dakota Insurance Commissioner of NMIC's participation in the settlement between NHS and Maryland.

**Request to Approve a NMIC Capital Contribution to NHS
in the Amount of Up to \$18,250,000**

23. NHS does not have access to sufficient levels of outside funding necessary to fund the initial settlement payment on its own and, therefore, requires NMIC's financial support in order to effectuate the settlement with Maryland. Upon approval by the Commissioner, NMIC will make an initial capital contribution of \$16,500,000 to NHS. The capital contribution will be funded by the amounts NMIC set aside for payment under the \$10,000,000 performance bond guaranteed and for accrued legal fees.

24. Up to an additional \$1,750,000 may be made available to NHS by NMIC to ensure NHS has appropriate working capital. This additional capital would be held at NMIC and not invested in NHS until such time as NHS's financial position required it. The Department believes that NHS should be able to fund its settlement obligations from its core operations and that NMIC will not be called upon to make any payments

under the guarantee other than the initial capital contribution of up to \$18,250,000.

25. NMIC's Board of Directors unanimously approved the NMIC capital contribution to NHS.

Request to Approve an Intercompany Agreement between NMIC and NHS

26. NMIC requests approval of an Intercompany Agreement between NMIC and NHS which is intended to further mitigate NMIC risk associated with the settlement payment guaranty. This agreement provides significant restrictions on NHS and will help to ensure that NHS remains focused on its historically profitable business and does not unknowingly expose NMIC to material financial risk.

27. Pursuant to the terms of the Intercompany Agreement, NHS will establish a separate bank account into which it will deposit funds to be used to make the five annual payments required by NHS's Settlement Agreement with Maryland. Two signatures will be required to withdraw amounts from this account: one signatory designated by NHS and one signatory designated by NMIC. NHS must deposit \$5,000,000 within 15 days following receipt of NMIC's initial capital contribution described above. Thereafter, on August 1, 2016, and the first day of each month thereafter, until and including July 1, 2020, NHS must deposit \$416,667 into this account. Should NHS be at risk of failing to meet certain obligations, NHS may request NMIC to approve withdrawals from this account.

28. Pursuant to the terms of the Intercompany Agreement, NHS must provide quarterly reports to NMIC, take steps to resolve pending or future disputes with MDHIX subcontractors, follow the implemented NHS Approval/Notification Guidelines, implement a dividend policy, agree to restrictions or conditions by the North Dakota

Insurance Department on NMIC's financial support and investment in NHS in connection with the Maryland Settlement Agreement and indemnify, hold harmless and defend NMIC for costs incurred by NMIC in defending and compromising actions arising out of the Settlement Payment Guaranty Agreement.

Costs and Risks to NHS if the Insurance Commissioner Does Not Approve the Settlement Payment Guarantee Agreement and NMIC Capital Contribution to NHS

29. The prime contract between NHS and Maryland makes NHS liable to Maryland for any and all shortcomings of the MDHIX system, including for the performance or non-performance of NMIC's subcontractors.

30. NHS hired subcontractors to perform technical work on its behalf. As detailed above, the work performed by NHS's subcontractors on the MDHIX project was unsatisfactory.

31. NHS's subcontractors have blamed NHS and each other for the MDHIX system's failures. This works to NHS's detriment because as prime contractor, NHS is contractually liable for all of the shortcomings to the MDHIX system. Furthermore, as NHS staff had little direct knowledge of the technical experience used to create the failed system and because this information is possessed by subcontractors who are now hostile to NHS, legal counsel for the Department believes NHS's ability to defend itself as the prime contractor responsible for the performance of the MDHIX against claims brought by Maryland is severely limited.

32. Any legal action brought by Maryland would be filed in a Maryland Circuit Court, which is the trial court of general jurisdiction. The problems with the MDHIX have received extensive publicity in Maryland. Legal counsel for the Department believes there is a substantial probability that Maryland jurors would be hostile to NHS given the

negative publicity of the issues with the MDHIX and because NHS is an out-of-state contractor.

33. The possible damages Maryland would assert against NHS generally fall into two categories: (1) payments made to other vendors in an attempt to both fix the system delivery by NHS and implement workarounds to that system because of a lack of full functionality; and (2) payments made to the contractor that replaced NHS which replaced the system delivered by NHS. Publically available information indicates Maryland made payments in excess of \$36 million to a third-party contractor to evaluate the system delivered by NHS and potential alternatives, assist with manual workarounds, and stabilize, remediate, and enhance that system to complete the 2013-14 open enrollment period. Regarding category (2), Maryland appears to have paid more than \$95 million for third-party contractors to replace the system delivered by NHS. Maryland may also assert a statutory claim for treble damages. In addition to these amounts, NHS would potentially be liable for indemnifying the state based on its attorneys' fees, which would continue to increase the longer and more drawn out the matter becomes.

34. Maryland has informed NHS that it would seek in excess of \$100,000,000 in damages from NHS if litigation were filed by Maryland against NHS concerning NHS and its subcontractors' failed attempt to build the MDHIX.

35. NHS's counsel has estimated that its costs for defense and experts to litigate claims between the state and NHS would be approximately \$7.8 million.

36. The contract between NHS and Maryland is highly favorable to Maryland. Pursuant to the terms of the contract, NHS is liable for its own conduct and that of its

subcontractors.

37. As NHS is responsible for any losses that arise from NHS or its subcontractors' performance or nonperformance, it is immaterial in considering NHS's exposure to Maryland whether the undisputed defects, design flaws, and missing functionality were caused by failures or omissions of NHS or its subcontractors.

38. Changes and delays to the MDHIX technical requirements contributed to the problems with the system that were experienced on and after October 1, 2013. The Request for Proposal ("RFP") for the MDHIX project was issued in October 2011, before the issuance by the federal government of critical rules and guidance for health insurance exchanges. The RFP, therefore, identified only high-level business requirements, which both Maryland and NHS understood would have to be fleshed out into detailed technical requirements after award.

39. Maryland officials have publicly acknowledged that Maryland's decision to begin development in advance of the federal regulations created substantial obstacles to performance. While other states waited for federal regulations to come out, Maryland tried to press forward to be a model for other states, at times having to redo work after new regulations came out.

40. Legal counsel for the Department have analyzed the defenses NHS could assert against Maryland's breach of contract claims and have concluded it will be difficult to successfully assert the defenses under Maryland law and before a Maryland jury.

41. Given the unfavorable terms of the contract, the number of defects and design flaws identified with the system, the fact that those defects and design flaws

have been acknowledged by multiple entities, and the limited utility of potential defenses, legal counsel for the Department has concluded that NHS is at significant risk of a significant adverse judgment on the state's breach of contract claims. NHS is likely fully liable to Maryland for performance failures regardless of whether those failures were caused by NHS or a subcontractor.

42. The settlement amount agreed to by the parties (\$45,000,000) is less than half of what the state would seek from NHS in any litigation.

Costs and Risks to NMIC and its Policyholders if the Insurance Commissioner Does Not Approve the Settlement Payment Guarantee Agreement and NMIC Capital Contribution to NHS

43. Maryland has stated it would name NMIC in a civil complaint resulting from NHS's failed attempt to create the MDHIX.

44. NMIC's legal counsel estimates legal fees and costs of defending NMIC in a civil lawsuit to be \$7.5 million due to the factual complexity of the claims and the number of parties likely to be involved. Additionally, NMIC is obligated under the \$10 million performance bond which it guaranteed on NHS's behalf.

45. NMIC was not a party to the contract between NHS and Maryland. Therefore, legal counsel for the Department believes there is not a significant risk of NMIC being held directly liable for contract based claims.

46. The Department is not aware of any evidence which indicates NMIC participated in the creation of the proposal for the MDHIX project, or that NMIC was involved in any communications with Maryland leading up to the contract award to NHS. However, two NMIC individuals were identified in the proposal as key project staff,

including a person with an NMIC title who was also president of one of NHS's subcontractors.

47. While NMIC's management believes it would prevail in any litigation brought by Maryland against NMIC, litigation against NMIC could negatively impact both its existing insurance business and its ability to attract new business.

48. Legal counsel for the Department believes Maryland would attempt to hold NMIC liable for any actions of NHS based on some form of derivative liability. The Department believes Maryland would attempt to assert derivative liability on NMIC based primarily on NMIC's financial support of NHS through the bond guaranty and other NMIC support of NHS through enterprise staffed functions, such as information technology.

49. It is unclear what discovery might reveal and an issue of fact for a jury could potentially be created regarding potential liability of NMIC on derivative liability claims or any secondary claims made without NMIC going through the full discovery process.

50. NMIC could potentially be in a difficult position if the case is put to a Maryland jury.

NHS's Value to NMIC and its Policyholders

51. NHS processes over 119,000,000 Centers for Medicare & Medicaid Services ("CMS") claims, serves approximately 13,100,000 beneficiaries, and approximately 290,000 healthcare providers each year under its federal contracts.

52. Almost all of NHS's revenues are generated from federal contracts awarded by the CMS. Legal counsel for the Department believes there is a substantial

likelihood the pendency of litigation would have significant negative consequences on NHS's ability to receive extensions of existing contracts or to receive new contracts. There is also a possibility of NHS's existing contracts being terminated.

53. NHS's core government contracting business has historically been relatively low risk and profitable. NHS company profitability has generally suffered during federal contract transition years or when it expanded into new areas outside its core business lines, including when it took on the MDHIX project.

54. NHS's federal contract performance ratings overall have generally been "very good" or "excellent."

55. NHS's past performance and technical expertise have recently led CMS to award NHS another five-year contract for its durable medical equipment work, which has an estimated value of \$137,000,000 in revenue over the contract term.

56. NHS received notice that CMS intends to extend one of NHS's existing Medicare contract for at least two additional years, combined with a presentation to and response from the U.S. Department of Health and Human Services Suspension and Debarment Officer who did not convey any present intent to commence suspension or debarment proceedings against NHS, sufficiently suggests NHS's present and future business opportunities are unlikely to be affected by the settlement with Maryland.

57. The 2015 NMIC budget provides for approximately \$54,000,000 in services to be furnished to NHS, for which NHS compensates NMIC for its costs related thereto. If NHS were to no longer require NMIC services due to the effects of litigation with Maryland, NMIC would have to absorb the stranded fixed costs and any stranded variable costs that had not fully wound down, along with severance pay related to any

NMIC reductions in force in areas providing shared services. The value to NMIC of NHS absorbing this overhead is \$12.6 million annually.

CONCLUSIONS OF LAW

1. The Commissioner has jurisdiction over the proposed acquisition pursuant to N.D.C.C. ch. 26.1-10.

2. The Form D statement, as supplemented, meets the filing requirements of N.D.C.C. § 26.1-10-05.

3. The Applicant has met the procedural requirements of N.D.C.C. ch. 26.1-10 with regard to seeking and receiving approval of the requests submitted within the Form D application.

4. An order approving or disapproving the requests made within the Form D filing may be issued based upon the contents of the Form D and supplemental materials filed with the Commissioner by the Applicant.

5. N.D.C.C. § 26.1-10-05(1) states that transactions within an insurance company holding system are subject to the following standards:

- a. The terms must be fair and reasonable.
- b. Agreements for cost-sharing services and management must include provisions as required by rules adopted by the Commissioner.
- c. The books, accounts, and records of each party must clearly and accurately disclose the precise nature and details of the transactions, including that accounting information that is necessary to support the reasonableness of the charges or fees to the respective parties.

- d. The insurer's surplus as regards to policyholders following any dividends or distributions to shareholder affiliates must be reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs.
- e. Charges or fees for services performed must be reasonable.
- f. Expenses incurred and payment received must be allocated to the insurer in conformity with statutory accounting practices consistently applied.

6. N.D.C.C. § 26.1-10-05(2)(a) says investments made by a domestic insurer involving a domestic insurer and any person in its insurance company holding system involving the lesser of 3 percent of the insurer's admitted assets or 25 percent of surplus as regards policyholders as of December 31 next preceding may not be entered unless the insurer has notified the Commissioner in writing of its intention to enter into the transaction at least 30 days prior thereto and the Commissioner has not disapproved it within that period.

7. N.D.C.C § 26.1-10-05(2)(a) states that NMIC's proposed investment in NHS of up to \$18,250,000 as outlined in the Form D is subject to the requirement that NMIC notify the Commissioner in writing of its intention to enter into the transaction at least 30 days prior thereto and the Commissioner has not disapproved it within that period as the proposed investment is greater than the lesser of 3 percent of the insurer's admitted assets or 25 percent of surplus as regards policyholders as of December 31 next preceding. Admitted assets at December 31, 2013, were \$458,189,154 and surplus was \$199,087,591. Three percent of the December 31, 2013,

admitted assets equaled \$13,745,675.

8. N.D.C.C. § 26.1-10-05(2)(e) states any guarantee made by a domestic insurer involving any person in its insurance company holding system exceeding the lesser of one-half of 1 percent of the insurer's admitted assets or 10 percent of surplus as regards policyholders as of December 31 next preceding may not be entered unless the insurer has notified the Commissioner in writing of its intention to enter into the transaction at least 30 days prior thereto and the Commissioner has not disapproved it within that period. One-half of one percent of the insurer's admitted assets at December 31, 2013, was equal to \$2,290,946.

9 The proposed guarantee by NMIC as outlined in the Form D is \$45,000,000 making this proposed transaction subject to the requirement that NMIC notify the Commissioner in writing of its intention to enter into the transaction at least 30 days prior thereto and the Commissioner has not disapproved it within that period.

10. N.D.C.C. § 26.1-10-05(2)(d) says all management agreements made by a domestic insurer involving any person in its insurance company holding system may not be entered unless the insurer has notified the Commissioner in writing of its intention to enter into the agreement at least 30 days prior thereto and the Commissioner has not disapproved it within that period.

11. The proposed management agreement between NMIC and NHS involves a domestic insurer and any person in its insurance company holding system making this proposed agreement subject to the requirement that NMIC notify the Commissioner in writing of its intention to enter into the transaction at least 30 days prior thereto and the Commissioner has not disapproved it within that period.

12. N.D.C.C. § 26.1-10-05(4) says the Commissioner, in reviewing the requests for approval within the Form D, shall consider whether the transactions comply with the standards set forth in N.D.C.C. § 26.1-10-05(1)(a-f) and whether the transactions may adversely affect the interests of policyholders.

13. The transactions comply with the standards set forth in N.D.C.C. § 26.1-10-05(1)(a-f), as applicable.

14. Based on the Findings of Fact, the transaction would be fair and reasonable. NHS and NMIC face potential liability to Maryland in excess of \$100 million. The settlement amount agreed upon by the parties is less than half of what Maryland would seek in litigation and would avoid the expenditure of approximately \$15 million in legal fees between NHS and NMIC and release all claims upon the \$10 million bond guaranteed by NMIC.

15. Based on the Findings of Fact, NMIC's policyholders could be negatively affected if the transactions proposed by NMIC are not approved. The proposed transactions will allow NMIC to avoid additional litigation costs and expenses and preserve NHS's value to NMIC and its policyholders. Based on the Findings of Fact, NMIC, through the Intercompany Agreement with NHS, will provide additional oversight of NHS in order to help ensure that NHS has the ability to make its payments under the Settlement Agreement with Maryland and that NHS does not put NMIC at additional material financial risk.

NOW, THEREFORE, based upon the above Findings of Fact and Conclusions of Law, the Commissioner enters an Order as follows:

ORDER

NMIC's request for approval of the NMIC Settlement Payment Guarantee Agreement with the State of Maryland is **HEREBY GRANTED**.

NMIC's request for approval of a capital contribution of up to \$18,250,000 by NMIC to NHS is **HEREBY GRANTED**.

NMIC's request for approval of the Intercompany Agreement between NMIC and NHS is **HEREBY GRANTED**.

The proposed transaction under the provisions of the Form D Statement Prior Notice of a Transaction filed with the Commissioner of Insurance is **HEREBY APPROVED**.

The Commissioner will retain jurisdiction over the subject matter of this proceeding and over the parties for the purpose of entering such further order or orders as may be deemed proper.

DATED this 9th day of December, 2015.



Adam Hamm
Commissioner
North Dakota Insurance Department
600 East Boulevard Avenue, Dept. 401
Bismarck, ND 58505
(701) 328-2440