



the association and small group markets, thereby creating some predictability in the premiums charged to the Company's subscribers from year to year?

- C. Should the Company be ordered to file an approved plan to recover that portion of post-employment compensation of the Company's former chief executive officer deemed by the Commissioner to be excessive under the insurance laws of this state, under the health insurance laws specifically applicable to the Company, and under Vermont's non-profit corporation laws?
- D. Should the Commissioner assert continuing jurisdiction over this proceeding, and issue such further supplemental orders as are necessary to insure that benefits and services are provided to subscribers at minimum cost under efficient and economical management of the Company? and

Whereas, the Department and the Company have engaged in discussions concerning how to achieve the Commissioner's regulatory goals as set forth in her November 3, 2009 Order without the need for a litigated administrative proceeding, and

Whereas, the Department and the Company have acknowledged that they share several common goals relating to cost containment, and they have accordingly agreed on a plan to achieve those goals, as set forth below and in Para A of this Order. The Commissioner acknowledges that the Company has made significant efforts to manage the medical costs of its members, and that the Company's medical cost management programs are comparable to, and strive to exceed those of many other health insurance companies. The Commissioner also acknowledges the Company's willingness to engage in a cooperative dialogue with the Commissioner relating to its cost containment efforts, and

Whereas, the Commissioner has found that medical trends in Vermont are not sustainable for individual Vermonters and Vermont businesses, and that more effective and expedited cost containment strategies and initiatives are needed, and

Whereas, the Commissioner has found that the ability of the Company to further manage the medical costs of its members may be strengthened by the Department's support for the Company's cost containment efforts in the larger health care community of Vermont, and

Whereas, the Company intends to evaluate alternative benchmarks, and adopt appropriate benchmarks through which it can assess and improve its programs to manage health care costs while at the same time assuring quality care for its members, and to use these benchmarks to guide its efforts to manage and reduce the rate of growth of medical trend across all plans for calendar years 2011 and 2012, and

Whereas, the Company intends to evaluate certain cost containment strategies, and to identify in a Medical Cost Containment Plan to be provided to the Commissioner within 45 days following the Commissioner's execution of this Order those strategies it believes have a reasonable potential for lowering medical trend during calendar year 2011. The Company has committed to engage in a similar evaluation process and file a second Medical Cost Containment Plan with the Commissioner on or before March 1, 2011, including in the Plan those strategies it believes have a reasonable potential for managing medical trend during calendar year 2012. The Company intends to evaluate

for possible inclusion in its 2010 Medical Cost Containment Plan the following cost containment strategies identified by the Commissioner or the Company during the course of their discussions since the issuance of the foregoing Order to Show Cause:

1. The analysis of data on variations in health care costs and utilization available through the Vermont Healthcare Claims Uniform Reporting and Evaluation System (“VHCURES”), and the application of the analysis, without compromising quality outcomes for patients, to changes in reimbursement methodologies, benefit design, and other cost-effective initiatives;
2. The development and implementation of a health policy strategy to minimize the impact of Medicare and Medicaid reimbursements on the Company’s health insurance rates (recognizing that the Company has limited ability to affect said impact);
3. The development of strategies to partner with employers (in particular, large group employers) to advance the Plan’s initiative to create a culture of wellness designed to lower medical costs reflected in health insurance premiums by helping employers improve the health of their employees;
4. The development of alternative, lower cost products, including a “healthy choices” discount product or employer-sponsored wellness product;
5. Continuation of an on-going dialogue with the Commissioner to identify cost containment issues where the Department can appropriately support collaboration between the Company and health care providers to contain health care costs; for example, restructuring contracts with hospitals to implement reimbursement reforms such as Diagnostic Related Group reimbursement or fixed fee schedules.

Whereas, the Department and the Company have agreed that rate volatility and membership instability in the association and small group markets are serious problems with negative impacts for Vermont subscribers; but the Department and the Company also agree that these problems are for the most part beyond the ability of one health insurance company to remediate. Furthermore, the Department and the Company also acknowledge that recently enacted federal health care legislation will require significant changes in state health insurance laws and regulation of the small group and association markets, and that these changes mandated by federal law have as a practical matter superceded the need for, and the feasibility of issuing a supplemental order to address these issues, and

Whereas, the Commissioner included in her November 3, 2009 Order an examination of the retirement compensation of the former chief executive officer of the Company, William R. Milnes (“Mr. Milnes”), because the Commissioner had reason to believe that such compensation was excessive, and because the Commissioner had expressed her belief that such compensation may have violated certain provisions of law applicable to the Company, and

Whereas, the Commissioner acknowledges that the Company has made significant changes to its executive compensation policies since the retirement of Mr. Milnes. Specifically, the Company has hired a new executive compensation consultant, the Company has clarified that the Executive and Compensation Committee is

responsible for establishing the total compensation strategy for the Company's officers, the Company has acknowledged that compensation levels must recognize the unique characteristics of the Vermont market, the Company had directed the Executive and Compensation Committee to conduct an annual review of executive total compensation, and the Company has directed the Executive and Compensation Committee to ensure transparency and disclosure to the Board on executive compensation decisions. Don George, the current chief executive officer of the Company, had his Supplemental Executive Retirement Plan frozen as of March 2, 2009, the date when Mr. George was elected President and chief executive officer. The Company has revised compensation targets and standards for every executive position through peer comparisons, including reference to the Vermont market, and has confirmed compensation levels for each executive. The Company has terminated its Long Term Incentive Program for executive compensation. The Company's annual incentive program targets for executive compensation have been revised to set what the Company asserts are "industry leading" performance targets, and annual incentive stretch goals are set at what the Company asserts are "best in class" performance goals, and

Whereas, notwithstanding the Company's recent revisions to its executive compensation policies, the Commissioner has certain regulatory duties, among which is an obligation to examine whether the Company's executives are being compensated in a manner consistent with the law when facts are brought to her attention giving her reason to question whether executive compensation is, or has been excessive. In determining whether Mr. Milnes' retirement compensation was excessive, the Commissioner has made diligent inquiry of the facts and the law pertaining to the matter, and based on such inquiry the Commissioner makes the following Findings of Fact and Conclusions of Law<sup>1</sup>:

#### General Findings of Fact

1. The Company is a nonprofit corporation established under 8 V.S.A. Chapter 123 to maintain and operate a hospital plan under Chapter 123 and a medical service plan under Chapter 125. It is required to be "maintained and operated solely for the benefit of subscribers," and to provide services "intended to insure that subscriber benefits are provided at minimum cost under efficient and economical management." 8 V.S.A. § 4512(a) and (c).
2. As used hereafter in this Supplemental Order the term "annual compensation" means the sum of base salary and incentive bonus compensation payments under Mr. Milnes' employment agreements with the Company, including compensation from the Company's affiliates. As used hereafter in this Supplemental Order, the term "retirement compensation" means the sum of compensation under Mr. Milnes' Supplemental Executive Retirement Plan ("SERP") agreement and the "qualified" retirement plan.

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<sup>1</sup> As noted in the "Consent of Blue Cross Blue Shield of Vermont" at p.21 of this Supplemental Order, the Company has neither admitted nor denied the Commissioner's Findings of Fact and Conclusions of Law; nevertheless the Company has acknowledged the jurisdiction of the Commissioner to issue these Findings of Fact and Conclusions of Law, and to issue this Supplemental Order.

3. Following Mr. Milnes' retirement, and notification by the Company in regulatory filings with the Department on March 2, 2009 that total payments to Mr. Milnes in 2008 amounted to \$7,354,465, the Commissioner issued a subpoena to the Company for records relating to Mr. Milnes' employment and compensation. Payments to Mr. Milnes at the time of his retirement included, a \$6,484,197 payment under Mr. Milnes' SERP agreement with the Company, which he elected to receive as a lump sum, and a \$526,881 payment under the "qualified" retirement plan in addition to salary and incentive bonus payments totaling \$883,630. See 2008 Supplemental Compensation Exhibits filed for BCBSVT and TVHP. The Company has informed the Department that it has not paid Mr. Milnes certain incentive bonus compensation payments which were to have been paid in 2009 and that it does not intend to make those payments
4. The Commissioner found in her Order of November 3, 2009 that she had reason to question whether the payment to Mr. Milnes was made in violation of Vermont law, specifically: (a) whether the payment was made in violation of 8 V.S.A. § 3504 ("an insurance company \* \* \* , in addition to all other powers granted to it by law, may provide a pension in pursuance of the terms of a retirement plan, adopted by its board of directors and approved by the commissioner \* \* \*"); (b) whether the payment was made in violation of the Company's special obligation to maintain and operate its health insurance plans "solely for the benefit of the subscribers thereof \* \* \*", and "to insure that benefits and services are provided at minimum cost under efficient and economical management of the corporation." 8 V.S.A. §§ 4512(a) and 4513(c); and (c) whether the payment was made in violation of the obligations of the officers and directors of the Company to discharge their duties "in a manner the director [or officer] reasonably believes to be in the best interests of the corporation." 11B V.S.A. §§ 8.30(a) and 8.42(a).
5. In response to the Commissioner's Order, the Company entered into the record of this proceeding its analysis of the legality of the retirement compensation paid to Mr. Milnes. See Company's Letter and Report, Exhibit A, incorporated by reference herein. The Company argues that the retirement payments to Mr. Milnes did not violate the law, asserting *inter alia* that 8 V.S.A. § 3504 does not require the Commissioner's approval of Mr. Milnes' pension plan because this statute constitutes express authorization for an insurance company to provide a pension "in addition to all other powers granted to [the insurance company] by law". Because the general law of nonprofit corporations authorizes the Company to compensate its officers and employees and provide for pensions, the Company argues that it has legal authority to provide a pension to its officers and employees without the approval of the Commissioner. The Company also argues, *inter alia*, that the SERP is a binding contract and there is no strong basis for recovering the amounts already distributed. The Company has also asserted that Mr. Milnes' total compensation was reasonable when compared to the total compensation of the executive officers of other similar health insurance companies. Third,

the Company argues *inter alia* that the payments to Mr. Milnes did not violate the fiduciary obligations of the officers and directors of the Company because the payments were not excessive, and because the officers and directors were legally protected from a claim that the payments were excessive by the “business judgment rule.” 11B V.S.A. §§ 8.30(b) and 8.42(b).

6. The Commissioner has carefully considered the Company’s Letter and Report, and has made further inquiry to determine whether Mr. Milnes’ retirement compensation was excessive and in violation of the law. An independent expert hired by the Department has reviewed the Company’s compensation of Mr. Milnes. The report of the Department’s independent consultant, concluding in part that Mr. Milnes was awarded excessive compensation, is incorporated by reference herein as Exhibit B.
7. The Department also has consulted with the Vermont Attorney General’s Office, in order to assess the legal merits of a potential claim to recover any compensation made to Mr. Milnes by the Company which may be found as excessive.

Conclusions of Law with respect to Section 3405.

8. The Commissioner concludes as a matter of law that the plain meaning of 8 V.S.A. § 3405 does not require the Commissioner’s approval of Mr. Milnes’ retirement compensation or pension if some other statute authorizes the Company to make those pension payments to Mr. Milnes. The Commissioner concludes that the general nonprofit corporation laws provide such authority to the Company, and that therefore the Commissioner’s approval of Mr. Milnes’ pension is not required.<sup>2</sup>

Findings of Fact with respect to Mr. Milnes’ Compensation

9. The Commissioner makes the following Findings of Fact based on the records provided to the Department by the Company pursuant to the Commissioner’s March 2009 subpoena, and the facts included in the Company’s Letter and Report, Exhibit A. The Commissioner’s Findings of Fact are also based on

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<sup>2</sup> The Commissioner does not agree with the Company’s argument that it is not an “insurance company” under Chapter 101 of Title 8, and that therefore the company is not subject to § 3405 or any other provision of Chapter 101. The Commissioner notes, for example, that Chapter 101 contains many of the fundamental financial and regulatory requirements applicable to all insurance companies, including the filing of an annual financial statement, the authority of the Department to examine the financial records and market conduct, standards for reinsurance, and the regulation of insurance holding companies. While the Company has been formed and is subject to the provisions of Chapters 123 and 125 of Title 8, the Company is also subject to the provisions of Chapter 101 of Title 8 unless expressly excluded from its provisions by the plain meaning of the statute. For example, prior to the 2004 Session of the General Assembly the Holding Company statutes, Subchapter 13 of Chapter 101 of Title 8 were expressly made inapplicable to the Company; since the enactment of these amendments the Company has been obligated to comply with the Holding Company statutes and their requirements.

the report of the Department's independent executive compensation consultant, Exhibit B, incorporated by reference herein.

*The Company's compensation policies*

10. Mr. Milnes began employment with the Company as President and Chief Executive Officer on March 26, 1998. Exhibit A, page 2.
11. When Mr. Milnes was initially hired, his compensation included a base salary of \$260,000 with an additional incentive payment of up to one-third of that base salary. 1998 Employment Agreement. The Company also agreed to provide Mr. Milnes with certain benefits, including a Supplemental Executive Retirement Plan ("SERP") that meant, in combination with benefits payable under the Company's "qualified plan", Mr. Milnes would continue to receive income after retirement equal to 60% of his final BCBSVT pay, calculated and determined by reference to Mr. Milnes' highest five year base and incentive bonus compensation. Exhibit A, pages 2-3.
12. The Company did not seek or receive approval of the Commissioner for the Company's compensation agreements with Mr. Milnes, either at the time of hire or any time subsequent to his hire
13. The Company engaged consultants to report on market level compensation and to advise the Company on appropriate compensation levels, including compensation to be paid to Mr. Milnes.
14. The Company increased Milnes' compensation on an annual basis, and determined to award incentive bonus compensation amounts based on achievement of corporate goals, increasing the value of future SERP payments to Mr. Milnes.
15. The Company's Board of Directors had a compensation policy of paying executives, including the President and CEO, "a base salary at the 25<sup>th</sup> percentile for a comparable position" with an opportunity to earn additional income through both short and long-term incentive bonus compensation programs. CEO Compensation, Report of Executive Committee, March 2007, page 3. The Company has stated that it "benchmarks executive compensation levels against compensation levels of comparable companies in New England and across the United States." See 2008 Supplemental Compensation Filing, March 2, 2009.
16. The Company's executive compensation policies translated into an annual compensation formula for Mr. Milnes which generally established annual base salary at the 25<sup>th</sup> percentile for companies determined by the Company or its consultants to be "comparable", and base salary plus performance incentives at the 50<sup>th</sup> – 75<sup>th</sup> percentile. CEO Compensation, Report of the Executive Committee, March 2007, page 3. The Department's independent consultant has characterized Mr. Milnes' compensation arrangement as "a classic pay-for-performance" design. Exhibit B, page 1.

17. Mr. Milnes' base salary when hired in 1998 was \$260,000. In 2004, Mr. Milnes' base salary had increased to \$385,000 and he was awarded additional incentive bonus compensation totaling \$401,300. By 2008 his original base salary had doubled, increasing to \$525,000, with total 2008 annual compensation of \$981,910.

*Executive compensation at BCBS companies versus compensation at non-BCBS managed care organizations*

18. Chief executive officer compensation within Blue Cross Blue Shield ("BCBS") companies is significantly higher than compensation levels at comparably-sized non-Blue Cross Blue Shield companies. The Company was explicitly informed by its executive compensation consultants of this significant difference in compensation levels. BCBS Vermont, CEO Compensation Report, Mercer Human Resource Consulting, March 2003, page 2. Materials and analysis provided by the Company to the Department do not include any explanation or justification for the demonstrably higher compensation paid by BCBS organizations to their chief executive officers.
19. In developing data on compensation for chief executive officers of comparable companies between 2003 and 2008, the Company relied primarily on a single executive compensation consultant, Mercer Human Resource Consulting ("Mercer") to identify "comparable" companies. Different "peer group" data was collected by Mercer in different years, including: a peer group of BCBS-only companies; a peer group of managed care organizations; and a peer group of Northeast managed care and health care organizations. In 2007, these comparisons showed that Mr. Milnes received annual compensation approximately 25% less than the median compensation in the BCBS-only peer group, and 25% more than the median compensation in the managed care organization peer group. Executive Compensation Review, Mercer Human Resource Consulting, March 7, 2007, pages 12-14.
20. In 2005, the Company decided to increase Mr. Milnes' base salary for 2006 from \$425,000 to \$475,000 when the appropriate percentile benchmark, utilizing data from similarly sized managed care organizations, was \$341,000. Blue Cross Blue Shield Vermont CEO Compensation Report, December 2005, p.3. In 2007, the Company again increased Mr. Milnes' base salary by reference to a benchmark it characterized as based on data from "comparable companies", although the new salary of \$500,000 actually corresponded with the 25<sup>th</sup> percentile of a "Blues Only" peer group with demonstrably higher compensation levels than a composite group of similarly sized managed care organizations. At that time, the managed care organization benchmark (25<sup>th</sup> percentile) was \$346,000 and a subset, focused on managed care and healthcare organizations in the Northeast, was only \$300,000. Executive Compensation Review, President and CEO Report, Mercer Human Resource Consulting, March 7, 2007, page 12.
21. Peer group data from non-Blue Cross Blue Shield managed care companies was available to the Company for use in establishing Mr. Milnes'

compensation, or in developing a “composite” peer group using combined data from the two groups of companies. President and CEO Compensation Assessment, Mercer Human Resources Consulting, February 27, 2008, page 7. Nevertheless, the Company documents demonstrate a reliance upon data from a BCBS-only peer group in establishing Mr. Milnes’ compensation levels. Report of the Executive Committee, March 2007, page 13.

22. The Department’s consultant has observed, and the Commissioner so finds, that in setting Mr. Milnes’ compensation the Company focused on a peer group consisting of BCBS-only companies, even though there does not appear to be any rational basis for excluding non-Blue Cross Blue Shield companies in the peer group for comparison purposes. Exhibit B pages 4, 5. The Department’s independent consultant has observed, and the Commissioner so finds, that both groups of companies need a chief executive officer with similar skills, knowledge of the specific health insurance market relevant to the companies, and knowledge of how services are delivered in these markets.
23. Executive compensation for executives and officers at the Company other than Mr. Milnes was determined by reference to a lower benchmark established in part by reference to managed care organizations rather than the higher paying BCBS-only group used in compensating Mr. Milnes. Executive Compensation Report, Summary of 2000-2007, Draft Report for Internal Review, April 9, 2007, Mercer (p.17).
24. The Department’s independent consultant believes, and the Commissioner so finds, that appropriate compensation levels can be determined in large part by reference to recruiting patterns, and there is no evidence that the Company cannot and does not recruit qualified executives from non-BCBS plans. Exhibit B, p 5.

*The “peer group” of BCBS companies used to determine Mr. Milnes’ compensation was not “comparable” to the Vermont Company*

25. The peer group composed of BCBS-only companies used in 2007 to review Mr. Milnes’ salary included 14 companies, all but one of which were substantially larger in terms of annual gross premiums than the Company. Of these 14 companies, the Excellus (BCBS) Health Plan in New York (the largest company included in the pool) had gross premiums of \$4.5 billion, compared to the Company’s 2007 gross premiums of \$590 million. Nine of the 14 companies had gross premium in excess of \$1 billion. Mercer Consulting, Executive Compensation Review, March 7, 2007 (p.26).
26. The peer group of managed care organizations developed in 2007 but apparently not used to establish Mr. Milnes’ compensation included 26 companies, only six of which had annual gross premiums greater than \$1 billion. The median annual gross premiums of these 26 health insurance companies was \$682.7 million, or slightly higher than the Company’s annual gross premium of \$590 million. Mercer Consulting, Executive Compensation Review, March 7, 2007 ( p.27).

27. The Department's independent consultant reviewed BCBS-only companies' peer group executive compensation data developed in October 2007 by a different compensation consultant. This data, developed for another BCBS company but available to the Company, reflected compensation data from 13 Blue Cross Blue Shield organizations with revenue much more comparable to the Company than the Blue Cross Blue Shield companies included in the Mercer peer group. The Department's independent consultant is of the opinion, and the Commissioner so finds, that more reliable and appropriate peer group data should have been used by the Company in establishing valid comparisons for purposes of setting Mr. Milnes' compensation. As a result, Mr. Milnes compensation was significantly higher than if the appropriate peer group data had been used. Exhibit B, page 7.
28. The Department's independent consultant believes, and the Commissioner so finds, that the "peer group" of health insurance companies used by the Company to determine Mr. Milnes' annual compensation inappropriately included a number of companies which are of a much greater size than the Company. Exhibit B, pages 2-3. While the Company's consultants applied a discount to these larger companies to arrive at a peer group for the Company, the Department's independent consultant is unable to determine whether the discount so applied was reasonable. Exhibit B, page 6. At high salary levels, even a relatively small discrepancy in applying a discount can result in a large difference in actual compensation. Based on his review of the Company's records, the Department's independent consultant has determined, and the Commissioner so finds, that the potential is great for Mr. Milnes' annual salary to have been much higher than the "true competitive range for the position." Exhibit B, page 6.

*Mr. Milnes' short- and long-term incentive bonus compensation payments*

29. In addition to his base salary, Mr. Milnes was eligible to earn short-term and long-term incentive bonus compensation payments. In 2003, Mr. Milnes was eligible for short-term (annual) incentive bonus compensation of as much as 33% of base salary. In 2006, total incentive bonus compensation payments to Mr. Milnes were \$411,271, in addition to base salary of \$475,000. CEO Compensation, Report of the Executive Committee, March 2007, pages 4, 6-7, 12-14. In 2007, the addition of incentive bonus compensation payments resulted in total direct compensation of \$987,657.
30. Mr. Milnes' short-term and long-term incentive bonus compensation payments were based on criteria which permitted a payment greater than 100% of the incentives. For example, in 2006 the Company determined that Mr. Milnes achieved 122.5% of his long-term incentive goals. Executive Summary of the Report and Analysis of the Administrative Expenses of Blue Cross Blue Shield of Vermont, Deloitte Consulting ("Deloitte"), September 14, 2007, pages 16, 20. In some years, Mr. Milnes was awarded incentive bonus compensation that was well in excess of his base salary. i.e., 2004 (base of \$385,000 and incentive bonus compensation of \$401,300) and 2005 (base

of \$425,000 and incentive bonus compensation of \$489,800). The Department's independent consultant agrees with Deloitte, which was critical of the Company's incentive program under which Mr. Milnes was frequently paid incentive payments in excess of 100% of the performance target, and the Commissioner so finds that the Company's incentive program was flawed for this reason among others. Exhibit B, page 1.

31. The Commissioner issued an Order on January 18, 2007 directing the Company to make an independent inquiry into the Company's administrative costs. Consent Order, Docket No. 08-102-H. As a result of the Commissioner's Order, an independent consultant, Deloitte, was retained by the Company. Deloitte found that, while the Company's overall compensation was at or below market averages for the executive team, the incentive program was flawed because it paid out at or above target more frequently than would be expected. Consequently, Deloitte recommended that the Company recalibrate its incentive targets to focus the incentives of the management team to clear stretch goals. Report and Analysis of the Administrative Expenses of Blue Cross Blue Shield of Vermont, Sept. 14, 2007, pages II-75 – II-76. The Commissioner agrees with these findings and adopts them as her own. Deloitte made a number of recommendations, accepted by the Company, to reduce its administrative costs, including a recommendation that the criteria for incentive bonus payments to Mr. Milnes and other executive officers be amended to establish more rigorous performance targets. Executive Summary of the Review and Analysis of the Administrative Expenses of Blue Cross Blue Shield of Vermont, Deloitte Consulting, September 14, 2007, pages 16, 20-21 and Commissioner Thabault, Letter dated January 18, 2008.

*Mr. Milnes' SERP retirement compensation*

32. As Mr. Milnes' annual compensation increased, the expected value of his retirement compensation also increased, as retirement compensation was calculated as a percentage of his annual compensation. In determining to increase Mr. Milnes' salary and incentive bonus compensation opportunities, there is no evidence that the Company separately considered or calculated the impact on SERP benefits that would accrue to Mr. Milnes upon the termination of his employment. The Commissioner similarly has found no evidence that the Company separately considered or calculated the impact on SERP payments of the increasingly large incentive bonus payments it awarded Mr. Milnes on a routine basis.
33. Most Blue Cross Blue Shield companies include some form of "supplemental retirement plan" in compensation agreements with their executive officers. Most Blue Cross Blue Shield companies have established an objective for income replacement of between 50% and 70%. Mercer Consulting, October 16, 2006, page 1. Competitive Practice - Nonqualified Deferred Compensation Plans. Mercer, the Company's primary consultant, did not identify whether its comparison data considered "income" for purposes of the income replacement

calculation to include only base salary compensation, or whether “income” should include base salary plus incentive compensation. Mr. Milnes’ SERP retirement plan calculated his retirement compensation based on a consideration of “income” as including both base salary and incentive compensation. Mercer Human Resource Consulting, October 16, 2006, page 1, Exhibit 2, Summary of Assumptions and Methodologies.

34. The Company’s most recent compensation consultant, Sullivan Cotter, found that income replacement benefits such as were provided in Mr. Milnes’ SERP plan typically ranged from 40% - 70%. 2009 Executive Compensation Review, Sullivan Cotter, June 15, 2009, page 16.
35. The Department’s independent consultant believes, and the Commissioner so finds, that the general structure of Mr. Milnes’ SERP agreement with the Company was generous, but that when compared to retirement agreements entered into by other Blue Cross Blue Shield companies and other similar types of companies, not particularly unusual. Exhibit B, page 1.
36. While it is not uncommon to include short-term annual incentive bonuses within the definition of “income” for the purpose of calculating “percent of income” retirement plans, it is not common to include long term incentives within the definition of “income.” 2009 Executive Compensation Review, Sullivan Cotter, June 15, 2009, pages 16 and 47. By including long-term incentive payments in the 60% calculation of annual replacement income for Mr. Milnes, the lump sum received by Mr. Milnes following his retirement was significantly higher than prevailing practices.

*Mr. Milnes’ total retirement compensation*

37. In January 2009, the Company engaged its pension actuary, JPMorgan Compensation and Benefit Strategies, to estimate the 2008 value of Mr. Milnes’ SERP. JPMorgan concluded that the projected benefit obligation of the Company under Mr. Milnes’ SERP as of January 1, 2008 was \$4.8 million. 2008 Actuarial Valuation, JPMorgan Compensation and Benefit Strategies, January 2009, page 2, 5. When Mr. Milnes retired at the end of November 2008, he received in December 2008 a lump sum of \$6,484,197 under the SERP, 35% higher than projected. 2008 Supplemental Compensation Filing, March 2, 2009. The reason for the difference between the estimated SERP payment, and the actual SERP obligation was in part due to the earlier than expected retirement date, increased salary calculations, actuarial adjustments and change in interest rate assumptions. Exhibit A, p.7.
38. Based on a February 27, 2008 analysis, when accrued annualized retirement benefits were added to Mr. Milnes’ annual compensation, his total annual remuneration in 2006 was \$1.08 million, compared with \$665,000 when compared to the 25<sup>th</sup> percentile of a peer group composed of comparable managed care organizations. Mercer Consulting. President and CEO Compensation Assessment, “Discussion Draft”, February 27, 2008, page 43. That same report concluded that (i) the annual value of retirement benefits

provided to Mr. Milnes was substantially in excess of the median, and above the 75<sup>th</sup> percentile of market practice.

*Mr. Milnes' was paid excessive compensation by the Company*

39. The Department's independent consultant observes, and the Commissioner so finds, that the annual compensation of Blue Cross Blue Shield chief executive officers appears to be approximately 45% to 50% higher than the annual compensation paid to executive officers of comparably-sized health insurance companies not affiliated with Blue Cross Blue Shield plans nationally when measured at the 25<sup>th</sup> percentile of each respective pool. Exhibit B, page 5.
40. The Department's independent consultant observes, and the Commissioner so finds, that from 2005-2007, at a time when chief executive officer compensation for Blue Cross Blue Shield companies was increasing at a rate of 10% annually, executive compensation nationally was increasing at a rate of 5-6% annually. Exhibit B, page 5.
41. The Department's independent consultant determined, and the Commissioner so finds, that if a peer group had been developed as a "composite" of the Blue Cross Blue Shield only peer group, and a peer group composed of non-Blue Cross Blue Shield companies, the trajectory of Mr. Milnes' salary "would have been very different", and estimated that difference to be at least 25% lower than what it was. Exhibit B, page 5.
42. Based on the above findings, the Commissioner finds that the Company paid excessive compensation to Mr. Milnes.

*The Company's revised executive compensation policies*

43. Since the Department initiated its investigation, the Company has taken a number of significant actions in response to questions and concerns relating to Mr. Milnes' compensation. First, the Company reports that it attempted to recover amounts paid to Mr. Milnes under the SERP. The Company's leadership has also reportedly attempted to meet with Mr. Milnes, and have communicated to Mr. Milnes and to the attorney retained by Mr. Milnes the Company's desire that Mr. Milnes repay some portion of the lump sum SERP payment. These efforts have not led to recovery or repayment of any funds by Mr. Milnes. Exhibit A.
44. During the same time period, the Company's Executive Committee reports that it met ten times for the primary purpose of reviewing and revising the Company's executive compensation policies and practices. Policy revisions and other related changes include: (a) retaining a new executive compensation consultant, (b) clarification that the Executive Committee is responsible for establishing the total compensation strategy for the Company's employees, (c) determining that "[t]otal cash compensation for all employees should be competitive with the appropriate market, allowing flexibility in setting pay based on the facts and circumstances of each situation," BCBSVT Total Compensation Philosophy, page 1, (d) acknowledgement that compensation levels must recognize the unique characteristics of the Vermont market, (e) a

requirement that the Executive Committee conduct an annual review of executive total compensation, and (f) a requirement that the Executive Committee ensure transparency and disclosure to the Board on executive compensation decisions.

45. By action of the Company's Executive Committee, the participation of Don George, the current chief executive officer, in the executive SERP was frozen as of March 2, 2009, the date when Mr. George was elected president and chief executive officer of the Company. The Company asserts that the present value of the projected savings (assuming retirement at age 65) to the Company attributable to this decision is \$1,442,012.
46. The Company also states that, at the direction of the Company's Executive Committee, every executive position was reviewed and revised to reflect peer comparisons that reference the Vermont market. The Company's long-term incentive program has been terminated, under which program annual distributions to the Company's executive officers averaged \$364,000 from 2005 through 2009. Excerpt from the Company's March 3, 2010 Executive Committee presentation. The Company further asserts that 2010 annual incentive program targets have been set so as to award incentive bonus compensation for "industry leading" performance, and stretch goals have been set at "best in class" performance.
47. As an additional cost-saving measure, the Company's Executive Committee acted to reduce meeting fees for all board committees by approximately 50% per meeting and the Board Chair reduced his own retainer by \$2,000. Minutes of Executive Committee meeting, June 15, 2009. The Board of Directors has also agreed to undertake a comprehensive evaluation of ways to further reduce Board compensation. Minutes of Board of Directors Meeting, May 25, 2010. In addition, the Company has reported that it reduced executive compensation and benefits paid in 2009 compared with 2008 by approximately \$1 million. Exhibit A.

#### Conclusions of Law with respect to Mr. Milnes' Compensation

48. The Commissioner does not agree with much of the Company's legal analysis relating to the provisions of Chapter 123 and 125 of Title 8, Vermont Statutes Annotated, and Vermont's Nonprofit Corporate Code. As a preliminary matter, the Commissioner observes that the issue posed by the Commissioner's November 3, 2009 Order is not whether the Commissioner has the authority to "require" or "guarantee" recovery of a portion of Mr. Milnes' retirement compensation, but rather whether the Company should be ordered to file with the Commissioner an approved plan to recover a portion of the retirement compensation.
49. The Commissioner also does not agree with the Company's legal argument that Chapters 123 and 125 of Title 8, Vermont Statutes Annotated, do not

provide the Commissioner with authority to require the Company to recover a portion of Mr. Milnes' retirement compensation if determined to be excessive. The Commissioner construes certain provisions of Chapters 123 and 125 of Title 8, Vermont Statutes Annotated, and in particular 8 V.S.A. §§ 4512(a), 4513(c), and 4584(c), to establish a higher standard of conduct for the Company and its officers and directors than is imposed on other nonprofit corporations formed under Title 11B, Vermont Statutes Annotated. In particular, the Company "is not a private business operating freely within the competitive marketplace; it is a quasi-public business subject to the regulation of the commissioner. The primary goal of that regulation is to ensure that [the Company] is 'maintained and operated solely for the benefit of the subscribers thereof \* \* \*' In re Vermont Health Service Corporation, 144 Vt. 617, 624 (1984). When read together with the general fiduciary obligations imposed on officers and directors by the general nonprofit corporation laws (11B V.S.A. §§ 8.30 and 8.42), these laws establish an obligation not merely to approve annual and retirement compensation for the Company's chief executive officer that is within the range of the compensation of the chief executive officers of comparable companies; rather the laws applicable to the Company create a higher obligation to compensate its officers only so much as is necessary to ensure that the Company can fulfill its statutory mission to its subscribers. While the "business judgment rule" embodied in 11B V.S.A. §§ 8.30(b) and 8.42(b) may be applicable to the Company as a nonprofit corporation, such that the officers and directors of the Company may be entitled to rely on relevant information and reasonable analysis provided by professionals such as attorneys and compensation consultants in making decisions on behalf of the Company, the Commissioner still has the right and the obligation to protect Vermont subscribers by issuing remedial supplemental orders if the Company has paid excessive compensation to its chief executive officer, notwithstanding that the Company's consultants may have offered opinions supporting such excessive compensation. The foregoing notwithstanding, the Commissioner does not dispute that the Company has the right to compensate its employees fairly and appropriately for work performed on behalf of the Company, consistent with the Company's statutory obligations.

50. There is little judicial or administrative precedent to guide the Commissioner's determination of whether Mr. Milnes' compensation was excessive. The Court in Gamble v. Group Hospitalization and Medical Services, Inc., 38 F.3d 126 (4<sup>th</sup> Cir. 1994) considered a claim by the former chief executive officer of a health insurance company doing business in Virginia and the District of Columbia. Because of the negative financial condition of the company, the insurance commissioners with jurisdiction over the company ordered it to cease making payments to Mr. Gamble in accordance with a Supplemental Executive Retirement Plan agreement entered into between Mr. Gamble and the company before his retirement. Because the legal question raised in Gamble was whether federal ERISA law preempted the actions of the insurance commissioners and required the

payment of compensation under the agreement, the case is not directly relevant to the matter of Mr. Milnes' compensation. Nevertheless, it is noteworthy that the Virginia and District of Columbia commissioners considered it to be within their authority to terminate SERP payments because of the severe financial condition of the health insurance company.

51. Neither is People v. Grasso, 861 N.Y.S. 2d. 627 (N.Y. Supreme Court Appellate Division, 2008) and its related decisions very helpful in considering this matter. In Grasso the New York Attorney General commenced an action seeking recovery of a lump sum termination payment of \$139.5 million to the former chief executive officer of the New York Stock Exchange. The decisions rendered in the Grasso matter primarily turned on questions of whether the Attorney General had standing to maintain the action under a nonprofit corporation law significantly different than the powers granted to the Vermont Attorney General under 11B V.S.A. § 3.03.
52. In the most instructive administrative decision on the subject, the question of executive compensation of health insurance company officers was addressed in the administrative proceeding Insurance Commissioner for the State of Maryland v. CareFirst, Inc. and William L. Jews, Case No. MIA-2007-10-027 ("CareFirst"). In CareFirst, the Maryland Insurance Commissioner determined that the proposal of the Maryland nonprofit health insurance company to pay its former chief executive officer post-termination compensation of \$17.9 million was in violation of a Maryland statute limiting compensation of officers to a "fair and reasonable amount" and directing the company to adopt compensation guidelines which assessed the reasonableness of compensation in comparison with similar nonprofit health insurance companies. Maryland Insurance Article, Section 14-139(c) and (d). The Maryland Commissioner found the largest component of the proposed \$17.9 million payment consisted of a Supplemental Employee Retirement Plan, and the Commissioner further found that no evidence was offered demonstrating the comparability of the total compensation of CareFirst's former chief executive officer, including the proposed SERP payment, to that of similar health insurance companies, as required by the Maryland statute.<sup>3</sup>
53. The Commissioner concludes as a matter of law, based on a review of the Company's subpoenaed records, the Company's Letter and Report, Exhibit A, the analysis by the Department's independent executive compensation consultant, Exhibit B, and the Department's own factual and legal analysis, that a portion of Mr. Milnes' total compensation between and including 2001 and 2008, including the post-retirement payment in December 2008, was excessive compensation; i.e. greater than required to manage and operate the Company solely for the benefit of subscribers, providing benefits at minimum

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<sup>3</sup> The Company asserts in its Letter and Report, fn 11, that the Maryland Commissioner's decision has been reversed by a lower Maryland court. Further inquiry reveals that the Maryland court decision was never entered as a judgment, and that a judicial appeal of the Commissioner's decision is still pending in the Maryland courts.

cost under efficient and economical management. 8 V.S.A. §§ 4512(a), 4513(c), and 4584(c).

54. The Commissioner's conclusion that Mr. Milnes' compensation was excessive is based on the following considerations, as demonstrated from the facts found from the record:

- a) A SERP is not an unusual feature for a chief executive officer of a business entity such as the Company, and the formula used by the Company for calculating Mr. Milnes' SERP payment (60% of highest wages) was generous but not unusual, but Mr. Milnes' SERP calculated "income replacement" retirement benefits based on a percentage of annual base compensation plus incentive compensation. The normal practice is to use base salary and short-term incentive compensation for the income replacement calculation under a SERP. - See 2009 Executive Compensation Review, Sullivan Cotter, June 15, 2009, page 47.
- b) Mr. Milnes' annual compensation was based on a comparison with annual compensation at other Blue Cross Blue Shield companies including a disproportionate number of Blue Cross Blue Shield companies which are much larger organizations than the Company. As a result, the data derived from the peer group of Blue Cross Blue Shield companies used to establish Mr. Milnes' compensation was unreliable, and resulted in the Company awarding Mr. Milnes higher base salary, higher total annual compensation, and higher retirement compensation than was typical for chief executives of similar companies of a similar size, and higher than required to attract and retain a competent chief executive officer for the Company.
- c) Other health insurance or managed care organizations of a similar size to the Vermont Company compensate their chief executive officers at a level of about 45% to 50% less than the compensation levels set by the Company for Mr. Milnes, even though the management skills and experience needed for chief executives at each type of health insurance company do not appear to the Commissioner to have any material differences.

55. The Commissioner concludes that Mr. Milnes' compensation for the last eight years of his employment was excessive by a factor of at least 25%. Using the factor of 25% for purposes of calculating the portion of Mr. Milnes' compensation which was excessive, the Commissioner concludes that Mr. Milnes' annual compensation for the last eight years of his employment was excessive by at least \$1.4 million, and Mr. Milnes' SERP payment was excessive by at least \$1.6 million. The Commissioner concludes, therefore, that Mr. Milnes' received excess compensation payments from BCBSVT in an amount of at least \$3 million.

56. The Commissioner concludes that the Company has taken significant steps to realign compensation payments and corresponding responsibilities for executives and officers at the Company, including substantial reductions in incentive bonus opportunities and benefits. Nevertheless, the Company is obliged to account to subscribers for the overpayments to Mr. Milnes.
57. The Commissioner acknowledges that there may be legal considerations that might bear on the potential for recovery of the excessive compensation paid to Mr. Milnes, either directly from Mr. Milnes or from other parties who may be legally responsible to the Company for its compensation decisions, some of which are described in Exhibit A. As set forth in Para. B of this Order, below, it will be the responsibility of the Company, acting in the interests of its subscribers, to determine the likelihood of success of a legal claim for recovery, and to weigh that likelihood against the legal expenses necessary to litigate the recovery claim, expenses which would increase the Company's administrative costs, and ultimately increase subscribers' premiums.
58. As further set forth in Para. B of this Order, below, if the Company concludes that the likelihood of recovery does not warrant the expenditure of funds for the legal services necessary to seek recovery, the Company will need to fashion some other remedy to make subscribers whole for the excessive compensation awarded to Mr. Milnes.
59. The Commissioner is imposing the requirements set forth in Paras. A through D of this Order, below, for the purpose of ensuring that the Company is operated and maintained solely for the benefit of its subscribers, and to provide benefits to its subscribers at minimum cost under efficient and economical management of the Company. 8 V.S.A. §§ 4512(a) and 4513(c).

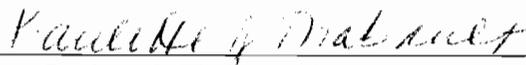
Accordingly, it is hereby ORDERED:

- A. Cost containment. Within 45 days following the Commissioner's execution of this Order, and on or before March 1, 2011 the Company (as used in the following Order, "Company" means Blue Cross Blue Shield of Vermont and TVHP) shall provide the Commissioner with its Medical Cost Containment Plan designed to reduce the rate of growth of the Company's trend for health care costs over the next two years. The Commissioner in her discretion may reopen this matter, and after notice and an opportunity to be heard may make such further orders as the Commissioner determines are necessary to ensure that benefits and services are provided at minimum cost under efficient and economical management of the Company.
- B. Executive Compensation. The Company shall take such actions as are sufficient to hold harmless the Company's subscribers from the excessive compensation paid to the Company's former chief executive officer, Mr. Milnes, between and including 2001 and 2008. Such actions may include recovery of the excessive compensation from Mr. Milnes or from any other legally responsible party, or

such other actions that the Company may propose and the Commissioner approves. In addition, the Company has proposed and the Commissioner agrees that it would be acceptable for the Company to elect to hold its subscribers harmless by providing a commensurate reduction in premiums for subscribers over a period designed not to exceed 24 months in accordance with the methodology described in Exhibit C attached hereto. The Company shall file with the Commissioner on or before 30 days following issuance of this Order a description of the manner in which it intends to comply with the provisions of this Para. B.

- C. Annual Reporting of Executive Compensation. In addition to the Supplemental Compensation Exhibit filed annually by the Company and TVHP, the Company is required to file for calendar year 2010 and all subsequent years a Combined Supplemental Compensation Exhibit, in the format prescribed by the National Association of Insurance Commissioners and in a manner approved by the Commissioner, on both a cash and accrual basis, reflecting the total annual compensation, and the total retirement compensation paid to the ten highest-compensated individuals, identified by their principle position title, employed within the Company's holding company system, including entities subject to the direct jurisdiction of the Commissioner, and entities not subject to the direct jurisdiction of the Commissioner under the direct or indirect control of the Company or TVHP. If the same individual has compensation allocated to more than one entity (regardless of differing title), the compensation amounts shall be combined and expressed as one figure, and in the case of differing titles, all position titles shall be displayed separately by a "backslash."
- D. Commissioner's Continuing Jurisdiction. The Commissioner shall retain continuing jurisdiction of this proceeding until May 1, 2012 for the purpose of monitoring and supporting implementation of the requirements of this Order.

Dated at Montpelier, Vermont this 1 day of June, 2010.

  
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Paulette J. Thabault, Commissioner

STATE OF VERMONT  
DEPARTMENT OF BANKING, INSURANCE, SECURITIES  
AND HEALTH CARE ADMINISTRATION

In Re: Blue Cross Blue Shield of Vermont )  
Request for Increase in Subscriber Rates ) Docket No. 09-131-H  
Filing Nos. 45346 and 45347 )  
)

**Consent of Blue Cross Blue Shield of Vermont**

I. Blue Cross Blue Shield of Vermont (“the Company”) hereby admits the jurisdiction of the Vermont Commissioner of Banking, Insurance, Securities and Health Care Administration (“the Commissioner”) (“the Department”) over the subject matter of this Order, Docket No. 09-131-H issued by the Commissioner (“the Supplemental Order”), and admits that the Commissioner retains jurisdiction over this matter for purposes of monitoring and enforcing this Supplemental Order.

II. The Company knowingly, voluntarily and unconditionally waives any and all rights to a hearing before the Commissioner, and to all other procedures otherwise available under the law with respect to the entry of this Supplemental Order. The Company also knowingly, voluntarily and unconditionally waives compliance with 3 V.S.A. Chapter 25 (Vermont Administrative Procedure Act) regarding contested cases. The Company acknowledges that, upon execution by the Commissioner, this Supplemental Order constitutes a valid order duly rendered by the Commissioner.

III. The Company knowingly, voluntarily and unconditionally waives any right it may have to judicial or administrative review by way of suit, appeal, or extraordinary remedy resulting from the issuance of this Supplemental Order; provided, however, the Company shall have a right to a hearing on any charge or allegation brought by the Department that the Company failed to adhere to, or violated any of the requirements of this Supplemental Order, and the Company shall have the right to appeal any adverse determination resulting from such charge or allegation.

IV. The Company acknowledges and agrees that it consents to the entry of this Supplemental Order knowingly, voluntarily and unconditionally, and that no promise was made, nor was any coercion used, to induce the Company to give such consent.

V. Without admitting or denying any of the facts or conclusions of law stated in this Supplemental Order (other than the jurisdiction of the Commissioner; personal and subject matter jurisdiction, and retention of jurisdiction for the purpose of monitoring and enforcing this Supplemental Order), the Company acknowledges its understanding of, and agrees to all terms, conditions and obligations contained in paragraphs A through D of this Supplemental Order.

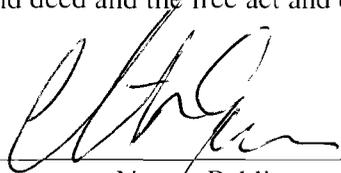
**Blue Cross Blue Shield of Vermont**

By:   
Title: PRESIDENT & CEO

Date: June 1, 2010

STATE OF VERMONT  
COUNTY OF CHITTENDEN

On the 1<sup>st</sup> day of June, 2010, personally appeared Don C. George, as authorized representative of Blue Cross Blue Shield of Vermont, who states that the execution of the foregoing Consent is his/her free act and deed and the free act and deed of Blue Cross Blue Shield of Vermont.

  
Notary Public