

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, SS.

SUPREME JUDICIAL COURT FOR
SUFFOLK COUNTY
NO. SJ-2000-003

LINDA L. RUTHARDT, as she is
COMMISSIONER OF INSURANCE of the
COMMONWEALTH OF MASSACHUSETTS, and
THOMAS REILLY, as he is
ATTORNEY GENERAL of the
COMMONWEALTH OF MASSACHUSETTS,

Plaintiffs,

v.

HARVARD PILGRIM HEALTH CARE, INC.,
PILGRIM HEALTH CARE, INC., and HARVARD
PILGRIM HEALTH CARE OF NEW ENGLAND,
INC.,

Defendants.

TEMPORARY RECEIVER'S FIRST STATUS REPORT

In accordance with paragraph 2 of the Temporary
Injunction and Order Appointing Temporary Receiver entered
January 4, 2000 (the "Receivership Order"), and the
Scheduling Order entered on January 19, 2000, Linda L.
Ruthardt, Commissioner of Insurance, as Temporary Receiver
(the "Temporary Receiver") of Harvard Pilgrim Health Care,
Inc., Pilgrim Health Care, Inc., and Harvard Pilgrim Health
Care of New England, Inc. (collectively, "HPHC") and

Thomas F. Reilly, Attorney General, submit this status report, which will summarize the reasons for requesting the Receivership Order, the steps taken to date and proposed further action concerning the recapitalization of HPHC.

Background

1. Pre-receivership status. Throughout 1999, HPHC management had numerous discussions with the Division of Insurance ("Division") concerning HPHC's financial condition and management's turnaround plan. In November 1999, HPHC management reported that as of September 30, 1999, HPHC had a consolidated statutory net worth of \$61 million. HPHC also anticipated operating losses for the last three months of 1999 and projected other adjustments (decreases in assets). The negative adjustments were anticipated to be offset by planned positive asset transactions. These included the proposed sale-leaseback of eight HPHC facilities and fixtures through a bond issue through the Massachusetts Health and Educational Facilities Authority ("HEFA"), in addition to the sale of other non-admitted assets and the sale/licensing of intellectual property. HPHC believed it could close at least \$88 million of those transactions so that they could be recorded on the December 31, 1999 statutory financial statement. Under those circumstances, HPHC's statutory

surplus would have been approximately \$65 - \$117 million at year end, depending upon the number of asset transactions completed.

2. While HPHC was thinly capitalized, its management was in the process of implementing a turnaround plan, including rate increases, re-negotiated contracts with providers, and reduced administrative expenses. HPHC anticipated that the turnaround plan would produce beneficial results in 2000, and it engaged in an intensive process to prepare a Year 2000 budget.

3. On the evening of January 3, 2000, HPHC's President and Chief Executive Officer informed the Commissioner that HPHC had identified new financial information which would likely preclude the completion of the HEFA bond financing. On the morning of January 4, 2000, HPHC management met with the Commissioner and her representatives. HPHC reported that, in the course of the November closing process and preparation for the year-end audit, the new financial team identified a deficiency in loss reporting that, when combined with other adverse adjustments due to changes in interest rates and operating losses in affiliated companies, accumulated to approximately \$70 million more 1999 losses. This meant that HPHC's capital would be approximately negative \$100

million as of December 31, 1999 on a statutory accounting basis and a positive \$40 million on a Generally Accepted Accounting Principles basis.

4. The Commissioner then advised HPHC management that a rehabilitation was necessary under the HMO receivership statute approved on November 24, 1999. St. 1999, c. 143, § 7 (enacting G.L. c. 176G, § 20). HPHC agreed to assent to such relief.

5. The Receivership Order and Initial Steps.
The Commissioner, through the Attorney General, proceeded to file the Verified Complaint and Request for Order Appointing Temporary Receiver on January 4, 2000. The Court (Marshall, C.J.) entered the Receivership Order that same day. In order to avoid disruption to continued health care in Massachusetts, the Receivership Order required all providers of health care to continue that care. As a corollary, the Receivership Order provided for post receivership obligations to be treated as administrative expenses so that they would be paid in full.

6. To avoid the serious consequences of a disruption in HPHC payments ,to hospitals and physicians, the Temporary Receiver directed HPHC to continue to pay all providers (aside from Rhode Island, where a separate Rhode Island receivership proceeding is in place) in the normal course

of business for services which pre-dated the Receivership Order. The Temporary Receiver and her representatives consulted immediately with the Massachusetts Medical Society and Massachusetts Hospital Association concerning these issues so that providers would have information regarding the receivership.

7. In order to minimize changes in HPHC's routine business, the Temporary Receiver authorized HPHC management to continue to carry out their day to day responsibilities pursuant to a letter detailing the limit of that authority. A copy of that letter is attached as Exhibit A. Management has cooperated with the Temporary Receiver and has provided the information requested within the time periods established.

8. The Temporary Receiver has taken several steps to assess HPHC's financial status:

a. The Temporary Receiver has begun a process to evaluate HPHC's reserves by reconciling accounts between HPHC and hospital providers. Hospitals with HPHC liabilities in excess of \$1 million have been provided with a statement of an estimated balance consisting of the amount due from HPHC for existing bills and an estimated amount for unbilled services offset by cash advances. This process is ongoing.

b. The Temporary Receiver has continued the engagement of PriceWaterhouseCoopers ("PWC") to audit HPHC's financial statements as of December 31, 1999, so that audited financial statements will be available as soon as possible. The objective is for that audit to be completed by the end of February.

c. The Temporary Receiver has directed the accounting firm previously engaged as consultant to the Division of Insurance regarding HPHC, KPMG Peat Marwick ("KPMG") , to review the profitability of HPHC's renewal business under the new rates negotiated by HPHC prior to the receivership, the cash available and HPHC's Year 2000 business plan. This will assist in evaluating the ongoing operations of HPHC.

9. The Temporary Receiver recognizes that she must see that the assets of HPHC are sufficient to pay all administrative expenses as required by the Receivership Order. She is monitoring this issue by evaluating estimates of post-receivership expenses and available cash and liquid assets on a weekly basis.

10. Because, the three HPHC corporations are charitable organizations, the Attorney General appeared as a party plaintiff representing the public interest in the

due application of charitable funds pursuant to G.L. c. 12, § 8, and the common law.¹

11. Recognizing the intense interest. of the many people and entities affected by the HPHC receivership, the Temporary Receiver, the Attorney General and their representatives have had meetings and discussions with many interested persons. These include, among others, the Insurance Commissioners of New Hampshire and Maine and the Director of Business Regulation of Rhode Island, Harvard Vanguard Medical Associates, the Massachusetts Medical Society, the Massachusetts Hospital Association, the Massachusetts Psychiatric Society, Health Care for All, HEFA and Financial Security Assurance, Inc. The Temporary Receiver and Attorney General have also held intermittent "press availabilities."

12. Identification and Evaluation of Recapitalization Options. The Temporary Receiver and Attorney General want to identify all possible options to recapitalize HPHC as quickly as possible so that public officials can determine which options are available, in the public interest and should be presented to the Court.

¹ A number of interested persons have filed notices of appearance. Two ,motions to intervene have been filed by several trade associations. If those motions are not

13. In order to identify and pursue the broadest range of options, the Temporary Receiver determined it was necessary to engage an investment banker. After interviewing a number of investment bankers, the Temporary Receiver engaged Salomon Smith Barney ("SSB") on January 17, 2000. SSB was selected for four basic reasons: (1) SSB is a large investment banking firm capable of pursuing all options at once, (2) it has considerable experience in the health care area, (3) it has significant experience with troubled not-for-profit entities, and (4) it could act quickly due to its familiarity with HPHC in Massachusetts constituencies stemming from its involvement in the proposed HEFA bond transaction. The engagement of SSB was negotiated with the assistance of the Attorney General's Office, and it is on terms which do not favor any particular outcome.

14. SSB is to identify and pursue all viable options to recapitalize HPHC and ensure continuity of care and coverage to HPHC members. The options may include tax exempt recapitalization options with HPHC remaining as an independent non-profit entity. This could include, for example, merger or other affiliations, a revived

resolved by agreement, the Temporary Receiver and Attorney General will file an opposition on January 31, 2000.

sale/leaseback of HPHC health centers through HEFA, a lease of non-admitted assets (furniture and fixtures) through HEFA, and a capital infusion from a third party or parties (e.g., by sale of surplus notes). The options also may include sale options to either a non-profit or for-profit buyer.

15. SSB began to pursue options on a dual-track approach at once by beginning to contact potential acquirers or sources of capital. SSB also began to work with HPHC management to prepare a confidential information packet consisting of (a) HPHC's November 30, 1999 financial statements, (b) HPHC's financial statements as of December 31, 1999, (c) the December 31, 1999 financial statements "normalized" to separate out one time 1999 events and discontinued Rhode Island operations, and (d) HPHC's Year 2000 projected results. This information packet will be provided to persons interested in a transaction regarding HPHC subject to a confidentiality agreement so that those persons may consider potential transactions and express interest.

16. SSB has also established a process to simultaneously run up to four "due diligence" rooms containing more detailed information so that persons contemplating a transaction may conduct the investigation

necessary to develop and present actual proposals, again subject to confidentiality agreement.

17. To date, approximately thirteen persons interested in proposing a transaction regarding HPHC have entered into confidentiality agreements and are receiving the information packet. These persons, among others, have indicated that they would like to conduct due diligence.

18. Status summary. HPHC members are continuing to receive care, its providers are continuing to be paid and a process is in place to broadly identify recapitalization options. Over \$100 million has been paid to health care providers since the beginning of this proceeding. Frequent meetings are being held with interested persons to keep them apprised of the process. As a consequence, the general situation is presently stable.

19. Proposals for further action. The Temporary Receiver and Attorney General propose to continue the options identification process described above in order to identify viable means of recapitalizing HPHC. They will consider those options and report to the Court when a desirable approach is available. In the meantime, the Temporary Receiver will continue to operate HPHC as usual and implement the turnaround plan reflected in HPHC's Year 2000 business plan and projections.

Respectfully submitted,

LINDA L. RUTHARDT COMMISSIONER
OF INSURANCE AS TEMPORARY
RECEIVER

and

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