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Verne, B. Michael

From:
Sent: Wednesday, December 06, 2006 9:15 AM
To: Verne, B. Michael
Subject: Another, different question for you

Background Facts: Company A and Company B are both health insurers, who currently have a contractual joint marketing arrangement whereby Company B sells Company A policies (for which Company A bears the risk) to employers in a particular market segment in which Company A does not currently compete. Company B receives a small percentage of the premium as an administrative and marketing fee. However, Company B reinsures the policies and receives approximately 50% of the net premium (after the administrative fee is deducted) for the reinsurance function. Neither Company A nor Company B have any ownership or equity interest in each other's assets or businesses. Their relationship is a purely contractual marketing arrangement.

Company A would like to terminate the contract/joint marketing arrangement, including Company B's reinsurance role, and Company A would assume all responsibilities and risks for contracts with employers when (and presumably if) those contracts are renewed. Company A must pay a penalty to Company B for terminating the contract. The amount of the penalty is based on the estimated value of future reinsurance premiums for the contracts that Company B would no longer reinsure and therefore not receive the premium. That penalty payment would almost certainly exceed $56.7 million and the size of person tests would be met.

Question: Is the payment from Company A to Company B a reportable transaction?

My answer: This situation does not involve voting securities in any way, and does not appear to be an acquisition of an asset. Rather, it is payment of a penalty for terminating a contract, and the amount of the penalty is based on the anticipated lost revenue stream to Company B. I could not find anything that would indicate that such a payment is somehow an acquisition of an asset or other reportable transaction. In this situation, the only thing that Company A is acquiring is the right to enter a contract independently of Company B. The only discussion that I could find of a somewhat analogous situation is the acquisition of executory contracts; although here it is not a right to perform under existing contracts, but rather the right to enter and perform future contracts independently. In any event, as I understand it, even where the acquisition of an executory contract is involved, the value of those contracts is zero (the buyer gets the income stream, but that value is offset by the obligation to perform), unless the seller has already performed some of the services, but the buyer will receive all of the payment/income stream. In those situations, the value would be the value of the premium paid (i.e., the value of the seller's services rendered for which the buyer is receiving the payment). Thus, even if Company A's payment of the termination penalty were viewed as an acquisition of Company B's executory contracts, the value would be zero since no premium would be paid -- Company A will receive all of the income stream and will be obligated for all of the performance (i.e., marketing, principal liability and reinsurance), under those contracts.

Am I missing anything?

Thanks.

Agree
B
12/6/06

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