

Johnson, Janice C.

From: [REDACTED]
Sent: Wednesday, April 29, 2009 8:58 AM
To: Johnson, Janice C.
Subject: Confirming Size of Transaction Discussion

Informed under that the liabilities would not be included in the purchase price.

*J. Johnson
to verify covers*

Janice,

Thank you again for speaking with me yesterday regarding my size-of-transaction question. I would like to confirm my understanding of our conversation.

The facts of the situation are as follows. Seller owns a health plan and proposes to sell certain assets of the plan to Buyer, specifically all of the contract rights to the membership of the health plan. Buyer would pay cash for the acquired assets. Seller would retain the other assets of the plan (e.g., cash, property and equipment) along with the liabilities. Following the sale, Seller would exit the health plan business, and in fact Seller's desire to exit the business expeditiously is the motivation for the sale.

The specific basis for my question concerns the health plan's liability for "incurred but not reported" claims ("IBNR"). IBNR is a balance sheet liability representing health insurance claims by covered individuals who have already received health care services that are covered by the plan, but who have not yet filed claims for coverage (payment) of those services. The run-out of these claims can take several months; however, the amount of the liability can be actuarially estimated at any point in time with a reasonable degree of accuracy.

In connection with this transaction, it has been proposed that Seller would transfer the IBNR to Buyer, along with cash equal to the actuarial value of the IBNR. In other words, Seller would pay the Buyer to take the liability. Seller's objective is to be able to wind up its claims processing activities expeditiously, which it can do if Buyer undertakes the responsibility to adjudicate and pay the IBNR claims. As a practical matter, Seller's "payment" to Buyer would likely be effected as an offset to the purchase price of the acquired assets.

Thus, the question is whether the liability transferred to Buyer also must be considered in establishing the size-of-transaction, given that, although Buyer technically would be assuming the liability, Buyer would also receive the funds from Seller to pay the liability? In other words, if the value of the acquired assets is \$100, and the IBNR has an actuarial value of \$25, is the transaction size \$100 or \$125?

Based on our conversation yesterday, my understanding is that, under the circumstances described, the liability would not be included in valuing the transaction (in other words, the size of transaction is \$100 in my example).

If you could kindly confirm that my understanding is correct, I would be most appreciative.

[REDACTED]

[REDACTED]

Disclaimer Required by IRS Rules of Practice:

Any discussion of tax matters contained herein is not intended or written to be used, and cannot be used, for the purpose of avoiding any penalties that may be imposed under Federal tax laws.