

**BEFORE THE COMMISSIONER OF INSURANCE  
OF THE STATE OF KANSAS**

In the Matter of the Plan of Conversion of            )  
BLUE CROSS AND BLUE SHIELD OF                    )  
KANSAS, INC.    )     Docket No. 3014-DM

**POST-HEARING MEMORANDUM, AND PROPOSED  
FINDINGS OF FACT AND CONCLUSIONS OF LAW,  
OF ANTHEM INSURANCE COMPANY, INC.**

Anthem Insurance Company, Inc. (“Anthem”) submits this post-hearing memorandum, and proposed findings of fact and conclusions of law, in support of the Application of Blue Cross and Blue Shield of Kansas, Inc. (“BCBSKS”) for approval to convert from a mutual company to a stock company (“Conversion Application”) and the Application of Anthem for approval to purchase all shares of common stock authorized and issued by BCBSKS and to transfer the shares to Anthem or its designated affiliate (“Acquisition Application”).

**INTRODUCTION**

The record clearly demonstrates that BCBSKS meets all statutory criteria set forth in K.S.A. 40-4004(a) and its Plan of Conversion should be approved. Likewise, the record clearly demonstrates that Anthem has made an appropriate Form A filing and none of the disqualifying conditions set forth in K.S.A. 40-33049(d)(1)(A) through (E) apply. Anthem’s application to purchase the BCBSKS stock should be approved. Although the Testimonial Team raises an isolated concern that Anthem might raise rates faster than BCBSKS, that concern is not well founded and is inconsistent with Anthem’s proven ability to improve underwriting margins with means other than raising

rates. Notwithstanding, to further alleviate even this remote concern, Anthem has offered a condition that would provide a safety net against potential rate increases in the small group market if Anthem cannot achieve the kind of savings it has achieved after every other affiliation it has entered into. That safety net is Anthem's Small Group Rate Stabilization Reserve. The Small Group Rate Stabilization Reserve puts at risk \$25 million that could be used by the Commissioner, if a need should arise, to off-set rate increases in the small group book of business. There simply cannot be any legitimate concern regarding approval of this transaction.

### **I. PROCEDURAL BACKGROUND**

1. On May 30, 2001, BSBSKS and Anthem entered into an Alliance Agreement ("Agreement") which contemplates a sponsored demutualization of BCBSKS and the acquisition by Anthem or its designated affiliate of all BCBSKS common stock. [Agreement, Exh. 2; Procedural and Scheduling Order (Aug. 23, 2001), p. 1; Order on Intervention (Oct. 23, 2001), p. 1 at ¶ 1].

2. On May 31, 2001, in accordance with K.S.A. 40-4002(b), BCBSKS submitted a draft Plan of Conversion ("Draft Plan") to the Commissioner for review and comment prior to the adoption of such plan by the Board of Directors of BCBSKS. [Procedural and Scheduling Order, p. 1; Order on Intervention, p. 1 at ¶ 2; Exh. 51, p. 3]. BCBSKS subsequently revised the Draft Plan to address concerns expressed by the Kansas Insurance Department Testimonial Team (the "KID Testimonial Team"). [Exh. 51, pp. 6-8].

3. On October 25, 2001, the Board of Directors of BCBSKS "unanimously approved and adopted the Plan of Conversion to enhance the Company's strategic and financial flexibility, and to make possible a distribution of the value of the Company to

Eligible Policyholders.” [Exh. 1, p. 1 at art. I]. In relevant part, the Plan of Conversion (“Plan”) proposes to extinguish all membership interests of BCBSKS policyholders in exchange for valuable consideration, including certain payments to eligible members, and to otherwise effectuate the conversion of BCBSKS into a stock company. [Id., pp. 4-17].

4. On July 25, 2001, Anthem filed its “Form A Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer” (“Form A”) with the Commissioner seeking approval to acquire BCBSKS in accordance with K.S.A. 40-3304. [Form A, pp. 1-23; Tr. Vol. I, p. 25 (official notice of Form A)].

5. On August 21, 2001, the Commissioner issued a Procedural and Scheduling Order to govern the further course of these proceedings. The Order also explained that the Commissioner had retained independent special counsel and independent advisors and had appointed certain members of her legal and technical staff to investigate, review, and comment on the proposed transaction, and to participate in the hearing, the KID Testimonial Team. [Procedural and Scheduling Order, pp. 3, 5]. The following individuals served on the KID Testimonial Team: Kathy Greenlee, General Counsel of the Department and KID Testimonial Team Leader; Patrick H. Cantilo, Cantilo & Bennett, LLP, Special Counsel for the KID Testimonial Team; David M. Platter, Senior Managing Director in the Investment Banking Division and Head of the Financial Institutions Group of Bear Stearns & Co., Inc. (“Bear Stearns”); Kenneth M. Beck, a principal with the Actuarial and Insurance Management Solutions practice of PricewaterhouseCoopers LLP (“PwC”); Denise G. Essenberg, Certified Public Accountant and partner with PwC; Sandra S. Hunt, a principal of PwC who specializes in government health policy, statistical modeling, Medicaid managed

care plans, and developing models for new health care delivery systems; and Mark H. Kovey, attorney and partner in the law firm of Scribner, Hall & Thompson, who specializes in taxation and tax law.

6. During late September 2001, the Kansas Medical Society (“KMS”), Kansas Hospital Association (“KHA”), Kansas State Nurses Association (“KNA”), the Kansas Association for the Medically Underserved (“KAMU”) and William A. Dakan (“Dakan”) filed petitions to intervene in this proceeding. [Order on Intervention, pp. 1-2].

7. On October 23, 2001, the Commissioner issued an order that authorized KMA, KHA, KNA and KAMU to intervene, but expressly limited their respective rights of participation in this proceeding. [Order on Intervention, pp. 4-6].<sup>1</sup>

8. On November 9, 2001, the Commissioner issued notice of the public hearing and notice of public comment meetings in this proceeding. On various dates between December 4 and 14, 2001, the Commissioner held public comment meetings in Hays, Garden City, Wichita, Pittsburg, and Topeka. [Notice of Public Hearing (Nov. 9, 2001); Notice of Public Comment Meetings (Nov. 9, 2001); Schedule of Proceedings (Oct. 26, 2001)].

9. The Commissioner’s Notice of Public Hearing was subsequently published, as required by the Procedural and Scheduling Order and K.S.A. 77-518, in the following newspapers: Topeka Capital-Journal, Lawrence Journal World, Pittsburg Morning Sun, Salina Journal, Wichita Eagle, Hays Daily News, Garden City Telegram and Colby Free Press. Proof of publication has been properly filed of record in these proceedings.

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<sup>1</sup> The Commissioner denied Mr. Dakan’s petition to intervene, stating that the KID Testimonial Team would represent the interests of policyholders and the general public, and that Mr. Dakan’s participation would interfere with the orderly and prompt conduct of this matter.

10. In accordance with the timetable set forth in the Procedural and Scheduling Order, the parties and intervenors filed written testimony and hearing memoranda to assist in the prompt and orderly conduct of the public hearing.

11. The public hearing was held from January 7 through 9, 2002 in the Capitol Plaza Hotel, 1717 SW Topeka Boulevard, Topeka, Kansas. The Commissioner personally served as the Presiding Officer for the public hearing.

12. BCBSKS presented evidence in support of the Conversion and Acquisition Applications, including sworn testimony from John W. Knack, Jr., President and Chief Executive Officer of BCBSKS; Michael M. Mattox, Executive Vice President of BCBSKS; Donald R. Lynn, Vice President of Finance of BCBSKS; William H. Pitsenberger, Vice President and General Counsel of BCBSKS; Paul G. Adams, Managing Director of Dresdner Kleinwort Wasserstein, Inc.; Daniel J. McCarthy, Consulting Actuary, Milliman, USA; Henry N. Butler, J.D., Ph.D.; and David Feldstein, Ph.D., Professor, Graduate School of Management, University of California at Irvine. BCBSKS was represented at the hearing by Gary D. McCallister and Thomas Kelliher of Gary D. McCallister & Associates; Eric Unrein of the law firm of Davis, Unrein, McCallister, Briggs and Head, L.L.P; and James Scoville and Carl Micarelli of the law firm of Debevoise & Plimpton.

13. Anthem presented evidence in support of its Acquisition Application, including sworn testimony from Larry C. Glasscock, President and Chief Executive Officer of Anthem; Michael L. Smith, Executive Vice President and Chief Financial Officer of Anthem; Dr. Samuel R. Nussbaum, M.D., Executive Vice President and Chief Medical Officer of Anthem; Donna O. Moore, Vice President, Health Care Management-

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[Order on Intervention, p. 5].

East Operating Region of Anthem; and David R. Frick, Executive Vice President and Chief Legal and Administrative Officer of Anthem. Anthem was represented by Randall J. Forbes and John C. Frieden of the law firm of Frieden, Haynes and Forbes, and Douglas R. Fauth, Vice President of Anthem Insurance Companies, Inc.

14. The KID Testimonial Team presented evidence including testimony from David M. Platter, Kenneth M. Beck, Denise G. Essenberg, Sandra S. Hunt, Mark H. Kovey and Kathy Greenlee. The KID Testimonial Team was represented by its Special Counsel, Patrick H. Cantilo of the law firm of Cantilo & Bennett, L.L.P.

15. Intervenors KMS and KHA presented testimony from Marvin M. Fairbanks, Director for Contracted Care at Stormont-Vail Healthcare, and Carl J. Schramm, an economist and lawyer. KMS was represented by Charles R. Hay of the law firm of Goodell, Stratton, Edmonds & Palmer, L.L.P. and KHA was represented by Douglas S. Laird of the law firm of Polsinelli Shalton & Welte, P.C.

16. Intervenors KNA and KAMU presented testimony from Dawn M. Touzin, Director of the Community Health Assets Project at Community Catalyst. KNA and KAMU were represented by Karen A. Eager of the Law Offices of Theodore J. Lickteig.

## **II. PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW**

### **A. Overview of the Parties and the Transaction.**

17. BCBSKS was formed in 1983 through the consolidation of Blue Cross of Kansas, Inc. (“BCK”) and Blue Shield of Kansas, Inc. (“BSK”). BCK and BSK were created during the 1940’s as “charitable and benevolent” corporations in accordance with specific enabling statutes for nonprofit hospital and medical service corporations in

Kansas.<sup>2</sup> When the 1969 Kansas Legislature repealed these enabling statutes, BCK and BSK lost their “charitable and benevolent” status, but gained the ability to realize profits. [Blue Cross and Blue Shield of Kansas, Inc., *supra*, Case No. 97-CV-608 (Memorandum Decision and Order, Jan. 7, 2000, pp. 1-2, 11); G.S. 40-1801 *et seq.* (1941), *repealed* 1969 Kan. Sess. Laws, ch. 429, § 3 (effective Jan. 1, 1970); G.S. 40-1901 *et seq.* (1945), *repealed*, 1969 Kan. Sess. Laws, ch. 429, § 3 (effective Jan. 1, 1970); Exh. 3, p. 4; Exh. 71. pp. 7-8].

18. During 1992, in response to directives from the 1991 Legislature set forth in K.S.A. 40-19c12, BCBSKS changed its ownership structure by converting to a mutual insurance company in which the equity ownership interests are held by its policyholders. BCBSKS is currently a for-profit domestic mutual life insurance company pursuant to the provisions of K.S.A. 40-501 *et seq.* [Blue Cross and Blue Shield of Kansas, Inc., *supra*, Case No. 97-CV-608 (Memorandum Decision and Order, Jan. 7, 2000, pp. 1-2)].

19. In 1997, the Kansas Attorney General filed a counterclaim against BCBSKS seeking to recover assets that allegedly became impressed with a charitable trust when BCBSKS and its predecessors lost their “charitable and benevolent” status. This litigation was subsequently resolved pursuant to a settlement agreement requiring BCBSKS to pay \$75 million dollars to a charitable foundation for the value of the assets that had been allegedly impressed with a charitable trust. [Tr. Vol. I, pp. 35-42; Exh. 3, p. 4; Exh. 71, pp. 7-8; Blue Cross and Blue Shield of Kansas, Inc., *supra*, Case No. 97-

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<sup>2</sup> In 1942, BCK was incorporated pursuant to “the mutual nonprofit hospital service corporation act,” G.S. 40-1801 *et seq.* (1941), as Kansas Hospital Service Association, Inc. (“KHSA”). In 1945, BSK was incorporated pursuant to “the nonprofit medical service corporation act,” G.S. 40-1901 *et seq.* (1945), as Kansas Physician’s Service, Inc. (“KPS”). See Blue Cross and Blue Shield of Kansas, Inc. v. Carla Stovall, Case No. 97-CV-608 (Dist. Ct. Shawnee Cty., Kan. Div. 14) (Memorandum Decision and Order, Jan. 7, 2000, pp. 1-2) (Available on the Internet at <http://www.shawneecourt.org/decisions/bcbsk.htm>).

CV-608 (Journal Entry of Dismissal With Prejudice, Sept. 6, 2000, and attached Settlement Agreement)].

20. BCBSKS is the largest health insurer in Kansas, insuring approximately 715,000 Kansas residents. The company also administers other health insurance plans, including administering government Medicare and Medicaid plans. [Exh. 3, p. 5].

21. Concerns about changing market conditions in the health insurance and service industries (including the increasing difficulties in competing with national firms as large business and commercial enterprises obtain health insurance from home offices located outside the State of Kansas) and faced with a substantial shrinking of customer base, continued underwriting losses and projected needs for additional capital, the Board of Directors of BCBSKS decided to demutualize and to sell its common stock to a suitable company with similar goals and service objectives. [Exh. 3, pp. 5, 14-15; Tr. Vol. I, pp. 35-42].

22. The search by BCBSKS for the right acquiring party was extraordinarily thorough. [Tr. Vol. II, p. 802; Exh. 5, pp. 2-4]. Management employed a team of outside advisors, including the actuarial consulting firm of Milliman USA (“Milliman”), the investment banking firm of Dresdner Kleiswort Wasserstein (“DKW”), and the law firm of Debevoise and Plimpton, to assist BCBSKS with its due diligence investigation. [Exh. 3, pp. 7-8]. In consultation with its advisors, BCBSKS selected seven (7) health insurance companies as prospective candidates and transmitted requests for expressions of interest and non-disclosure agreements to each of them for a response. The Board of Directors of BCBSKS conducted the due diligence process with great care, paying particular attention to issues affecting policyholders. Local control was an issue the Board considered important when conducting its due diligence investigation.

23. The prospective candidates expressing interest in acquiring BCBSKS (“Respondents”) were initially asked to answer detailed questions that focused on strategic issues. In February 2001, management of BCBSKS and its advisors interviewed the Respondents. After several Respondents were eliminated from further consideration, BCBSKS resumed its detailed investigation to determine which of the remaining companies would best serve the interests of the policyholders. Three Respondents survived this process and were subjected to “quite rigorous and quite extensive” examination by BCBSKS [Tr. Vol. II, p. 800]. Following the completion of this detailed due diligence investigation, including comparative assessments and analysis of the proposed consideration for policyholders, the Board of Directors unanimously selected Anthem to acquire BCBSKS and authorized the execution of the Alliance Agreement [Exh. 5, pp. 2-4; Exh. 52, pp. 5-7].

24. In Anthem, BCBSKS found a financially strong company that shares a similar philosophy in providing health insurance coverage. Anthem was formed in 1944 under the name of Mutual Hospital Insurance, Inc., known as Blue Cross of Indiana. Mutual Medical Insurance, Inc., known as Blue Shield of Indiana was formed in 1946. In 1985, the two companies merged under the name of Associated Insurance Companies, Inc. (“Associated Insurance”).

(a) In 1993, Southeastern Mutual Insurance Company, d/b/a Blue Cross and Blue Shield of Kentucky, merged with Associated Insurance.

(b) In 1995, Community Mutual Insurance Company, an Ohio-domiciled mutual insurance company d/b/a Community Mutual Blue Cross and Blue Shield, merged into Associated Insurance.

(c) In 1996, the company changed its name to Anthem Insurance Companies, Inc.

(d) In 1997, Blue Cross and Blue Shield of Connecticut, Inc. merged into Anthem.

(e) In 1999, Anthem acquired New Hampshire-Vermont Health Service, d/b/a Blue Cross and Blue Shield of New Hampshire, and Rocky Mountain Hospital and Medical Service d/b/a Blue Cross and Blue Shield of Colorado and Nevada.

(f) In 2000, Anthem acquired Associated Hospital Service of Maine, d/b/a Blue Cross and Blue Shield of Maine.

Exh. 34, pp. 1-3].

25. Today, Anthem serves over 7.8 million customers in Indiana, Kentucky, Ohio, Connecticut, New Hampshire, Maine, Colorado and Nevada with approximately \$2.1 billion in surplus. In each of the states in which Anthem operates, it has substantially increased the number of its insureds. Over the last several years, Anthem has added 720,000 new customers. Approximately ninety percent (90%) of Anthem's insureds renew their policies each year. Anthem is now one of the strongest Blue Plans in the country and one of the largest health benefits companies in the nation. [Exh. 34, pp. 3-4; Tr. Vol. II, p. 797].

26. During its due diligence investigation, the Board of Directors of BCBSKS recognized Anthem's outstanding performance as a health insurance company in the states in which Anthem conducts business operations. [Tr. Vol. I, pp. 32-33].

27. Anthem's health plans in Connecticut, New Hampshire, Maine and Ohio are among the very few health plans to receive the highest accreditation level from the

nation's most respected managed care accrediting agency, the National Committee on Quality Assurance. [Vol. II, p. 550; Exh. 34, p. 11; Exh. 63, pp. 38-39].

28. Anthem BCBS in Maine was recently selected as one of the top two asthma disease programs reviewed by the Managed Care and Initiative Project at the Tufts University School of Medicine. Anthem West's mobile dental program for indigent children, "Miles for Smiles," won the overall award for outstanding community involvement from the American Association of Health Plans. [Exh. 34, p. 10].

29. Anthem has received 16 Brand Excellence Awards presented by the Blue Cross Blue Shield Association and it has been recognized by Fortune Magazine as one of the ten most admired health care companies in the United States. [Exh. 34, p. 11].

30. On November 2, 2001, the Indiana Commissioner of Insurance approved a Plan of Conversion enabling Anthem to convert from a mutual insurance company to a stock insurance company. A new, publicly traded holding company named Anthem, Inc. became the holder of all of Anthem's stock. The principal reason for Anthem's recent demutualization was to increase the company's financial flexibility by improving its access to capital. [Exh. 34, p. 2].

31. On January 11, 2002, the policyholders of BCBSKS approved the Plan of Conversion in this docket by an overwhelming 63% of all votes cast (i.e., 63,504 for and 36,618 against). On January 14, 2002, in accordance with the Procedural and Scheduling Order, BCBSKS reported the official results of this policyholder vote to the Kansas Insurance Department.

#### B. The Terms of the Alliance Agreement

32. The Plan of Conversion is contingent on the immediate sale of all BCBSKS common stock to Anthem West, Inc. ("Anthem West"), a wholly-owned

subsidiary of Anthem and Anthem's designee for purposes of this transaction. Upon closing of the sale transaction, BCBSKS will become a wholly-owned subsidiary of Anthem West and the legal name of BCBSKS will be changed to Anthem Health Plans of Kansas, Inc., d/b/a Anthem Blue Cross and Blue Shield. [Tr. Vol. II, p. 795].

### **Consideration To Be Paid To Policyholders**

33. Anthem has agreed to pay \$190 million for all shares of BCBSKS common stock. Eligible policyholders will receive \$142 million following the close of the transaction and \$48 million will be placed in escrow pending the outcome of certain contingencies. Any sums remaining in the Escrow Fund after the disposition of these contingencies will be distributed to eligible policyholders. [Exh. 52, pp.3-4]. A Policyholder Committee, consisting of five individual insureds of BCBSKS appointed by the Commissioner, shall oversee the escrow fund and shall be authorized to select its own accountants and other advisors. Anthem has agreed that the Commissioner shall have the exclusive authority to select the members of the Policyholder Committee. [Exh. 51, p. 7; Tr. Vol. III, pp. 833-834].

34. BCBSKS has declared a special distribution to eligible policyholders that is payable following the sale in an aggregate amount equal to the amount by which the consolidated closing book value of BCBSKS exceeds \$155 million. BCBSKS presently estimates that aggregate amount of this special distribution will be \$131 million for eligible policyholders. [Exh. 52, pp.3-4; Exh, 3, pp. 11-12].

### **Anthem's Commitments Under The Alliance Agreement**

35. The Alliance Agreement defines in detail the respective rights and responsibilities of the parties in connection with the proposed acquisition. In relevant part, Anthem's commitments under the Agreement include the following matters.

(a) Anthem has agreed to use its best efforts to have a candidate from BCBSKS's present Board of Directors nominated and elected to Anthem's Board of Directors. [Exh. 3 p. 13].

(b) Anthem has agreed to create and maintain a local advisory board for Anthem's Kansas business. Anthem will also provide proportionate representation for Kansas policyholders on a regional advisory board that will contribute to the oversight and development of Anthem's West Region. [Exh. 3 p. 13].

(c) Anthem will establish and maintain hospital, medical and dental advisory committees similar in size and composition to the BCBSKS counterpart currently in existence. [Exh. 3, p. 13].

(d) Anthem has agreed that all employees of BCBSKS as of the Closing Date will become employees of Anthem Health Plans of Kansas and that Anthem will maintain proportional employment in Kansas. [Exh. 34, pp. 14, 16; Tr. Vol. II, p. 798]. Anthem has also committed to move a national informational technology network data center to Topeka, Kansas. [Exh. 34, p. 3].

(e) All policyholders of BCBSKS will remain policyholders of Anthem following the closing of the transaction. [Exh. 3, p. 12; Vol. I, p. 796].

(f) Anthem has assured that there will be no significant changes to the product families (HMO, POS and indemnity) beyond those previously identified by BCBSKS. [Tr. Vol. II, p. 797].

(g) Anthem will honor BCBSKS's existing commitments to hospitals, physicians and other health care providers. [Tr. Vol. II, pp. 796-797].

36. At the hearing of this matter, Anthem, Inc. agreed to guarantee all the insurance obligations of BCBSKS and to enter into a guaranty agreement in the same form entered into in the States of Ohio, Kentucky and Connecticut. [Tr. Vol. II, p. 802]. The form of that guarantee agreement is attached hereto in Appendix B.

### C. The Conversion or Demutualization of BCBSKS and Statutory Requirements

#### **Statutory Requirements**

37. Disposition of BCBSKS's proposed Plan to convert from a mutual company to a stock company is governed by K.S.A. 40-4004(a), which provides that the Commissioner shall approve the conversion if she finds:

(a) That the plan of conversion is fair and equitable to policyholders;

(b) That the plan of conversion complies with the provisions of the conversion statute;

(c) That the plan of conversion does not unjustly enrich any director, officer, agent or employee of BCBSKS; and

(d) That the new stock insurer would meet the minimum requirements to be issued a certificate of authority by the Commissioner to transact business in this state and the continued operations of the new stock insurer would not be hazardous to existing or future policyholders or the public.

Because substantial evidence of record establishes that the Plan of Conversion satisfies each of these statutory criteria, the Commissioner should issue the requisite findings and approve the conversion of BCBSKS from a mutual company to a stock company.

**The Plan is Fair and Equitable to Policyholders.**

38. The evidence of record demonstrates that the amount and allocation of consideration under the Plan of Conversion and related transactions is fair and equitable to the policyholders of BCBSKS. Therefore, the Plan satisfies the requirements of K.S.A. 40-4004(a)(1).

**The Amount of Consideration Is Fair and Equitable.**

39. The adequacy of the consideration earmarked for eligible policyholders is evidenced not only by the overwhelming vote of BCBSKS policyholders in favor of the Plan of Conversion but also by the uncontroverted opinions of expert financial advisors who have independently determined that, from a financial point of view, the amount of consideration is fair and equitable to policyholders.

40. The evidence of record clearly establishes that the Board of Directors of BCBSKS considered the conversion to a stock company an extremely serious matter. The process of selecting Anthem was thorough, time-consuming and costly, but the Board wanted to make certain that the contemplated transaction would be in the best interests of its policyholders.

(a) BCBSKS engaged the investment firm of Dresdner Kleinwort Wassenstein (“DKW”) to evaluate whether the total consideration to be distributed to eligible policyholders pursuant to the Alliance Agreement is fair and equitable. The credentials, experience and expertise of DKW in performing such assessment are

impressive. At a meeting of the Board of Directors of BCBSKS held on May 24, 2001, DKW presented its opinion that, from a financial point of view, the aggregate cash consideration to be paid to eligible policyholders pursuant to the Alliance Agreement is fair. [Exh. 16, p.4; Exh. 15A]. The Board of Directors also reviewed with DKW various alternatives to the contemplated conversion and sale to Anthem, including the possibility of continuing operations on a stand-alone basis. After careful consideration, the Board unanimously approved the Alliance Agreement and authorized management to execute it. [Exh. 5, pp. 3-4].

(b) On November 9, 2001, as requested by the BCBSKS Board of Directors and required by the Plan of Conversion, DKW issued a second opinion based on updated information and concluded that, from a financial point of view, the aggregate of the purchase price and the special distribution to be paid to policyholders is fair. [Exh. 16, pp. 4-5, 10-14; Exh. 15; Exh. 15A].<sup>3</sup>

(c) Bear Stearns, the financial advisor for the KID Testimonial Team, also independently determined from a financial point of view that the aggregate consideration to be distributed pursuant to the Alliance Agreement to policyholders is fair. [Tr. Vol. I, p. 1054; Exh. 52].

41. Finally, Kansas law expressly provides that consideration paid to policyholders in connection with the conversion to a stock company “shall be deemed to

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<sup>3</sup> In evaluating the price to be paid to policyholders, DKW utilized three industry-accepted methods of valuation: Comparable Company Analysis; Comparable Transaction Analysis; and Discounted Cash Flow Analysis. The Comparable Company Analysis produced an enterprise value range of \$93 million to \$220 million and transaction value range of \$224 million to \$351 million. The Comparable Transaction Analysis, in which specific market place transactions are examined, produced an enterprise value range of \$130 million to \$232 million and a transaction value in a range of \$257 million to \$363 million. Finally, the Discounted Cash Flow Analysis produced an enterprise value range of \$150 million to \$222 million and a transaction value range of \$281 to \$353 million. [Exh. 16, pp. 10-14; Exh. 15].

be fair and equitable . . . if the consideration is at least the amount of statutory surplus attributable to the contributions of policyholders.” K.S.A. 40-4004(b). Since the financial consideration provided to policyholders under the Alliance Agreement significantly exceeds the amount of statutory surplus attributable to policyholder contributions, the conversion is “fair and equitable to policyholders” as a matter of law.

#### The Allocation of Consideration Is Fair and Equitable.

42. The Board of Directors of BCBSKS engaged the actuarial firm of Milliman, USA (“Milliman”) to devise a fair and equitable method of allocating consideration to policyholders in connection with the proposed demutualization of BCBSKS. Milliman has been previously retained as actuarial advisors in numerous insurance company demutualizations and has assisted state insurance regulators in connection with insurance company conversions. [Exh. 18, pp. 1-3]. Daniel J. McCarthy testified that Actuarial Standard of Practice 37 (“ASOP 37”) entitled “Allocation of Policyholder Consideration in Mutual Life Insurance Company Demutualizations” is the most authoritative professional guidance in determining proper allocations. This method of allocation has two components: variable and fixed. The variable component is based on policy contributions to the company’s statutory surplus and asset valuation reserve, plus the “present value of contributions that the policy . . . is expected to make in the future.” The fixed component recognizes the value of each policyholder’s membership and allocates this value to eligible policyholders on a pro rata basis. As determined by Milliman, the variable share allocated to BCBSKS policyholders represents approximately two-thirds of the distribution. Although the variable share would normally be a larger percentage, the fixed share in this distribution has a higher value than customarily used because of factors peculiar to BCBSKS, including the fact that a

significant amount of the distribution is from surplus that was in the company prior to its conversion to a mutual insurance company in 1992. [Exh. 18, pp. 4-7]. Based on its vast experience in policyholder allocations, Milliman has opined that the proposed allocation of consideration is fair and equitable to eligible policyholders. [Exh. 17].

43. The KID Testimonial Team assigned PwC the responsibility of reviewing the Plan of Conversion and assessing the merits and fairness of the proposed allocation of consideration among the policyholders. Subject to minor adjustments, which BCBSKS agreed to make to the Plan, PwC concluded that the proposed allocation among eligible policyholders is fair and equitable. [Tr. Vol. III, p. 1084 and Exh. 54, p. 10].

**The Plan Complies With All The Provisions Of The Conversion Statute.**

44. The Plan of Conversion complies with all provisions of the conversion statute and no party to this proceeding seriously contends otherwise. As Greenlee testified in relevant part, “we do not believe that any aspect of the proposed transaction would violate applicable statutory standards.” [Tr. Vol. II, p. 8].<sup>4</sup> The Plan of Conversion accordingly satisfies the provisions of K.S.A. 40-4004(a)(2).

**The Transaction Will Not Unjustly Enrich Any Director, Officer, Agent or Employee of BSBSKS.**

45. The record is clear that no person associated with BCBSKS can expect any compensation, stock or other benefit as a result of the transaction. Most mergers or acquisitions would normally contain an enhanced level of compensation for officers and directors who have devoted so many years to the successful operation of a major

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<sup>4</sup> Greenlee’s reservations concerning the potential for a rate increase will be addressed later in this memorandum.

insurer, but no such provisions were made for anyone affiliated with BCBSKS. Indeed, executive officer compensation will not change as a result of the transaction and no officer, director, agent or employee will be compensated for anything other than services performed. [Exh. 29, p. 11; Exh. 13, p. 11; Tr. Vol. I, p. 902]. Likewise, to avoid even the appearance of impropriety, the only employment commitment made by Anthem is that it intends to offer employment to all individuals employed by BCBSKS after the closing of this transaction. [Tr. Vol. II, p. 798; Exh. 38, p. 6]. These undisputed facts demonstrate that the Plan of Conversion will not unjustly enrich any officer, director, agent or employee of BCBSKS. The Plan, therefore, satisfies the provisions of K.S.A. 40-4004(a)(3).

**Anthem Would Meet the Minimum Requirements to be Issued a Certificate of Authority and its Operations Would Not Be Hazardous to Existing or Future Policyholders or the Public.**

46. Anthem clearly meets the minimum requirements to be issued a Kansas Certificate of Authority and there is no evidence to suggest that Anthem's operations would be hazardous to existing or future policyholders or the public. PwC conducted a detailed review of Anthem, its operations, its current financial status and performance, its relationship with policyholders and the public, its performance and market conduct in other states, its professional relationships with hospital and medical associations, its litigation and community involvement and concluded there were no statutory reasons for disallowing the transaction. [Exh. 56 and 63]. Based on her assessment of the reports and opinions of PwC and other members of the KID Testimonial Team, Greenlee testified that absent the possibility of a rate increase "this transaction complies with Kansas law in every other respect." [Tr. Vol. II, p. 883]. Greenlee likewise observed that Anthem would meet all requirements necessary to be issued a Certificate of

Authority and “the continued operations of the new stock insurer would not be hazardous or prejudicial to existing or future policyholders or the public.” [Exh. 51, p. 8]. Therefore, the evidence of record establishes that the Plan of Conversion satisfies the requirements of K.S.A. 40-4004(a)(4).