

BEFORE THE COMMISSIONER OF INSURANCE
OF THE STATE OF KANSAS

In the Matter of the Conversion and Acquisition of
BLUE CROSS AND BLUE SHIELD OF KANSAS, INC.

Docket No. 3014-DM

**[BLUE CROSS AND BLUE SHIELD OF KANSAS, INC.’S PROPOSED]
FINDINGS OF FACT, CONCLUSIONS OF LAW
AND ORDER APPROVING CONVERSION AND ACQUISITION**

I. Nature of the Proceedings

1. These proceedings pertain to the sponsored demutualization of Blue Cross and Blue Shield of Kansas, Inc. (hereinafter “BCBSKS”), which provides for the conversion of BCBSKS from a mutual life insurance company to a stock company and thereafter the acquisition of all of the issued and outstanding shares of common stock authorized and issued by BCBSKS to Anthem Insurance Companies, Inc. (hereinafter “Anthem”).

2. BCBSKS’ application for approval of the conversion pursuant to K.S.A. 40-4001 *et seq.* and the Anthem’s application for approval of acquisition of control of BCBSKS pursuant to K.S.A. 40-3304 *et seq.* are linked in a single transaction, in that (a) the effectiveness of the Plan of Conversion is conditioned on approval of the change of control and (b) the closing under the Alliance Agreement, by which Anthem proposes to acquire control of BCBSKS, cannot occur unless the Plan of Conversion is effective.

3. Each of the paragraphs set forth herein shall be deemed a finding of fact, a conclusion of law, or both a finding of fact and a conclusion of law, as appropriate.

II. Legislative Background and Statutory Requirements

A. The Conversion Law

4. Article 40 of Chapter 40 of the Kansas Statutes Annotated (the “Conversion Law”) was enacted by the Kansas Legislature to permit domestic mutual insurers to convert to domestic stock insurers.

5. The Conversion Law sets forth a number of specific requirements as to what must be included in a plan of conversion. It also sets forth specific procedural requirements relating to the adoption of a plan and its submission for approval by the policyholders and the Commissioner.

6. The Conversion Law permits three alternative types of plans of conversion. K.S.A. 40-4003a. The first type of plan listed in the statute, which is the type adopted by BCBSKS, authorizes an exchange of policyholders’ membership interests for cash or other consideration. K.S.A. 40-4003a(a). The Conversion Law requires such a plan to include the following elements: (1) a description of the structure, forms and allocation of the proposed consideration to the policyholders; (2) the projected range of the number of shares of capital stock to be issued by the new stock insurer; (3) a description of any amendments to the insurer’s articles of incorporation; (4) provisions establishing the method by which the initial board of directors of the stock insurer will be selected; and (5) any other additional information the Commissioner may reasonably request. K.S.A. 40-4003a(a)(1).

7. Under the Conversion Law, the Commissioner may require a plan of conversion to contain a closed block for participating individual life insurance policies, but a closed block is not required by the statute. K.S.A. 40-4003b.

8. Any plan of conversion under the Conversion Law must be approved by two-thirds of the insurer’s entire board of directors. In addition, that same majority must adopt a resolution

stating the reasons that conversion would benefit the insurer and be in the best interests of its policyholders. K.S.A. 40-4002(a).

9. The insurer must submit the plan of conversion to a vote of its policyholders at a meeting called for that purpose pursuant to the insurer's bylaws. K.S.A. 40-4002(d). The policyholder meeting must be called by a majority of the insurer's board of directors, the board's chairperson or the president, and notice of it must be accompanied by "a copy of the plan and any information that the commissioner deems necessary to policyholder understanding, including a comprehensible summary of the plan in a form approved by the commissioner." K.S.A. 40-4005. Two-thirds of the policyholders voting in person or by proxy at the policyholder meeting must approve the plan, except that if a majority of all policyholders vote, then a majority of those voting will constitute approval. K.S.A. 40-4002(d).

10. The insurer must submit the final plan of conversion as adopted by its board of directors to the Commissioner for approval. K.S.A. 40-4002(c). As part of her review, the Commissioner is required to hold a public hearing on the plan, providing the insurer and policyholders at least 20 days written notice of the hearing. K.S.A. 40-4004(a). The Commissioner may request that the insurer produce any documents and information in its possession that are reasonably necessary to enable her to make the findings required to approve the plan. K.S.A. 40-4004(c). Further, in reviewing the plan for approval, the Commissioner may retain experts and charge their expenses, reasonably incurred, to the insurer. K.S.A. 40-4013.

11. The Conversion Statute requires the Commissioner to approve the plan if she finds that (1) the plan of conversion is fair and equitable to policyholders; (2) the plan of conversion complies with the provisions of this act; (3) the plan of conversion does not unjustly enrich any director, officer, agent or employee of the insurer; and (4) the new stock insurer would meet

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. K.S.A. 40-4004(a).

12. The Commissioner's discretion with regard to the "fair and equitable" requirement of K.S.A. 40-4004(a)(1) is limited by K.S.A. 40-4004(b), which provides that "[t]he amount of consideration provided by the converting insurer to policyholders shall be deemed to be fair and equitable pursuant to subsection (a), if the consideration is at least the amount of statutory surplus attributable to contributions of policyholders."

13. Upon approval of the plan of conversion by the board of directors, the Commissioner and by a vote of the requisite number of eligible policyholders, the insurer must file the plan in the office of the Commissioner. K.S.A. 40-4002(f). In addition, the insurer must file the amended articles of incorporation with the Kansas Secretary of State within twenty four hours after the Commissioner issues a certificate of authority to the converted insurer. K.S.A. 40-4014.

B. The Acquisition Law

14. The Commissioner's review of the proposed acquisition is governed by K.S.A. 40-3304 (the "Acquisition Law"), which is part of the Kansas Insurance Holding Companies Act, K.S.A. 40-3301 *et seq.* (the "Holding Companies Act").

15. The Legislature has declared that "the policies and purposes" of the Holding Companies Act "are to promote the public interest by," among other things, "[f]acilitating the achievement" of the objectives of the act. K.S.A. 40-3301(c)(1) These objectives, as articulated by the Legislature, include:

- permit[ting] insurers to: (1) Engage in activities which would enable them to make better use of management skills and facilities;
- (2) diversify into new lines of business through acquisition or

organization of subsidiaries; (3) have free access to capital markets which could provide funds for insurers to use in diversification programs; (4) implement sound tax planning conclusions; and (5) serve the changing needs of the public and adapt to changing conditions of the social, economic and political environment, so that insurers are able to compete effectively and to meet the growing public demand for institutions capable of providing a comprehensive range of financial services.

K.S.A. 40-3301(a).

16. The Acquisition Law provides that no person may acquire control of a domestic Kansas insurer unless it has filed with the Commissioner certain information, listed in K.S.A 40-3304(b). *See* K.S.A. 40-3304(a). The required information, commonly known as a “Form A” filing, must be provided by the person acquiring control in a statement made under oath and the statement must be accompanied by a filing fee of \$1,000. K.S.A. 40-3304(b).

17. The Acquisition Law provides that the Commissioner “shall approve” a proposed acquisition of control unless, after a public hearing in accordance with the Kansas Administrative Procedures Act, she finds that (A) after the change of control, the insurer would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed; (B) the financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interest of its policyholders; (C) plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest; (D) the competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control;

or (E) the acquisition is likely to be hazardous or prejudicial to the insurance- buying public.
K.S.A. 40-3304(d)(1).

18. Thus, under the Acquisition Law, an acquisition of control must be approved after receipt of a Form A filing containing the required information, unless the Commissioner finds by a preponderance of the evidence in the hearing record that one of the grounds for disapproval under K.S.A. 40-3004(d)(1) is present.

III. Procedural History

A. Adoption and Submission of the Plan of Conversion and Form A Application.

19. On September 14, 2000, the BCBSKS' Board of Directors unanimously authorized the company's management to explore potential alliances and propose recommendations for such alliances to the Board of Directors. (Tr., Vol. 1, p. 119:11). Following extensive and conscientious efforts in contacting, receiving from and considering responses to request for expression of interest from all qualified and proven Blue Cross and Blue Shield plan consolidators, BCBSKS' senior management unanimously recommended to the Board a proposal submitted by Anthem for consideration and approval. (Tr. Vol. 1, pp. 119:17; 122:19). In coming to this recommendation, the senior management represented to the Board its best considered judgment, as well as the judgment of its independent advisors who assisted in the process of collecting and considering proposals submitted by respondents. (Tr. Vol. 1, pp. 119:17; 121:12).

20. On May 24, 2001, the BCBSKS Board of Directors, who collectively had 281 years of experience and services to BCBSKS, approved the proposed agreement with Anthem and authorized senior management to execute a definitive agreement. (Tr. Vol. 1, pp. 121:21; 128:11).

21. After executing the alliance agreement on or about May 30, 2001, BCBSKS on May 31, 2001 submitted a draft Plan of Conversion to the Kansas Department of Insurance in accordance with K.S.A. 40-4002(b). (Exhibit 5, p. 4, pre-filed testimony of Michael Mattox; Exhibit 51, p. 3, pre-filed testimony of Kathy Greenlee).

22. Thereafter, BCBSKS subsequently revised the draft Plan of Conversion to incorporate changes requested by the Kansas Insurance Department's Testimonial Team (hereinafter "KID Testimonial Team"). (Exhibit 51, pp. 6-8).

23. On October 25, 2001, the Board of Directors of BCBSKS unanimously approved and adopted a Plan of Conversion to enhance the company's strategic and financial flexibility, and to make possible the distribution of the value of the company to eligible policyholders. (Tr. Vol. 1, p123:12; Exhibit 1, p. 1, Art. 1).

24. BCBSKS' Board of Directors unanimously approved the Plan of Conversion (Exhibit 1) on October 25, 2001. The Board of Directors also unanimously adopted a resolution pursuant to K.S.A. 40-4002(a) finding that "the Conversion will benefit BCBSKS and is in the best interests of BCBSKS and its policyholders" and stating reasons for its conclusion. (Exhibit 28, p. 9.)

25. If the Plan becomes effective, (1) BCBSKS will become a wholly-owned subsidiary of Anthem, which will purchase 100% of BCBSKS' stock for \$190 million, and (2) the Company's Eligible Policyholders will receive a cash payment as consideration for relinquishing their membership interests, as discussed more fully below.

26. In compliance with K.S.A. 40-4003a(a)(1), the Plan of Conversion submitted by BCBSKS includes, among other things, a description of the structure, forms and allocation of the proposed consideration to the policyholders, a description of the number of shares of capital

stock to be issued by BCBSKS to Anthem, a description of amendments to BCBSKS' Articles of Incorporation, and provisions establishing the method by which the initial board of directors of BCBSKS as a stock insurer will be selected.

27. On July 25, 2001, Anthem filed its "Form A Statement Regarding the Acquisition or Control of or Merger with a Domestic Insurer (hereinafter "Form A") with the Commissioner seeking approval to acquire BCBSKS in accordance with K.S.A. 40-3304(d)(1) (Form A, pp 1-23; Tr. Vol. 1, p.26:7-18).The Form A submitted by Anthem includes all materials and attachments required under the statutes.

B. Testimonial Team Review.

28. On August 21, 2001, the Commissioner issued a Procedural and Scheduling Order governing the further course of the proceedings. Prior to the entry of this order, the KID Testimonial Team was formed and headed by the Department's General Counsel, Kathy Greenlee. Special counsel to the Testimonial Team, Patrick H. Cantilo, of Cantilo & Bennett, LLP was engaged to represent the Testimonial Team. Thereafter, additional advisors and consultants were engaged to assist the Testimonial Team, namely David M. Platter, Senior Managing Director in the Investment Banking Division and head of the Financial Institution's Group of Bear Stearns & Co., Inc., (hereinafter "Bear Stearns"); Kenneth M. Beck, a principal with the Actuarial and Insurance Management Solutions Practices of PricewaterhouseCoopers, LLP, (hereinafter "PwC"); Denise G. Essenberg, Certified Public Accountant and partner with PwC; Sandra S. Hunt, a principal of PwC; Mark H. Kovey, attorney and partner in the law firm of Scribner, Hall & Thompson to serve as the tax advisor. (See Procedural and Scheduling Order at p. 11, para. 21.) The expenses of the outside advisors and consultants retained by the KID Testimonial Team in connection with the review of the Plan of Conversion and demutualization,

but not the acquisition, are being paid or reimbursed by BCBSKS in accordance with K.S.A. 40-4013. (Exhibit 29, p. 9).

29. Certain material changes to the Plan were made by BCBSKS and Anthem as the result of the Testimonial Team's review and comments. For example, a number of improvements were made to the public disclosure process. The draft Policyholder Information Statement was amended in a number of respects. The Testimonial Team insisted that the parties disclose as an additional risk factor that the Plan, if approved, could result in future premium increases and/or other changes intended to increase profitability (Exhibit 23, p. 12). In addition, the Policyholder Information Statement was amended to provide enhanced disclosures of the tax treatment, for policyholders, of the Special Distribution and distribution of the Purchase Price (Exhibit 23, pp. 32-35).

30. Additionally, BCBSKS amended the Plan to provide that the Policyholder Committee be appointed by the Commissioner and be comprised of five members, all of whom shall be insureds of BCBSKS, provided that at least two of the initial members of the Policyholder Committee be selected from a slate recommended by the Board prior to the Closing Date. The Plan was also amended to strengthen the Commissioner's oversight over the Policyholder Committee and to empower the Policyholder Committee to select its own accountants and other advisors.

31. Further, the portion of the \$190 million Purchase Price to be placed in escrow pending final resolution of the Contingent Litigation Matter was reduced from the entire \$190 million to \$48 million, enabling \$142 million of the Purchase Price to be distributed to Eligible Policyholders. In addition, the Plan was amended to insure that the Special Distribution would consist of the entire amount by which the Closing Book Value exceeds \$155 million.

32. BCBSKS reassessed elements of the Plan and the resulting proposed allocation of consideration among Eligible Policyholders in numerous respects:

- a. The allocation among policyholders of the initial net statutory surplus is no longer a component of the calculation of actuarial contributions (“AC”);
- b. Changes were also made to the AC models of BCBSKS for merit-based (*i.e.*, experience-rated) group cases, which resulted in allocation of relatively smaller distributions to those cases which did not meet targeted/pricing profit margins compared to those cases which did meet targeted profit margin;
- c. The profits earned on “side funds” (or bank accounts) will be recognized as an additional source of AC in the final version of the historical AC model;
- d. BCBSKS corrected three methodological errors of the actuarial projections underlying the development of AC-factors for the Longer Term Care product line;
- e. The prospective AC projections for the Small Group Rate Reform product line have been revised to eliminate assumed premium rate increases which were deemed to be overly aggressive;
- f. AC calculations were revised to be consistent with the Management Projections;
- g. Changes were made to the historical and prospective AC model that affects all product lines.

Review and comment by the Testimonial Team’s tax consultant, Scribner, resulted in refinements in certain of the Plan’s tax treatments, including:

- a. The transaction has been changed to require that BCBSKS must deposit into the Escrow Fund, and thereby make available for the benefit of Eligible Policyholders, the net after tax amount of all tax savings to BCBSKS from tax deductions for any interest added by BCBSKS to the payments to be received by the Eligible Policyholders under the Plan;
- b. The review process that will be followed by the Policyholder Committee for items that will be paid from the Escrow Fund to BCBSKS for reimbursement of expenses which expenses reduce the funds available to be paid to the Eligible Policyholders, has been improved by virtue of certain definitions added to the

documents to clarify the tax treatment of the expenses and the reformation of the Policyholder Committee process;

- c. The portion of the Purchase Price that will be paid to the Eligible Policyholders has been increased;
- d. Independent counsel for BCBSKS provided to the Testimonial Team a legal memorandum that supported the federal income tax law opinion issued to BCBSKS and included in the Policyholder Information Statement.

C. Prehearing Procedure.

33. On September 24, 2001, the Kansas Medical Society (hereinafter “KMS”), the Kansas Hospital Association (hereinafter “KHA”), the Kansas State Nurses Association (hereinafter “KSNA”), and the Kansas Association for the Medically Underserved (hereinafter “KAMU”) filed petitions to intervene in this matter. On September 20, 2001, William E. Dakan filed a petition to intervene in this matter. (See Petitions for Interventions filed by KMS, KHA, KSNA, KAMU, and William E. Dakan, and Order on Intervention dated October 23, 2001).

34. Following receipt of responses, objections and supplemental briefs by the parties and the proposed intervenors, the Commissioner entered her order granting limited intervention to KMS, KHA, KSNA, and KAMU and denying intervention to William E. Dakan for the reasons set forth in said order. See Order on Intervention dated October 23, 2001, pp. 4-6.

35. On October 26, 2001, the Commissioner entered her Scheduling Order and Preliminary Public Comment Meeting Plan scheduling Public Comment Meetings throughout the state of Kansas in Hays, Garden City, Wichita, Pittsburg, and Topeka, Kansas and requiring notice thereof to be published no later than seven days in advance of the Public Comment Meetings in accordance with the order. (See Scheduling Order and Preliminary Public Comment Meeting Plan dated October 11, 2001).

D. Notice to Policyholders and the Public.

36. On October 26, 2001, the Commissioner entered her Schedule of Proceedings Order establishing the dates upon which the distribution of combined notice of hearing and special meeting and Policyholder Information Statement were to be distributed to eligible policyholders, establishing the dates on which publication notice was to be made in selected newspapers, establishing the dates for the Public Comment Meetings in Hays, Garden City and Wichita for December 4-5, 2001, the Public Comment Meetings in Pittsburg and Topeka, Kansas on December 13-14, 2001, the deadlines for the filing of pre-filed testimony and briefs, and rebuttal testimony and briefs, scheduling the formal Public Hearings pursuant to K.S.A. 40-4004 and K.S.A. 40-3304(d)(1), scheduling the policyholder vote for January 11, 2002 at 10:00 A.M.; scheduling the reporting of the policyholder vote by BCBSKS to the Kansas Insurance Department on January 14, 2002 and establishing other deadlines for the filing of Findings of Fact, Conclusions of Law, closing of the Public Hearings, and the final order of the Commissioner. (See Schedule of Proceedings Order dated October 26, 2001).

37. During the period November 19, 2001 to November 27, 2001, and (for a small group of policyholders in a subsequent mailing) on December 12, 2001, BCBSKS sent a package of notice materials by first class mail to the address of each policyholder as it appears on BCBSKS' records as required by K.S.A. §§ 40-4004 and 40-4005, BCBSKS' By-Laws and the Plan of Conversion (Exhibit 25; Exhibit 29, p.4) All notice materials were reviewed and approved by the staff of the Kansas Insurance Department. The materials contained in those packages are described in Exhibit 29, pp. 4-5.

38. At the urging of the KID Testimonial Team, the Policyholder Information Statement and other materials sent to policyholders prominently and repeatedly disclosed as the first "risk factor" the possibility that greater rate increases than would otherwise occur would

take place after acquisition, in order to increase profitability for Anthem's stockholders. (Exhibit 23 at p. 12).

39. Notice of the Public Hearings was published in the Topeka Capital – Journal, Lawrence Journal World, Pittsburgh Morning Sun, Salina Journal, Wichita Eagle, Hays Daily News, Garden City Telegram, and Colby Free Press as evidenced by the proof of publication which has been properly filed of record in these proceedings. The Commissioner's Notice of Public Hearing was subsequently published as required by the Procedural and Scheduling Order and K.S.A. 77-520 in the above-described newspapers. (See Proof of Publication, which was been properly filed of record in these proceedings).

40. In accordance with the schedule established in the Procedural and Scheduling Order entered herein, the parties and intervenors filed written testimony, supporting memorandum briefs and rebuttal testimony.

IV. The Public Hearing.

A. Commencement of the Hearing.

41. The public hearings were commenced on January 7 and continued through January 9, 2002, in the Emerald III Room at the Capital Plaza Hotel, 1717 S.W. Topeka Boulevard, Topeka, Kansas, with the Commissioner of Insurance presiding over the proceedings as the Presiding Officer for the Public Hearings.

42. Two procedural motions were filed before commencement of the public hearing. These motions were denied in part. (Tr. Vol. 1, pp. 24:10, 343:14). The Commissioner decided that the parties would not be permitted to provide opening or closing statements, on the grounds that the parties' pre-hearing briefs presented legal argument and that the parties' post-hearing submissions would serve in lieu of a closing statement. (See Tr. Vol. 1, p. 23:21).

43. BCBSKS was represented at the Public Hearings by Gary D. McCallister and Thomas A. Kelliher of Gary D. McCallister & Associates, Ltd., Chicago, Illinois; Eric I. Unrein of the law firm of Davis, Unrein, McCallister, Biggs & Head, LLP, Topeka, Kansas, and by James C. Scoville and Carl Micarelli of the law firm of Debevoise & Plimpton, New York, New York.

44. BCBSKS introduced Exhibit numbers 1 through 33, inclusive, and Exhibit numbers 59, 62, 66 and 68-70. Included within these exhibits was pre-filed sworn testimony as well as rebuttal testimony. In addition, BCBSKS presented the following witnesses who testified orally at the time of the Public Hearings, 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 and Treasurer 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 Paul Feldstein, Ph.D., Professor, Graduate School of Management, University of California at Irvine. (Tr. Vol. 1).

45. Anthem was represented at the Public Hearings by Randall J. Forbes and John C. Frieden of the law firm of Frieden, Haynes & Forbes, Topeka, Kansas, and Douglas R. Fauth, Vice President of Anthem Insurance Companies, Inc. Anthem introduced Exhibit numbers 34-41, which included pre-filed written testimony and rebuttal testimony. Anthem also offered oral testimony from Larry C. Glasscock, President and Chief Executive Officer; Michael L. Smith, Executive Vice President and Chief Financial Officer; Samuel R. Nussbaum, M.D., Executive Vice President and Chief Medical Officer; Donna O. Moore, Vice President, Health Care

Management – East Operating Region; David R. Frick, Executive Vice President and Chief Legal and Administrative Officer. (Tr. Vol. 2).

46. The KID Testimonial Team was represented at the Public Hearings by its special counsel, Patrick H. Cantilo of the law firm of Cantilo & Bennett, LLP, Austin, Texas, and by Linda Sheppard of the Kansas Insurance Department Testimonial Team. The KID Testimonial Team presented Exhibits 51-56 inclusively, which included pre-filed testimony. In addition, the KID Testimonial Team called the following witnesses to provide oral testimony at the public hearing: David M. Platter, Kenneth M. Beck, Denise G. Essenberg, Sandra S. Hunt, Mark H. Kovey, and Kathy Greenlee. (Tr. Vols. 2-3).

47. Intervenor KMS was represented at the Public Hearings by Charles R. Hay of the law firm of Goodell, Stratton, Edmonds & Palmer, LLP, Topeka, Kansas. The intervenor KHA was represented at the Public Hearings by Douglas S. Laird, of the law firm of Polsinelli, Shalten & Welte, P.C., Kansas City, Missouri. Intervenors KMS and KHA introduced Exhibits 71-73 into evidence, which included pre-filed testimony. The intervenors, KMS and KHA presented oral testimony from Carl J. Schramm, Ph.D., J.D. and Marvin M. Fairbanks, RN, Director for Contracted Care at Stormont Vail Health Care. (Tr. Vol. 3).

48. Intervenors KSNA and KAMU were represented at the Public Hearings by Karen A. Eager, of the Law Offices of Theodore J. Lickteig, Lawrence, Kansas. The intervenors KSNA and KAMU entered Exhibits 74-75 into evidence, which included pre-filed and rebuttal testimony. These intervenors offered oral testimony from Dawn M. Touzin, Director of the Community Health Assets Projects at Community Catalyst. (Tr. Vol. 3).

49. On January 25, 2002, the parties and intervenors are to file their proposed Findings of Fact, Conclusions of Law and supporting memoranda. Upon the filing of these papers and as of January 25, 2002, the Public Hearings are closed.

50. On or before February 25, 2002, the Final Order of the Commissioner is to be filed in accordance with K.S.A. 77-526(g).

B. Testimony of John W. Knack, Jr.

51. John W. Knack, Jr., the President and Chief Executive Officer of BCBSKS, was called as a witness by BCBSKS. (Tr. Vol. 1, pp. 28:16, 29:3) Mr. Knack presented prefiled written testimony as well as oral testimony. (Ex. 3; Tr. Vol. 1, pp. 31:14-45:7) PowerPoint slides used by Mr. Knack during his testimony were also admitted in evidence as an exhibit. (Ex. 4; Tr. Vol. 1, p. 48:1) The subjects of his testimony included information about the company generally, the reasons it has pursued the sponsored demutualization by which BCBSKS proposes to convert to stock form and be acquired by Anthem, and the advantages of the sponsored demutualization.

52. Among other things, Mr. Knack testified that the advantages of the sponsored demutualization include that (a) the sponsored demutualization provides BCBSKS with sufficient capital to compete with national commercial companies as well as access to a larger total capital pool with which to acquire other health plans or related businesses, (b) the sponsored demutualization enables BCBSKS to take advantage of economies of scale by eliminating duplicative resources and streamlining BCBSKS' compliance efforts in an increasingly complex regulatory environment, (c) by virtue of becoming part of the diversified geographical base of Anthem that results from the sponsored demutualization, BCBSKS will have increased flexibility in responding to localized adverse risk events, and will be able to participate better in insurance offerings to multi-state accounts, (d) BCBSKS will be able to offer a greater variety of career

paths to its employees, with the potential for greater and more varied challenges, which in turn should permit it to continue to attract and retain the kinds of employees needed to provide policyholders with quality service, and (e) the sponsored demutualization will allow BCBSKS to take advantage of best practices in health insurance from Anthem and its other health insurance affiliates. (Ex. 3, p. 6)

53. Mr. Knack also noted that Eligible Policyholders will receive a cash distribution for their otherwise illiquid membership interests pursuant to the Plan of Conversion. (Exhibit 3, p. 11) Mr. Knack further testified that after assessing the competitive conditions in the health insurance and services industry, BCBSKS determined that it needs to enhance its strategic and financial flexibility. (Ex. 3, p. 5) He stated that if BCBSKS is to continue to provide high quality insurance services at reasonable costs to our policyholders in the health insurance market that has been become national in scope, it must spread its costs over a sufficiently large policyholder base. (Ex. 3, p. 5) Mr. Knack testified that the Company's potential customer base within the state shrinks every year as national corporations purchase or supplant local businesses. (Ex. 3, p. 6) He noted that minimal population growth was forecast for BCBSKS' service area, and that government-sponsored programs also are likely to erode BCBSKS' business. (Tr. Vol. 1, p. 41:21) He also testified that the Company's inability to diversify its risks geographically makes it susceptible to an adverse local illness, or adverse local legislation, or natural disaster, all of which could have substantial impacts to the financial soundness of the Company. (Ex. 3, p. 6)

54. Mr. Knack also discussed the need to spread fixed costs, such as for information technology ("IT") systems, across a larger policyholder base. (Tr. Vol. 1, pp. 35:14-38:21) Among other things, he testified that BCBSKS expected that it would need to invest \$40 million to \$50 million in the future in IT infrastructure to develop and implement disease-management

programs (Tr. Vol. 1, p. 38:4) Mr. Knack testified that he believed scale economies would be achievable after a consolidation and that they would reduce the need for premium increases and promote financial strength of the company. (Tr. Vol. 1, p. 44:3)

55. In his written testimony, Mr. Knack also summarized the process by which BCBSKS had negotiated the Plan and the terms of the Plan. (Ex. 3, pp. 3-4, 7-13)

C. Testimony of Michael M. Mattox.

56. Michael M. Mattox, Executive Vice President of BCBSKS, was called as a witness by BCBSKS. (Tr. Vol. 1, p. 116:9) Mr. Mattox presented pre-filed written testimony and oral testimony. (Ex. 5; Tr. Vol. 1, pp. 117:21-129:16; 130:12) PowerPoint slides used by Mr. Mattox during his testimony were also admitted in evidence as an exhibit. (Exhibit 6; Tr. Vol. 1, p. 130:12) The subjects of his testimony included the negotiation of the Alliance Agreement with Anthem and the development of the Plan of Conversion.

57. Among other things, Mr. Mattox testified that after negotiations and considerations of alternatives, the Company entered into the Alliance Agreement with Anthem on May 30, 2001, agreeing to a sponsored demutualization subject to the Commissioner's approval and certain other conditions set forth in the agreement (Ex. 5, pp. 2-4; Tr. Vol. 1, pp. 121:12-122:21). Mr. Mattox testified that the Board and management determined that the sponsored demutualization would be in the best interest of the policyholders because it would give the Company the ability to survive and grow in the highly competitive health insurance and services industries. (Tr. Vol. 1, p. 123:12; Ex. 5, p. 4)

58. Mr. Mattox also testified as to the efforts of BCBSKS management, together with a team of outside advisors, in developing the Plan of Conversion, the discussions that BCBSKS and its advisors had with the Testimonial Team and its advisors, and the active involvement of the Board of Directors in considering the Plan of Conversion. (Tr. Vol. 1, pp. 118:24-124:2) In

addition, Mr. Mattox summarized the terms of the Plan of Conversion and the Alliance Agreement. (Ex. 5, pp. 4-11)

D. Testimony of Paul J. Feldstein.

59. Paul J. Feldstein, Ph.D., a professor of Health Care Management at the Graduate School of Management at the University of California at Irvine (Tr. Vol. 1, p. 203, Ex. 8-12) was called as an expert witness by BCBSKS. Dr. Feldstein presented a pre-filed report, pre-filed rebuttal testimony and oral testimony. The subjects of his testimony included issues related to the effect of health plan ownership on performance.

60. Because of the lack of available studies specifically concerning mutual health insurance plans, Dr. Feldstein focused on the literature comparing non-profit and for-profit health insurance plans (Tr. Vol. 1, Ex. 10. p. 1). He testified that health insurance markets were price-competitive, and that the extent to which for-profit health plans can create and use market power to increase premiums, reduce quality, and have an inadequate provider network is limited by the extent of health plan competition, ease of entry by competitors, and by informed purchasers, such as large employers (Tr. Vol. 1, pp. 211:2; 235:37, Ex. 10). He also testified that using HEDIS and NCQA quality measures and comparing for-profit and not-for-profit Blue plans do not suggest that there is any difference in these measures by ownership status (Tr. Vol., Exs. 10 and 11). Dr. Feldstein concluded that ownership status by itself does not appear to be a predictor of health plan performance (Tr. Vol., 1, Ex. 10, pp. 33-34). Indeed, based on tabulated data (Exhibit 11, table 7) the for-profit health plan performed better than the not-for-profit health plan on most measures. (Tr. Vol. 1, p.235:3-22).

61. Dr. Feldstein, in his rebuttal testimony, testified that an increase in premiums relative to competitors is unprofitable in the health insurance industry (Tr. Vol. 1, pp. 236- 240; Ex. 12, pp.1-2). He stated that the price elasticity of demand for an individual insurer has been

estimated to range from -2.5% to -7.0%, so that the reduction in the insurer's revenue from the loss in enrollment will more than offset the gain in revenue from the higher relative premium (Tr. Vol. 1, Ex. 12, pp. 1-2). He also testified that an insurer increasing its premiums relative to its competitors will end up with a higher risk pool, as lower risks will more readily switch to competitors. *Id.*

E. Testimony of Donald R. Lynn.

62. Donald R. Lynn, Vice President of Finance and Treasurer of BCBSKS, was called as a witness by BCBSKS. (Tr. Vol. 1, p. 290:16) Mr. Lynn presented pre-filed written testimony, pre-filed written rebuttal testimony and oral testimony. (Exs. 13, 14; Tr. Vol. 1, pp. 308:21, 293:23-307:4) The subjects of his testimony included financial issues related to the proposed sponsored demutualization.

63. Mr. Lynn testified about the reasons that BCBSKS chose to pursue the sponsored demutualization. He testified that while BCBSKS is financially sound and enjoys a strong in-state market share, Kansas businesses in general have experienced, and continue to experience, loss of local autonomy in making buying decisions regarding health coverage because businesses have been purchased or have merged with large national corporations. (Tr. Vol. 1, p. 294:24; Ex. 13, p. 2) Mr. Lynn stated that this trend has caused the Company a loss of enrollment and potential enrollment growth. (Tr. Vol. 1, p. 295:9; Ex. 13, p. 2) Mr. Lynn also testified that BCBSKS is limited in its ability to expand geographically and BCBSKS is unable to diversify its risks geographically, exposing it to risks from adverse local illness, adverse local legislation, natural disasters, and targeted pricing by competitors seeking market share. (Tr. Vol. 1, pp. 295:12-296:10; Ex. 13, pp. 2-3) In addition, Mr. Lynn described the consideration to be distributed to policyholders under the Plan of Conversion. (Tr. Vol. 1, p. 297:16-299:4; Ex. 13, pp. 4-6)

64. In addition, Mr. Lynn testified that officers' current employment arrangements were similar to those in other companies, that their compensation will not change solely as a result of the demutualization, and that they will not receive any stock, stock options, stock appreciation rights or other equity interest in Anthem as a result of the transaction. (Tr. Vol. 1, p. 299:19)

65. Mr. Lynn testified about BCBSKS' pricing strategies in connection with its small group business, which is currently operating at a loss. In particular, he testified that BCBSKS' previous decision to reduce premiums temporarily on its small group market was motivated in part by a desire to improve its market share and the quality of its risk pool. (Tr. Vol. 1, p. 303:11). He further testified that BCBSKS' pricing decisions were made on the basis of business considerations, not on a desire to confer a gratuitous benefit on small-group customers, and that it does not intend to operate its small-group business at a loss indefinitely, regardless of whether the transaction is completed. (Tr. Vol. 1, p. 303:16; Ex. 14, p. 1)

66. In addition, Mr. Lynn testified about work that BCBSKS was doing to identify potential areas that could have an impact on its administrative expenses and claims expenses. (Tr. Vol. 1, pp. 303:24-306:3) He also noted that, in addition to benefits from improved efficiency, policyholders would benefit from receiving cash in exchange for their membership interests under the Plan of Conversion. (Tr. Vol. 1, pp. 297:16; 306:14) He testified that about \$160,000,000 of this distribution will go to BCBSKS' approximately 124,000 Medicare supplement policyholders. (Tr. Vol. 1, p. 306:14)

67. Mr. Lynn also testified that at the effective date of the Plan of Conversion, he estimates that BCBSKS' statutory surplus would be approximately \$55 million after taking into account the Special Distribution to policyholders contemplated by the Plan of Conversion, and approximately \$190 million prior to taking into account the Special Distribution. (Tr. Vol. 1, p.

309:5) He noted that each of these numbers is less than the estimated \$273 million to \$321 million in consideration that will be distributed to policyholders under the Plan of Conversion.

(Tr. Vol. 1, p. 309:18)

F. Testimony of Paul G. Adams.

68. Paul G. Adams, a principal with the investment banking firm of Dresdner Kleinwort Wasserstein (“DrKW”), was called as a witness by BCBSKS. DrKW acted as BCBSKS’ financial advisor in connection with the sponsored demutualization. Mr. Adams presented prefiled written testimony and oral testimony. The subjects of Mr. Adams’ testimony included the fairness opinions delivered by DrKW to BCBSKS’ Board of Directors (Exhibit 15 and 15A). Mr. Adams also summarized DrKW’s engagement by BCBSKS, DrKW’s review of BCBSKS’ business (Exhibit 16, pp. 4-6), and the consideration being distributed to eligible policyholders under the Plan (*Id.*, pp. 8-10).

69. Mr. Adams testified that DrKW had delivered two opinions to BCBSKS’ Board that the aggregate of the Purchase Price and the Special Distribution is fair to the Eligible Policyholders as a group from a financial point of view, based on the assumptions set forth in those opinions. (*Id.*, pp. 4-5) Copies of the opinions were admitted into evidence. Mr. Adams further testified that in reaching this opinion, DrKW used three methods to determine an appropriate valuation range for BCBSKS: comparable company analysis; comparable transaction analysis; and discounted cash flow analysis. (*Id.*, pp. 10-11) Based upon these three methods, Mr. Adams determined that the range of BCBSKS’ enterprise value is \$93 million to \$232 million (assuming that a Special Distribution of \$131 million is made), and the range of its transaction value is \$224 million to \$363 million. (*Id.*, p. 11)

G. Testimony of Daniel J. McCarthy.

70. Daniel J. McCarthy, a consulting actuary of Milliman USA, was called as a witness by BCBSKS. Milliman USA acted as BCBSKS' actuarial consultant in connection with the sponsored demutualization. Mr. McCarthy presented prefiled written testimony and oral testimony. The subjects of Mr. McCarthy's testimony included the actuarial fairness opinion delivered by him to BCBSKS' Board of Directors. (Ex. 18, pp. 4-5)

71. Mr. McCarthy discussed the method used for allocating consideration among eligible policyholders, the basis for using that method, and the support for that method in demutualization precedents and in the actuarial literature. (*Id.*, pp. 5-8) Mr. McCarthy also discussed the reasons for using a fixed share that is larger than has historically been the case in other demutualizations in the United States. (*Id.*, pp. 6-7)

72. Mr. McCarthy testified that he had delivered an opinion to the Board of Directors stating that (1) the principals, assumptions, methodologies, and formulas used to allocate consideration among the Eligible Policyholders are reasonable and appropriate and consistent with the requirements of the Kansas Conversion Law, (2) the Plan of Conversion's exclusion of a special provision, such as a Closed Block, to preserve the dividend expectations of policyholders is fair and equitable, and (3) the Plan of Conversion's allocation of consideration is fair and equitable to the Eligible Policyholders. (*Id.*, p. 9) A copy of the opinion was admitted into evidence. (Ex. 17; Tr. Vol. 1, p. 405:19-21.)

73. Mr. McCarthy also testified that while BCBSKS' statutory surplus would be approximately \$55 million immediately after the conversion and acquisition, BCBSKS would satisfy its risk-based capital requirement of \$84 million because it could also count its asset valuation reserve of approximately \$69 million toward satisfaction of the requirement. (Tr. Vol. 1, pp. 398:24-399:12)

H. Testimony of William H. Pitsenberger

74. William H. Pitsenberger, Vice President and General Counsel of BCBSKS, was called as a witness by BCBSKS. Mr. Pitsenberger presented prefiled written testimony and oral testimony. The subjects of his testimony included legal aspects of the demutualization.

75. Among other things, Mr. Pitsenberger discussed BCBSKS' compliance with the statutory requirements for adoption and filing of the Plan of Conversion (Ex. 29, pp. 3-4), notice to policyholders (*id.*, pp. 4-5), the effect of the Plan of Conversion and conditions to its effectiveness (*id.*, pp. 5-7), BCBSKS' payment of costs related to the Plan (*id.*, p. 9), and the reasons that BCBSKS believes the Plan fulfills the statutory conditions for approval (*id.*, pp. 9-12). Mr. Pitsenberger also summarized the Escrow Fund provisions of the Plan. (*Id.*, pp. 8-9)

I. Testimony of Henry N. Butler.

76. Henry N. Butler, J.D., Ph.D., Professor of Economics, Dean of the School of Business and Economics and Chairman of the Law and Organizational Economics Center at Chapman University in Orange, California, was called as an expert witness by BCBSKS (Tr. Vol. 1, p. 456, Exs. 30-31 and 33). Dr. Butler presented a pre-filed report, pre-filed rebuttal testimony and oral testimony. *Id.* The subjects of his testimony included issues related to the economic impact of the sponsored demutualization. *Id.*

77. Among other things, Dr. Butler testified that there is no reason to believe that the competitive landscape of the Kansas health care market will be adversely affected by completion of the proposed transactions (Tr. Vol. 1, pp. 474-475, 477-78, 486-87, Exs. 30, pp. 2, 8,9, 33, pp. 1-2). He noted that BCBSKS and Anthem do not currently compete in the same market (Tr. Vol. 1, Ex. 30, pp. 8-9, 33, pp. 3-4).

78. Dr. Butler testified that competition in the Kansas health insurance market is robust, and that neither BCBSKS nor Anthem can charge supra-competitive premiums, reduce coverage

or reduce services without a profound risk of losing a substantial amount of business (Tr. Vol. 1, pp.465-67, 468-69, 470-71, 473-74, 476, 477-78, 478-479, 480, and 486-87, Exs. 30, pp. 2,2-3,3-4, 5, 7-9, 10-11, 11-12, 12-15, 33, pp. 1-4). He testified that on the supply side of the health insurance market, provider networks are an important source of competition (Tr. Vol. 1, Ex. 30, pp. 2-3). Dr. Butler testified that in Kansas, provider networks provide access to or “rent” their networks to insurance companies, third party administrators and direct employer contractors. He stated that the ability of competitors to quickly access a network makes the Kansas health care financing market “contestable,” which means that potential competition constrains BCBSKS’ ability to raise rates. Dr. Butler also testified that on the demand side of the health insurance market, there are literally thousands of potential purchasers of health insurance policies, many of which are sophisticated purchasers that are very sensitive to their healthcare costs and not necessarily brand-loyal (Tr. Vol. 1, Ex. 30, pp. 3-4).

79. Dr. Butler also testified about the “consumer welfare” standard applied in antitrust cases, and stated that to the extent Anthem is able to achieve economies of scale in administration, the acquisition could result in lower costs to BCBSKS and lower prices to consumers (Tr. Vol. 1, pp. 475-80, Exs. 30, pp. 9012). Dr. Butler also expressed the opinion that attempts by groups representing hospitals, doctors and nurses to use the regulatory process to their advantage was a form of “rent seeking” and should not be given weight in deciding whether the transaction was in the interest of consumers (Tr. Vol. 1, pp. 480-83, Ex. 33, pp. 11). Dr. Butler also testified that the imposition of conditions on the acquisition intended to protect consumers could have the unintended effect of distorting competition to the detriment of consumers.

80. Dr. Butler also testified that the change in organizational form does not change the ability to increase prices above those of the competition (Tr. Vol. 1, pp. 474-75, 477-78, 479-80, 486-87, Exs. 30, pp. 12-15, 30, pp. 1-4) Dr. Butler testified that economic logic suggests that ownership form is not an important determinant of pricing (Tr. Vol. 1, Ex. 30, p. 13). Dr. Butler testified that close substitutes are readily available in Kansas, and there is always a threat of entry of new competitors (“contestability”), a stock health insurer does not have the ability to profitably raise its price above the market price. *Id.* Thus, Dr. Butler testified, transformation from a mutual insurer to a stock insurer does not necessarily mean that the stock insurer will charge premiums higher than would have been charged by the mutual insurer under the same market conditions. *Id.* pp. 13-14.

J. Testimony of Larry C. Glasscock.

81. Larry C. Glasscock, President and Chief Executive Officer of Anthem, was called as a witness by Anthem (Tr. Vol. 2, p. 546:21). Mr. Glasscock presented pre-filed written testimony and oral testimony (Ex. 34, Tr. Vol. 2, p. 552:2).

82. In his testimony, Mr. Glasscock provided an overview of Anthem. As Mr. Glasscock testified, Anthem currently consists of eight independent BCBS plans choosing to affiliate and thereby forming one strong BCBS organization. (Tr. Vol. 1, p. 552:13) In the early to mid-1990s, the BCBS plans of Kentucky and Ohio joined together with the Indiana BCBS to form Anthem. (Tr. Vol. 1, p. 552:22) Eventually, the BCBS plans in Colorado, Nevada, Connecticut, New Hampshire, and Maine joined the Anthem family. (Tr. Vol. 2, p. 553:5) Mr. Glasscock testified that as a result, Anthem is one of the strongest Blue Plans in the nation with approximately \$2.1 billion in surplus. (Exhibit 34, p. 2)

83. Mr. Glasscock also addressed recent trends in the health insurance industry. Mr. Glasscock testified that one of the most recent and dramatic changes in the industry has been the

significant consolidation of health insurance companies. (Tr. Vol. 2, p. 553:21) Thanks to this consolidation, the resulting health insurance companies are larger and better capitalized than they have ever been in the past. (Tr. Vol. 2, p. 553:25)

84. Mr. Glasscock also discussed Anthem's operating philosophy and the delivery of health care to Anthem customers. Anthem's operating philosophy is very simple: that philosophy is to improve the health of the people they serve. (Tr. Vol. 2, p. 555:10) Mr. Glasscock also testified that Anthem's overriding commitment is to deliver the best health product to its customers. (Tr. Vol. 2, p. 556:3)

K. Testimony of Michael L. Smith.

85. Michael L. Smith, Vice President and Chief Financial Officer of Anthem, was called as a witness by Anthem. Mr. Smith presented pre-filed and rebuttal written testimony and oral testimony. (Tr. Vol. 2, p. 633, Ex. 35).

86. Mr. Smith discussed the financial performance of Anthem, emphasizing its size and strength. (Tr. Vol. 2, pp. 637-40, Ex. 35, pp. 3-9). In his written testimony, Mr. Smith testified that affiliation with Anthem will bring additional strength to BCBSKS, and that Anthem's financial flexibility allows it to expand existing business opportunities, further improve service to customers and invest in health management initiatives. (Tr. Vol. 2, Ex. 35, pp. 3-9).

87. Mr. Smith noted that Anthem and BCBSKS calculate their administrative costs differently. (Tr. Vol. 2, Ex. 35, pp. 9-10). Mr. Smith testified that Anthem's administrative expense ratio continues to decrease, and that Anthem has demonstrated an ability to reduce administrative costs after acquisition of existing Blue Cross and Blue Shield companies. (Id. See also Ex. 39, pp. 2-5). He also stated his belief that BCBSKS and Anthem working together can continue to reduce administrative costs. (Id. See also Ex. 39, pp. 2-5).

88. Mr. Smith submitted a document (Exhibit 50), which he testified represented a snapshot of work in progress that Anthem and BCBSKS were performing to identify potential cost savings resulting from the proposed acquisition in excess of \$7 million. (Tr. Vol. 2, Ex. 50).

89. Mr. Smith also submitted rebuttal testimony in which he further explained how, working together, BCBSKS and Anthem can continue to reduce administrative costs in Kansas. (Tr. Vol. 3, Ex. 39). He explained that on a “PM PM” (per member/per month) basis Anthem’s administrative expenses are less than BCBSKS’. (Tr. Vol. 3, pp. 1354-58). More specifically, BCBSKS spends \$3.26 more per member per month to provide services to its members. (Id.).

90. Additionally, in his rebuttal testimony, Mr. Smith refuted speculation offered by Sandra Hunt, a witness called by the Testimonial Team, that certain premium rates would be higher under Anthem than BCBSKS. (Tr. Vol. 3, Ex. 39, pp. 1-2 and 5-6). Mr. Smith explained that Ms. Hunt assumed that, among the many factors that determine profit margins, the only one that will be different under Anthem is premium levels. In the small group market. (Id., pp. 1-2). Ms. Hunt assumed administrative costs would remain unchanged. (Id.). Mr. Smith explained how a combination with Anthem will positively affect administrative expenses by describing, among other things, the work performed by the integration teams, Anthem’s history of decreasing administrative costs in other states, and the benefits Kansas will experience from an increase in membership. (Id., pp. 3-5).

L. Testimony of Samuel R. Nussbaum.

91. Samuel R. Nussbaum, M.D., Executive Vice President and Chief Medical Officer of Anthem, was called as a witness by Anthem (Tr. Vol. 2, p. 696:1). Dr. Nussbaum presented pre-filed and rebuttal written testimony and oral testimony (Ex. 36; Tr. Vol. 2, p. 701:25). The subjects of Dr. Nussbaum’s testimony included medical policy and provider relations.

92. Dr. Nussbaum explained that in the Anthem companies, “medical policy” is used to determine whether new medical treatments are more effective in certain conditions than existing treatments; whether a new mode of treatment is experimental and/or investigational, or conversely, is appropriate for widespread application; and whether it is appropriate to provide benefits for a certain procedure, knowing that a more effective procedure is available (Ex. 36, p. 2). He testified that Anthem’s medical policy development is based on evidence-based decision making, and it also seeks input from network physicians in the states Anthem serves (Tr. Vol. 2, p. 704:17).

93. Dr. Nussbaum stated that while medical policy provides guidance, Anthem’s locally based medical directors are involved in complex clinical decisions (Tr. Vol. 2, p. 705:15). He explained that Anthem’s policy is that individual medical care decisions are made locally, and that Anthem anticipates that a Kansas physician will act as the medical director for BCBSKS after the acquisition. *Id.*

94. Dr. Nussbaum also testified that matters such as medical management and medical decision-making will occur at the local level, with the Kansas medical director working in conjunction with Kansas participating physicians (Tr. Vol. 2, p. 706:3). He testified that Anthem’s relationship’s with health care providers are also guided by the principle that health care is a local activity (Tr. Vol. 2, p. 709:9). He testified about Anthem’s success in maintaining broad provider networks in the states that it serves (Tr. Vol. 2, pp. 709:9 – 711:1).

95. Dr. Nussbaum also testified about Anthem’s disease management programs, which are designed to improve clinical outcomes and quality of care. (Tr. Vol. 2, p. 714:8) He also discussed Anthem’s experience in sharing best practices across the Anthem organization (Tr. Vol. 2, p. 714:22).

96. On rebuttal, Dr. Nussbaum presented his pre-filed rebuttal written testimony. (Tr. Vol. 3, p. 1363:5; Ex. 40) In that written testimony, Dr. Nussbaum demonstrated that Marvin Fairbank's assertions regarding the Milliman & Robertson Care Guidelines are inaccurate. (Exhibit 40)

M. Testimony of Donna O. Moore.

97. Donna O. Moore, Vice President of Health Care Management for Anthem's East operating region, was called as a witness by Anthem (Tr. Vol. 2, p. 773:1). Ms. Moore presented pre-filed written testimony and oral testimony (Ex. 37, Tr. Vol. 2, p. 780:9).

98. In her testimony, Ms. Moore explained Anthem's operating model of local health care management. (*Id.*)

N. Testimony of David R. Frick.

99. David R. Frick, Executive Vice President and Chief Legal and Administrative Officer of Anthem, was called as a witness by Anthem. Mr. Frick presented prefiled written testimony and oral testimony. (Tr. Vol. 2, p. 791, Ex. 38).

100. Among other things, Mr. Frick testified that after acquisition, Anthem expects to offer through post-conversion BCBSKS the same range of products after the acquisition as those currently offered by BCBSKS, and that no significant changes to BCBSKS' product families—HMO, PPO, POS and Indemnity—are planned in the near term beyond those previously identified by Blue Cross and Blue Shield of Kansas management. (Tr. Vol. 2, pp. 796-97, Ex. 38, pp. 3-4). Mr. Frick testified that about 9 out of 10 Anthem customers renew each year, and that enrollment has increased in states where Blue plans have affiliated with Anthem. (Tr. Vol. 2, p. 797, Ex. 38, p. 4).

101. Mr. Frick further testified that Anthem intends to honor BCBSKS' existing physician, hospital and other health care professional contracts for the duration of their existing

terms. (Tr. Vol. 2, pp. 797-98, Ex. 38, pp. 4-5). He testified that Anthem maintains very broad networks in the states where it operates, and that the size of its networks has grown following each Blue Plan affiliation with Anthem. (*Id.*).

102. Mr. Frick also testified that Anthem will offer employment to all individuals employed prior to the closing by BCBSKS. (Tr. Vol. 2, p. 798, Ex. 38, pp. 6-7). He testified that Anthem has also agreed to maintain a significant employment presence within Kansas on an ongoing basis. (*Id.*).

O. Testimony of Kathy Greenlee.

103. Kathy Greenlee, General Counsel of the Kansas Insurance Department, was called as a witness by the KID Testimonial Team. Ms. Greenlee presented prefiled written testimony and oral testimony.

104. Kathy Greenlee was head of the testimonial team whose goal was to determine whether the proposed transactions violate any of the statutory requirements to which they are subject. (Tr. Vol. 2, pp. 881:23-882:3.) With the sole exception of alleged rate increases in the individual and small group markets, Ms. Greenlee unequivocally testified that the transactions comply with Kansas law in every other respect. (Tr. Vol. 2, p. 883:14-17; Ex. 51 at pp. 4-5.) The standards satisfied include but are not limited to the following:

- The Plan of Conversion is fair and equitable to the policyholders;
- The Plan of Conversion complies with the provisions of the conversion statute;
- The Plan of Conversion does not unjustly enrich any director, officer, agent or employee of BCBSKS;
- The new stock insurer meets 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;
- After the change of control, BCBSKS would be able to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed;
 - Anthem's financial condition would not jeopardize the financial stability of BCBSKS or prejudice the interest of its policyholders;
 - Anthem has not plans or proposals to liquidate BCBSKS, sell its assets or consolidate or merge it with any person, or to make any other material changes in its business or corporate structure or management that would be unfair or unreasonable to BCBSKS' policyholders or adverse to the public interest;
 - The competence, experience and integrity of those persons who would control the operation of BCBSKS are such that it would not be adverse to the interest of BCBSKS' policyholders and of the public to permit the acquisition of control; and,
 - The acquisition is not likely to be hazardous or prejudicial to the insurance-buying public.

(Exhibit 51, pp. 4-5, 8-9; Tr. Vol. 2, pp. 900:10; 900:17; 901:2;902:11;903:6;904:4.)

105. With regard to the sole exception (speculated rate increases in the small group and individual, under 65 non-Medicare markets), Ms. Greenlee has fully relied upon the PWC Market Impact report marked as Exhibit 56, part 6, at pp. 58-61. (Tr. Vol. 2, p.908;7-12).

P. Testimony of David M. Platter.

106. David M. Platter, Senior Managing Director of the Investment Banking Division of Bear, Stearns & Co., Inc. ("Bear Stearns"), was called as a witness by the KID Testimonial

Team. (Tr. Vol. 3, p. 1047:16) Bear Stearns was the financial advisor to the KID Testimonial Team. (Tr. Vol. 3, pp. 1048:23-1049:4) Mr. Platter presented pre-filed written testimony (to which was appended a copy of Bear Stearns' opinion letter and a Summary of Work Performed by Bear Stearns) and oral testimony. (Ex. 52; Tr. Vol. 3, p.1051:8-22) The subjects of Mr. Platter's testimony included the fairness opinion that Bear Stearns delivered to the Kansas Insurance Department. (Tr. Vol. 3, p. 1055:5-22)

107. Mr. Platter testified that based on Bear Stearns' review of the financial aspects of the transaction, Bear Stearns delivered an opinion that the aggregate consideration to be received by the eligible policyholders under the Plan of Conversion was fair to those policyholders, taken as a group, from a financial point of view. (Ex. 52; Tr. Vol. 3, p. 1054:19-25) Mr. Platter based this conclusion on a comparable company analysis, a comparable transaction analysis and a discounted cash flow analysis. (Ex. 52; Tr. Vol. 3, p. 1061:5-18)

Q. Testimony of Kenneth M. Beck.

108. Kenneth M. Beck, a Principal with the Actuarial and Insurance Management Solutions practice of the firm of PricewaterhouseCoopers LLP ("PwC"), was called as a witness by the KID Testimonial Team. (Tr. Vol. 3, p. 1078:7) PwC served as an advisor to the KID Testimonial Team on actuarial and accounting matters. Mr. Beck presented pre-filed written testimony and oral testimony.(Ex. 54; Tr. Vol. 3, p. 1081:1) The subjects of Mr. Beck's testimony included the actuarial fairness opinion delivered by him to the Kansas Insurance Department. (Ex. 54; Tr. Vol. 3, p. 1079:22-25; 1080:1-4)

109. Mr. Beck testified that, as stated in his written opinion, the principles, methodologies and assumptions that BCBSKS is using to allocate the consideration to eligible policyholders are fair and equitable to the eligible policyholders. (Tr. Vol. 3, p. 1081:3-24;

1084:3-24.) A copy of Mr. Beck's opinion was admitted into evidence. (Ex. 54, Sched. 1; Tr. Vol. 3, 1081:1.)

R. Testimony of Denise G. Essenberg.

110. Denise G. Essenberg, a partner with PwC and a Certified Public Accountant, was called as a witness by the KID Testimonial Team (Tr. Vol. 1, pp. 1086-87, Ex. 55). Ms. Essenberg presented prefiled written testimony (to which was appended a Compensation Review Summary) and oral testimony (Tr. Vol. 1, pp. 1086-95, Ex. 55).

111. The subjects of Ms. Essenberg's testimony included the work PwC had done for the KID Testimonial Team in reviewing (1) whether the financial condition of Anthem is such as might jeopardize the financial stability of BCBSKS or prejudice the interest of its policyholders; (2) whether the competence and experience of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the acquisition of control; (3) the accuracy and completeness of financial information contained in the Policyholder Information Statement; (4) the planned procedures of BCBSKS' management to ensure the accuracy, completeness, and overall integrity of in-force records used to determine eligibility for, and allocation of, policyholder consideration; (5) management's implementation of a reasonable process with appropriate controls in place to ensure a complete and accurate printing of policyholder materials, mailing of packages to eligible policyholders and tabulation of policyholder votes; (6) management's implementation of a reasonable process with appropriate controls in place to ensure a complete and accurate distribution of consideration to eligible policyholders; and (7) management's existing compensation levels, bonuses and directors fees compared with proposed levels following demutualization, including a benchmark with relevant peer groups in order to ensure compliance with applicable statutory guidance (Tr. Vol. 3, Ex. 55, pp. 1-2).

112. Ms. Essenberg testified that PwC conducted a thorough and detailed examination of each of the issues the KID Testimonial team asked it to evaluate (Tr. Vol. 3, Ex. 55, pp. 3-6, 9-16). She testified that during the course of the examination, PwC did not encounter any matters or issues that were not resolved to the satisfaction of the KID Testimonial Team. (*Id.*, p. 7.)

113. Ms. Essenberg concluded that (1) there is no indication that the financial condition of Anthem is such as might jeopardize the financial stability of the BCBSKS or prejudice the interest of its policyholders; (2) the Policyholder Information Statement is fair and accurate with respect to the financial information it contains; (3) management will not be unfairly compensated as a result of this transaction (Tr. Vol. 3, pp. 1088, 1089, 1092-95, Ex. 55, pp. 8, 9-16).

114. Ms. Essenberg also testified that the vote tabulation was being conducted by a nationally recognized firm, Equiserve; that the process was being overseen by Deloitte & Touche, hired by BCBSKS to audit the vote tabulation process; and that the work of Equiserve and Deloitte & Touche was being monitored by PwC, as consultants to the KID Testimonial Team (Tr. Vol. 3, pp. 1088-92). She testified that she and her team reviewed the accuracy and completeness of the policyholder eligibility database, participated in and monitored the process at Equiserve to ensure the complete mailing of information to policyholders and tabulation of the vote, and performed independent testing to ensure the completeness of the tabulation. *Id.*

S. Testimony of Mark H. Kovey.

115. Mark H. Kovey, a partner with the law firm of Scribner, Hall & Thompson, LLP (“Scribner”), was called as a witness by the KID Testimonial Team. (Tr. Vol. 3, p. 1096.) Scribner served as a tax law consultant to the KID Testimonial Team. Mr. Kovey presented pre-filed written testimony and oral testimony. (Ex. 53; Tr. Vol. 3, p. 1098.)

116. Mr. Kovey testified that Scribner was asked to assist in the Testimonial Team’s review by (1) evaluating and analyzing the information provided to the Testimonial Team and

Scribner by BCBSKS and Anthem for appropriateness and credibility; (2) evaluating the consequences under federal income tax concepts and rules of the sponsored demutualization to BCBSKS and its policyholders; (3) evaluating the tax opinions and memorandum regarding the transaction submitted to the Testimonial Team by BCBSKS and Anthem; and (4) assisting the Testimonial Team in conducting tax due diligence on BCBSKS and Anthem. (Ex. 53, p. 2.)

117. Mr. Kovey testified that there do not appear to be any outstanding tax issues that raise a material concern as to the financial capacity of the parties to undertake the transactions and fulfill their obligations under the Plan. (Ex. 53, p. 7; Tr. Vol. 3, p. 1099:21-24.) He also concluded that the tax related representations contained in the Policyholder Information Statement, which detail the expected tax consequences to Eligible Policyholders generally, are accurate and should provide the policyholders with sufficient information to make the necessary decisions or to consult with their tax advisors, as is recommended in the statement. (Ex. 53, pp. 7-8; Tr. Vol. 3, pp. 1099:25 – 1100:7.) Finally, he is satisfied that the memorandum prepared by Debevoise & Plimpton provides reasonable support for the legal opinion of the firm that is attached to the Policyholder Information Statement. (Ex. 53, p. 8; Tr. Vol. 3, p. 1100:8-19.)

118. Mr. Kovey suggested that a number of tax-related conditions be imposed if the Commissioner approves the Plan. (Ex. 53, pp. 6-7; Tr. Vol. 3, pp. 1100:20 – 1108:12.) He acknowledged, however, that his proposed conditions related to depositing future tax refunds not reflected on the closing balance sheet into the Escrow Fund would have the effect of giving policyholders the upside of tax overpayments while burdening Anthem with the downside of tax underpayments. (Tr. Vol. 3, pp. 1109:20 – 1110:16.) He also acknowledged that the closing balance sheet would be prepared by the Policyholder Committee appointed by the Commissioner. (Tr. Vol. 3, pp. 1119:4-13.)

T. Testimony of Sandra S. Hunt.

119. Sandra S. Hunt, a principal with PwC, was called as a witness by the KID Testimonial Team. (Tr. Vol. 3, p. 1128.) She testified that she specializes specialize in government health policy, statistical modeling, Medicaid managed care plans, and development of models for new health care delivery systems. (Ex. 56, p. 1.) Ms. Hunt presented pre-filed written testimony and oral testimony (Ex. 56; Tr. Vol. 3, p. 1129:15-18), as well as a report titled Assessment of Market Impact of the Anthem, Inc. Purchase of Blue Cross Blue Shield of Kansas (the “Market Impact Assessment”) (Ex. 56, Sched. 1; Ex. 63).

120. Ms. Hunt testified regarding the potential effect of the proposed transaction on various aspects of the Kansas insurance market. In particular, she testified as follows:

- In other states in which Anthem operates, rates increase and insurance premiums have remained consistent with general market levels. In some cases, financial performance has improved significantly following ownership transfer and rates of increase have been lower than expected. Anthem has maintained insurance coverage levels in all states in which it operates and in some cases has increased market share (Tr. Vol. 3, pp. 1168:23-1169:9). These markets were price sensitive markets and in the final analysis, Anthem was charging competitive rates in the aggregate. (Tr. Vol. 3, pp. 1169:20-1171:2);
- In other states in which it operates, Anthem was participating in the small group, individual non-group, large group and Medicare Supplements markets. Anthem was found in some instances to be the only carrier offering a choice of coverage to individuals in certain states. Anthem was found to be participating actively in the

rural markets and there is no fear Anthem is going to withdraw from the rural market. (Tr. Vol. 3, p. 1171:3-21).;

- Anthem was considered by the “stakeholders” (hospital associations and medical societies) and the insurance departments of other states in which Anthem operates that Anthem was considered to be a good corporate citizen, its market behavior was considered to be in good faith and it was a well performing plan. (Tr. Vol. 3, pp. 1172:25-1174:2). In the interviews with the “stakeholders”, Anthem passed with flying colors. (Tr. Vol. 3, p. 1174:18-25);
- There is nothing to suggest there is any reason to believe jobs will be moved from Kansas or other locations as a result of this particular transaction. (Tr. Vol. 3, pp. 1175:14-1176:3);
- Anthem’s contracting practices with providers would differ little from BCBSKS’ current approach. (Exhibit 56, p.7);
- Insurance coverage will likely remain available at current levels. (*Id.*); and
- Anthem’s administrative processes shows complaint ratios in other markets generally below those of other plans in the same market. (*Id.*)

121. Ms. Hunt also testified that the proposed transaction could result in rate increases in the small group market and individual market, but that increases in other areas of business are unlikely. (Assessment, pp. 59-61). While a number of assumptions were made by Ms. Hunt and her team, she acknowledged, however, the following:

- Health plans have a legitimate concern about being affected adversely by adverse selection (Tr. Vol. 3, pp. 1150:23-1151:2; 1162:2-24);

- An elasticity of demand model was not used as part PwC’s analysis. PwC did not study the question of what market share might be lost depending on various elasticity of demand factors in Kansas or any market and PwC did not apply the law of demand in their analysis. (Tr. Vol. 3, pp. 1152:8-1153:13; 1155:18-25);
- Ms. Hunt recognized that increases in premium rates will be tempered by market condition and willingness of consumers to pay higher premiums, mitigated by change in benefit design or number of people choosing to purchase insurance. (Tr. Vol. 3, pp. 1171:22- 1172:17); and
- PwC recognized that improvements in underwriting margins could be achieved through means other than premium rate increases including changes in benefit design, adjustments to provider payment rates, economies of scale, operating efficiencies and the effects of access to capital—none of which were considered in PwC’s analysis relating to alleged potential rate increases. (Tr. Vol. 3, pp. 1183:1-16; 1187:16-1188:6).

U. Testimony of Carl J. Schramm.

122. Carl J. Schramm, Ph.D., J.D., was called as a witness by KMS. (Tr. Vol. 3, p. 1245.) Dr. Schramm is a former professor of Health Management and Policy at Johns Hopkins University. Dr. Schramm presented a written report and oral testimony. (Exs. 71 and 72, and Tr. Vol. 3, p. 1245:16). Dr. Schramm submitted two reports: (1) a report ostensibly prepared regarding this transaction (Ex. 71), and (2) a report prepared for the Abell Foundation relating to the proposed CareFirst conversion and acquisition (Ex. 72).

123. Dr. Schramm acknowledged that neither report was peer-reviewed, and both set forth hypotheses which are untested in the economic literature (Tr. Vol. 3, pp 1290:25; 1291:1-

5). Further, he acknowledged that the hypothesis in Exhibit 71 does not apply any econometric techniques, and, thus fails to control for any variables such as market share, regulatory issues, percentage of HMOs, or demographics. (Tr. Vol. 3, p. 1279:24 - 1280:10). Dr. Schramm also expresses skepticism as to whether economies of scale result from the consolidation of health insurance companies (Tr. Vol. 3, p.1289: 22- 1290:9), but he cites no study supporting his opinion (Tr. Vol. 3, p. 1290:10 – 13).

124. Dr. Schramm admits the existence of the well recognized and generally accepted “survival principle” which stands for the proposition that surviving companies, in fact, enjoy economies of scale. (Tr. Vol.3, p.1289:6-21).

125. Dr. Schramm in his previous writings admits “employers move their employee groups using price as a near exclusive reason for change; beneficiary satisfaction often does not enter into the picture at all”....”When presented with multiple plan options by their employers, it has been shown that employees routinely will change carriers, switching away from carriers with high level customer satisfaction, for as little as \$12 to \$15 per month out-of-pocket difference.” (Exhibit 72, at p. 71; Tr. Vol. 3, pp. 1305:25-1306:18).

V. Testimony of Marvin M. Fairbank.

126. Marvin M. Fairbank, Director for Contracted Care at Stormont Vail Health Care, was called as a witness by KHA. (Tr. Vol. 3, p. 1319.) Mr. Fairbank presented written and oral testimony. At the hearing, the Commissioner ordered Mr. Fairbank’s original written testimony to be struck from the record to the extent it consisted of anecdotes from other states about alleged handling of individual claims by Anthem affiliates in those states. (Tr. Vol. 1, pp. 342:21 – 343:9.) Mr. Fairbank subsequently submitted revised written testimony. (Ex. 73.)

127. Mr. Fairbank testified that at Stormont Vail, he had negative experiences with claims denials and delays in payment by Anthem’s Ohio subsidiary, which insures Goodyear

employees, including Kansas residents. Mr. Fairbank testified that many of those denials related to length of hospital stay. He also testified that BCBSKS, which has a role in administering these claims, had been helpful in overturning the initial determinations made by Anthem's Ohio subsidiary. (Tr. Vol. 3, pp. 1319-1326; Ex. 73.)

W. Testimony of Dawn M. Touzin.

128. Dawn M. Touzin, director of the Community Health Assets Project at Community Catalyst, was called as a witness by KSNA and KAMU. (Tr. Vol. 3, p. 1327.) Ms. Touzin presented written testimony and supplemental written testimony as well as oral testimony. (Exs. 74-75; Tr. Vol. 3, pp. 1334:16-19, 1336:18-19.)

129. Ms. Touzin testified about conditions that had been imposed by commissioners approving Blue Cross Blue Shield plan acquisitions in other states. She testified that in earlier acquisitions, regulators were reluctant to impose conditions because of solvency concerns, but that more recently some regulators have imposed market conduct based conditions. (Tr. Vol. 3, pp. 1327-1353.)

X. Conclusion of the Hearing.

130. At the conclusion of the hearing, the Commissioner ordered BCBSKS to file the result of the policyholder vote and the parties to file post-hearing briefs and proposed Findings of Fact and Conclusions of Law on or before January 25, 2002.

V. Results of the Policyholder Vote.

131. The policyholder vote was conducted on January 11, 2002, and was reported to the Commissioner on January 14, 2002. The total number of votes cast in person or by proxy was 100,122, representing over 58% of BCBSKS' eligible policyholders. The Plan was approved by a vote of 63,504 in favor to 36,618 against.

VI. Background of the Transaction: Auction Process and Reverse Due Diligence.

132. On September 14, 2000, the Board of Directors of BCBSKS unanimously authorized management to work with the Board's Governance Committee to explore potential alliances and to propose recommendations for a course of action (Tr. Vol. 1, Ex. 23, p. 16). On December 12, 2000, management engaged the investment banking firm of Dresdner Kleinwort Wasserstein to advise them on pursuing a strategic partnership with potential interested parties. *Id.* Management, led by Chief Executive Officer, John Knack, initiated contact with seven potential strategic partners, including Anthem. *Id.* These parties each executed a letter of confidentiality and submitted a written expression of interest in order for discussions to proceed. *Id.*

133. Management required the expressions of interest to address several strategic issues, including long term strategies which would improve security and service for BCBSKS' current and future insureds, which management believed the Board would want to take into consideration in determining whether a transaction was in the best interests of policyholders. (Tr. Vol. 1, Ex. 23, p. 16). These strategic issues also included the participant's vision and mission, its current and proposed corporate governance and structure, its history and commitment to services to policyholders, its commitment to and local presence in the Kansas market, its dedication to government programs, its plans for employee opportunities, its financial objectives and exposures, its operations plans and strategies and its current and proposed management structure and its plans for employee integration. *Id.*

134. BCBSKS received expressions of interest from six of the seven parties. (Tr. Vol. 1, Ex. 23, p. 16). During a series of meetings held in Kansas City, Kansas in February 2001, these interested parties gave presentations to BCBSKS' management and Dresdner Kleinwort Wasserstein representatives. *Id.* After evaluating the expressions of interest and management

presentations, BCBSKS' management invited three of the interested parties, including Anthem, to participate in further discussions in pursuit of a proposal for a strategic partnership. *Id.* These three were the companies management believed, based on the strategic issues outlined above, were most likely to offer a transaction that the Board would find is in the best interests of policyholders. *Id.*

135. During the weeks of April 2, 2001 and April 9, 2001, participants in this second round of discussions were invited to Kansas City to conduct further due diligence, which consisted of presentations given by BCBSKS' management and access to a data room. (Tr. Vol. 1, Ex. 23, p. 16). Participants were also provided with a copy of presentation materials prepared by BCBSKS' management with the assistance of Dresdner Kleinwort Wasserstein. *Id.*

136. During the week of April 16, 2001, BCBSKS' management conducted on-site due diligence at the headquarters of each of the second round participants. (Tr. Vol. 1, Ex. 23, p. 16). The due diligence consisted of presentations given by the management of the second round participants and one-on-one breakout sessions. *Id.* The breakout sessions allowed BCBSKS' management to more closely assess the second round participants' suitability for a strategic partnership in various areas, including: (1) management style; (2) sales and marketing; (3) finance; (4) medical management; (5) member/provider service; (6) information systems; (7) corporate status and organization; (8) future strategic positioning. *Id.*, pp. 16-17.

137. Based on the expressed legal form of a transaction by each potential acquirer, on April 24, 2001, a draft of a purchase agreement was sent to two of the second round participants and a draft of an agreement and plan of merger was sent to the third participant (Tr. Vol. 1, Ex. 23, p. 17). On April 27, 2001, one of these participants notified BCBSKS of its intention to no longer continue in the process. *Id.*

138. On April 30, 2001, the Anthem Board of Directors met and reviewed the acquisition (Tr. Vol. 1, Ex. 23, p. 17). Based on the information presented, the Anthem Board unanimously approved the proposed transaction and determined that the proposed transaction was in the best interests of Anthem. *Id.* Management of Anthem was authorized to proceed to execute a definitive agreement to consummate the proposed transaction with such changes as management determined to be appropriate. *Id.*

139. On May 4, 2001, Anthem and the other participant submitted their respective proposals to Dresdner Kleinwort Wasserstein (Tr. Vol. 1, Ex. 23, p. 17). Dresdner Kleinwort Wasserstein and BCBSKS' legal counsel, Debevoise & Plimpton, assisted BCBSKS in evaluating each proposal, assessing the key terms and conditions and discussing enhancements to the proposals with each party. *Id.* Anthem responded with a revised term sheet on May 8, 2001. *Id.* The other interested party indicated a willingness to consider amendments to its proposal. *Id.*

140. On May 9, 2001, each of the interested parties gave presentations detailing its proposal and its company to BCBSKS' Board (Tr. Vol. 1I, Ex. 23, p. 17).

141. The two proposals were further negotiated from May 10, 2001 to May 23, 2001. (Tr. Vol. 1, Ex. 23, p. 17). These negotiations included negotiation of definitive agreements with each party. *Id.* Over the course of this period, BCBSKS' management concluded that the proposal from Anthem represented the offer that best met the objectives of BCBSKS' Board in seeking a business partner and determined to recommend the Anthem proposal to the Board. *Id.*

142. On May 24, 2001, BCBSKS' Board met to review, with the assistance of its management and financial and legal advisors, the proposed definitive agreement and the conversion and the acquisition contemplated by the agreement (Tr. Vol. 1, Ex. 23, p. 17).

BCBSKS' Board considered the financial aspects of the proposed transaction with the advice and assistance of its financial advisor, Dresdner Kleinwort Wasserstein. *Id.* Representatives of Dresdner Kleinwort Wasserstein made a presentation to BCBSKS' Board regarding the fairness of the cash consideration to be paid to eligible policyholders, and delivered its oral opinion, which was subsequently confirmed in a written opinion dated May 24, 2001, that the aggregate of the purchase price and the special distribution payable to the eligible policyholders and into the escrow fund for the benefit of the eligible policyholders pursuant to the alliance agreement and the plan was fair to the eligible policyholders, from a financial point of view. *Id.* The Board also considered the alternatives of merging with another mutual insurance company or continuing to operate on a stand-alone basis. *Id.* The Board considered, among other things, the strategic issues referenced above. *Id.* Based upon the information presented, the Board unanimously approved the proposed definitive agreement and authorized management to execute the proposed definitive agreement. *Id.*

143. The definitive alliance agreement was executed on May 30, 2001 (Tr. Vol. 1, Ex. 23, p. 17). On May 31, 2001, a press release was issued jointly by BCBSKS and Anthem announcing that the alliance agreement had been signed. *Id.*

144. The parties amended the alliance agreement on September 28, 2001, to extend the date upon which the plan must be adopted by the Board from September 30, 2001 to November 30, 2001 (Tr. Vol. 1, Ex. 23, p. 17).

145. On October 25, 2001, BCBSKS' Board met to review and discuss, with the advice and assistance of BCBSKS' management and its actuarial, financial and legal advisors, the plan (Tr. Vol. 1, Ex. 23, p. 17). BCBSKS' actuarial, financial, and legal advisors led a detailed discussion of the proposed plan. *Id.* Daniel J. McCarthy, F.S.A., M.A.A.A., an independent

consulting actuary associated with Milliman USA, an actuarial consulting firm, delivered an opinion, dated October 25, 2001, stating, among other things, that the principles, assumptions, methodologies, and formulas used to allocate consideration among the eligible policyholders of BCBSKS as set forth in the plan are reasonable and appropriate and consistent with the requirements of the Kansas Conversion Law, and the resulting allocation of consideration is fair and equitable to the eligible policyholders (Tr. Vol. 1, Ex. 23, p. 17). After discussion and deliberation, the Board determined that the plan was in the best interests of the policyholders, unanimously approved the plan, unanimously recommended the plan to the policyholders, and unanimously authorized other actions relating to the proposed transaction. *Id.*, pp. 17-18.

146. The Plan of Conversion was filed for approval with the Kansas Insurance Department on October 26, 2001 (r. Vol. 1, Ex. 23, p. 18.)

147. The Alliance Agreement was further amended on November 9, 2001. (Tr. Vol. 1, Ex. 23, p. 18). The amendment reflects several modifications that had been agreed to in principle and generally incorporated into the Plan as adopted, including a reduction in the portion of the purchase price to be deposited into the escrow fund to \$48 million, a modification of the procedures relating to the appointment and service of the policyholder committee appointed to oversee the escrow fund, and to clarify the handling of tax matters relating to the escrow fund and the contingent litigation matter (Tr. Vol. 1, Ex. 23, p. 18).

VII. Major Features of the Proposed Conversion and Acquisition.

A. The Purchase by Anthem.

148. The Alliance Agreement (Ex. 2) provides that immediately upon BCBSKS' conversion from a mutual insurance company to a stock insurance company, Anthem West, Inc., a subsidiary of Anthem, will purchase 100% of BCBSKS stock for \$190 million (the "Purchase Price"). The Purchase Price represents a \$35 million premium over BCBSKS' estimated closing

book value, determined on the basis of generally accepted accounting principles, of \$155 million. Of the \$190 million Purchase Price, \$142 million will be made available for distribution to Eligible Policyholders and BCBSKS will deposit the balance of the Purchase Price, \$48 million, into an Escrow Fund.

B. Policyholder Compensation.

149. Upon effectiveness of the Plan of Conversion (Ex. 1), BCBSKS will distribute to its eligible policyholders \$142 million of the purchase price received from Anthem, plus a “Special Distribution” of the accumulated surplus of BCBSKS. The Special Distribution will be equal to the amount by which the Closing Book Value of BCBSKS (as defined in the Alliance Agreement) exceeds \$155 million. BCBSKS has estimated that the amount of the Special Distribution will be approximately \$131 million. Eligible policyholders will also receive interest on these funds at the rate of 7% per annum from the effective date of the conversion until the day the funds are distributed to eligible policyholders. In addition, as discussed below, policyholders may also receive a distribution from the Escrow Fund at a later date.

150. The distribution of compensation is in exchange for policyholders’ interests as members of BCBSKS as a mutual life insurance company. Policy and contract rights will not be changed in any respect by the transaction.

151. K.S.A. 40-4004(b) provides that the amount of consideration to be distributed to policyholders is deemed to be fair and equitable if the consideration is at least the amount of statutory surplus attributable to contributions of policyholders. Based on the testimony presented at the hearing, the Commissioner finds that BCBSKS has established by a preponderance of the evidence that the consideration provided to policyholders under its Plan of Conversion, excluding the amount to be placed in the Escrow Fund, will exceed its total statutory surplus. (*See, e.g.*, Tr. Vol. 1, p. 309:5, 18.) Furthermore, Anthem and BCBSKS have stated in their pre-

hearing rebuttal briefs that they agree to accept, as a condition of approval, that they will not close the transaction unless the amount of consideration to be distributed, excluding the amount to be placed in the Escrow Fund, exceeds BCBSKS' total statutory surplus. On this basis, the Commissioner finds and concludes that the amount of consideration to be distributed to policyholders is fair and equitable within the meaning of K.S.A. 40-4004.

152. Two independent investment banking firms—Bear Stearns, which was retained by the KID Testimonial Team, and DrKW, which was retained by BCBSKS—have given opinions that the amount of consideration to be distributed to policyholders is fair and equitable to the eligible policyholders as a group from a financial point of view. (Ex. 15; Ex. 15A; Ex. 52, Sched. 1.) In addition, the testimony shows that the terms of the transaction were the subject of arm's length negotiation between the management of BCBSKS, representing the interests of BCBSKS and its policyholders, and Anthem, following evaluation of other potential acquirers. (See, e.g., Ex. 5, pp. 2-4.) In addition, the Alliance Agreement contains a provision permitting the BCBSKS' Board to receive and consider superior offers from other potential acquirers, but the testimony shows that no competing offers have been received. (Ex. 2, § 10.01(b)(2); Tr. Vol. 1, 122:21-123:11.) On the basis of all the evidence in the record, including these facts, the Commissioner finds and concludes that the amount of consideration provided to policyholders is fair and equitable even apart from the statutory surplus test of K.S.A. 40-4004(b).

C. Escrow Fund

153. The Escrow Fund will address potential costs and expenses related to a matter involving a subpoena received by BCBSKS from the U.S. Department of Health and Human Services on February 28, 2001 (the "Contingent Litigation Matter"), and certain other expenses described in the Plan of Conversion, the Alliance Agreement and the Escrow Agreement (which is Exhibit D to the Plan of Conversion). A Policyholder Committee selected by the

Commissioner will oversee the Escrow Fund. Although the Escrow Agreement states that the Commissioner's appointees must be reasonably acceptable to Anthem, Anthem stated at the hearing that it would agree to waive that provision as a condition of the Commissioner's approval of the conversion and acquisition (Tr. Vol. 2, p. 90:12-20). The Commissioner will retain regulatory oversight over the Escrow Fund, including the investment and distribution of the assets held in the Escrow Fund, to ensure that policyholder interests are protected and that the actions of the Policyholder Committee comply with the Escrow Agreement, the Plan of Conversion and applicable law.

154. Upon resolution of the Contingent Litigation Matter, the balance of the Escrow Fund, after making allowances for taxes and expenses, will be distributed to Eligible Policyholders according to the Plan of Conversion. However, should the Policyholder Committee determine that it would be impractical to distribute the remaining funds, taking into account the cost of distribution compared to the amount remaining in the Escrow Fund, no distribution would be made, but the balance would be donated to a charity.

155. The Contingent Litigation Matter represents a contingent liability of BCBSKS, of unknown size, existing prior to the proposed conversion and acquisition. Except for the Escrow Fund, it is likely that the Contingent Litigation Matter would be taken into account by Anthem or any other potential purchaser in determining the price that it would be willing to pay for BCBSKS. The testimony shows that BCBSKS management regards the inclusion of an Escrow Fund as a benefit to policyholders to the extent it insulates them from the possibility that a reduction of the purchase price for the Contingent Litigation Matter would exceed the eventual costs associated with the Contingent Litigation Matter. The testimony also shows that the size of the Escrow Fund was reduced to \$48 million at the urging of the KID Testimonial Team, with

the result that any liabilities from the Contingent Litigation Matter exceeding that amount will be borne by Anthem. Based on all the evidence in the record, including these facts, the Commissioner finds that the inclusion of the Escrow Fund does not provide any grounds to refuse to find that the Plan of Conversion is fair and equitable to policyholders.

D. Allocation of Policyholder Compensation.

156. Under the Plan, each policyholder will receive a fixed component of consideration and a variable component of consideration. The fixed component is allocated in an equal amount to each policyholder, while the variable component is allocated among policyholders on the basis of past and projected future actuarial contribution to the Company's surplus. This method of allocation has been widely used in recent insurance company demutualizations in the United States, and is recognized in the authoritative actuarial literature, including Actuarial Standard of Practice 37, as an appropriate allocation method.

157. Two independent consulting actuaries—Mr. Beck of PwC, who was retained by the KID Testimonial Team, and Mr. McCarthy of Milliman USA, who was retained by BCBSKS—have given opinions that the allocation of consideration among eligible policyholders is fair and equitable. (Ex. 17; Ex. 54, Sched. 1; Tr. Vol. 1, p. 406:4-5).

158. The fixed share in this conversion accounts for one-third of the total consideration to be distributed. This proportion is larger than has historically been the cases in recent life insurance company demutualizations in the United States. However, even though the variable shares will account for only two-thirds of the total, each Eligible Policyholder's variable share is very likely to exceed the amount of that policyholders' actuarial contribution, consistent with the guidance provided by ASOP 37. (Tr. Vol. 1, pp. 402:8 – 403:8.) Moreover, a significant portion of the amount to be distributed arises from surplus which arose prior to the conversion of

BCBSKS to mutual insurer status in 1992, and is not readily attributable to current policyholders. (*Id.* p. 403:9-24.)

159. On the basis of all the evidence in the record, the Commissioner concludes that the allocation of consideration among eligible policyholders is fair and equitable to the policyholders, provided that that allocation is implemented in accordance with the actuarial model, principles and formulas upon which the consulting actuaries for the KID Testimonial Team and BCBSKS have agreed.

E. Exclusion of a Closed Block.

160. The Plan of Conversion does not establish a closed block. K.S.A. 40-4003(b) does not require the establishment of a closed block, but it provides that, if a closed block is established, it will consist of “all of the participating individual policies of life insurance of the mutual life insurer in force on the effective date of the plan of conversion for which the insurer has an experience-based dividend scale payable in the year in which the plan is adopted.” BCBSKS has no participating individual life insurance policies in force, nor has it ever issued any such policies. In addition, BCBSKS does not pay experience-based dividends on individual policies. (Tr. Vol. 1, pp. 403:25 – 405:5.)

161. On the basis of all the evidence in the record, the Commissioner finds and concludes that the non-inclusion of a closed block in the Plan is fair and equitable to policyholders and consistent with the Conversion Law.

VIII. Future Operations and Solvency

162. Under the Plan, BCBSKS will have a GAAP book value of \$155 million after the distribution.

163. Based on all the evidence in the record, including the testimony of Mr. Lynn and Mr. McCarthy (Tr. Vol. 1, pp. 309:5, 398:24 – 399:12), the Commissioner concludes that

BCBSKS after conversion will have sufficient statutory surplus to meet all relevant licensing requirements of Kansas law, and that its risk-based capital levels will not be below the thresholds for action by the Commissioner.

164. The rules of the Blue Cross and Blue Shield Association require Anthem to take responsibility for its subsidiaries' insurance obligations. In addition, in its prehearing rebuttal brief, Anthem agreed at the suggestion of the KID Testimonial Team to accept, as a condition of the Commissioner's approval order, a requirement that it furnish a guaranty of BSBSKS' insurance obligations identical to that which it has provided in regard to its subsidiaries in other states.

165. On the basis of the evidence in the record, the Commissioner concludes that BCBSKS, after the conversion and acquisition, would meet minimum requirements to be issued a certificate of authority by the Commissioner to transact business in this state, and its continued operations would not be hazardous to existing or future policyholders or the public.

166. Anthem has presented testimony that its business strategy calls for provider relations and eligibility determinations to be made at a local level in each state where an Anthem subsidiary does business, with certain exceptions for national accounts for which uniform criteria are applied to all employees of a multi-state employer. Anthem has also presented testimony that it intends to maintain a medical director in Kansas for its Kansas policies and to maintain a substantial workforce in Kansas. Anthem has no plans to liquidate BCBSKS, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management that would be unfair and unreasonable to BCBSKS' policyholders and not in the public interest.

IX. Effect on Rates.

167. The PwC Market Impact Assessment suggests that material rate increases, beyond what would otherwise occur, are likely to take place in the small group market and the individual market if the acquisition takes place. (Assessment, pp. 60-61) The Assessment indicates, however, that rate increases in other areas of business are unlikely. (*Id.*, p. 59) Ms. Hunt, who oversaw the preparation of the report, testified that she calculated this amount by projecting the increases on the small group market and the individual market that would be needed to generate underwriting margins of 2.5% across the board by the year 2005, assuming that all other things were equal. (Ex. 59, pp. 6-7)

168. Ms. Hunt's calculation presents the result of a mathematical calculation of the rate increases that would be needed to produce the hypothesized underwriting margin in the hypothesized year, assuming that all relevant factors other than small group rates and individual rates remain constant. (Assessment, p. 58) The assumptions underlying the calculation, however, lack adequate evidentiary support and are contrary to the credible evidence in the record.

169. In particular, Ms. Hunt's Assessment states that BCBSKS' goal is to achieve 2%-3% underwriting margins by 2007, but her calculation is based on the assumption that a 2.5% underwriting margin will be achieved by 2005. (*Id.*) Ms. Hunt offers no basis to doubt Anthem's statement that it does not hope to achieve those goals until 2007. Ms. Hunt states that she believes that shareholders would expect profits sooner (Tr. Vol. 3, p. 1224:1-12), but she does not offer any basis for the 2005 date other than sheer speculation. She also has not established that she is qualified to offer a credible expert opinion as to when Anthem shareholders would expect 2% to 3% underwriting margins.

170. Moreover, Ms. Hunt has offered no basis to believe that a 2.5% underwriting margin can be achieved by 2005, through premium increases or otherwise. As the KID Testimonial Team's financial advisor, Mr. Platter of Bear Stearns, testified at the hearing, a company's goals can differ from projections of what the company actually expects to achieve (Tr. Vol. 3, pp. 1075:16 – 1077:14), and Ms. Hunt also acknowledged that that could be the case (Tr. Vol. 3, pp. 1232:10-1233:3). And as Mr. Platter and Mr. Lynn both testified, even long-term projections in the health insurance business are inherently unreliable. (Tr. Vol. 3, p. 1072:13; Tr. Vol. 1, pp. 302:24 – 303:2)

171. Ms. Hunt also bases her calculation on an assumption that Anthem will seek to achieve its hypothetical goal of 2.5% underwriting margin by 2005 entirely through rate increases. (Ex. 56, p. 6; Assessment, p. 60) The testimony presented by BCBSKS and Anthem demonstrates that those companies have substantial reasons to believe that they can improve profitability through other means, including increasing membership, taking advantage of economies of scale and the adoption of corporate best practices (such as drawing on Anthem's experience with disease management). (*See, e.g.*, Tr. Vol. 1, pp. 35:12 – 36:14, 38:4-21, 216:9 – 217:7; Tr. Vol. 2, pp. 626:6-18, 637:13-19; Tr. Vol. 3, pp. 1355:19 – 1356:6; Ex. 14, p. 2; Ex. 50.) Ms. Hunt states, without giving details, that BCBSKS operates efficiently and assumes that no further improvements in efficiency are possible (Tr. Vol. 3, p. 1144:6-21). Mr. Smith, however, testified that Anthem has identified a number of areas in which other Anthem affiliates operate more efficiently than BCBSKS (Tr. Vol. 2, p. 637:13-19; Tr. Vol. 3, p. 1355:19 – 1356:6), and is in the process of evaluating potential cost savings (Ex. 50). Mr. Lynn also testified that BCBSKS was in the process of identifying improvements in efficiency that it could implement even apart from the Anthem transaction. (Ex. 14, p. 2.) Anthem also hopes to

increase profitability by growing BCBSKS' membership. (Tr. Vol. 2, p. 626:6-18.) Mr. Knack discussed the fixed costs of new information technology systems, which could be more efficiently spread across a larger company. (Tr. Vol. 1, pp. 35:12 – 36:14, 38:4-21.)

Furthermore, Dr. Feldstein testified that available economic evidence suggests that economies of scale are operative in the health insurance market. (Tr. Vol. 1, p. 216:9 – 217:7.) On the basis of the evidence in the record, it is unlikely that Anthem would seek to attain a goal of 2.5% underwriting margins entirely through rate increases as Ms. Hunt assumes.

172. Ms. Hunt's projections also assume that rate increases will have no effect on demand. (Tr. Vol. 3, pp. 1152:8-13; 1152:24-1153:12; 1155:18-1157:2) As Dr. Feldstein and Dr. Butler testified, increases in premiums are likely to cause insurance buyers to switch to competitors or otherwise decide not to renew their policies. (Tr. Vol. 1, pp. 236-40, 465-67, 468-69, 470-71, 473-74, 475, 476, 477-78, 478-79, 480, 486-87; Ex. 12, pp. 1-2; Ex. 30, pp. 2-5, 7-9, 10-11, 11-15; Ex. 33, pp. 1-4.) As a result, raising premiums above competitors' rates is likely to be unprofitable. Ms. Hunt's assumption in her calculation of a direct linear relationship between premiums and profitability—in effect, assuming that no policyholders will cancel their policies as a result of rate increases—is not supported by the record.

173. The intervenors have suggested that they dispute the price-competitiveness of some rural markets, but have not challenged that at least part of BCBSKS' service area is price-competitive. While Dr. Schramm—called as a witness by intervenors KMS and KHA—questions the degree of competitiveness of Kansas markets, he acknowledges the Kansas health insurance market is price sensitive and that the market is contestable within limits (Tr. Vol. 3, pp. 1294:11 – 1295:1). Dr. Schramm in his previous writings also acknowledges that “employers move their employee groups using price as a near exclusive reason for change; beneficiary

satisfaction often does not enter into the picture at all,” and that “[w]hen presented with multiple plan options by their employers, it has been shown that employees routinely will change carriers, switching away from carriers with high level customer satisfaction, for as little as \$12 to \$15 per month out-of-pocket difference.” (Ex. 72, at p. 71; Tr. Vol. 3, pp. 1305:25 – 1306:18.)

174. Ms. Hunt assumes that rates will increase more rapidly if the conversion and acquisition goes forward than if BCBSKS remains a mutual company. (Tr. Vol. 3, pp. 1222:14 – 1223:5) The only direct evidence in the record on this point, however, is the testimony of Mr. Lynn, which indicates that BCBSKS intends to return its unprofitable lines of business to profitability and does not intend to subsidize any of its customers except for sound business reasons. (Ex. 14, p. 1) Mr. Lynn stated that BCBSKS intended to do so partly by raising premiums, even if it remains a mutual company. On the basis of this testimony, it appears unlikely that pre-conversion BCBSKS will be more hesitant than Anthem to raise premiums to maximize its profitability.

175. Finally, the Commissioner notes that PwC’s role in preparing the portion of its Market Impact Assessment dealing with rate increases is that of an advocate hired to support the case of a litigant, and not a neutral evaluator of fact such as a court-appointed expert. Ms. Greenlee testified that PwC prepared the rate-increase portion of the Market Impact Assessment in response to her request that PwC should see if it can “make the case” for rate increases. (Tr. Vol. 2, p. 898:15) Ms. Hunt also testified that she deleted from the Market Impact Assessment a table that her colleague had noted did not “make the case” for rate increases under Anthem (Tr. Vol. 3, pp. 1200:24-1202:17; 1207:21-1208:8). The Commissioner does not suggest that there was anything improper about PwC’s role in this regard. In light of its adversarial role, however, PwC’s retention by the KID Testimonial Team does not entitle its testimony to any greater

weight than the testimony of the experts retained by the private parties, insofar as the issue of rate increases is concerned.

176. The KID Testimonial Team has taken the position that to find the plan “fair and equitable,” the Commissioner must balance the possibility of future rate increases against the possible advantages to policyholders. No such balancing test is required under the Conversion or Acquisition Laws. Assuming that such a test existed, however, the Commissioner finds that Ms. Hunt’s testimony about possible future rate increases rests on implausible assumptions and pure speculation, and for that reasons is not entitled to any weight. On the other side of the balance, the Commissioner finds that management has a firm basis to believe, in its business judgment, that increased efficiencies and economies of scale can be realized through the sponsored demutualization. The Commissioner finds that management has a firm basis to believe, in its business judgment, that the conversion will BCBSKS can make itself more stable and more secure for the benefit of policyholders in the future by becoming part of a larger organization. Furthermore, if the conversion is completed, policyholders will receive hundreds of millions of dollars of compensation that would otherwise be unavailable to them. A large portion of this compensation will flow to elderly Medicare Supplement policyholders, and in some cases it will be enough to pay an entire year’s premiums. On this basis, the Commissioner concludes that the testimony about possible rate increases does not alter her conclusion that the Plan of Conversion is fair and equitable to policyholders.

177. Furthermore, any rate increases that might occur in the future will be the result of a future business decision by Anthem or BCBSKS, not a proximate result of the conversion or acquisition. Speculation about whether these contingencies will or will not come to pass is not properly before the Commissioner on an application to approve the conversion.

178. In reaching the conclusion that the conversion is fair and equitable, the Commissioner has taken into account the fact that she has regulatory authority over rates of health insurers, both group and nongroup, under K.S.A. 40-2215. For nongroup rates, the Commissioner may disapprove any form connected with a rate if the benefits provided under such form are not reasonable in relation to the premium charged. K.S.A. 40-2215(d)(1). Furthermore, all rates, both group and nongroup, are required to be reasonable, not excessive, and not unfairly discriminatory. K.S.A. 40-2215(e)(1). The Commissioner has authority to enforce these laws. K.S.A. 40-281, 40-2215.

179. Moreover, regardless of whether Ms. Hunt's conclusions are believed, the Commissioner concludes that it would be improper to disapprove the conversion under the Conversion Law solely on the basis of rate increases allegedly resulting from BCBSKS' new status as a stockholder-controlled company. The loss of voting control by policyholders—which is the basis of Ms. Hunt's suggestion of future premium increases—is one of the membership interests for which policyholders are being compensated through the distribution of cash consideration. To the extent that the “fair and equitable” standard contemplates a balancing of what policyholders are gaining against what policyholders are giving up, the legislature has prescribed the controlling standard in K.S.A. 40-4004(b), which provides that “[t]he amount of consideration” provided to policyholders “*shall be deemed* to be fair and equitable” if it is “at least the amount of statutory surplus attributable to contributions of policyholders” (emphasis added). As discussed above, this standard is satisfied. Thus, the Conversion Law does not permit the Commissioner to disapprove the Plan of Conversion on the basis that the alleged disadvantages of stockholder ownership—including potential rate increases—are not

overbalanced by some other, additional benefit to policyholders beyond the consideration that the legislature has deemed by law to be sufficient.

180. The Commissioner also notes that at the insistence of the KID Testimonial Team, the Policyholder Information Booklet and the Policyholder Information Guide prominently disclosed that “The transaction may result in future premium increases and/or other measures to return to profitability,” and discussed this perceived risk at length. Notwithstanding this disclosure, a clear majority of the policyholders who voted cast their ballots in favor of the Plan. Even if the statute permitted it, the Commissioner does not believe that it would be an appropriate exercise of her discretion under the “fair and equitable” standard to substitute the Testimonial Team’s judgment for the judgment of the policyholders, who approved the Plan after a full disclosure of all material risks and all other material facts.

181. The Commissioner also notes that K.S.A. 40-4002(a) calls on the Board of Directors to make the determination that the conversion “would benefit the insurer and be in the best interests of its policyholders.” The Board of Directors in fact made such a finding. There is no basis in the record to doubt that they did so in good faith, in the exercise of their considered business judgment and without any conflicts of interest. While the Commissioner must review the Plan of Conversion to determine that it is fair and equitable to policyholders, she should not invade the statutory role of the Board by substituting her own judgment for the directors’ judgment as to the relative weight to be given to the risks and benefits of the conversion.

182. The Commissioner further concludes that the concerns about possible future rate increases also do not provide grounds to disapprove the acquisition under the Acquisition Law on the grounds that it is “likely to be hazardous or prejudicial to the insurance-buying public.” K.S.A. 40-3304(d)(1)(E). To disapprove an acquisition under the Acquisition Law, the

Commissioner must affirmatively find by evidence in the record that a ground for disapproving the transaction is present. The Commissioner finds that the evidence in the record fails to establish that significant rate increases are likely beyond those that would occur in the absence of the transaction. The Commissioner also concludes, based on all the testimony in the record, that it has not been established that the acquisition will have any adverse effect on competition in the Kansas health insurance market.

183. The Commissioner also concludes that even if additional rate increases were likely, that fact without more would not be sufficient to establish that the transaction would be “hazardous or prejudicial to the insurance-buying public.” While rate increases are disadvantageous to the policyholders who must pay them, they can be necessary to the financial stability of insurance companies faced with increased medical costs. Rate increases can also be necessary to avoid unfair cross-subsidization between risk groups, as the Kansas Supreme Court has recognized. *Blue Cross of Kansas, Inc. v. Bell*, 227 Kan. 426, Syl. ¶ 7, 607 P.2d 498 (1980). BCBSKS’ small-group business is currently operating at a loss, and Mr. Lynn has testified that BCBSKS intends even in the absence of the proposed conversion and acquisition to raise premiums and take other measures to return it to profitability, rather than to continue to subsidize that business through premiums received on other lines of business or by depleting its surplus. No showing has been made that any projected additional rate increases alleged to result from the acquisition would be “hazardous” or “prejudicial” to the public in these circumstances.

184. Moreover, “hazardous to the insuring public” and similar phrases are used throughout the Kansas insurance statutes to refer to financial solvency concerns. Reading K.S.A. 40-3004(d)(1)(E) against the background of those statutes, the Commissioner concludes that the phrase “hazardous or prejudicial” as used in that section should be understood to refer to

transactions having a material negative effect on the financial condition of the insurer. As discussed above, the Commissioner has concluded that the conversion and acquisition does not threaten BCBSKS' financial condition, particularly in view of the agreement by Anthem, Inc. to deliver a guaranty of BCBSKS' insurance obligations in the same form as the guaranties provided to other states.

185. The Commissioner specifically rejects the suggestion, raised in the brief of KAMU and KSNA, that potential rate increases also are a ground to disapprove the conversion under K.S.A. 40-4004(a)(4), which requires the insurer to show that “the new stock insurer would meet 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.” That section requires the insurer to show only that the “continued operations” will not be hazardous, but there is nothing inherently hazardous to the public about permitting a stockholder-owned health insurer to “operat[e].” Furthermore, the placement of this requirement in the context of licensing requirements in K.S.A. 40-4004(a)(4), makes clear that it refers to financial solvency concerns as used in that section.

186. Implicit in some of the arguments about future rate increases—and explicit in the testimony of Dr. Schramm—is the notion that BCBSKS has a special role in providing service to certain segments of the public by virtue of its history as a nonprofit insurer or the perception that it still operates as a nonprofit. The Commissioner, however, is barred from taking this concern into account by the court-approved Settlement Agreement dated August 20, 2000 among the Attorney General, the Commissioner and BCBSKS (Ex. 59). Section 12 of the Settlement Agreement expressly provides that:

The Commissioner . . . agree[s] that, with respect to any proposed action by BCBSKS under K.S.A. §§ 40-4001 et seq. [*i.e.*, the Conversion Law] [or] 40-3301 et seq. [*i.e.*, the Holding Company Act], BCBSKS' past or existing status as a non-profit entity . . . shall not in itself cause any of the Public Officials [including the Commissioner] to apply any different standards of approval . . . than they would apply to any proposed action by a Kansas mutual insurance company other than BCBSKS under K.S.A. §§ 40-4001 et seq. [or] 40-3301 et seq. . . .

Section 12 of the Settlement Agreement also provides that the payments made under the Settlement Agreement “satisfy fully any charitable, benevolent, public benefit, social welfare, or similar obligations which may have existed in the past, may exist now, or may exist or arise in the future, as a result of BCBSKS having been organized or deemed not-for-profit entities. . . .” On this basis, the Commissioner concludes that she may not impose any obligations for the public benefit on BCBSKS on the basis of its history as a not-for-profit entity.

187. Dr. Schramm also stated the view that the transaction would have alleged “anti-competitive” effects because of the size of Anthem and the possibility of “predatory pricing.” (Tr. Vol. 3, pp. 1257:16 - 1260:25). BCBSKS and Anthem, however, are not currently competitors, and the transaction will not directly operate to reduce competition. [cites] When questioned about his argument, Dr. Schramm admitted that he has no evidence with regard to predatory pricing in Kansas (Tr. Vol. 3, p. 1297:12-17), and claimed ignorance with regard to the principal federal laws designed to protect competition (Tr. Vol. 3, p. 1297:25-1298:5; Tr. Vol. 3, pp. 1297:25-1298:25). Further, the Federal Trade Commission granted early termination to its review of the transaction, thereby recognizing the absence of anti-competitive effects (Ex. 26). Further, it is clear that Dr. Schramm has performed no economic analysis of competition in this case, as demonstrated by his refusal to even describe any elements of the “Rule of Reason” analysis in this case and his failure to offer any basis to believe that BCBSKS can control price

or exclude competition (Tr. Vol. 3, pp.1300:24-1302:8). The Commissioner finds that Dr. Schramm’s testimony is not reliable or credible and is entitled to no weight.

188. Finally, the Commissioner notes Anthem has agreed to provide a “Small Business Rate Stabilization Fund” to provide further assurances to the Commissioner and the people of Kansas of Anthem’s commitment to the small group business of BCBSKS. The fund would be available to the Commissioner as a subsidy to offset rates that would otherwise be necessary to achieve market driven margins in the small group market. The initial balance of the Small Business Rate Stabilization Fund will be \$25 million and may be used by the Commissioner during the five year period following the closing of the transaction. In order to avoid volatility of rates in the marketplace, the maximum amount of the Small Business Rate Stabilization Fund utilized in any given year could not exceed the amounts set forth below:

Time Period	Total Portion of Small Business Rate Stabilization Fund Utilized in Period
Year 1	40%
Year 2	25%
Year 3	20%
Year 4	10%
Year 5	5%

189. The Commissioner finds that the proposed Small Business Rate Stabilization Fund fully addresses the concerns expressed by the Testimonial Team about possible future rate increases in the small group market. Kathy Greenlee concludes, based on her reliance on the PwC Market Impact Report (Exhibit 56), that there is the potential for premiums to increase two to three percent across all lines of business of BCBSKS. (Tr. Vol. 3, p. 912:1-21). The KID Testimonial Team has said in Ms. Greenlee’s testimony and in its brief that if it can be assured that these potential premium increases can be avoided or minimized through operating

efficiencies, membership growth or means other than premium increases in these two lines of business, then the KID Testimonial Team's concern may be able to be removed. (Tr. Vol. 2, pp.931:6-932:20; KID Testimonial Team's Pre-filed Brief at 38.). She further testified she did not have a "magic formula" or condition to suggest that would sufficiently assure her that her concerns on this issue is resolved in order for her to give an unequivocal recommendation for the approval of these transactions. (Tr. Vol. 2, pp. 931:7- 932:20). For this reason, the Commissioner finds that the ultimate conflict in the testimony as to the credibility of the KID concern does not need be reconciled as a result of Anthem's willingness to create the Small Business Rate Stabilization Fund that becomes available to be used under the Commissioner's oversight and control.

X. Competence, Experience and Integrity of Anthem Management.

190. PwC, at the request of the KID Testimonial Team, undertook an examination of the market conduct of Anthem-controlled plans in other states, and found no material grounds to question the competence, experience and integrity of Anthem and its management.

191. On the basis of PwC's review, the information in Anthem's Form A filing and the other evidence in the record, the Commissioner finds no basis to question the competence, experience and integrity of Anthem and its management.

192. In reaching this conclusion, the Commissioner has taken into account the testimony of Mr. Fairbank and finds that, considered in the light of all of the evidence in the record, that testimony does not change the Commissioner's conclusion.

XI. Compensation of BCBSKS Management.

193. At the request of the KID Testimonial Team, PwC conducted a review of BCBSKS' executive compensation and benefit programs in connection with the proposed conversion and acquisition. PwC concluded that the proposed BCBSKS conversion and alliance with Anthem

will not impact director and executive compensation and benefit programs such that the result would be a violation of the statutory requirement that (i) the plan of conversion does not unjustly enrich any director, officer, agent or employee of the insurer, K.S.A. 40-4004(a)(3), or that (ii) no director, officer, agent or employee of the insurer shall receive any fee, commission, or other valuable consideration whatsoever, other than regular salary and compensation, for in any manner aiding, promoting or assisting in the conversion except as set forth in the plan of conversion, K.S.A. 40-4007(b). PwC also concluded that the Director and executive compensation and benefit programs of BCBSKS are consistent with “best practices” for such compensation and benefit programs, and provide levels of total compensation that are consistent with levels provided to similarly situated directors or executives within the peer groups of BCBS and public insurance companies.

194. The evidence shows that the compensation of persons who are executive officers of BCBSKS immediately prior to the conversion and the acquisition will not change solely as a result of the sponsored demutualization. In particular, none of the officers or directors of BCBSKS will receive any stock, stock options, stock appreciation rights or other equity interests in Anthem as a result of the transaction. To the extent Anthem or its subsidiaries continue to employ BCBSKS’ current officers, agents and employees in the future, they will be compensated for their ongoing services on the terms agreed between them and their employer.

195. On the basis of the evidence in the record, the Commissioner concludes that no director, officer, agent or employee of the insurer shall receive any fee, commission, or other valuable consideration whatsoever, other than regular salary and compensation, for in any manner aiding, promoting or assisting in the conversion.

196. On the basis of the evidence in the record, the Commissioner concludes that the plan of conversion does not unjustly enrich any director, officer, agent or employee of the insurer.

XII. Conclusions and Decision.

197. Based upon the Commissioner's review of all the evidence in the record, consisting of the oral testimony of expert and fact witnesses at the public hearing and the prefiled written testimony and other exhibits admitted into evidence at the public hearing, the Commissioner finds, concludes and orders as follows:

A. Conversion.

198. BCBSKS adopted its plan of conversion in compliance with K.S.A. 40-4003a(a), which authorizes an exchange of policyholders' membership interests for cash or other consideration.

199. The Plan includes all information required by K.S.A. 40-4003a(a).

200. BCBSKS' Board of Directors adopted the proposed Plan in compliance with K.S.A. 40-4002(a).

201. BCBSKS' Board of Directors found that conversion would benefit the insurer and be in the best interests of its policyholders in compliance with K.S.A. 40-4002(a).

202. The Company submitted the Plan of Conversion to the Commissioner for her approval on October 26, 2001 in compliance with K.S.A. 40-4002(c).

203. Notice of the hearing on the Plan of Conversion was given in compliance with K.S.A. 40-4004(a).

204. A special policyholder meeting was duly called in compliance with K.S.A. 40-4005.

205. Notice of the policyholder meeting, accompanied by all information the Commissioner deems necessary to policyholder understanding, including a comprehensible

summary of the plan in a form approved by the Commissioner, was given in compliance with K.S.A. 40-4005.

206. A majority of the policyholders cast votes on the Plan of Conversion. Of those voting, a majority voted in favor. Therefore, the Plan of Conversion has been approved by the policyholders in compliance with K.S.A. 40-4002(d).

207. Subject to the conditions set forth herein, the Plan of Conversion is fair and equitable to policyholders.

208. The consideration being distributed to policyholders is at least the amount of statutory surplus attributable to contributions of policyholders, and the amount of the consideration is therefore deemed fair and equitable pursuant to K.S.A. 40-4004(b).

209. The Plan of Conversion complies with the provisions of the Conversion Law.

210. The Plan of Conversion does not unjustly enrich any director, officer, agent or employee of the insurer.

211. The converted stock insurer would meet 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.

212. Therefore, the Plan of Conversion satisfies the criteria for approval under K.S.A. 40-4004(a) subject to the conditions set forth herein.

B. Acquisition.

213. The Form A filing submitted by Anthem included all the information required by K.S.A. 40-3304(b), and was submitted with the required filing fee.

214. The Commissioner conducted a hearing on the proposed acquisition in compliance with K.S.A. 40-3304(d)(2) and the Kansas Administrative Procedure Act.

215. It has not been established that after the change of control, BCBSKS would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed.

216. It has not been established that the financial condition of Anthem or Anthem West, Inc. is such as might jeopardize the financial stability of the BCBSKS or prejudice the interest of its policyholders.

217. It has not been established that Anthem or Anthem West, Inc. has any plans to liquidate BCBSKS, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management that would be unfair and unreasonable to BCBSKS' policyholders of the insurer and not in the public interest.

218. It has not been established that the competence, experience and integrity of those persons who would control BCBSKS are such that it would not be in the interest of policyholders of BCBSKS and of the public to permit the acquisition of control.

219. It has not been established that the acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

220. Therefore, no grounds for disapproval of the acquisition of control exist under K.S.A. 40-4004(d).

C. Conditions.

221. The foregoing conclusions are subject to each of the following conditions proposed by the KID Testimonial Team, which Anthem and BCBSKS have indicated they do not oppose if the Commissioner believes them to be necessary:

- a. The amount of consideration to be provided by BCBSKS to Eligible Policyholders shall not be less than the amount of its statutory surplus on the Effective Date.

b. Anthem, Inc. shall provide a written corporate guarantee substantially in the form of the written guarantee entered into for the benefit of the policyholders of Anthem’s insurance companies in Connecticut, Ohio and Kentucky.

c. Anthem shall waive the requirement, set forth in section 6.3(f) of the Plan of Conversion, that appointments by the Commissioner to the Policyholder Committee “be reasonably acceptable to” Anthem.

d. BCBSKS and Anthem shall develop an acceptable method for handling the requirement that interest paid to the Eligible Policyholders be reported to the IRS.

e. The allocation of consideration to the Eligible Policyholders shall be implemented in accordance with the actuarial model, principles and formulas upon which the consulting actuaries for the KID Testimonial Team and BCBSKS have agreed.

222. The foregoing conclusions are also subject to the condition that Anthem shall implement and maintain the rate stabilization fund described as follows:

a. The initial balance of the Small Business Rate Stabilization Fund will be \$25 million and may be used by the Commissioner during the five year period following the closing of the transaction. In order to avoid volatility of rates in the marketplace, the maximum amount of the Small Business Rate Stabilization Fund utilized in any given year could not exceed the amounts set forth below:

	Total Portion of Small Business Rate Stabilization Fund Utilized in Period	
Time Period	<hr/>	
Year 1	40%	
Year 2	25%	
Year 3	20%	
Year 4	10%	
Year 5	5%	

b. The methodology for utilizing the Fund would be as follows:

Anthem would submit, on a regular basis, the small group rate increases needed to achieve a competitive margin. The submission would be calculated using standard actuarial practices, according to small group regulations in Kansas, and would include all of the factors indicated by sound actuarial practice. The approximate total dollar value of the rate increase would be calculated by multiplying the average per contract rate increase times the current number of small group contracts. The Commissioner, at her discretion, could then utilize the Small Business Rate Stabilization Fund, up to the annual limits outlined above, to offset the indicated rate increase. This would then result in a revised rate increase for use in the small group marketplace. An illustration of this appears below.

Illustration

Current premium per contract per month	\$380
Requested increase	10%
Resulting premium per contract per month	\$418
Average premium increase	\$38
Number of small group contracts renewing	15,000
Total annual dollar value of requested rate increase	\$6,840,000
Offset directed by Commissioner	\$3,000,000
Resulting total rate increase	\$3,840,000
Increase per contract per month	\$21.33
Resulting premium per contract per month	\$401.33
Resulting rate increase percentage	5.6%

223. Based on an evaluation of the record, it is the Commissioner's judgment that the conversion and acquisition comply with the statutory requirements for approval without the imposition of any further conditions beyond those set forth above. The Commissioner has fully considered the brief submitted by the KID Testimonial Team and the testimony submitted by Kathy Greenlee, Mark H. Kovey and Dawn Touzin, and determined that they do not change the Commissioner's conclusion in this regard.

D. General Conclusions.

224. The Commissioner retains jurisdiction of all matters relating to the conversion and acquisition until the preceding conditions have been met.

225. The Commissioner has considered all of the arguments and objections presented at the public hearing and in the briefs of the parties and intervenors. In addition, though it is not a

part of the hearing record and does not constitute evidence, the Commissioner has taken into account the arguments and objections raised at the Public Comment Meetings and has considered them in light of the testimony and evidence admitted into the record at the public hearing. Upon consideration the record in its entirety, and for the reasons specified in these Findings of Fact, Conclusions of Law and Order, the Commissioner determines that none of the arguments and objections, individually or in the aggregate, merits a decision that the conversion should not be approved, subject to the conditions set forth herein.

226. Based upon the foregoing, and subject to the satisfaction of each and every condition set forth herein, the conversion is hereby APPROVED, and the acquisition is hereby APPROVED.

Dated: _____, 2002.

Kathleen Sebelius
Commissioner of Insurance
State of Kansas