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

POST-HEARING BRIEF OF BLUE CROSS AND BLUE SHIELD OF KANSAS, INC. IN SUPPORT OF ITS PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER APPROVING CONVERSION AND ACQUISITION

Blue Cross and Blue Shield of Kansas, Inc. ("BCBSKS" or the "Company") submits this post-hearing brief to the Commissioner in further support of BCBSKS' application for approval of its Plan of Conversion (the "Plan" or "Plan of Conversion") pursuant to K.S.A. 40-4001 to -4014 (the "Conversion Law"), and the application of Anthem Insurance Companies, Inc. ("Anthem") for approval of its acquisition of control of BCBSKS pursuant to K.S.A. 40-3304(d)(1) (the "Acquisition Law").

INTRODUCTION

The Kansas Insurance Department's Testimonial Team (the "Testimonial Team") has agreed with BCBSKS on all material issues of fact and conclusions of law. The accompanying Proposed Findings of Fact, Conclusions of Law, and Order Approving Conversion and Acquisition (the "Findings"), as well as BCBSKS' and Anthem's prehearing briefs, set forth the legal requirements to be met for approval of the conversion and acquisition of BCBSKS. The Findings also set forth the evidence showing how those requirements have been met in detail. Those points are therefore not repeated here.

Having agreed that in every other respect, the Plan is fair and equitable to policyholders, is not hazardous or prejudicial to the public, and meets all other requirements for approval, the Testimonial Team raises only one objection: its assertion the potential for rate increases upon conversion and acquisition is greater than it would be in the absence of the transaction, and that because of that potential, the Commissioner would be justified in disapproving the transaction. The Testimonial Team's assertion rests on a misunderstanding of the relevant standards. As a matter of law, neither the Conversion Law nor the Acquisition Law permits the Commissioner to "balance" the potential for greater rate increases against benefits that the transaction confers on policyholders to determine if the transaction is "fair and equitable to policyholders" under the Conversion Law or "hazardous or prejudicial to the insurance-buying public" under the Acquisition Law.

The balancing in the Conversion Law has been done by the legislature, which has concluded that payment of consideration equal to the statutory surplus attributable to policyholder contributions is *per se* fair and equitable compensation to policyholders for loss of the Company's mutual status. Beyond this statutory requirement, the question of whether the transaction is appropriate is a question for the Board of Directors of the Company and the policyholders themselves. The Board unanimously approved the transaction in the exercise of its business judgment after a thorough evaluation of the alternatives, and the policyholders have voted overwhelmingly to approve the Plan of Conversion. The Commissioner has no basis to overrule the Board's and the

policyholders' decisions and deprive the policyholders of the hundreds of millions of dollars in consideration that they have a right to expect.

The phrase "hazardous or prejudicial to the insurance-buying public" in the Acquisition Law also does not envision the Commissioner's balancing the speculative possibility of future rate increases against advantages of the transaction. Numerous statutes using similar phrases make clear that these terms refer to impaired financial condition or similar threats to the ability of policyholders to enforce their insurance contracts. Here, there is no serious question about the solvency of BCBSKS or Anthem, the trustworthiness of Anthem's management, or anything else that might make Anthem's acquisition of BCBSKS "hazardous" or "prejudicial" to the public.

Finally, the Testimonial Team's "evidence" in support of its claim of likely rate increases is based entirely on speculation. As Ms. Hunt of PricewaterhouseCoopers ("PwC") admitted at the hearing, her report is based on numerous conjectural assumptions for which she could provide no basis, and that in many instances are contrary to the competent evidence in the record or to plain common sense. Speculation and conjecture is not evidence, and it does not support a finding disapproving the conversion or acquisition.

Moreover, Anthem has agreed to provide a rate stabilization fund, which addresses the rate increase concerns raised by the Testimonial Team.

Regardless of what may be deeply-held beliefs and subjective convictions within the Testimonial Team, the Commissioner's ability to consider those factors has been

limited by the Kansas legislature, and those beliefs and subjective convictions must be disregarded for the Commissioner to fulfill her duties under the law.

ARGUMENT

I. The Conversion Law Does Not Call for the Commissioner to Balance Rate Increases Against Advantages to Policyholders.

In enacting the Conversion Law, the Kansas Legislature made clear that Kansas mutual insurers should be allowed to demutualize in compliance with the conditions set forth in the law. The suggestion that stock insurers are inherently bad for policyholders, merely because they are stock companies and have an incentive to maximize profits for their stockholders by raising rates, is not a sufficient basis to disapprove the Plan.

Further, the Testimonial Team's suggestion that policyholders must receive—in addition to the consideration they are receiving under the Plan—a concrete countervailing benefit to offset the possibility of profit-driven future additional rate increases is contrary to law. The legislature recognized that whenever a mutual insurance company demutualizes, its policyholders are relinquishing something, *i.e.,* their interests as members of a mutual insurance company. K.S.A. 40-4003c(a). Among these interests is the right to control the election of directors in the mutual insurance company, which is surrendered to shareholders once the conversion takes place. K.S.A. 40-4003c(a)(1). The legislature provided that in exchange for those membership interests, eligible policyholders should receive consideration in the form of cash or other value. K.S.A. 40-4003a(a)(2). The legislature also required the Commissioner to approve a plan of

conversion if she finds (among other requirements) that it is "fair and equitable to policyholders." K.S.A. 40-4004(a)(1).

The Legislature, however, placed an important constraint on the Commissioner's discretion in determining whether a plan of conversion is fair and equitable, by providing that "[t]he amount of consideration provided by the converting insurer to policyholders shall be deemed to be fair and equitable pursuant to [K.S.A. 40-4004(a)], if the consideration is at least the amount of statutory surplus attributable to contributions of policyholders." K.S.A. 40-4004(b). Here, this test is easily met. As BCBSKS' Vice President of Finance and Treasurer, Mr. Lynn testified, the amount of consideration to be distributed to policyholders will far exceed its statutory surplus at the closing. (Tr. Vol. 1, p. 309:9-23). Prior to taking account of the special distribution, the statutory surplus is expected to be about $190 million at closing, and the total of the special distribution and the purchase price is estimated to be approximately $273 million even without the $48 million in funds being placed into escrow. (*Id.*) Moreover, Anthem and BCBSKS have agreed to guarantee that the amount of consideration will exceed the statutory surplus at closing. *A fortiori*, the consideration distributed to policyholders will exceed that portion of the statutory surplus that is "attributable to contributions of policyholders." K.S.A. 40-4004(b).[1] Thus, by statute, the policyholders are receiving more than the required minimum amount of consideration deemed to be fair and equitable.

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[1] Further, though the statute does not require it, Mr. McCarthy has testified that *each* policyholder's compensation is likely to exceed that policyholder's contribution to surplus. (Tr. Vol. 1, p. 403:4-7). As the uncontroverted testimony of both Mr. McCarthy and Mr. Beck shows, the method being used to allocate

Ms. Greenlee therefore misstates the law when she claims that "the Commissioner would . . . be justified in concluding that . . . the Plan will not be fair and equitable to policyholders" on the basis that "additional rate increases are likely to . . . outweigh any benefits expected from the conversion." (Ex. 51 at 2 (Greenlee pre-filed direct testimony)). As discussed, the conversion statute itself builds in a quid pro quo, by providing to policyholders a distribution of consideration based on statutory surplus in exchange for their membership interests. K.S.A. 40-4003a(a)(2), 40-4004(b). Beyond that, the Conversion Statute imposes no requirements that the conversion provide policyholders with *additional* benefits beyond those that they enjoyed as policyholders of a mutual insurance company, and beyond those that the statute deems to be fair and equitable compensation for their membership interests.

II. The Board of Directors and Policyholders Have Fully Taken Into Account the Benefits and Risks of the Transaction, and the Commissioner Has No Authority to Second-Guess Their Judgment.

The fact that the legislature has disabled the Commissioner from requiring benefits to policyholders beyond consideration equal to the statutory surplus attributable to policyholder contributions does not, of course, mean that the costs and benefits of the transaction are irrelevant to whether a conversion is appropriate. The legislature, however, has put those decisions squarely in the hands of the Board of Directors and the policyholders.

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consideration among the policyholders is fair and equitable to policyholders. (*See* Tr. Vol. 1, p. 405:9-21 (McCarthy); Tr. Vol. 3, p. 1081:6-18, 1084:3-7; Ex. 17 (McCarthy Opinion); Ex. 54 sched. 1 (Beck Opinion)).

Under K.S.A. 40-4002(a), the insurer's Board of Directors is to make a finding that "conversion would benefit the insurer and be in the best interests of its policyholders." BCBSKS' Board has made the required finding after due deliberation and full consideration of the relevant facts. (*See* Ex. 28 at 9 (minutes); Ex. 5 at 2-4 (Mattox pre-filed testimony)). As the body entrusted by statute with directing the management of the Company, K.S.A. 17-6301(a), elected by the policyholders for that purpose, and representing many years of accumulated experience with the Company and its business, (Ex. 14 (Lynn rebuttal testimony)), the Board of Directors is best situated to weigh the competing considerations in a conversion, as the legislature has mandated. *See* K.S.A. 40-4002(a). Indeed, the Kansas Supreme Court admonished in *Blue Cross of Kansas, Inc. v. Bell,* 227 Kan. 426, 607 P.2d 498 (1980), that

> the Insurance Commissioner should keep in mind that . . . the general insurance laws . . . [do not] give him authority to govern the everyday management details of BCBSK, or to substitute his judgment for that of the boards of directors of these companies as to either the wisdom and expediency of business policies or the methods of carrying on the business of the companies.

Id. at 439, 607 P.2d at 508.

Moreover, the Legislature has mandated that the policyholders must approve the Plan by a vote. K.S.A. 40-4002(d). In this manner, policyholders can exercise their own judgment as to whether they believe the conversion is in their interests after weighing the risks and the benefits. Under K.S.A. 40-4005, BCBSKS was required to mail to policyholders "any information the commissioner deems necessary to policyholder understanding, including a comprehensible summary of the plan in a form approved by

the commissioner." The Testimonial Team insisted, (*see* Ex. 51 at 8 (Greenlee pre-filed testimony)), that BCBSKS must take the extraordinary step of including the following "risk factor" in its policyholder mailings:

> **The transaction may result in future premium increases and/or other measures to return to profitability**
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> BCBSKS, upon its conversion to a stock company owned by Anthem, is expected to take measures to return to operating profitability, which may differ from those which it would have taken in the absence of the conversion. These measures may include material premium increases, initiatives to improve operating efficiencies and cost containment measures. The nature and impact of these measures have not been identified and their efficacy cannot be assured. The stockholders and investors who will own Anthem, the 100% owner of BCBSKS, have made investments on which they will expect a reasonable return. These stockholders will have the power to elect directors who will endeavor to fulfill their expectations.

(Ex. 23 at 12). This alarmingly worded risk factor was prominently referenced—in some cases in bold capital letters—throughout the Policyholder Information Statement (Ex. 23 at ii, vii, 3, 19, 28), in the Policyholder Instruction Guide (Ex. 20 at ii, 6), and even on the back of the proxy card itself (Ex. 21). This risk factor was also presented in a Power Point slide at all five of the public comment meetings throughout the state. (Tr. Vol. 2, pp. 904:24 - 905:6.)

In spite of these disclosures, in spite of the unrelenting publicity campaign generated by providers (whose own stated interest in higher reimbursements would itself put upward pressure on premiums), and in spite of BCBSKS' inability to respond to this negative publicity due to the restrictions that had been placed upon its communications

with policyholders, BCBSKS' policyholders voted overwhelmingly in favor of the transaction. Since policyholders voted for the transaction in spite of the disclosed "risk"—in the language insisted upon by the Testimonial Team—the only possible inference is that they were willing to exchange that risk for the benefits of the transaction. Having insisted on the disclosure, the Testimonial Team cannot now suggest that policyholders were inadequately informed to make this decision.

III. Rate Increase Concerns Are Insufficient to Justify Disapproving the Acquisition as "Likely to Be Hazardous or Prejudicial to the Insurance-Buying Public."

The Testimonial Team also suggests that its rate increase fears provide the Commissioner grounds to disapprove the acquisition 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). Setting rates to make a profit, however, is not "hazardous" or "prejudicial." Indeed, BCBSKS is already making a profit in the Medicare supplement, individual and large-group lines of business, and the Testimonial Team has not suggested that it must lower those rates. Moreover, the Commissioner herself has regularly granted certificates of authority to stock insurers. In granting a certificate of authority, the Commissioner is not required to consider the likely future rates of a stock insurer. *See* K.S.A. 40-209, 40-214.

The argument that the Commissioner should disapprove an acquisition because of speculative future increases in premiums was rejected in *Ginther v. Commissioner of Insurance*, 427 Mass. 319, 693 N.E.2d 153 (1998). In *Ginther*, a policyholder challenged the Massachusetts Insurance Commissioner's approval of an acquisition of a Massachusetts insurer (Paul Revere) by an out-of-state insurer, claiming that the new

insurer might make adverse changes in its business. The Superior Court dismissed the challenge, holding that

> [p]laintiffs' alleged injuries are speculative and are not the proximate consequence of the subject acquisition. Whether Paul Revere will discontinue its disability policy line, discontinue Niagara's agency, or implement a policy of resisting claims is wholly speculative. Further, whether these contingencies come to pass or not will be the result of an internal business decision of Paul Revere, not the subject acquisition.

427 Mass. at 321-322, 693 N.E.2d at 156 (quoting Superior Court opinion; affirming on grounds of lack of standing).

Moreover, raising the possibility of rate increases at this stage—based on guesses about what might happen in the future and before the putative higher rates have been filed—is premature. The Commissioner 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. Essentially, the Testimonial Team is asking the Commissioner to prejudge the appropriateness of rates that have not yet been filed, based on speculation as to what those rates might be.

Contrary to what the Testimonial Team suggests, the Commissioner does not have to invent a meaning for "hazardous or prejudicial to the insurance-buying public." An

important rule of statutory construction used to determine legislative intent is that identical words or terms used in different statutes on a similar subject are interpreted to have the same meaning in the absence of anything in the context to indicate that different meaning was intended. *Callaway v. City of Overland Park*, 211 Kan. 646, 508 P.2d 902 (1973). In fact, variations on the terminology "hazardous to the public" appear in numerous Kansas insurance statutes.[2] In each case, the phrase is used in a context suggesting an impaired financial condition or similar conditions that would justify suspending or denying an insurer's license or placing it in supervision or receivership. That is, the concern of these statutes is that the insurer is not generating sufficient premiums to pay claims when due—not that it is charging rates designed to cover the cost

[2] K.S.A. 40-222b(a) ("Whenever the financial condition of any insurance company…might be hazardous to the insuring public….); K.S.A. 40-436(i) ("No domestic life insurance company shall be authorized to issue such contracts…until such company has satisfied the commissioner that its condition and methods of operation …will not be such as to render its operation hazardous to the public or to its policyholders in this state."); K.S.A. 40-759(a) and 40-760(a)("When the commissioner …finds that a domestic society…is conducting its business fraudulently or in a manner hazardous to it members, creditors, the public or the business…."); K.S.A. 40-1219a ("…if …the insurer has attained a financial condition such that its continued operations might be hazardous to the insuring public…."); K.S.A 40-3613(b) ("If…the commissioner has reasonable cause to believe that any domestic insurer is in such condition as to render the continuance of such domestic insurer's business hazardous to the public or to holders of its policies or certificates of insurance…."); K.S.A. 40-3616(a) ("The insurer is in such condition that the further transaction of business would be hazardous financially to its policyholders, creditors, or the public…"); and K.S.A 40-3621(c) ("…the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, creditors, or the public…").

of claims and contribute to surplus.[3] Joined in context with "hazardous," the term "prejudicial" should also be understood to refer to a threat to the interests of the insurance-buying public in financially sound and trustworthy insurers.

IV. There Is Nothing Unfair or Undesirable About Faster Rate Increases to End Cross-Subsidization.

The Testimonial Team's position and Ms. Greenlee's testimony do not explain why faster rate increases on unprofitable lines of business are necessarily unfair, inequitable, hazardous or prejudicial. The Testimonial Team just assumes that they are. While rate increases may be disadvantageous (at least in the short run) to the policyholders who must pay them, they can be necessary to the financial stability of insurance companies faced with increased medical costs. The Testimonial Team has made no attempt to show that these particular rate increases are harmful.

The Testimonial Team also overlooks established law that eliminating disparities in profitability among lines of business enhances fairness. As things currently stand, BCBSKS' small group business is being subsidized at the expense of other profitable

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[3] This is particularly clear with regard to the assertion by intervenors 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 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), underscores that it refers to financial solvency concerns.

lines of business, including the elderly retirees who make up the Medicare supplement market. The Kansas Supreme Court has held that eliminating such disparities is an appropriate reason to raise rates. *Blue Cross of Kansas, Inc. v. Bell*, 227 Kan. 426, 439, 607 P.2d 498, 508 (1980). In particular, even in a nonprofit hospital or medical service corporation,

> in fixing rates for one class or group such class or group should neither be subsidized nor have to bear part of the burden of subsidizing another group or groups. . . . [T]he goal should be that one risk group should not be subsidized at the expense of others.

Id. On this basis, the Court overturned the Commissioner's refusal to approve rate increases.

The material presented by the Testimonial Team does not allege that post-conversion BCBSKS will raise premiums to a higher level than it would without a conversion, only that it will raise premiums to restore small group and individual business to financial health two years sooner than it otherwise would. (Tr. Vol. 3, p. 1220:1-7.) On the basis of the policy articulated in *Blue Cross v. Bell*, it would be a desirable and equitable result if post-conversion BCBSKS could equalize the disparity in profitability among BCBSKS' lines more rapidly than BCBSKS now can, whether by rate increases or otherwise. Certainly there is nothing unfair or inequitable in expecting each line of BCBSKS' business to pay its fair share of premiums.

Finally, implicit in the Testimonial Team's position and explicit in the testimony of Mr. Schramm (Tr. Vol. 3, pp. 1268:12 – 1270:1) is the notion that BCBSKS has an obligation to the public welfare by virtue of its history as a nonprofit company. Any

consideration of BCBSKS' former status, however, is foreclosed by the court-approved Settlement Agreement dated August 20, 2000 among the Attorney General, the Commissioner and BCBSKS. (Ex. 59.) That agreement 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." (*Id.* § 12.) It further expressly provides that the present or former status of BCBSKS as a nonprofit cannot be taken into account in evaluating a demutualization or acquisition of control:

> 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. . . .

(*Id.*) Consequently, any attempt to impute a charitable purpose to BCBSKS or to impose public welfare obligations upon it would be wholly improper and would violate BCBSKS' rights under the Settlement Agreement.

V. The Evidence in the Record Does Not Support a Finding of Likely Additional Rate Increases.

In any event, the Testimonial Team's concern about additional future rate increases rests on sheer speculation. A decision of an administrative agency after a hearing must be supported by substantial evidence in the record. K.S.A. 77-621(c)(7).

"Substantial evidence is evidence possessing both relevance and substance that furnishes a substantial basis of fact from which the issues can reasonably be resolved." *City of Wichita v. PERB*, 259 Kan. 628, 630, 913 P.2d 137, 140 (1996). "Findings . . . based on . . . suspicion and conjecture, are arbitrary and baseless," and are insufficient to support an administrative agency determination. *In re Kansas Corp. Comm'n Decision Granting Certificate of Need to Providence-St. Margaret Health Ctr.*, 232 Kan. 787, 794, 659 P.2d 199, 204 (1983) (quoting *Southwestern Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 47, 386 P.2d 515 (1963)). Particularly under the Acquisition Law, where the burden of proof is on the opponents of the transaction (Tr. Vol. 2, pp. 1002:20 – 1003:19), Ms. Hunt's testimony falls far short of what is required to establish that the transaction should be disapproved.

To try to support their concern about potential rate increases, the Testimonial Team has offered only the oral and written testimony of Ms. Sandra Hunt (Tr. Vol. 3, pp. 1128-1244 & Ex. 56), together with the Market Impact Assessment (Schedule 1 to Ex. 56) (the "Assessment") prepared by Ms. Hunt and her team at PricewaterhouseCoopers ("PwC"). The Assessment asserts that 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 at 60-61.) The Assessment and Ms. Hunt's testimony admit, however, that "it is unlikely that increases would occur in all market segments." (Ex. 59 at 6; Assessment at 59; Tr. Vol. 3, pp. 1181:19-1182:15). The Assessment is devoid of any clear indication of the basis on which Ms. Hunt makes her

prediction of future rate increases on small group and individual policies, and Ms. Hunt's testimony makes clear that they are purely speculative.

Ms. Hunt's projections are based on the *assumption* that BCBSKS will achieve a 2.5% underwriting margin across the board by 2005, and will do so entirely by raising premiums in the small group and individual markets. Ms. Hunt acknowledges, however, that she has no basis to believe these results are achievable simply by raising premiums. In particular, she acknowledges that "for the past six years, Blue Cross Blue Shield has experienced underwriting losses averaging 2 percent." (Tr. Vol. 3, p. 1135:17-19). She also acknowledges "the expectations that Blue Cross Blue Shield expressed in valuing the company with a .4 percent underwriting margin as the best expectation of the level of underwriting gains that would be achieved." (*Id.* at pp. 1135:23-1136:3.) But based on her stated belief that "stock insurance companies" have "expectations . . . of underwriting gains of at least 3 percent," she simply assumed that BCBSKS would "reach those underwriting gains" after acquisition by Anthem. (*Id.* at 1136:9.)

Ms. Hunt's projections are nothing more than the preordained 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. 60.) The assumptions underlying the calculation lack evidentiary support and are contrary to the credible evidence in the record.

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. (Assessment p. 58.) Ms. Hunt offers no basis to doubt BCBSKS' 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, pp. 1222:25 – 1223:5), but she does not offer any basis for the 2005 date other than sheer speculation. (Tr. Vol. 3, p. 1187:9-15). As the Department'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).

Ms. Hunt also *assumes* that Anthem will seek to achieve its hypothetical goal of 2.5% underwriting margin by 2005 entirely through rate increases. (Tr. Vol. 3, pp. 1182:23 – 1183:16.) Ms. Hunt states, without giving details, that BCBSKS operates efficiently and assumes that no further improvements in efficiency are possible. (Tr. Vol. 3, p. 1144:16-25.) In fact, BCBSKS and Anthem have demonstrated ways in which they can improve profitability through means other than rate increases.

In particular, 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, pp. 1355:19-1356:6) and is in the process of evaluating potential cost savings. (Ex. 50.) BCBSKS, through its internal program known as "SIEVE," is also 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.) Moreover, the cost of new information technology systems, such as those to deal with disease management, would be an expense for BCBSKS that could be more efficiently spread across a larger company or set up on Anthem's existing systems. (Tr. Vol. 1, pp. 35:12 – 36:14, 38:4-21.) Furthermore, Dr. Feldstein testified that available economic evidence suggests, under the "survivor principle," that economies of scale are operative in the health insurance market. (Tr. Vol. 1, pp. 216:9 – 217:7.) On the basis of the evidence in the record, it is virtually inconceivable that Anthem would seek to attain a goal of 2.5% underwriting margins entirely through rate increases, without any component of cost savings, as Ms. Hunt assumes.

Ms. Hunt's projections also assume that rate increases will have no effect on demand. 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.) Dr. Feldstein noted that the elasticity of demand for health insurance has been estimated at between –2.5 and –7. (Ex. 12, p. 1.) As a result, raising premiums above competitors' rates is likely to reduce rather than increase profits. (*Id.*) Ms. Hunt admitted, however, that she and her team "did not use an elasticity of demand model" in analyzing the likely effect of price increases. (Tr. Vol. 3, p. 1152:12-13). While she understood elasticity of demand to mean "probability of increasing the total revenue as a result of a price

increase," she astonishingly failed to consider "what the elasticity of demands are or is for insurers, health insurers" when she attempted to project whether profitability could be increased by raising premiums. (Tr. Vol. 3, pp.1152:19-21, 1152:24 - 1153:3). Rather, Ms. Hunt's calculation assumed a direct linear relationship between premiums and profitability—in effect, assuming that no policyholders will cancel their policies as a result of rate increases. (See Assessment pp. 60-61.) This assumption is both implausible and unsupported by the record.

In addition, in assuming that Anthem could increase profitability merely by raising rates, Ms. Hunt admitted that she failed to take into account the Commissioner's regulatory powers to disapprove rate increases. (Tr. Vol. 3, p.1236:9-13). Ms. Hunt also testified that she did not take into account the contestability of the Kansas market as a limiting factor on rate increases. (Tr. Vol. 3, p. 1159:6-12).

Ms. Hunt also fails to consider basic economic theory in predicting that the purported increases will be concentrated in the small group and individual markets. When asked the basis for this conclusion, she stated simply that she believed that increases were not likely for merit-rated groups because they are merit rated, and that increases were not likely for Medicare supplement policies because "that product has historically shown underwriting gains, and we didn't believe they would seek to achieve additional gains in that area." (Tr. Vol. 3, p. 1139:4-11). She thus did not base her conclusion on any direct analysis of whether demand or competition would constrain price increases.

Another fundamental flaw in Ms. Hunt's analysis is her assumption that rates will increase more rapidly if the conversion and acquisition goes forward than if BCBSKS remains a mutual company, on the assumption that BCBSKS has no interest in achieving a profit on this business. While she speculates that Anthem is more likely to have the "inclination" to "test the market" by raising premiums (Tr. Vol. 3, pp. 1230:15, 1226:24-1227:5), she offers no basis to believe that this is in fact the case. The only evidence in the record on this point is the testimony of Mr. Lynn, which indicates that BCBSKS intends to return its unprofitable lines of business to profitability partly by raising premiums and does not intend to subsidize any of its customers except for sound business reasons. (Ex. 14 at 1 (Lynn rebuttal testimony)).

Finally, the record shows that Ms. Hunt added the rate increase section to her report only after Ms. Greenlee asked her if "a case could be made" for additional rate increases in the small group and individual markets as a result of the conversion. (Tr. Vol. 2, p. 898:15). Further, Ms. Hunt admitted that she deleted a table from the report that she and her colleague Ms. Maerki concluded did not make the case for rate increases (Tr. Vol. 3, pp. 1200:24-1202:1, 1207:21-1208:8), and instead "refocused" her work on the area in which she thought she could make a case for rate increases (*id.* at p. 1208:7). Particularly in view of the arbitrary assumptions on which the PwC report rests, these events make clear that the PwC report does not represent a neutral or balanced presentation of the facts with respect to possible rate increases.

VI. The Testimonial Team Ignores the Evidence of the Benefits of Conversion.

Moreover, even if the Testimonial Team were right that BCBSKS and Anthem had to demonstrate real benefits from the transaction to overcome the possibility of rate increases, BCBSKS and Anthem clearly have done so. As discussed above, Anthem and BCBSKS have identified a number of ways that they can implement cost savings, which can help keep premiums low. Further cost savings are likely to be identified as BCBSKS and Anthem continue to work together. Policyholders will also benefit from the increased financial stability that comes with being part of a larger and more geographically diverse company.

Finally, policyholders will receive, in the aggregate, up to $321 million in consideration. Many Medicare supplement policyholders will be receiving enough to cover their premiums for an entire year. The Testimonial Team has pointed out that small group policies will receive relatively little consideration; but that is as it should be, because those policyholders have benefited from obtaining insurance at rates below BCBSKS' costs, and in effect have been subsidized over the years by the surplus built from BCBSKS' profitable lines of business.

VII. The Rate Stabilization Fund Addresses Any Concerns About Premium Increases.

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 BCBS. 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%

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.

The Commissioner should find 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 it is 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). This proactive response to this issue provides a safety net for small businesses facing increases in health insurance premiums in the small group market and will benefit those Kansans affected by the potential volatility in this market. For this reason, the Commissioner is requested to find 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 BCBS'

willingness to create the Small Business Rate Stabilization Fund that becomes available to be used under the Commissioner's oversight and control.

VIII. The Legislature Has Limited the Discretion Available to the Commissioner; Under the Facts and Law as They Exist, She Has No Alternative but to Approve the Conversion and Acquisition

The first U.S. Supreme Court case to hold that insurance is affected with a public interest to an extent sufficient to permit state regulation, *German Alliance Insurance Co. v. Lewis*, 233 U.S. 389 (1914), originated in Kansas. Since that time, the Kansas legislature has enacted wide-ranging protections for insurance consumers, many addressing some of the concerns expressed by policyholders, the Testimonial Team, the public or the intervenors in this proceeding. Among other things,

- K.S.A 40-22a13 et seq. creates a comprehensive mechanism allowing for external review by independent review agencies of medical necessity denials of claims by health insurers.
- K.S.A 40-2257 regulates discontinuance of a particular type of individual insurance policy by requiring 90 days advance notice to the insured and the offering of all other types of individual insurance policies being sold by the insurer to persons holding the type of policy being discontinued, and regulates discontinuance by an insurer of all individual insurance, requiring 180 days notice to the Commissioner of Insurance and to each policyholder and prohibiting future issuance of individual coverage for five years.
- K.S.A. 40-2209(d) regulates discontinuance of a particular type of group insurance policy by requiring 90 days advance notice to the insured and the offering of all other types of group insurance policies being sold by the insurer to groups holding the type of policy being discontinued, and regulates discontinuance by an insurer of all group insurance for small employers, requiring 180 days notice to the Commissioner of Insurance and to each group policyholder and covered employees, requiring discontinuance of all group policies by the insurer, and prohibiting future issuance of group coverage in the discontinued market for five years.

Most significant with respect to the alleged issues of fact in this proceeding is the comprehensive set of statutes that the legislature has created to govern rate regulation, as well as the separate and comprehensive statutes governing demutualization of a mutual insurer and acquisition of one insurer by another. Because of this comprehensive scheme of regulation adopted by the legislature, which spells out in detail the criteria that must be applied, there are no material disputed issues of fact to be considered by the Commissioner in considering the Plan of Conversion and the proposed acquisition, only issues of law.

To be sure, the parties dispute the potential of future rate increases in excess of what BCBSKS might implement in the absence of the transaction, but that dispute is simply not material to the issues that the Commissioner has to decide. Nothing in the conversion or acquisition law calls on the Commissioner to prejudge rate filings which might occur or make the possibility of rate changes a factor in judging the transaction. In other words, even if the Commissioner believed the speculation of the Testimonial Team about future rate approaches—indeed, even if BCBSKS did not dispute that speculation—that belief would not be a factor in judging this transaction. Any theoretical harm to the public that might arise from changes in rating practices is subject to oversight under separate statutes at the time the revised rates are filed.

The Testimonial Team's Pre-Filed Brief takes the position that the Commissioner may judge the conversion and acquisition on a wholly discretionary basis. That is not the law of Kansas. Some other states simply grant discretion to the commissioner of insurance, rather than setting forth standards of judgment. *See, e.g.,* Mich. Comp. Laws

Ann. § 500.5901(4)(c). But even in such states, commissioners will generally look to other state statutes and other commissioners' practices in judging a transaction. *See Demutualization of Insurance Companies: A Comparative Analysis*, 27 Tort & Ins. L. J. 709, 720 (1992). Had the Kansas legislature wished to grant the Commissioner unfettered discretion, rather than establishing comprehensive standards to be read *in pari materia* with other provisions of the insurance code, it could have done so. It did not.

Nothing in the demutualization or acquisition statutes suggests that speculation about future premium rates is a legitimate consideration in judging a conversion or acquisition. The reason for the silence is clear: to the extent premium rates are of regulatory concern, they are governed by other statutes. The Testimonial Team's attempt to inject their speculative concerns about future premium rates into this proceeding unfairly imposes special and unequal burdens on BCBSKS to which its competitors are not subject, and it invites error on the part of the Commissioner in deciding the issues in this proceeding.

CONCLUSION

Based on the evidence in the record, the only possible outcome consistent with the criteria set forth by the legislature is approval of the conversion and the acquisition. For all of the reasons set forth above and in the other submissions of BCBSKS and Anthem, the proposed conversion and acquisition satisfy all legal requirements and must be approved.

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