

**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

**The Kansas Association for the Medically Underserved and the Kansas State
Nurses Association's Findings of Fact and Conclusions of Law**

COMES NOW the Kansas Association for the Medically Underserved (KAMU) and the Kansas State Nurses Association (KSNA) and jointly submits this Findings of Fact and Conclusions of Law.

On January 9, 10 and 11, 2002, the above captioned matter came on for hearing before the Honorable Commissioner of Insurance, Kathleen Sebelius. At this hearing the parties: Blue Cross and Blue Shield of Kansas (BCBSK), Anthem Blue Cross and Blue Shield (Anthem) the Kansas Insurance Department Testimonial Team (KID), as well as the Intervening parties: Kansas Medical Society (KMS), Kansas Hospital Association (KHA), the KAMU and KSNA, presented testimony and evidence regarding the conversion and acquisition of BCBSK. As a result of the evidence and testimony presented at the hearing, the Commissioner of Insurance must concluded that the facts do not support the conversion and acquisition of BCBSK and as a consequence, the conversion and acquisition does not meet the statutory requirements and must be disapproved. In support of the Commissioner's disapproval of the plan of conversion and acquisition, KAMU and KSNA state the following Findings of Fact and Conclusions of Law:

I. Legal Standard for Commissioner’s Decision

A. The Commissioner’s Authority

Pursuant to K.S.A. 40-4001, the Commissioner “ has broad authority in reviewing such conversion, and the procedures and criteria to be applied by commissioner are flexible within the parameters of this act.”

B. Standard of Review

Although no specific case or statute defines the Commissioner’s standard for reviewing the transaction, from all of the applicable conversions statutes and from the statutes covering the Administrative Procedures Act, it is clear that the Commissioner’s decision must be based on facts and evidence. K.S.A. 40-4000 et. seq.; K.S.A. 77-501 et. seq. K.S.A. 40-4004, clearly establishes that the Commissioner’s decision must be supported by facts drawn both from the plan of conversion submitted by BCBSK and by evidence and testimony presented at the hearing. Thus, the proponents of the plan of the conversion have the burden to establish a sufficient factual basis to prove that the conversion meets all of the statutory requirements set out in K.S.A. 4004 (a) (1-4). Moreover, the Commissioner’s decision must be based “exclusively upon the evidence of record in the adjudicative proceeding and on matters officially noticed in that proceeding.” K.S.A. 77-526. The Commissioner must find that there is substantial evidence before the conversion may be approved. K.S.A. 77-622(c). Substantial evidence is evidence that possesses both relevance and substance and furnishes a substantial basis in fact from which the issue can reasonably be resolved. SRS v. Paillet, 270 Kan. 646, 16 P.3d 962 (2001). If substantial evidence does not support the proposed conversion and acquisition meets the requirements set out in K.S.A. 40-4004 and K.S.A.

33-3304(d), then the Commissioner does not have a sufficient factual basis and it would be an abuse of discretion to approve the proposed conversion and acquisition of BCBSK.

II. Findings of Fact

At the Formal Public Hearing, parties and intervenors presented testimony and evidence. Some of that evidence and testimony was uncontroverted and uncontested. The central controverted issue was whether the conversion and acquisition of BCBSK would be “hazardous to existing or future policy holders or the public.” K.S.A. 40-4004(a)(4). As Intervenors, KSNA and KAMU were limited in the scope of their intervention and do not contest whether BCBSK has met the conditions for conversion as set out in K.S.A. 40-4004(a)(1-3) or acquisition as set out in K.S.A. 40-.3304(d)(1-3).

II. Uncontested facts

The KID Testimonial Teams presentation of evidence and testimony by the following witnesses was uncontested:

1. The testimony of David Platter of Bears, Stearns & Co. regarding whether the transaction is fair to eligible policyholders from a financial point of view. (Transcript Vol. II, Platter, p. 1047-64).
2. The testimony of Kenneth M. Beck of PricewaterhouseCoopers regarding the merits and fairness of the proposed allocation of consideration to be distributed among eligible policyholders. (Transcript Vol. II, Beck, p. 1078-83).
3. The testimony if Mark H. Kovey of Scribner, Hall & Thompson relating to tax issues that impact the proposed transaction. (Transcript Vol. II, Kovey, p. 1096-1107).

4. The testimony of Denise G. Essenberg of PricewaterhouseCoopers regarding accounting and actuarial information relevant to the plan of conversion and acquisition. (Transcript Vol. II, Essenberg, p. 1086-89).

B. Uncontroverted facts about the Health Insurance Industry in Kansas

The Commissioner's decision is critical to the future of the health insurance industry in Kansas. No other Kansas Insurance Commissioner has ever faced by a decision of this magnitude in regard to the future of health insurance in Kansas. As such, the uncontroverted facts about the existing nature of BCBSK and health insurance must guide the Commissioner in reaching her decision. The following uncontroverted facts were established regarding health insurance in Kansas:

1. BCBSK owns 67% of the market share of health insurance in Kansas. (Exhibit Vol. II, Exhibit 56, p. 19).
2. Only 3 other health insurance companies who compete with BCBSK can claim even a 2% market share in Kansas. (Exhibit Vol. II, Exhibit 56, p. 22).
3. BCBSK is not in danger of imminent insolvency. (Transcript, Vol. I, Knack, p. 62).
4. More than 700,000 Kansans will be impacted by the Commissioner's decision in this case. (Exhibit Vol. II, Exhibit 56, p. 3).
5. Of those 700,000 Kansans, only 172,000 or one-fourth are considered policyholders eligible to vote on the conversion. (Knack, Transcript Vol. I, p.69).

6. Currently, Kansas ranks above the national average for health insurance coverage with 88% of Kansas having some form of coverage. (Exhibit Vol. II, Exhibit 56, Table 3-1, p. 14).
7. Currently, Kansas ranks above the national average for individuals who have individual health insurance plans. Eight percent of Kansans have some form of individual coverage. (Exhibit Vol. II, Exhibit 56, Table 3-2, p. 15).
8. BCBSK is “poised for the future with innovative plan designs, strong networks of both hospital and medical care providers and legislative involvement to support efforts both in Topeka and Washington.” (Transcript Vol. I, Knack, p. 78 (quoting from policyholder brochure)).
9. BCBSK’s premiums are below the premiums of other states in which Anthem currently conducts business. (Exhibit Vol. II, Exhibit 56, Table 5-6, p. 37).
10. BCBSK has operated with underwriting losses in all of its large group, small group and individual product plans. (Exhibit Vol. II, Exhibit 56, Table 4-7, p. 26-27).
11. Anthem, as a for-profit, stockholder company, will demand, at a minimum, underwriting gains of 2-3%, which will necessarily result in dramatic premium increases for Kansas policyholders. (Exhibit Vol. II, Exhibit 56, p. 63; Table 5-14, p. 55; Table 6-1 & 6-2, p. 61).

These facts underscore the current availability of health insurance in Kansas, the dominance of BCBSK in the Kansas market place, its current stability and the

potential impact that a for-profit, stockholding company will have on the future soundness and affordability of health insurance in Kansas. In the context of these facts, the Commissioner must carefully analyze the case that BCBSK presented at the public hearing.

C. BCBSK’s Case was Rigorously Controverted and BCBSK Failed to Provide a Factual Basis for it Claim that the Conversion and Acquisition would be Beneficial to Existing or Future Policyholder or the Public.

In BCBSK and Anthem’s Pre-filed Testimony and Briefs it was argued that the conversion and acquisition justified approval because the transaction would be beneficial to policyholders.

1. BCBSK and Anthem presented five basic arguments in support of the transaction: 1) it will provide capitol for BCBSK to compete on a national scale; 2) it will enable BCBSK to take advantage of “economies of scale;” 3) it will diversity the company geographically and increase its flexibility in responding to localized adverse risk events; 4) it will assist in attracting and retaining employees; 5) it will allow BCBSK to take advantage of the “best practices in health insurance.” (BCBSK, Pre-filed Brief, p. 1, 8; Exhibit Vol. I, Exhibit 3, Knack p. 6; Exhibit Vol. I, Exhibit 13, Lynn, p. 4; Exhibit Vol. II, Exhibit 34, Glasscock, p. 3-7; Exhibit Vol. II, Exhibit 35, Smith, p. 6, 8-9).

Capitol Infusion

2. John Knack, President and CEO of BCBSK testified that the transaction would enhance BCBSK capitol strength and make capitol

available for investments and acquisitions. (Transcript Vol. I, Knack, p. 64).

3. On cross-examination, Mr. Knack admitted that there was no agreement with Anthem stating that Anthem would provide direct infusion of capitol into BCBSK. (Transcript Vol. I, Knack, p. 64-6).

Geographic Diversity & Adverse Risk Events

4. Mr. Knack testified that the transaction will diversity the company geographically and increase its flexibility in responding to localized adverse risk events. (Exhibit Vol. I, Exhibit 3, Knack p. 6).
5. On cross-examination, Mr. Knack admitted that diversifying the company geographically would not lessen the risks but, in fact, would expose BCBSK to the risks that take place in Anthem's nine other states. (Transcript Vol. I, Knack, p. 68).
6. Donald R. Lynn, Vice-President of Finance for BCBSK testified regarding potential adverse risks events that could impact BCBSK. (Transcript Vol. I, Lynn, p. 344-45).
7. Mr. Lynn could not specify any time that BCBSK was actually adversely impacted by a risk event. (Transcript Vol. I, Lynn, p. 344-45).

Economies of Scale

8. Mr. Knack testified that the transaction would save BCBSK money by taking advantage of economies of scale. (Transcript Vol. I, Knack, p. 68).

9. On cross-examination, Mr. Knack admitted that BCBSK has never quantified how economies of scale would specifically benefit or impact BCBSK and that no one has not provided the KID Testimonial Team with such evidence. (Transcript Vol. I, Knack, p. 69, 92).
10. Dr. Paul Feldstein testified regarding his theories on the benefits of private ownership of health insurance companies. (Transcript Vol. I, Feldstein, p. 203-50).
11. While Dr. Feldstein stated that he believed that economies of scale exist in the health insurance market, he stated that he had not actually measured any economies of scale in the health insurance market. (Transcript Vol. I, Feldstein, p. 215).
12. Dr. Feldstein's testimony also admitted that he had not gathered any data or information on Kansas for purposes of applying his theories to the facts as they exist in Kansas. (Transcript Vol. I, Feldstein, p. 265-68).
13. One example of how BCBSK could be impacted by economies of scale was that economies of scale could help to lower administrative costs. (Transcript Vol. II, Glasscock, p. 584)
14. Mr. Glasscock could provide not specifics on how he would lower costs. (Transcript Vol. II, Glasscock, p. 585)
15. Mike Mattox, Executive Vice-President of BCBSK, also could not provide any specifics as to how Anthem could lower costs. (Transcript Vol. I, Mattox, p.186).

16. BCBSK is already more administratively efficient than Anthem states. (Exhibit Vol. II, Exhibit 56, p. 25).
17. Dr. Henry Butler testified as an expert on the market impact of the transaction. (Transcript Vol. I, Butler. p. 456-480).
18. Dr. Butler testified that the conversion and acquisition would increase market competition and potential keep Anthem from dramatically increasing premium. (Transcript Vol. I, Butler. p. 456-480).
19. On cross-examination, Dr. Butler admitted that he had little or no knowledge regarding the special market impact that the transaction would have on rural areas of Kansas. (Transcript Vol. I, Butler. p. 456-480).
20. Dr. Butler also admitted that had never applied his market impact theories to specific conversion or acquisition of a health insurance company nor had he actually attempted to apply this market impact theory to any post-conversion or acquisition case. (Transcript Vol. I, Butler. p. 510-11).
21. Dr. Carl Schramm testified that economies of scale do not necessarily work in the health insurance industry with the same force as in other industries. (Exhibit Vol. II, Exhibit 71, Schramm, p. 63).
22. Dr. Schramm's research concluded that the insurance industry is very stable and that the size of various players is so predominate that it practically excludes competition. (Transcript Vol. III, Schramm, p. 1257-58).

Attracting & Retaining Employees

23. Mr. Mattox testified that the transactions will allow BCBSK to attack and retain employees. (Transcript Vol. I, Mattox, p. 141-42).
24. On cross-examination, Mr. Mattox was unable to specify how the transaction would result in BCBSK being better able to attract or retain employees. (Transcript Vol. I, Mattox, p. 143-44, 172-73).
25. Mr. Mattox also testified that Anthem guaranteed to continue proportional employment in Kansas. (Transcript Vol. I, Mattox, p. 173).
26. Mr. Mattox could not specify what proportional employment would mean in terms of maintaining the current number of BCBSK employees. (Transcript Vol. I, Mattox, p. 173).

Best Practices in Health Insurance

27. Mr. Lynn could not identify any of Anthem's best practices that BCBSK could take advantage of as a result of the transaction. (Transcript Vol. I, Lynn, p. 344-45).
28. No other evidence or testimony was solicited regarding specific "best practices" and the beneficial impact it would have on BCBSK policyholders or the insurance buying public.

As the foregoing facts state, BCBSK five arguments for conversion were not supported by evidence. No BCBSK or Anthem witness was able to provide any facts, evidence or data on Kansas demonstrating that any of these so-called advantages would have any positive impact on policyholders, premiums or the public.

D. Ample Evidence Supported the Fact that the Conversion and Acquisition of BCBSK will Result in Potentially Dramatic Premium Increases

1. Sandra Hunt of PricewaterhouseCooper was the only expert who did a complete analytical study of the Kansas insurance market, BCBSK and Anthem. (Exhibit Vol. II, Exhibit 56, p. 1-70).
2. As a result of her comprehensive research and analysis, Ms. Hunt concluded that to reach a goal of 2% to 3% underwriting gains, Anthem would then premiums would have to increase 6% to 7% above the expected market increase. (Exhibit Vol. II, Exhibit 56, p. 1-70).
3. No BCBSK or Anthem witness was able to rebut the issue of premium increases with any specificity or actual plan that was to be implemented. (Transcript Vol. III, p. 1354-1367).
4. Small group plans have the potential for the greatest impact of premium increases as they suffer from the greatest underwriting losses. (Exhibit Vol. II, Exhibit 56, p. 26-7).

The most critical issue for the commissioner is the very real threat of dramatic increases in premiums. Premium increases will impact not only the affordability of insurance but also would detrimentally impact Kansans access to insurance.

CONCLUSIONS OF LAW

The central question for the Commissioner is whether BCBSK has presented a plan and sufficient evidence for the Commissioner to conclude that the conversion is compelled under K.S.A. 40-4004(a)(1-4). K.S.A. 40-4004(a)(1-4) states:

The commissioner shall approve the plan if the commissioner 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, 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.

This case also concerns the acquisition of BCBSK under K.S.A. 40-3304(d). K.S.A. 40-3304(d) provides: the commissioner shall approve the acquisition unless she find:

- (1) After the change of control the domestic insurer would not be able to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed;
- (2) The financial condition of the acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interests of its policyholders;
- (3) The plan or proposal of the acquiring party to liquidate the insurer, to sell its assets, or to consolidate or merge its existing operations, 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; or
- (4) 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 insurer and the public to permit the merger or other acquisition of control; or
- (5) The acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

Important to both K.S.A. 40-4004 and K.S.A. 40-3304(d), is the requirement that the transaction not be “hazardous.” Under the rules of statutory construction, words, unless they are technical or have a peculiar meaning, are given their ordinary meaning.

Holloway v. Water Co., 100 Kan. 414, 167 P. 265; K.S.A. 77-201. In this context, the word “hazardous” does not have a peculiar meaning. Hazardous means “exposed to or involving danger; perilous; risky, involving risk of loss.” Black’s Law Dictionary (6th Edition, 1990).

Pursuant to the law and specifically the requirement that the transaction will not be hazardous to policyholders or the public, the Commissioner must conclude that

Kansans are at risk. Based on the facts and evidence presented the Commissioner cannot find, pursuant to the applicable statutes that the conversion and acquisition of BCBSK will not be hazardous.

The issue of hazardous to existing or future policyholder and the public was controverted and highly contested at the hearing and in pre-filed testimonies and briefs. In particular, it was shown that there is a great risk that premiums will rise if the transaction is approved. More importantly, this premium increases discussed would be more than a simply increase dictated by the market. These increases would be dramatic as Anthem must show a profit for its stockholders. Neither BCBSK nor Anthem presented any evidence establishing how these dramatic premium increases would be avoided if the transaction is approved. Neither BCBSK nor Anthem presented the Commissioner with a firm plan or specific actions it will take to avert the premium increases it will need to show a profit. There can be little doubt that dramatic increases in premiums will detrimentally affect Kansans and put the health insurance market and the health insurance buying public at risk.

BCBSK and Anthem presented only generalized theories and vague principles to controvert the issue of premium increases. Based on the facts adduced at the Public Hearing, the Commissioner must conclude that BCBSK does not meet the statutory criteria for approval of the conversion.

**Should the Conversion be Approved, the Commissioner Must Impose Condition
To the Acquisition**

Should the Commissioner find the evidence supports conversion and acquisition, it is incumbent upon the Commissioner to impose certain conditions upon Anthem to insure that Kansans are protected. These conditions are set out in the Prefiled Brief of the

KID Testimonial Team and in the Pre-filed and Supplemental Testimony of Dawn Touzin. (KID Prefiled Brief, p. 39; Exhibit Vol. II, Exhibit 74, 75).

The Commissioner has broad powers and authority to impose these conditions. K.S.A. 40-4001. Given the vague plan and lack of specificity in BCBSK and Anthem's testimonies, conditions are essential to the protection of existing or future policyholders and the public. Moreover, given the fact that BCBSK currently dominates the Kansas insurance market, conditions should be imposed as simply Anthem's cost for doing business in Kansas.

CONCLUSION

Although much of the evidence regarding fairness of the consideration, allocation of the consideration, accounting, auditing and tax implications were uncontrovered, the issue of whether this transaction will be hazardous to Kansans was hotly contested. BCBSK and Anthem were not forthcoming with information and evidence to dispel the public's or the intervenor's concerns over the transaction. BCBSK did not prove that the conversion and acquisition would not be hazardous to Kansans. Based on the facts, the Commission must conclude as a matter of law, that the conversion and acquisition will be hazardous.

In the alternative, should the Commissioner find that the question of hazardous was not conclusively shown, then the Commissioner must impose conditions on Anthem. Anthem will be greatly benefiting from acquiring a sound, strong company like BCBSK that own a large market share in Kansas. Conditions should be imposed as a cost for doing business in Kansas.

WHEREFORE, KSNA and KAMU respectfully submit this Findings of Fact and Conclusions of Law and requests that the Commissioner disapprove of the conversion and acquisition of BCBSK.

Respectfully,

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CERTIFICATE OF SERVICE

I, Karen A Eager, certify that a true and correct copy of the foregoing Findings of Fact and Conclusions of law this 25th day of January 2002, been electronically transferred and mailed to the below identified counsel or parties:

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