

**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

**PREHEARING MEMORANDUM OF ANTHEM INSURANCE COMPANY, INC.
IN SUPPORT OF ITS APPLICATION**

Anthem Insurance Company, Inc. (“Anthem”) submits this memorandum in support of the application of Blue Cross and Blue Shield of Kansas, Inc. (“BCBSKS”) to convert from a non-profit mutual company to a stock company and the application of Anthem for approval to purchase all shares of common stock authorized and issued by BCBSKS in connection with its conversion to a stock company. The evidence at hearing will demonstrate that these proposed transactions comply with the requirements of Kansas law and should be approved.

Procedural Background

1. These proceedings were initiated to secure the Commissioner’s approval of two proposed transactions that will enable Anthem to acquire ownership and control of Blue Cross and Blue Shield of Kansas, Inc. (“BCBSKS”). The proposed transactions contemplate that BCBSKS will convert from a mutual company to a stock company and that Anthem or its designated affiliate will purchase all shares of common stock authorized and issued by BCBSKS in connection with its conversion to a stock company.

2. On May 30, 2001, Blue Cross and Blue Shield of Kansas, Inc. (“BCBSKS”) and Anthem entered into an Alliance Agreement (the “Agreement”) which specifies the terms and conditions under which Anthem or its designated affiliate will acquire ownership of BCBSKS.

3. On May 31, 2001, BCBSKS submitted its draft Plan of Conversion (the “Plan” or “Conversion”) to the Commissioner for review, comment and approval in accordance with K.S.A. 40-4001, et seq. In relevant part, the Plan proposes to extinguish all membership interests in the mutual company in exchange for valuable consideration, including certain payments to eligible members, and to otherwise effectuate the transformation of BCBSKS into a stock company.

4. On July 25, 2001, Anthem submitted its Form A (“Statement Regarding the Acquisition of Control Of or Merger With a Domestic Insurer”) to the Commissioner seeking approval to acquire BCBSKS in accordance with K.S.A. 40-3304(d)(1) and the Agreement of the parties.

5. On August 21, 2001, the Commissioner issued a Procedural and Scheduling Order (the “Order”) that establishes, among other things, the procedural and substantive requirements for intervention in this docket.

Standard for Approval of the Proposed Transactions

6. In these conversion and acquisition proceedings, the Kansas Legislature has established overlapping statutory criteria which frame the material issues for decision and define the scope of relevant inquiry at the hearing. See K.S.A. 40-4004(a) (conversion) and K.S.A. 40-3304(d)(1) (acquisition of control).

(a) The Commissioner “shall approve” the BCBSKS plan of conversion if she finds: (i) that it is fair and equitable to policyholders; (ii) that it complies with the act governing conversions; (iii) that it does not unjustly enrich any director, officer, agent or employee of the insurer; (iv) that the new stock insurer would be qualified to transact business in Kansas; and (v) that the continued operations of the new stock insurer would not be hazardous to existing or future policyholders or the public. See K.S.A. 40-4004(a)(1)–(4).

(a) The Commissioner “shall approve” Anthem’s proposed acquisition of control unless she finds: (i) that it would not satisfy the requirements to write existing lines of business; (ii) that the financial condition of any acquiring party might jeopardize the financial stability of the insurer or prejudice the interests of policyholders; (iii) that the acquiring party plans to make material changes in the insurer’s business, corporate structure or management that would be unfair and unreasonable to policyholders and not in the public interest; (iv) that the persons who would control the operations of the insurer lack necessary competence, experience and integrity; or (v) that the acquisition is likely to be hazardous or prejudicial to the insurance-buying public. See K.S.A. 40-3304(d)(1)(A)–(F).

7. Despite substantial similarities between the statutory criteria governing conversions and acquisitions, a proposed conversion must be approved by the Commissioner upon finding that the transaction satisfies the criteria for approval set forth in K.S.A. 40-4004(a)(1)-(4). On the other hand, the Commissioner must approve an acquisition of control unless she expressly finds that the proposed transaction meets the criteria for disapproval set forth in K.S.A. 40-3304(d)(1)(A)-(F).

8. The Kansas Legislature has expressly declared that “the policies and purposes” of the Kansas Insurance Holding Companies Act, K.S.A. 40-3301, et seq., “are to

promote the public interest by,” among other things, “[f]acilitating the achievement” of certain specified objectives, see K.S.A. 40-3301(c)(1), which 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.”

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

9. The hearing evidence will establish that after Anthem’s purchase of all shares of common stock authorized and issued by BCBSKS in connection with its conversion to a stock company, Anthem will be more than able to satisfy the requirements for the issuance of a license to write the lines of insurance for which BCBSKS is presently licensed.

10. The hearing evidence will demonstrate that the financial condition of Anthem will not jeopardize the financial stability of BCBSKS or prejudice the interests of its policyholders. Anthem is one of the nation’s largest health benefits companies, serving over 7.8 million customers primarily in Indiana, Kentucky, Ohio, Connecticut, New Hampshire, Maine, Colorado and Nevada. It is one of the strongest Blue Plans in the country. Anthem’s financial statements show Anthem, for the period ending September 30, 2001, had surplus at more than \$2.1 billion, based on Generally Accepted Accounting Principles (“GAAP”), with total adjusted capital on a statutory basis in excess of \$1.9 billion. In comparison, standing alone, BCBS-KS’s reserve for the protection of policyholders at the end of 2000 was \$328.5 million on a GAAP basis and \$230.5 million on a statutory basis. For the nine months ending

September 30, 2001, Anthem's operating revenue increased 21% to \$7.5 billion. For the same period, its net income rose 65% to \$254.5 million. Anthem's income before discontinued and unusual items for 1999 was \$152.0 million. In 2000, Anthem reported net income of \$226.0 million on GAAP revenues of approximately \$8.8 billion. In addition, for the period ending September 30, 2001, Anthem reported net income of \$254.5 million on GAAP revenues of approximately \$7.8 billion. Anthem has consistently maintained statutory surplus well above industry averages. Anthem's investment portfolio as of September 30, 2001 of approximately \$4.2 billion (approximately \$180 million in the form of cash) is a significant symbol of Anthem's overall financial strength and operating success.

11. The hearing evidence will be that Anthem has no plans to liquidate BCBSKS, sell its assets, consolidate or merge it or make any other material change in its business or corporate structure or management that would be unfair or unreasonable to policyholders of BCBSKS and not in the public interest. Anthem intends to provide coordinated regional and corporate support services and assistance to its Kansas subsidiary, but leave the day-to-day management and health care delivery decisions to managers with the Kansas subsidiary. Consistent with Anthem's belief that health care is a local activity and its resulting operating model, most of the administrative activities of Anthem's Kansas business will continue to be managed and conducted out of BCBSKS's current facilities in Kansas. It is expected that current employees of BCBSKS will perform most of the day-to-day administrative activities that will support Anthem's Kansas business. Anthem intends and has agreed to offer continued employment to BCBSKS employees including its management. Following the closing of the transaction, the policy and contract holders of BCBS-KS, Premier Health, Inc., HMO Kansas, Inc., and Advance Insurance Company will remain policy or

contract holders of such entities without a break in continuity of benefits and services to such contract and policyholders. In addition, Anthem Health Plans of Kansas, the new corporate name anticipated for BCBSKS, expects to offer the same range of products after the acquisition as those currently offered by BCBS-KS, and expects to continue offering products throughout the state. No significant changes to BCBSKS's product families – HMO, POS, and Indemnity – are planned in the near term beyond those previously identified by BCBSKS management. After the closing, Anthem Health Plans of Kansas intends to assume and honor BCBSKS's existing provider contracts for the duration of their existing terms, including those with physicians and hospitals. Thus, it is expected Anthem Health Plans of Kansas will acquire BCBSKS's existing networks of providers, who will continue to provide service to the policy and contract holders of Anthem Health Plans of Kansas, Premier Health, Inc. and HMO Kansas, Inc. Anthem has no plans to reduce the networks. Provider contracting is a function performed by local and regional personnel and Anthem's goal is to have broad, statewide networks.

12. The biological affidavits attached as Exhibit D to Anthem's Form A Statement Regarding the Acquisition of Control or Merger with a Domestic Insure dramatically demonstrates that Anthem's Directors and Executive Officers possess outstanding competence, experience and integrity.

13. The hearing evidence will demonstrate that Anthem's acquisition of the common stock of BCBSKS will not be hazardous or prejudicial to the insurance buying public of Kansas, but will be beneficial to them. The acquisition will provide BCBSKS increased financial flexibility through improved access to capital. It will allow BCBSKS to effectively compete with larger health care benefit companies that possess substantial reserves and member

base. The acquisition will allow BCBSKS to be better positioned to develop new systems and programs as well as provide core business processes with state-of-the-art and efficient operating hardware and software and spread operational costs over a wider geographic and economic base. The acquisition will provide BCBSKS access to needed capital to support clinical programs that promote customer health. Anthem believes there are significant operating advantages that can be obtained by creating a strong multi-regional Blue Cross and Blue Shield company. Underwriting cycles can be better managed, consolidated financial strength can be used to develop better products for customers, vendor costs can be reduced, and structural investments and fixed expenses (such as information systems development and disease management costs) can be spread among a greater number of customers. All of these factors will help Anthem provide value for current BCBSKS customers as well as the remainder of the Kansas insurance buying public. The acquisition will not tend to substantially lessen competition or tend to create a monopoly in Kansas. Indeed, the transaction will actually help sustain health insurance competition in Kansas since over time new health benefits products not presently offered in the marketplace may be introduced. Anthem contracts with more than 75,000 physicians in the states it serves, and 99.7% of all hospitals in those states are in Anthem's networks. In Colorado and Nevada, two other states that along with Kansas would comprise the Anthem West Region, there has been an expansion of primary and specialty physicians in the network following their affiliation with Anthem. In Colorado, our HMO network grew from 1,664 to 1,829 primary care physicians and from 4,882 to 5,482 specialty care physicians. Our Colorado PPO physician network grew from 6,950 to 7,314 physicians. In Nevada, our HMO network grew from 441 to 657 primary care physicians, and from 1,890 to 2,102 specialty care physicians. Our Nevada PPO physician network grew from 2,524 to 3,165 physicians.. Quality scores, reflected by HEDIS measurement, continue to improve in all Anthem states, demonstrating the effectiveness of programs developed to improve the health of

Certificate of Service

The undersigned hereby certifies that a copy of the foregoing was served upon counsel by depositing same in the United States Mail, first class postage prepaid, on this 17th day of December 2001, properly addressed as follows:

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