

BEFORE THE COMMISSIONER OF INSURANCE  
OF THE STATE OF KANSAS

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

Docket No. 3014-DM

**EXECUTIVE SUMMARY OF WRITTEN TESTIMONY**  
**SUBMITTED BY BCBSKS**

COMES NOW Blue Cross and Blue Shield of Kansas, Inc. (“BCBSKS”) and respectfully submits its Executive Summary of the Written Testimony submitted by BCBSKS.

**EXECUTIVE SUMMARY OF THE EXPERT REPORT OF**  
**HENRY N. BUTLER, J.D., Ph.D.**

**Background**

Henry N. Butler, JD. Ph.D. was retained by counsel for Blue Cross and Blue Shield of Kansas as an independent expert witness. The specific issues he has been asked to address, his qualifications to address them, the opinions he has formed, and the basis for these opinions are briefly set forth in this summary.

**Qualifications**

1. Henry N. Butler, J.D., Ph.D. is currently employed at Chapman University in Orange, California where he is the James Farley Professor of Economics, Dean of the George L. Argyros School of Business and Economics, and Chairman of the Law and Organizational Economics Center. He received a B.A. in economics from the University of Richmond in 1977, and M.A. and Ph.D. in Economics from Virginia Tech in 1979 and 1982, and a J.D. from the University of Miami in 1982. He has also held academic positions at Texas A&M University (1982-86), the University of Chicago (1985-86), George Mason University (1986-93), and the University of Kansas (1993-2001). Prior to joining Chapman University in July 2001, he was the Fred and Mary Koch Distinguished Professor of Law and Economics where he was tenured in both the law and business schools, and he was the Director of the Law and Organizational Economic Center (“LOEC”) at Kansas University. This center runs an economic institute for state judges. Approximately 1,000 judges from 48 states have participated in the LOEC programs since 1995.
2. Dr. Butler’s primary areas of research are antitrust, financial services, corporate governance, and the impact of government regulation on business.

3. Dr. Butler has taught a wide variety of courses in business and law schools, including antitrust law and economics, insurance law and regulations, contract, law and economics, industrial organization economics, and the legal environment of business.

### **Assignment**

1. Dr. Butler was asked to analyze the legal and economic impact of the proposed sponsored demutualization of BCBSKS and subsequent acquisition by Anthem Insurance Companies, Inc. (“Anthem BCBS”).

### **Summary of Conclusions**

2. Dr. Butler concludes that completion of the proposed transactions will be in the public interest because of their effects on competition, and on consumer welfare, will either be neutral or beneficial.
3. The Kansas health insurance market (health care financing market) reflects structural characteristics indicating the market is competitive.
4. On the supply side of the health insurance market BCBSKS has developed an extensive network of physicians, hospitals and other health care providers. These providers enter into voluntarily agreements with BCBSKS, which are presumably mutually beneficial. As a result, these provider networks are an important source of competition for BCBSKS. Provider networks in Kansas operate in such a way that other insurance companies, third party administrators, and direct employer contractors can gain access to provider networks makes the Kansas health care financing market “contestable”, which means that competition imposes a severe constraint on BCBSKS’ ability to raise prices above competitive levels.
5. On the demand side of the health insurance market, there are literally thousands of potential purchasers with health insurance policies, many of whom are sophisticated large employers who are very sensitive to their health care costs. As a result, group purchasers are highly mobile and not necessarily brand loyal. Simply stated, if prices or services are not within competitive levels, consumers of group insurance policies, and to a lesser extent individuals policyholder will switch to more competitively favorable programs.
6. The combination of contestability on the supply side and price sensitive buyers on the demand side means robust competition is present in the Kansas health insurance market.

### **Nature of Competition in the Kansas Health Insurance Market**

7. It is important to recognize that competition in the Kansas health insurance markets takes place on many dimensions. The broadest dimensions of competition are price and quality:
  - Price competition in the form of competition for writing policies by offering lower premiums, deductibles, and co-payments is probably what most people think of first when they think of competition between health insurance companies,

- Quality competition in the form of competition through covered procedures, exclusions, availability of insured services, extent of managed care, filing requirements, payment rates, customer service, and the size and scope of the provider network.
8. Market competition in general, and in particular Kansas, allows insurers to compete by offering different combinations in terms of price and quality. Indeed, many insurers (including BCBSKS) make different combinations in price and quality available to policyholders through a complete portfolio of health care coverage options to all consumer types (small and large groups, individuals and government plans).
  9. Insurers also compete through offering extensive health provider networks to potential policyholders. The breadth of the network may be considered to be more highly valued by a substantial number of consumers. Given that insurers invest millions of dollars in developing networks with health care providers, it is obvious Anthem BCBS will have a strong incentive to maintain the valuable and well-functioning network of providers that has been developed over the years by BCBSKS.
  10. The mutual interdependence of the insurers and the provider networks (health care providers and hospitals) is a competitive constraint in both markets. This is to say, that these parties voluntarily cooperate to combine health care financing with health care delivery. The exchange between insurers and provider networks in attempting to arrive at a competitive product, namely creating alternative price-quality combinations results in increased consumer welfare through variety in product line and prices. While BCBSKS has considerable market share and is the largest health insurer in Kansas, it is important to keep in mind the wide range of choices that are available to purchasers of group insurance. For example, large employers have the option of self-insurance if the market rates for additional insurance are excessive. These choices place a major constraint on the ability of BCBSKS or other carriers to charge premiums above the competitive market rate.
  11. 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. The conversion from a mutual insurer to a stock insurer cannot and does not raise any anti-competitive concerns. There is no plausible way that such a change in ownership structure will increase the market power of BCBSKS. This is merely a change in form, not a change in substance. The competitive structure of the Kansas health insurance market will be the same after the completion of the demutualization as it was before the conversion since Anthem BCBS.
  12. The proposed acquisition of BCBSKS by Anthem BCBS is not a merger of competitors because the firms do not operate in the same geographic market. Therefore, it neither increases market concentration nor threatens competition. Indeed, the acquisition by Anthem BCBS does have the potential to increase competition if potential costs savings are translated into lower rates.
  13. Competition in the Kansas health insurance market is robust. Neither BCBSKS nor Anthem BCBS can charge supra-competitive premiums, reduce

coverage or reduce services without there being a profound risk of losing a substantial amount of their business. The proposed transactions do not pose any anti-competitive threats and thus should be presumed to be in the public interest.

### **The Consumer Welfare Standard and the Public Interest**

14. The “consumer welfare standard” holds that the antitrust laws are intended to protect competition that benefits consumers. While the proposed Anthem BCBS acquisition of BCBSKS is not an anti-trust case, the application of the consumer welfare standard to the proposed transaction is useful.
15. In both instances, the conversion by BCBSKS from a mutual insurer to a stock insurer and the mere changing of the form of ownership, there are no plausible anti-competitive stories that explain how Anthem BCBS’ ownership of BCBSKS will translate into increased market power of the type that the anti-trust laws are concerned. Consumer welfare is not adversely affected.
16. Moreover, to the extent Anthem BCBS is able to achieve economies of scale in administration, the acquisition could result in lower costs to BCBSKS and lower prices to consumers. Consumer welfare would be enhanced under this scenario, because greater competitive pressure will be faced by all Kansas health insurance companies as a result of this acquisition.
17. The anti competitive concerns raised by some special interest groups – such as doctors, nurses, hospitals, and other health care providers – should be seen as efforts to protect them from competitive markets rather than efforts to promote the public welfare. These interest groups may be engaged in what economists call “rent –seeking”, the use of political activities to gain profits, or (“rent”) that they would not be able to earn through normal market exchanges. Rent seeking substitutes government coercion for voluntary market transactions. Dr. Butler opines the interest groups’ arguments presented thus far should be afforded little or no weight (unless they relate specifically to allege harm to consumers).
18. The public interest at stake in the proposed transaction is adequately protected by the competitive forces at work in the Kansas health insurance market.
19. The consumer welfare and the public interests are protected by the iron triangle of competition – competition for policyholders, competition for providers, and potential competition from new entry. Anthem BCBS must be mindful and responsive to these competitive forces.
20. BCBSKS’ conversion from a mutual insurer to a stock insurer should have no impact on the competitive position of the insurer. This occurs because the competitive pressures that serve to control price and quality prior to the demutualization will still be present after the demutualization.
21. It is tempting to think that a stock insurer must necessarily have higher premiums than a mutual insurer. After all, they must earn a profit! However, economic logic suggests that ownership form is not an important determinant of pricing because each insurer in a competitive market is a price taker. Price takers select the quantity they are willing to sell at the market price. Because 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. Thus, 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.

22. The view that shareholders demands for a return on their investment will lead to higher premiums by stock insurers and mutual insurers is flawed for the same reason. Premium competition constrains the ability of firms to charge whatever premiums their investors might theoretically desire. Although for-profit insurers may have stronger incentives to be hard bargainers in an attempt to negotiate lower fee schedules and payments to health care providers, the bottom line is that the shift from not-for-profit to for-profit does not impact the ability of such firms to negotiate more favorable terms. The reason is straightforward – the form of the insurer does not determine its market power and, thus, market power (or bargaining power) cannot be increased by merely changing the ownership status of the insurer.
23. Finally, with regard to the impact of the conversion from mutual insurer to stock insurer, it must be understood that any statements about the conversion not having an impact on premiums does not mean that the stock insurer will not charge higher premiums. The stock insurer might charge higher prices for the same reason that a mutual insurer might charge higher prices. Indeed, as long as medical trends continue to raise, prices will rise – regardless of the organizational form of the insurer.
24. The important point of Dr. Butler’s analysis is that the change in organizational form does not change the ability to increase prices above those of the competition.

#### **Is the Transaction Fair and Equitable to the Policyholders?**

25. The statutory procedure for policyholder approval of the demutualization appears to provide adequate protection to the policyholders. It is important to recognize that different policyholders might have different, yet legitimate, perspectives on the merits of the transaction. This is the very reason the statutes require policyholder approval by their vote. The voting mechanism allows a weighing of the various shareholders’ perspectives. Assuming voters have the opportunity to be fully informed, the outcome produced by the voting mechanism should be viewed as fair and equitable within the statutory framework.

#### **Beware of the Law of Unintended Consequences**

26. Several of the interveners have suggested that the Commissioner should put various restrictions on the operation of BCBSKS as a condition of the completion of Anthem BCBS’ acquisition of BSBSKS. Such proposed restrictions, although purported to be in the public interest, have the potential to distort competition in the Kansas health insurance market to the detriment of the public. Any restrictions that hobble BCBSKS’ ability to compete with other health insurers will reduce competition in the market and could result in

higher health insurance premiums for all Kansans. The unintended consequences of restrictions placed upon this transaction may be a reduction in consumer choice, and an increase in premiums – an unintended harm to an otherwise vibrant health insurance market.

**EXECUTIVE SUMMARY OF EXPERT REPORT**  
**OF PAUL J. FELDSTEIN, Ph.D.**

**Background**

Dr. Feldstein has been retained by counsel for Blue Cross and Blue Shield of Kansas as an independent expert witness. The specific issues he has been asked to address, his qualifications to address them, the opinions he has formed, and all of the basis for these opinions are briefly set forth in this summary.

**Qualifications**

1. Paul J. Feldstein is a Professor and holds the Robert Gumbiner Chair in Health Care Management at the Graduate School of Management at the University of California at Irvine since 1987. Before taking this position, he was Professor, Associate Professor, and Assistant Professor of Health Services Management and Policy for a period of 23 years at the School of Public Health and the Department of Economics at the University of Michigan in Ann Arbor.
2. Dr. Feldstein has spent the majority of his career teaching and doing research on the economics of the health care sector of the economy, including health care insurance and financing. He has published a number of articles in the field, on such topics as the factors that affect employees' decisions to switch health plans, the effect of HMO competition on private health insurance premiums, and the effect of utilization review programs on health care use and expenditures. He has written six books and the fifth edition of his textbook titled, Health Care Economics, was published in 1998.
3. Dr. Feldstein's teaching at the University of California at Irvine encompasses courses on Health Care Economics, Health Policy, and Microeconomics.
4. Dr. Feldstein has also served as a member of the board of directors of Sutter Health, a \$3 billion non-profit California health care company, Omni, a non-profit HMO, Province Healthcare, a for-profit hospital company, and he was also the Director of the Division of Research at the American Hospital Association. In addition he has served as an expert witness or consultant on a variety of health economics issues in a number of different venues.

**Assignment**

1. Dr. Feldstein was asked to analyze issues related to the effect of health plan ownership on performance.
2. The specific issues he was asked to describe are as follows:
  - Discuss how competitive markets work with respect to the health insurance market;
  - Discuss the advantages and disadvantages of both the for-profit and not-for-profit forms of ownership in health care;
  - Review the empirical literature on whether there is a difference in health plan performance between not-for-profit and for-profit health plans; and
  - Perform additional analyses of the relative performance of not-for-profit and for-profit health plans based on readily available public data.

## Summary of Conclusions

1. The market for health insurance is very price competitive. In addition to competing on their premiums (price), health insurers also compete on the basis of their provider networks and customer satisfaction.
2. Although data are published by national organizations on health plan quality and outcomes, to date these measures have not been widely used by purchasers in choosing their health plans.
3. Consolidation of health plans (as well of hospitals) has been occurring in recent years to take advantage of economies of scale and to gain market power. A health plan's market power, unlike hospitals, is severely limited by ease of entry by outside insurers, by providers establishing their own health plans, and by large employers becoming self insured.
4. There has been a recent trend in not-for-profit health plans becoming for-profit. This has particularly been the case for the Blue plans, which have been consolidating.
5. There are various advantages and disadvantages for each form of ownership. When information on quality is not readily available, consumers are more likely to rely on not-for-profit rather than for-profit hospitals and health plans. In the current marketplace, not-for-profit Blue plans are at a competitive disadvantage with their for-profit competitors in raising capital and in attracting top executives. Further, not-for-profit health plans lack outside monitoring that results in some plans being inefficient and able to pursue goals inconsistent with their subscribers' interests.
6. For-profit plans have easier access to capital, either through issuing stock or debt instruments. The apparent concern with for-profit health plans is that they will increase premiums, cut back on quality, and reduce their provider network to generate profits, which can then be paid out as dividends to their stockholders. 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.
7. The difficult financial position many health care providers claim they have found themselves in has been the result of intense health plan competition, not the form of ownership of the health plan. There is no reason to believe their financial position will worsen solely because of a change in ownership.
8. 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.
9. When just two Blue plans, Blue Shield (not-for-profit) and Blue Cross (for-profit) serving the same market (California), thus controlling for regional differences in practice patterns and other confounding factors, are examined using the same NCQA measures, it is clear that on commonly used measures of performance, the for-profit Blue plan performs better, on balance, than the non-profit Blue plan.
10. Given the competitive market in which health plans find themselves, namely, that health plans compete on the basis of price, service, and their provider network, there is no reason for a health plan that is competing successfully in the marketplace to dramatically change the basis of its success simply because of a change in it

ownership. Instead, it is likely that with a change to for-profit ownership, a health plan will attempt to build on those factors that enable it to increase its market share, namely, remaining price competitive, attempting to improve its service, and strengthening its provider network.

11. In conclusion, ownership status by itself does not appear to be a predictor of health plan performance. Of greater importance is the degree of market competition, organizational structure, and the availability of large purchasers to discipline health insurers. Thus conversion from a non-profit Blue plan to a for-profit form of ownership, by itself, should not have any adverse effect on health plan outcomes because many quality measures are heavily influenced by physicians, and the impact of changing ownership should not affect quality of care if the physician network is not substantively changed.

**EXECUTIVE SUSMMARY OF WRITTEN TESTIMONY**  
**OF JOHN W. KNACK, JR.**

**Background**

1. John W. Knack, Jr. is President and Chief Executive Officer of Blue Cross and Blue Shield of Kansas, Inc. I am responsible for directing the management of the company and for guiding the company in the development of the business plans and strategies.
2. I believe that the sponsored demutualization under the Plan of Conversion is in the best interest of our policyholders and will ensure the continuing financial strength of our company.
3. The conversion will not change any policy and contract rights. Any changes to policy benefits and premiums will continue to be governed by the terms of the policies and by applicable law.
4. Neither BCBSKS executives nor board members have been offered any financial incentives in exchange for their recommendations regarding the conversion and acquisition.

**Overview of Blue Cross and Blue Shield of Kansas**

5. My statement provides a general overview of BCBSKS. In that overview, I briefly discuss the history of BCBSKS from the 1940s to the present day.
6. In 1992, BCBSKS ceased being a non-profit organization and became a mutual life insurance company. BCBSKS is currently the largest health insurer in Kansas.

**Purpose of the Sponsored Demutualization**

7. My written statement outlines the reasons why the Company is pursuing the sponsored demutualization under the Plan of Conversion as follows:
  - The sponsored demutualization provides us 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.
  - The sponsored demutualization enables us to take advantage of economies of scale by eliminating duplicative resources and streamlining our compliance efforts in an increasingly complex regulatory environment.
  - By virtue of our becoming part of the diversified geographical base of Anthem that results from the sponsored demutualization, we will have increased flexibility in responding to localized adverse risk events, avoiding the twin perils of decreased financial stability or excessive increases in rates to avoid financial instability. A corollary of having such a diversified base would also be our ability to participate better in insurance offerings to multi-state accounts.

- We will be able to offer a greater variety of career paths to our employees, with the potential for greater and more varied challenges, which in turn should permit us to continue to attract and retain the kinds of employees needed to provide policyholders with quality service.
  - The sponsored demutualization will allow us to take advantage of best practices in health insurance from Anthem BCBS and its other health insurance affiliates.
8. After assessing the competitive conditions in the health insurance and services industry, the Company has determined that it needs to enhance its strategic and financial flexibility.
  9. During the public comment process, some individuals have raised the concerns that because “BCBSKS is not broken, the Company should not try to fix it.” However, this concern ignores the reality of the current business environment as well as the business environment nationally. If we are 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, the Company must spread its costs over a sufficiently large policyholder base.
  10. The Company’s potential customer base within the state shrinks every year as national corporations purchase or supplant local businesses.
  11. As we are unable to diversify our risks geographically, we are 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.
  12. The sponsored demutualization, in which we become a part of a substantially larger, multi-state insurer, offers BCBSKS several ways to expand its market and products, and to improve its service to policyholders. These benefits and improvements are detailed in my written statement.
  13. In addition to market access, a principal purpose of the sponsored demutualization is that Eligible Policyholders will receive a cash distribution for their otherwise illiquid membership interests pursuant to the Plan of Conversion.

**Process of the Sponsored Demutualization**

14. After negotiations and considerations of alternatives, the Company entered into the Alliance Agreement with Anthem BCBS on May 30, 2001, agreeing to a sponsored demutualization. That agreement resulted from a determination 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.
15. In pursuing the sponsored demutualization, BCBSKS management, together with a team of outside advisers, spent months working to draft the Plan of Conversion. The Board of Directors actively discussed and

resolved issues that arose in its consideration of the Plan of Conversion. The Board also heard presentations and reviewed opinions by outside advisers on various aspects of the sponsored demutualization. The Company's management team and outside advisers also engaged in extensive consultations with the Testimonial Team.

16. On October 25, 2001, the Board of Directors of BCBSKS unanimously approved the Plan of Conversion.
17. BCBSKS mailed a policyholder information statement dated November 9, 2001, to all eligible policyholders.
18. In December, the Commissioner solicited comments on the Plan of Conversion and Acquisition at five public comment meetings.
19. On January 7 through 9, 2002, the Commissioner will hold a public hearing on the Plan of Conversion in accordance with Article 40 of Chapter 40 of Kansas Statutes Annotated. On January 11, 2002, BCBSKS will hold a special meeting of policyholders to vote on the sponsored demutualization. If the Plan of Conversion is approved by the Commissioner and Eligible Policyholders, the Company will proceed with the sponsored demutualization.

#### **The Conversion and Acquisition**

20. Upon the Company's conversion to a stock company, all of BCBSKS' stock will be sold to Anthem BCBS. As a result, policyholders will receive cash consideration in exchange for their membership interests.
21. If the Plan of Conversion becomes effective, (1) BCBSKS will become a wholly-owned subsidiary of Anthem, and (2) the Company's Eligible Policyholders will receive a cash payment as consideration for relinquishing their membership interests.
22. For the plan to become effective, it must be approved by a vote of Eligible Policyholders at a special meeting and by the Commissioner following the public hearing.
23. Immediately upon effectiveness of the conversion, Anthem BCBS or a wholly owned subsidiary will purchase 100% of BCBSKS stock for \$190 million
24. The cash consideration is comprised of two elements: the Purchase Price and a Special Distribution.

**EXECUTIVE SUMMARY OF WRITTEN TESTIMONY**  
**OF MICHAEL M. MATTOX**

**Background**

1. My name is Michael M. Mattox. I am Executive Vice President of Blue Cross and Blue Shield of Kansas, Inc. Prior to serving in that position, I was the Company's Vice President of Marketing, Provider Relations and Reimbursement.
2. I hold a Bachelor of Science degree in business administration and a Bachelor of Art's degree in communication from Northwestern State University.

**Background to the Alliance Agreement**

3. On September 14, 2000, the BCBSKS Board of Directors unanimously authorized the Company's management to explore potential alliances and to proposed recommendations for such alliances.
4. The Company initiated contact with seven potential partners, including Anthem BCBS, on December 12, 2000, requesting that they submit a letter of interest regarding a potential alliance.
5. Based upon the responses from the potential partners and a series of meetings in February 2001, BCBSK management invited three parties to continue in the process, including Anthem BCBS. Management believed that these parties were most likely to offer a transaction that was in the best interest of the policyholders.
6. After further presentations and the completion of due diligence, management decided that the proposed definitive agreement with Anthem BCBS represented the best offer and recommended the Anthem BCBS proposal to the Board of Directors.
7. On May 24, 2001, the Board unanimously approved the proposed definitive agreement with Anthem BCBS and authorized management to execute it.
8. After executing the Alliance Agreement, management developed a detailed plan to convert the company from a mutual insurance company to a stock insurance company to implement the terms of the Alliance Agreement; this plan is referred to as the Plan of Conversion.
9. On October 25, 2001, the Board unanimously approved the Plan of Conversion.

**Structure of the Acquisition**

10. The acquisition is a series of related transactions from which the Company will convert from a mutual insurance company to a stock insurance company and become a direct or indirect wholly-owned subsidiary of Anthem BCBS. These transactions are more fully described in my written statement.

11. The Alliance Agreement also includes certain covenants and agreements between the parties. These covenants and agreements are likewise described in my written statement.

**Closing**

12. The acquisition will close on the earliest practicable date after the conditions to the obligations of the Parties set forth in the Alliance Agreement and the conditions set forth in the Plan of Conversion have either been satisfied or waived.
13. The Alliance Agreement provides that the Parties' respective obligations are subject to the satisfaction of several conditions to the closing. These conditions are detailed in my written statement.
14. The Alliance Agreement also provides that the Company's obligations to consummate the closing is subject to the satisfaction of several additional conditions, also detailed in my written statement.
15. To become effective, the Commissioner must approve the Plan of Conversion as well as Anthem's acquisition of control of a domestic insurer (Form A).
16. Section 40-3304(d)(1) of Kansas Statutes Annotated directs the Commissioner to approve the acquisition of control after the public hearing unless she finds that certain detrimental consequences would result from that acquisition. These potential negative consequences, which the Commissioner should examine, are enumerated in my written statement as well as K.S.A. §40-3304.
17. The Alliance Agreement gives both Parties the ability to terminate the agreement at any time prior to closing under certain conditions. Again, those conditions are enumerated in my written statement.

**EXUCUTIVE SUMMARY OF WRITTEN TESTIMONY**  
**OF DONALD R. LYNN**

**Background**

1. My name is Donald R. Lynn. I am Vice President of Finance and Treasurer of Blue Cross and Blue Shield of Kansas, Inc.

**BCBSKS Background**

2. BCBSKS was formed in 1983 by the consolidation of Blue Cross of Kansas and Blue Shield of Kansas and is currently the largest health insurer in Kansas.
3. While BCBSKS is financially sound and enjoys a strong in-state market share, the Company is not immune to the Kansas business environment. 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. This trend has caused the Company a loss of enrollment and potential growth opportunities. Additionally, census forecasts suggest only marginal growth in population in the Wichita and extreme southwest Kansas areas, and declining growth in the Company's remaining market area.
4. The Company is limited in its ability to expand geographically. The Company is unable to diversify its risks geographically.
5. These market conditions demonstrate that now is the time to affiliate with Anthem BCBS. The conversion and acquisition will address the above concerns regarding the Company policyholder base and the present market conditions in Kansas as well as nationally. Despite these market conditions, some individuals have commented that BCBSKS should take a "wait and see" approach rather than going forward with the affiliation. But such an approach is a risky one, especially in light of its possible consequences as documented in the recent history of Blue Cross and Blue Shield of Colorado.

**Sponsored Demutualization**

6. In an effort to address these changing market conditions and limitations, BCBSKS plans to convert from a mutual life insurance company to a stock life insurance company. This Plan of Conversion requires the approval of Eligible Policyholders and the Commissioner.
7. BCBSKS management believes that this conversion and affiliation with Anthem BCBS, a larger multi-state insurer, will benefit our policyholders in several ways. These benefits are detailed in my written statement.
8. The sponsored demutualization will not change policy contract rights in any respect.

## **Consideration**

9. As a result of the sponsored demutualization, Eligible Policyholders will receive cash consideration in exchange for their membership interests.
10. The cash consideration will be comprised of two elements, the Purchase Price and a Special Distribution, as more fully explained in my written statement.
11. Upon BCBSKS' conversion, Anthem BCBS will purchase 100% of BCBSKS stock for \$190 million. At closing, \$142 million of the Purchase Price will be distributed to Eligible Policyholders and BCBSKS will deposit the balance of the Purchase Price, \$48 million, into an escrow fund to address potential costs and expenses relating to the Contingent Litigation Matter. 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 subject to the determinations of the Policyholder Committee.
12. If the Plan of Conversion becomes effective, BCBSKS will make a Special Distribution to Eligible Policyholders in addition to the distribution of the Purchase Price. The Special Distribution will be equal to the amount by which the closing book value of BCBSKS exceeds \$155 million.
13. If the Plan of Conversion becomes effective, each policyholder will be entitled to receive that Eligible Policyholder's proportionate share of the Special Distribution and the Purchase Price.

## **Tax Issues**

14. Each policyholder should consult his or her own tax advisors to determine the tax consequences of a sponsored demutualization. In general, Eligible Policyholders will be taxed at capital gains rates on the cash paid to them that is treated as payment for membership interests. A portion of the amount received may be paid or treated as interest, which will be taxed at ordinary income rates. The Company will inform Eligible Policyholders of the amount, if any, of each payment to them that will be treated as interest.
15. Tax consequences to each Eligible Policyholder of payments from the escrow fund will depend on whether the Eligible Policyholder is entitled to total payments in the conversion totaling \$3,000 or less, or more than \$3,000. If that total amount is \$3,000 or less, the Eligible Policyholder will be taxed at capital gains rates on the full amount of cash received from the escrow fund in the year received. If the total amount will be more than \$3,000, the Eligible Policyholder will be taxed at capital gains rates on a portion of the cash paid from the escrow fund and the remainder of the cash paid will be treated as interest and taxed at ordinary income rates in the year of receipt.

### **Compensation of Officers and Employees**

16. 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. None of the officers or directors of BCBSKS will receive any stock, stock options, stock appreciation rights or other equity interests in Anthem BCBS as a result of the transaction. BCBSKS' employment agreements with certain officers include severance arrangements. The terms are comparable to arrangements in place for senior management of similar companies. Under these officers' employment agreements, termination of employment under certain conditions, including in certain circumstances a change of control of BCBSKS, will entitle the officer to receive certain severance payments. These arrangements will remain in place regardless of whether or not the acquisition of BCBSKS by Anthem is consummated.

### **Financial Condition of Company After Conversion and Acquisition**

17. After the sponsored demutualization, BCBSKS will meet all statutory requirements regarding its financial condition. BCBSKS will be a wholly-owned subsidiary of Anthem BCBS, one of the nation's largest health benefits companies.
18. Anthem BCBS' product portfolio includes a diversified mix of health insurance products. Anthem also offers a broad range of administration and health insurance services and partially insured products, and several specialty products including group life, disability, prescription management, workers compensation, dental and vision plans.

### **Valuation**

19. BCBSKS' financial advisor, Dresdner Kleinwort Wasserstein, Inc., performed valuation analyses of BCBSKS. In completing these analyses, this financial advisor estimated valuation ranges of BCBSKS. In estimating these value ranges, the advisor used three valuation methods: comparable company analysis; comparable transaction analysis; and discounted cash flow analysis. Under each analysis, the aggregate cash consideration provided under the Plan of Conversion was within the resulting value ranges.
20. Based in large part on these analyses, Dresdner Kleinwort Wasserstein opined that the aggregate of the Purchase Price and the Special Distribution payable to Eligible Policyholders and into the escrow fund for the benefit of Eligible Policyholders is fair to the policyholders from a financial point of view.

**EXECUTIVE SUMMARY OF WRITTEN TESTIMONY**  
**OF WILLIAM H. PITSENERGER**

**Background**

1. My name is William H. Pitsenberger. I am Vice President/General Counsel of Blue Cross and Blue Shield of Kansas, Inc.
2. I earned a Bachelor of Arts degree from the University of Kansas and a juris doctor degree from Washburn University School of Law.

**Overview of Demutualization**

3. On May 30, 2001, BCBSKS entered into an Alliance Agreement with Anthem BCBS calling for a sponsored demutualization.
4. On October 25, 2001, the Board of Directors unanimously approved the Plan of Conversion.
5. As part of the Commissioner's review, the Kansas Insurance Department held five public comment meetings in December 2001.
6. The Department will hold a hearing on the Plan of Conversion and Acquisition of BCBSKS on January 7 through 9, 2002.
7. The BCBSKS Board of Directors have called a Special Meeting and Vote on the Plan of Conversion to be held on January 11, 2002.
8. If the Commissioner and Eligible Policyholders approve the plan, and the conditions to closing set forth in the Alliance Agreement are either satisfied or waived, then 100% of BCBSKS' stock will be acquired by Anthem BCBS.

**Filing Requirements**

9. The Conversion Law of Kansas sets forth a number of procedural requirements necessary for the conversion, all of which BCBSKS has satisfied or will satisfy.

**Notice Requirements and Materials Mailed to Policyholders**

10. Over the period from 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 under Kansas law.
11. All the notice materials were reviewed and approved by the staff of the Kansas Insurance Department. The materials contained in those packages are described in my written statement.

**Conditions to Effectiveness of the Plan**

12. The Plan of Conversion provides that several conditions must be satisfied before it can become effective. These conditions are listed in my written statement.

13. The effectiveness of the Plan of Conversion is contingent upon certain conditions to the closing of the Alliance Agreement, also listed in my written statement.

#### **Effect of the Plan**

14. When the plan becomes effective, all policyholders' membership interests will be extinguished and BCBSKS will become a direct or indirect wholly-owned subsidiary of Anthem. Eligible Policyholders will receive cash compensation for the relinquishing of their membership interests.
15. Although BCBSKS will change from a mutual insurance company to a stock insurance company, policy and contract rights will not be changed as a result of the conversion and acquisition. Any changes to benefits or premiums will continue to be governed by the terms of the policy and by applicable law.

#### **Distribution of Consideration**

16. Dresdner Kleinwort Wasserstein has issued an opinion that the aggregate cash consideration payable to the Eligible Policyholders pursuant to the Plan of Conversion is fair to the Eligible Policyholders from a financial point of view.
17. In compliance with K.S.A. § 40-4002(g), the Plan of Conversion provides that an Eligible Policyholder is a person or entity that on the date that BCBSKS Board of Directors initially approved the plan, held an original insurance policy that was issued or assumed by BCBSKS.
18. Under the Plan of Conversion, Eligible Policyholders are entitled to receive their proportionate share of the aggregate cash consideration.

#### **Escrow Fund**

19. BCBSKS received a subpoena dated February 28, 2001, from the Office of the Inspector General, U.S. Department of Health and Human Services ("Contingent Litigation Matter"). The subpoena seeks documents related to an investigation of possible improper claims against Medicare. At present, the Company is not aware of any facts that would give rise to liability for any inappropriate claims made against Medicare.
20. To address the concerns of Anthem BCBS regarding potential exposure rising from the Contingent Litigation Matter, BCBSKS will deposit \$48 million of the Purchase Price into an escrow fund to pay costs and expenses attributable to the Contingent Litigation Matter.

#### **Costs Related to the Plan**

21. The Testimonial Team has retained outside advisors and consultants in connection with its review of the Plan of Conversion. The expenses attributable to those outside advisors and consultants relating to the demutualization, but not the acquisition, are being paid or reimbursed by BCBSKS in accordance with K.S.A. § 40-4013.

### **Fulfillment of Statutory Requirements**

22. The Kansas Conversion Law specifically requires a number of terms and conditions to be included in a plan of conversion. The BCBSKS Plan of Conversion satisfies all of these requirements, as explained in my written statement.
23. The Kansas Conversion Law also establishes criteria for the consideration and approval of a plan by the Commissioner. Likewise, the Company's Plan of Conversion satisfies all of these criteria: the plan of conversion is fair and equitable to policyholders; the allocation of cash consideration among Eligible Policyholders is fair and equitable; the Plan of Conversion complies with all applicable provisions of law; the compensation of persons who are executive officers of BCBSKS immediately prior to the conversion will not change solely as a result of the conversion and the plan does not unjustly enrich any officer or employee of the Company; upon conversion, the Company will have the capital that is required of a domestic stock insurer and otherwise will satisfy all requirements for transacting the business of insurance in Kansas; and the continued operations of the new stock insurer would not be hazardous to existing or future policyholders or to the public.

**EXECUTIVE SUMMARY OF WRITTEN TESTIMONY**  
**OF PAUL G. ADAMS**

**Background**

1. My name is Paul G. Adams. I am a managing director of the investment banking firm Dresdner Kleinwort Wasserstein, Inc. I have held that position since 1996 and have been the head of the firm's Health Care Group since July 1998. I focus on health care services and insurance practices and specialize in mergers, acquisitions and financings. I hold a B.S. in accounting from the University of Illinois and M.B.A. from the University of Chicago.
2. Dresdner Kleinwort Wasserstein is an investment banking firm engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwriting, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes.
3. BCBSKS selected my firm to advise it on pursuing a strategic partnership because we are a nationally recognized investment banking firm and because of our experience in the valuation of companies, including companies in the health care industry.

**Summary of Dresdner Kleinwort Wasserstein's Engagement by BCBSKS**

4. On May 24, 2001, we issued an opinion as to the fairness, from a financial point of view, of the Purchase Price payable to BCBSKS' Eligible Policyholders pursuant to the Alliance Agreement.
5. As required by the Plan of Conversion, we issued a second opinion to the BCBSKS board dated November 9, 2001, confirming the fairness of the aggregate of the Purchase Price and the Special Distribution payable to Eligible Policyholder and into the escrow fund.

**Review of BCBSKS' Business by Dresdner Kleinwort Wasserstein**

6. In connection with the May 24, 2001 fairness opinion, we reviewed certain financial, industry and market information with respect to BCBSKS.
7. Prior to delivering the November 9, 2001 fairness opinion, we reviewed BCBSKS' current financial condition and business prospects.

**Consideration Payable to Eligible Policyholders**

8. The cash consideration payable to Eligible Policyholders under the Plan of Conversion has two elements: (1) Eligible Policyholders will receive the Purchase Price of \$190 million, subject to certain contingencies, and (2) Eligible Policyholders will receive a Special Distribution, estimated to be \$131 million.
9. It is our opinion that the aggregate of the Purchase Price and the Special Distribution is fair to the Eligible Policyholders from a financial point of view.

**BCBSKS Valuation**

10. Dresdner Kleinwort Wasserstein used three methods to determine an appropriate valuation range for BCBSKS: comparable company analysis; comparable transaction analysis; and discounted cash flow analysis.
11. In each case, we calculated a range of BCBSKS' enterprise and transaction value.
12. Based upon these three methods, we determined that the range of BCBSKS' enterprise value was \$93 million to \$232 million, and the range of its transaction value was \$224 million to \$363 million.
13. Based upon these analyses, it is our opinion that the aggregate of the Purchase Price and Special Distribution is fair to Eligible Policyholders.

**EXECUTIVE SUMMARY OF WRITTEN TESTIMONY**  
**OF DANIEL J. McCARTHY**

**Background**

1. My name is Daniel J. McCarthy. I am a consulting actuary in the New York City office of Milliman USA, Consultants and Actuaries.
2. I have been a consulting actuary at Milliman's since 1972. I have a Bachelor of Science degree in mathematics from Fordham University.
3. I am a Fellow by examination of the Society of Actuaries and have served as a member of its Board of Governors. I am also a member of the American Academy of Actuaries and currently serve as its President and a Member of its Board of Directors.
4. Since joining Milliman in 1972, I have directed a number of our firm's major consulting assignments for insurance companies.
5. Milliman has served as actuarial advisor to BCBSKS in connection with the company's Plan of Conversion.

**Responsibilities in BCBSKS' Demutualization**

6. I directed the work of Milliman in our assignment with BCBSKS developing and implementing the actuarial concepts and principals involved in the allocation of policyholder consideration under the Plan of Conversion.
7. I provided an actuarial opinion, dated October 25, 2001, to BCBSKS' Board of Directors concerning the fairness of the allocation of consideration among Eligible Policyholders and the appropriateness of excluding a Closed Block provision under the Plan of Conversion.

**Distribution of Consideration**

8. The Plan of Conversion provides for distribution to Eligible Policyholders of consideration comprised of a Special Distribution and the Purchase Price. The amount of such consideration distributed to each Eligible Policyholder is expressed as that Eligible Policyholder's proportionate share of the total amount of consideration distributed to all Eligible Policyholders.
9. The Variable Share of the distribution is the majority of the consideration to be distributed to Eligible Policyholders, comprising 2/3 of the total. Its allocation among the Eligible Policyholders is based on an "actuarial contribution method," which takes into account both historical contributions to surplus since BCBSKS became a mutual insurance company in mid-1992 and anticipated future contributions to surplus. This method is recognized in the actuarial literature as an appropriate allocation method.
10. The allocation of the Fixed Share component accounts for 1/3 of the total amount of consideration to be distributed to Eligible Policyholders. Under this component, each Eligible Policyholder is allocated the same

proportionate share of the consideration without regard to the actuarial contribution of the policy. This component of the allocation ensures that each Eligible Policyholder will receive some distribution.

11. In my opinion, it is appropriate and consistent with the general guidance provided in ASOP 37, that the Fixed Share be larger in this instance than has historically been the case in other demutualizations in the United States. There are two principal reasons for this view. First, based on an estimate of the anticipated total amount of distribution, the total of the actuarial contributions will be less than 2/3 of the amount distributed. Second, 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.
12. A portion of the Purchase Price will be deposited in the escrow fund and distributed to Eligible Policyholders after satisfaction of certain liabilities and expenses. I believe that this is a fair and equitable way to deal with the uncertainty of the escrow fund distribution.

### **Opinions**

13. 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.
14. 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.
15. The Plan of Conversion's allocation of consideration is fair and equitable to the Eligible Policyholders.

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**CERTIFICATE OF SERVICE**

I, the undersigned, certify that a true and correct copy of the foregoing document, has this \_\_\_\_\_<sup>th</sup> day of December, 2001, been sent by United States mail, postage prepaid, to the below identified counsel or parties.

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