

BEFORE THE COMMISSIONER OF INSURANCE STATE OF KANSAS

IN THE MATTER OF THE CONVERSION AND ACQUISITION
OF BLUE CROSS AND BLUE SHIELD OF KANSAS, INC.

CASE NO. 3014-DM

PREFILED TESTIMONY OF KATHY GREENLEE

Credentials

Q. Please state your name.

A. Kathy Greenlee.

Q. Please identify your employer and state your position.

A. I am General Counsel to the Kansas Insurance Department (AKID@).

Q. Please describe your professional background.

A. I have been with KID for almost seven years where, among other things, I consult with and advise the Commissioner of Insurance on a broad range of regulatory and policy issues. I currently supervise 15 legal division staff, including six attorneys. Prior to serving as General Counsel, I served as Director of the Consumer Assistance Division of KID. As Director, I handled complex consumer complaints involving all lines of insurance, informed the Commissioner and department staff of complaint trends or developing issues, and recommended legislative initiatives, among other assignments. Prior to my engagement with KID, I served as Assistant Attorney General with the Kansas Office of the Attorney General from 1991 to 1995.

I am Chair of the NAIC Managed Care Organization working group, have authored sections of the Kansas Long-Term Care Handbook for the Kansas Bar Association, and have made numerous presentations at multiple professionals seminars on various insurance issues, including health insurance issues. I received a B.S. from the University of Kansas in 1985 and J.D. from the University of Kansas School of Law in 1988.

Q. Are you familiar with the Plan of Conversion filed with KID by Blue Cross and Blue Shield of Kansas, Inc. (ABCBSKS@) dated October 25, 2001 (APlan of Conversion@), and the Form A filed with KID by Anthem Insurance Companies, Inc. (AAnthem@) for the acquisition of control of BCBSKS by Anthem (collectively referred to as the AProposed Transaction@)?

A. Yes I am.

Q. If I refer to the Plan of Conversion and the Form A as the Proposed Transaction will you understand that I am referring to those filings and, when the question indicates, the corresponding predecessor drafts and amendments?

A. Yes.

Q. Are you ready to provide testimony regarding the Proposed Transaction?

A. Yes.

Summary of Testimony

Q. Please summarize your testimony briefly.

A. The KID was first advised of BCBSKS= Proposed Transaction in May, 2001. Since that time, KID has retained several accounting, actuarial, investment banking, legal, and tax consultants (collectively, along with me and other members of KID, the "Testimonial Team") to assist it in evaluating the Proposed Transaction. The Testimonial Team has engaged in a review and analysis of the Proposed Transaction, including, but not limited to, extensive analyses of the voluminous information provided by BCBSKS and Anthem. In addition, members of the Testimonial Team have engaged in numerous telephone conferences, meetings, and written correspondence with BCBSKS and Anthem representatives and consultants regarding the various elements of the Proposed Transaction.

The work of the Testimonial Team was designed to reach a determination as to whether the Proposed Transaction would violate any of the statutory requirements to which it is subject under applicable provisions of the Kansas Insurance Code. In this regard, it should be noted that the Proposed Transaction is complex, and in the course of the Testimonial Team=s review, numerous legal and other issues were identified, researched, and discussed in sufficient depth to arrive at our conclusions. Moreover, during the course of the Testimonial Team=s review, the Proposed Transaction was amended and revised requiring further review. After fully reviewing the Proposed Transaction, the Testimonial Team has concluded that the Proposed Transaction is likely to result in increases in BCBSKS= premium rates, above those that would occur in the absence of the transaction ("additional rate increases@). These additional rate increases are likely to be of sufficient magnitude to justify a finding that they outweigh any benefits expected from the conversion. In the absence of adequate evidence to the contrary presented at the Evidentiary Hearing, the Commissioner would therefore be justified in concluding that, on that basis, the Plan will not be fair and equitable to policyholders and instead may be hazardous or prejudicial to the insurance-buying public.

Aside from the issue of additional rate increases, it appears that the proposed conversion and acquisition satisfy the applicable statutory requirements. However, if the Commissioner determines that the conversion and the acquisition should be approved, the Testimonial Team recommends that the approval be conditioned on certain matters described more fully below.

Unless otherwise indicated, references to Awe@ or "our@ herein refer to the Testimonial Team.

To the extent I employ the use of undefined capitalized terms, I intend to ascribe the same meaning to such terms as does the Plan of Conversion, the Alliance Agreement between BCBSKS and Anthem dated May 30, 2001 (AAlliance Agreement@), and the exhibits to both documents.

Formation of the Testimonial Team

Q. When did you first learn that BCBSKS was seeking to demutualize and be acquired by Anthem?

A. BCBSKS submitted the draft Plan of Conversion to KID on May 31, 2001.

Q. Were the Proposed Transaction documents that were forwarded to KID on May 31, 2001, similar to the Proposed Transaction documents now pending before the Commissioner?

A. Somewhat. Over the ensuing months, the Proposed Transaction has undergone a number of substantial changes.

Q. What did KID do when it first learned of the Proposed Transaction?

A. KID formed the Testimonial Team to review the Proposed Transaction so that we could advise the Commissioner, at the appropriate time, of our conclusion as to whether or not the Proposed Transaction complied with applicable insurance standards and law. Accordingly, the Testimonial Team retained a number of experts and consultants to assist in the review of the Proposed Transaction. In accordance with statutory provisions, BCBSKS and Anthem will underwrite the expense of such consultants and experts.

Q. Please describe the Testimonial Team that was assembled for the review of the Proposed Transaction.

A. The Testimonial Team, of which I am in charge, includes members of KID=s own staff and outside consultants. Testimonial Team members from KID=s staff consist of Ms. Linda Sheppard, Assistant General Counsel, Mr. Don Gaskill, Chief Financial Examiner, Mr. Tom Foley, staff actuary, and myself. The Testimonial Team first retained Mr. Patrick Cantilo, Mr. Pierre Riou, and Ms. Leanne Foster of Cantilo & Bennett, L.L.P. who assisted in the engagement of other members of the Testimonial Team and have provided legal, regulatory and review oversight advice. The other principal consultants include Mr. Kenneth Beck, Mr. Robert Matczak, Ms. Jean Wodarczyk, and Ms. Sandra Hunt of PricewaterhouseCoopers, LLP (APwC@) who provided actuarial consultation; Ms. Denise Essenberg, Mr. Joseph Duffy, Mr. Roger McArt and Mr. John Wohletz of PwC who provided accounting and auditing consultation; Mr. William Harrington, Mr. Peter Rubinas, and Mr. Jason Weile of PwC, who provided informational technology consultation; Mr. Peter Winslow, Mr. Mark

Kovey, and Ms. Lori Brown of Scribner, Hall & Thompson, LLP (AScribner@) who provided tax consultation; and Mr. David Platter, Mr. David Grill, Mr. Neal Jacobs, Mr. James Farrell, and Mr. Michael Fairchild of Bear, Stearns & Co. Inc. (ABear Stearns@) who provided investment banking consultation.

Q. Please explain who coordinated and supervised the work of the Testimonial Team.

A. I have supervised and coordinated the work of the Testimonial Team=s consultants since their engagement.

Q. Have the Testimonial Team=s consultants been retained by BCBSKS or Anthem or have they otherwise been required to report to BCBSKS or Anthem?

A. No. At all times, the Testimonial Team=s consultants have been engaged exclusively by KID to review the Proposed Transaction and have not been required to report to BCBSKS or Anthem in any respect.

Q. Please describe the goals of the Testimonial Team in its review of the Proposed Transaction.

A. Principally, the Testimonial Team goal was to review the Proposed Transaction and report to the Commissioner its observations as to whether, pursuant to K.S.A. ' ' 40-4004(a) and 40-3304(d)(1):

1. The Plan of Conversion is fair and equitable to policyholders;
2. the Plan of Conversion complies with the provisions of the conversion statute;
3. the Plan of Conversion does not unjustly enrich any director, officer, agent or employee of BCBSKS;
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;
5. after the change of control BCBSKS would be able to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed;
6. Anthem=s financial condition would not jeopardize the financial stability of BCBSKS or prejudice the interest of its policyholders;
7. Anthem=s plans or proposals to liquidate BCBSKS, sell its assets or consolidate or merge it with any person, or to make any other material changes in its business or

corporate structure or management, are not unfair or unreasonable to BCBSKS= policyholders or adverse to the public interest;

8. the competence, experience, and integrity of those persons who would control the operation of BCBSKS are such that it would not be adverse to the interest of BCBSKS= policyholders and of the public to permit the acquisition of control; and
9. the acquisition is not likely to be hazardous or prejudicial to the insurance-buying public.

Review Process

Q. Please describe the process by which the Testimonial Team reviewed the Proposed Transaction.

A. Beginning in June of 2001, BCBSKS and Anthem provided the Testimonial Team materials regarding the Proposed Transaction, with emphasis on data concerning how the membership interests would be liquidated. The materials distributed by BCBSKS and Anthem and their representatives included actuarial, accounting, legal, tax, and other reports and compilations, which were in turn reviewed by the appropriate members of the Testimonial Team. At various times, when the information provided by BCBSKS or Anthem required clarification or elaboration, with my approval, members of the Testimonial Team communicated with BCBSKS and/or Anthem and their representatives either in person, in writing, or by telephone to obtain such clarification and elaboration.

Q. Did the Testimonial Team assist BCBSKS or Anthem in the design and structuring of the Proposed Transaction?

A. No. At all times the Testimonial Team made it clear to BCBSKS and Anthem and its representatives that the Testimonial Team would not participate in the design or the structure of the Proposed Transaction. Rather the Testimonial Team confined itself to a review of the Proposed Transaction in light of the applicable legal standards. In particular, it was not part of the Testimonial Team=s purpose to maximize the efficiency, profitability, marketability or competitive advantage of the Proposed Transaction.

Q. Did the Testimonial Team provide comments and suggestions to BCBSKS and Anthem regarding the Proposed Transaction?

A. Yes. At various times during our review process when it appeared to the Testimonial Team that elements of the Proposed Transaction might be deemed unfair, unreasonable, or inequitable to the policyholders, or otherwise inconsistent with the public interest, we so advised BCBSKS, Anthem, or both as the situation warranted providing them an adequate opportunity to consider whether they wished to revise the Proposed Transaction in response to our comments or concerns.

Description of the Proposed Transaction

Q. Please describe briefly your understanding of the Proposed Transaction.

A. I understand that, under the Proposed Transaction, BCBSKS proposes to convert from a mutual insurer owned by its policyholders to a stock insurer (or demutualize) and become a wholly owned subsidiary of Anthem. This type of transaction is often referred to as a sponsored demutualization. Eligible policyholders would receive cash in exchange for their membership interests in BCBSKS. The demutualization is contingent upon Anthem's purchase of all of BCBSKS' outstanding stock for \$190 million, of which \$142 million would be distributed to Eligible Policyholders. The remaining \$48 million of the purchase price would be deposited into an Escrow Fund pending the resolution of the Contingent Litigation Matter (ACLM). Amounts left in the Escrow Fund after that resolution and satisfaction of certain related liabilities, would also be distributed to Eligible Policyholders. In addition, it is my understanding that the BCBSKS Board has approved a special distribution to Eligible Policyholders equal to the amount by which the Closing Book Value exceeds \$155 million should the Commissioner approve the Proposed Transaction.

Q. Could you briefly describe your understanding of the CLM to which you refer above?

A. The CLM refers to an investigation related to a subpoena dated February 28, 2001, that the Company received from the Office of the Inspector General, U.S. Department of Health and Human Services pursuant to 5 U.S.C. App. 3 § 6(a)(4). The subpoena seeks documents related to an investigation of possible improper BCBSKS claims against Medicare. The parties' use of the Escrow Fund was intended to permit pursuit of the proposed transaction without the need for final resolution of the CLM, which may take several years. The \$48 million in escrow would be used to pay all costs, expenses, and liabilities related to the CLM, to pay related taxes which might become payable, and to pay all costs and expenses (including taxes) of the escrow. A Policyholder Committee would be charged with oversight of the Escrow Fund.

Changes to the Plan

Q. During the course of, or as a result of, the work performed by the Testimonial Team in its review of the Proposed Transaction, were any changes made to the Plan?

A. Yes.

Q. Would you briefly summarize those changes?

- A. Yes. I will not attempt to recount each and every change made in the course of our review, but I will describe what I believe are the most significant changes made during the process of the Testimonial Team's review and work performed. I should note that some changes made by BCBSKS and Anthem as a result of the Testimonial Team's comments were to the structuring of the Proposed Transaction and its component parts, while other changes focused on improvements in the process of fully informing policyholders and other interested persons of the risks and consequences associated with the Proposed Transaction. I will begin by summarizing changes made to the structure of the Proposed Transaction.

First, the Plan originally provided that the Policyholder Committee, which is to oversee the Escrow Fund and the conduct of the CLM, was to be appointed by BCBSKS' Board of Directors and was to consist of five individuals who were members of the Board immediately prior to the Closing Date and who were acceptable to Anthem. The Testimonial Team expressed concerns that the Policyholder Committee would not actually include policyholders, but only former Board members. Consequently, BCBSKS amended the Proposed Transaction to provide that the Policyholder Committee would be appointed by the Commissioner and include five members, all of whom shall be insureds of BCBSKS, provided that at least two of the initial members of the Policyholder Committee would be selected from a slate recommended by the Board prior to the Closing Date. In addition, the Plan was amended to strengthen the Commissioner's oversight over the Policyholder Committee and to empower the Policyholder Committee to select its own accountants and other advisors.

Secondly, the Testimonial Team expressed serious concerns about the original proposal to place the entire \$190 million purchase price into the Escrow Fund pending final resolution of the CLM. After joint discussions and subsequent comments and concerns raised by the Testimonial Team, the parties decided to reduce the portion of the \$190 million to be placed in escrow pending final resolution of the CLM from the entire \$190 million to \$48 million, enabling \$142 million of the Purchase Price to be distributed to Eligible Policyholders, together with the Special Distribution, as soon as reasonably practicable after resolution of the Final Closing Balance Sheet. In addition, the Plan was amended to insure that the Special Distribution would consist of the entire amount by which the Closing Book Value exceeds \$155 million, rather than, as originally proposed, allowing the Special Distribution to consist of some lesser portion of that amount, with a deferred Additional Purchase Price equal to 30% of the Closing Book Value in excess of \$155 million after payment of the Special Distribution.

Lastly, several enhancements were made to the methodology for calculating the allocation of the Special Distribution and Purchase Price among individual policyholders due to the work of our actuarial consultants. The details of those changes are fully explained in Mr. Ken Beck's testimony.

Because the Proposed Transaction requires both the approval of the Commissioner and an approval vote by Eligible Policyholders, the Testimonial Team made numerous comments pertaining to the various drafts of the Policyholder Information Statement and other disclosure documents, press releases, and other communications proposed by BCBSKS to be used in connection with their policyholder vote solicitations. In this regard, I believe it is fair to say that the comments of the Testimonial Team prompted BCBSKS to change substantially the Policyholder Information Statement and other materials which now more completely describe the potential risks involved with the Proposed Transaction. Specifically, the draft Policyholder Information Statement was amended to disclose as an additional risk factor that the Proposed Transaction, if approved, could result in future premium increases and other changes intended to increase profitability. BCBSKS also amended the Policyholder Information Statement to provide enhanced disclosures of the tax treatment, for policyholders, of the Special Distribution and distribution of the Purchase Price.

Q. Are you satisfied that, as of the date of this testimony, BCBSKS has responded to all of the Testimonial Team=s risk-related comments in the Policyholder Information Statement?

A. Yes.

Conclusion

Q. As a result of its work, has the Testimonial Team reached any conclusions with respect to the Proposed Transaction?

A. Yes. The Testimonial Team has concluded that the Proposed Transaction is likely to result in material increases in BCBSKS= premium rates, above those that would occur in the absence of the transaction. Apart from those additional rate increases, we do not believe that any aspect of the Proposed Transaction would violate any applicable statutory standards and, therefore, may be approved by the Commissioner subject to certain conditions described below. Specifically, the new stock insurer, after the change of control, would meet minimum requirements to be issued a certificate of authority by the Commissioner to transact business in this state, and to write the lines of insurance for which it is presently licensed, and the continued operations of the new stock insurer would not be hazardous or prejudicial to existing or future policyholders or the public. Anthem has represented, in Item 5 of its Form A, that it has no present plans or proposals to liquidate BCBSKS, sell its assets (other than such sales of assets as may be contemplated in the ordinary course of BCBSKS' business) or consolidate or merge it with any person, or to make any other material changes in its business or corporate structure or management. The Testimonial Team has no reason to believe otherwise. Therefore, the Testimonial Team does not believe that there is an issue as to whether any such plans or proposals would be unfair and unreasonable to BCBSKS' policyholders or not in the public interest.

Detailed conclusions from our investment banking consultants are presented in Mr. David Platter=s testimony, from our accounting and informational technology consultants in Ms. Denise Essenberg=s testimony, from our tax consultants in Mr. Mark Kovey=s testimony, from our actuaries in Mr. Kenneth Beck=s testimony, and from our market impact advisors in Ms. Sandra Hunt=s testimony.

Q. Did the Testimonial Team examine the integrity of those persons who would control the operation of the insurer after consummation of the Proposed Transaction?

A. Yes. Members of the Testimonial Team from KID processed the names of Anthem=s senior management members, as provided in Anthem=s Form A filing, through the sources upon which it relies customarily for such analysis. That review did not yield any material negative findings such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control.

Q. Has the Testimonial Team worked with the intervenors in this case?

A. To the extent reasonably possible, the Testimonial Team has sought to provide the intervenors information that would reflect the analysis by the Testimonial Team of issues of concern to the intervenors. In addition the Testimonial Team has sought to assist the intervenors in collecting information for their own review. As part of these efforts, members of the Testimonial Team have met, and communicated by other means, with the intervenors and their representatives and have strived to provide them early reports of the Testimonial Team=s own review.

Q. What recommendation does the Testimonial Team offer the Commissioner regarding approval of the Proposed Transaction?

A. In a perfect world, the Testimonial Team=s review would have resulted in an unequivocal favorable or negative recommendation. The nature of this transaction does not permit such a definitive conclusion.

As detailed more fully in the materials submitted by Bear Stearns and in the Testimonial Team=s brief, the Purchase Price to be paid by Anthem can be deemed to fall within the range of fair market values if an assumption is made that BCBSKS will not, after completion of the transaction, realize material underwriting gains. On the other hand, as explained in Ms. Sandra Hunt=s report, there is little reason to believe that Anthem will not be forced to raise premium rates so as to satisfy its investors= expectations of such gains. There has been no showing that Anthem can generate the expected profits in any other way.

Moreover, neither Blue Cross nor Anthem has identified clear benefits to policyholders from the conversion. The principal reasons articulated for the Plan are much more focused on traditionally corporate interests, such as accumulation of capital for acquisitions and other corporate needs, preservation of market positions, enhancing career paths, and the like.

In the final analysis, it appears very probable that the Proposed Transaction will result in additional rate increases above the already inevitable increases produced by market and economic conditions. It is hard to justify imposing those increases on policyholders for the benefit of the goals articulated as motivation for the conversion. But the balancing of these competing interests is ultimately the prerogative of the Commissioner, informed by the evidence and argument produced by all the parties. On the state of the record as it currently exists, the Testimonial Team believes the exercise of the Commissioner's discretion could justify either approval of the Proposed Transaction or its rejection as unfair because of the additional rate increases.

Q. If the Commissioner determines that the Proposed Transaction should be approved, does the Testimonial Team recommend that the approval be conditioned in any way?

A. Yes. The Testimonial Team recommends that any approval be conditioned as follows:

1. That Blue Cross demonstrate that the amount of consideration to be provided by BCBSKS to Eligible Policyholders will be at least the amount of its statutory surplus on the Effective Date. This is an accounting determination that the Testimonial Team expects the parties will be able to satisfy upon closing of the transaction.
2. That Anthem confirm in writing that it will guarantee all insurance obligations of BCBSKS. Although Anthem has expressed its intent to adhere to the conditions of the Blue Cross Blue Shield Association licensing agreement, the Testimonial Team believes a more precise commitment would be appropriate, which would not be dependent on changes that may be made by Blue Cross Blue Shield Association in the future.
3. That, contrary to Section 6.3(f) of the Plan of Conversion, the appointments by the Commissioner to the Policyholder Committee not be required to *be reasonably acceptable to* Anthem. Anthem as the purchaser cannot demonstrate a stake in the management of these policyholder funds that justifies such an overarching "veto" power.
4. That the Policyholder Committee have the power to review the tax returns filed for at least the first three tax years following the Conversion Date to ensure that no amount of taxes paid during the last year preceding the Conversion Date is refunded to BCBSKS when, if those taxes had not been paid prior to the Conversion, a larger Special Distribution would have been paid to the Eligible Policyholders under the formula.
5. That all tax refunds received by BCBSKS after the Conversion for taxes paid in tax years preceding the Conversion be deposited into the Escrow Fund to benefit the

Eligible Policyholders unless the amount of such refund was reflected as an asset on the Closing Balance Sheet.

6. That BCBSKS and Anthem develop an acceptable method for handling the requirement that interest paid to the Eligible Policyholders be reported to the IRS.
7. That Anthem advise unequivocally whether it intends to deduct for tax purposes the Special Distribution or the Purchase Price paid to the Eligible Policyholders. While the Testimonial Team believes that such a deduction is improbable, if it is obtained there will be a material issue concerning to whose benefit it should inure.
8. That the allocation of consideration to the Eligible Policyholders be implemented in accordance with the actuarial model, principles and formulas upon which the consulting actuaries for the Testimonial Team and BCBSKS have agreed. The actuarial review has been accelerated and is not fully complete. It is important that the principles upon which the parties have agreed actually govern the distribution of policyholder consideration.

Q. Does that conclude your testimony today?

A. Yes.

Thank you Ms. Greenlee.