

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

WRITTEN STATEMENT OF WILLIAM H. PITSEMBERGER

**I. Background**

My name is William H. Pitsenberger. I am Vice President/General Counsel of Blue Cross and Blue Shield of Kansas, Inc. (“BCBSKS” or the “Company”). I have held that position since 1984, and have been with the Company since 1978. Prior to joining the BCBSKS, I was a Policy Examiner/Law Clerk for the Kansas Insurance Department. I earned a bachelor of arts degree from the University of Kansas and a juris doctor degree from Washburn University School of Law. I am admitted to practice before the bar of the Kansas Supreme Court; the U.S. District Court, 10<sup>th</sup> Circuit Court of Appeals; and the Supreme Court of the United States. In addition, I am a member of the American Bar Association; the American Health Lawyers Association; the American Corporate Counsel Association; the American Society of Corporate Secretaries; the National Association of Corporate Directors, and the Kansas Bar Association.

My statement addresses certain legal aspects of the proposed conversion of BCBSKS from a mutual life insurance company to a stock life insurance company, a process known as “demutualization.” This type of transaction is expressly authorized and governed by Article 40 of Chapter 40 of Kansas Statutes Annotated, as amended, which I

will refer to as the “Conversion Law.” Upon conversion, pursuant to the Alliance Agreement between Anthem Insurance Companies, Inc. (“Anthem”) and BCBSKS (the “Alliance Agreement”), dated as of May 30, 2001, as amended as of September 28, 2001 and November 9, 2001, Anthem West, Inc., a subsidiary of Anthem, will acquire 100% of BCBSKS stock, making the Company an indirect, wholly-owned subsidiary of Anthem. This process of conversion and acquisition is called a “sponsored demutualization.”

## **II. Overview of Demutualization**

I will begin by briefly addressing the five principal steps involved in our proposed sponsored demutualization.

*First*, on May 30, 2001, with the approval of the Board of Directors, BCBSKS entered into an Alliance Agreement with Anthem calling for a sponsored demutualization.

*Second*, BCBSKS’ Board of Directors unanimously approved the Plan of Conversion on October 25, 2001. The Plan of Conversion sets forth the terms and conditions under which the BCBSKS Membership Interests of Eligible Policyholders will be exchanged for cash.<sup>1</sup>

*Third*, the Plan of Conversion and related materials have been submitted to the Commissioner of Insurance (the “Commissioner”) of the Kansas Insurance Department (the “Department”) for her review. As part of the Commissioner’s review, the Department held five Public Comment Meetings in December 2001. In addition, the

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<sup>1</sup> Capitalized terms used in this statement, unless otherwise defined herein, have the meanings set forth in the Plan of Conversion.

Department will hold a Public Hearing on the Plan of Conversion and Acquisition of BCBSKS on January 7 through 9, 2002 (the “Public Hearing”) in accordance with K.S.A. § 40-4004(a). Eligible Policyholders and other interested persons have the opportunity to comment on the Plan of Conversion orally or in writing. We hope and expect that after the review process, the Commissioner will issue an order approving the Plan.

*Fourth*, the BCBSKS Board of Directors has called a Special Meeting and Vote (the “Special Meeting”) on the Plan of Conversion of Blue Cross and Blue Shield of Kansas, Inc., to be held on January 11, 2002, in Topeka, Kansas. In accordance with the Conversion Law, the Plan of Conversion may not proceed unless it receives the affirmative vote of two-thirds of at least 15 Eligible Policyholders of BCBSKS entitled to vote on the Plan, unless a majority of all Eligible Policyholders vote, in which case a majority of those voting will constitute approval. Eligible Policyholders are entitled to one vote each on the Plan of Conversion and may cast it by proxy or in person at the Special Meeting.

*Fifth*, if the Commissioner and the Eligible Policyholders approve the Plan, and the conditions to closing set forth in the Alliance Agreement between BCBSKS and Anthem are either satisfied or waived, then 100% of BCBSKS’ stock will be acquired by Anthem. The successful sale of BCBSKS stock to Anthem is a condition to the effectiveness of the Plan.

### **III. Filing Requirements**

The Conversion Law sets forth a number of procedural requirements, all of which BCBSKS has satisfied or will satisfy. In accordance with K.S.A. § 40-4002(a),

BCBSKS' Board of Directors unanimously approved the proposed Plan of Conversion on October 25, 2001. The Company submitted the Plan of Conversion to the Commissioner for approval on October 26, 2001, pursuant to K.S.A. § 40-4002(c). BCBSKS also has filed all additional information requested by the Department to date. Upon approval of the Plan of Conversion by the Commissioner and the requisite number of Eligible Policyholders, the Company will file it in the office of the Commissioner. Within twenty four hours after the Commissioner issues a certificate of authority to BCBSKS, the Company will file a certified copy of its Restated Articles of Incorporation with the Kansas Secretary of State.

#### **IV. Notice Requirements and Materials Mailed to Policyholders.**

Over the period from November 19, 2001 through November 27, 2001, and (for a small group of policyholders in a subsequent mailing) on December 12, 2001, in accordance with K.S.A. §§ 40-4004 and 40-4005, our by-laws and the Plan of Conversion, BCBSKS sent a package of notice materials by first-class mail to the address of each Eligible Policyholder as it appears on BCBSKS' records. All the notice materials (other than the return envelope) were reviewed and approved by the staff of the Department acting on behalf of the Commissioner. The materials consist of:

- A booklet titled "Policyholder Instruction Guide and Q/A," which provides key information about the Plan in a concise, reader-friendly format;
- A set of three cards, consisting of a form of written proxy complying with K.S.A. § 40-4002(d) for voting on the plan, a taxpayer identification number card, and a member record card;
- A pre-addressed return envelope, for returning the proxy card and taxpayer identification number card; and

- A Policyholder Information Statement in a form satisfactory to the Commissioner, including a detailed description of the Plan of Conversion and a copy of the Plan, as well as other information necessary to Eligible Policyholders' understanding of the conversion and the acquisition. Included with the Policyholder Information Statement were a notice of the Special Meeting and a notice of the Public Hearing in a form satisfactory to the Commissioner.

In addition, "Plan 65" policyholders received a four-page leaflet providing assurances from the Company regarding their coverage and services.

A copy of all of these materials, with an affidavit confirming mailing, will be submitted to the Commissioner as part of the record of this proceeding.

#### **V. Conditions to Effectiveness of the Plan**

The Plan of Conversion provides that several conditions must be satisfied before it can become effective. Among these are the following: (1) the Commissioner must approve the Plan of Conversion; (2) the Plan must be approved by two-thirds of the Eligible Policyholders who vote at the Special Meeting, or if a majority of Eligible Policyholders vote, by a majority of that ballot; (3) BCBSKS must receive certain tax opinions from counsel; (4) the Company must receive assurances from the Securities and Exchange Commission or an opinion from legal counsel regarding the status of the Escrow Fund; (5) the Company must receive an opinion from Dresdner Kleinwort Wasserstein confirming the fairness, from a financial point of view, of the Purchase Price and the Special Distribution to Eligible Policyholders; and (6) Anthem must acquire 100% of the Company's stock. We have received the opinion referred to in 5 above, a copy of which is attached to the Policyholder Information Statement.

In addition, the effectiveness of the Plan of Conversion is contingent upon certain conditions to the Closing of the Alliance Agreement. Those conditions include the following: (1) any applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 as amended must have expired or have been terminated; (2) no actions have been commenced by or before any governmental authority against either BCBSKS or Anthem that are reasonably likely to make the transactions contemplated by the Alliance Agreement illegal or impossible to consummate or to have a Material Adverse Effect on either party; and (3) BCBSKS and Anthem have each individually satisfied certain conditions.

BCBSKS' Board of Directors has the right to withdraw the Plan of Conversion at any time prior to receiving a certificate of authority from the Commissioner.

## **VI. Effect of the Plan**

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. Membership Interests include any voting rights, assessment rights, and rights to share in the Company's surplus. As compensation for relinquishing those Membership Interests, Eligible Policyholders will receive cash consideration. The Plan of Conversion will become effective at 11:59:59 p.m. on the date that the Commissioner issues a new certificate of authority to the Company (the "Conversion Date"). 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 the acquisition. As

always, any changes to benefits or premiums will continue to be governed by the terms of the policy and by applicable law.

## **VII. Distribution of Consideration**

As provided in the Conversion Law, if the Plan of Conversion becomes effective, Eligible Policyholders are entitled to receive cash consideration in exchange for their Membership Interests in the Company. 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. As discussed in greater detail in the written testimony of Mr. Paul Adams, Dresdner Kleinwort Wasserstein, our financial advisor, 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.

Under the Plan of Conversion, Eligible Policyholders are entitled to receive their Proportionate Share of the aggregate cash consideration. In determining Eligible Policyholders' Proportionate Share, the Company has taken into account the Eligible Policyholders' Membership Interests—their right to vote and to a share of any surplus remaining in the unlikely event of a liquidation of the Company. Mr. Daniel J. McCarthy of Milliman USA, Inc., the Company's actuarial consultant, discusses the allocation of cash consideration among Eligible Members in detail in his written statement. Mr. McCarthy also opines that the Plan of Conversion's allocation of cash consideration is fair and equitable to the Eligible Policyholders.

## **VIII. Escrow Fund**

BCBSKS received a subpoena dated February 28, 2001 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 “Contingent Litigation Matter”). The subpoena seeks documents related to an investigation of possible improper claims against Medicare. At this point, we are not aware of any facts that would give rise to liability in the Company for any inappropriate claims made against Medicare. Nevertheless, given the nature of the Contingent Litigation Matter, we cannot estimate what the final related costs and expenses will be.

To address the concerns of Anthem regarding potential exposure arising 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 and certain other expenses described in the Alliance Agreement and the Escrow Agreement. The Company negotiated the amount of the Escrow Fund with Anthem based on results of past investigations of other companies and assuming an unfavorable resolution of the Contingent Litigation Matter. We believe the Escrow Fund is a fair method of providing for potential costs that relate to the Contingent Litigation Matter, a pre-closing event, because it offers Anthem protection from those costs and, at the same time, protects Eligible Policyholders from sacrificing value should the matter be resolved without substantial expense.

A Policyholder Committee, selected by the Commissioner, will oversee the Fund, including the investment and distribution of its assets, and the Commissioner will retain

regulatory oversight to ensure that policyholder interests are protected and that the actions of the Policyholder Committee comply with the Escrow Agreement, the Plan of Conversion and applicable law. Upon resolution of the Contingent Litigation Matter and other matters specified in the Alliance Agreement and Escrow Agreement, the balance of the Escrow Fund, after making allowances for taxes and expenses, will be distributed to Eligible Policyholders according to the Plan of Conversion. Given the uncertain nature of the Contingent Litigation Matter, we do not know when the Escrow Fund will be distributed.

#### **IX. Costs Related to the Plan**

The testimonial team consisting of staff members of the Kansas Insurance Department (the “KID 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 to the acquisition, are being paid or reimbursed by the Company in accordance with the K.S.A. § 40-4013.

#### **X. Fulfillment of Statutory Requirements**

##### **A. Elements of Plan**

The Kansas Conversion Law specifically requires a number of terms and conditions to be included in a plan of conversion. BCBSKS’ Plan of Conversion satisfies all of these requirements.

The Plan of Conversion sets forth a description of the structure, form and allocation of the proposed cash consideration to Eligible Policyholders. In particular, the

Plan provides that (1) upon conversion, BCBSKS will issue and Anthem will acquire shares of Common Stock representing all of the issued and outstanding shares of Common Stock (§ 6.2(e)); (2) as soon as reasonably practicable thereafter, the Company will distribute in cash to Eligible Policyholders a Special Distribution, representing the excess of the Company's Closing Book Value over \$155 million, and a portion of the Purchase Price paid by Anthem for BCBSKS stock (§ 6.2(f)); (3) the Company will allocate cash consideration to each Eligible Policyholder based on the Eligible Policyholder's Fixed Share Percentage and a Variable Share Percentage (Article VIII); and (4) as a condition to the effectiveness of the Plan, BCBSKS will receive an opinion from Dresdner Kleinwort Wasserstein, its financial advisor, that the aggregate cash consideration is fair, from a financial point of view, to the Eligible Policyholders (§ 6.4(c)). As required by the Conversion Law, the Plan includes as exhibits the Company's proposed Restated Articles of Incorporation and Bylaws to take effect on the Conversion Date (Exhibits B and C), and includes provisions for the selection of the Company's initial Board of Directors upon conversion (§ 9.1).

**B. Requirements for Approval**

In addition to setting forth the required elements of a plan of conversion, the Conversion Law establishes criteria for the consideration and approval of a plan by the Commissioner. The Company's Plan of Conversion satisfies all of these criteria.

*First*, the Plan of Conversion is fair and equitable to policyholders. All policies will remain in force in accordance with their terms, and Eligible Policyholders will receive a fair distribution of cash consideration in exchange for termination of their

Membership Interests. As set forth more fully in the written statement of Mr. Paul Adams of Dresdner Kleinwort Wasserman, the aggregate cash consideration to be paid to Eligible Policyholders is fair from a financial point of view. In any case, all policyholders will benefit from being insured by a more secure, financially stronger and more competitive Company, as described more fully in the written statement of John W. Knack, Jr.

*Second*, the allocation of cash consideration among Eligible Policyholders is fair and equitable as explained in detail in the written statement of Mr. McCarthy.

*Third*, as outlined above, the Plan of Conversion complies with all the applicable provisions of the Conversion Law, and other applicable provisions of law are fully met.

*Fourth*, 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 of Conversion does not unjustly enrich any director, officer, agent or employee of the Company.

*Fifth*, 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. As explained in the statement of Mr. Donald R. Lynn, the Company's Vice President of Finance, if the Plan of Conversion is effective, BCBSKS will retain \$155 million in capital, which is sufficient to meet the capital requirements of an insurance company under Kansas law. BCBSKS is currently transacting the business of insurance in Kansas and satisfies all requirements for doing so.

*Sixth*, the continued operations of the new stock insurer would not be hazardous to existing or future policyholders or the public. Indeed, the conversion and acquisition is expected to improve policyholders' and the public's security by providing the Company with greater flexibility, financial strength and improved access to capital as explained in the statements of Mr. Knack and Mr. Lynn.

*Seventh*, the Company has provided all documents and information requested by the Department.

## **XI. Conclusion**

For the reasons described above, BCBSKS' Plan of Conversion satisfies all of the requirements set forth in the Conversion Law and is in the best interests of the Company and its policyholders. It is therefore respectfully requested that the Commissioner approve the Plan.

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William H. Pitsenberger

Dated: December 17, 2001

Sworn to before me this 17th day of December, 2001

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Notary Public