

1 **BEFORE THE INSURANCE COMMISSIONER**
2 **FOR THE STATE OF DELAWARE**

3
4 **In Re: The Proposed Affiliation of)**
5 **BCBSD, INC., doing business as)** **Docket No.: 1509-10**
6 **Blue Cross Blue Shield of Delaware)**
7 **with HIGHMARK INC.)**
8

9 **DIRECT TESTIMONY OF KAREN HANLON, A WITNESS CALLED BY**
10 **HIGHMARK INC. AT THE HEARING OF OCTOBER 5-7, 2011**

11 **Q. Please state your full name.**

12 **A.** Karen L. Hanlon.

13 **Q. By whom are you employed and at what location?**

14 **A.** I am employed by Highmark Inc., which I will refer to in the remainder of my testimony
15 as Highmark, at the company's headquarters in Pittsburgh, Pennsylvania.

16 **Q. What is your job title with Highmark Inc.?**

17 **A.** I am the Senior Vice President for Financial Planning and Analysis.

18 **Q. What is your educational background?**

19 **A.** I completed an undergraduate degree in business at Grove City College in Grove City,
20 Pennsylvania in 1992.

21 **Q. Do you hold any professional designations?**

22 **A.** I am a Certified Public Accountant (CPA).

23 **Q. How long have you been employed by Highmark?**

24 **A.** I have worked at Highmark for 14 years.

25 **Q. By whom were you employed prior to your employment with Highmark?**

26 **A.** Prior to working at Highmark, I worked for five years at KPMG Peat Marwick in
27 Pittsburgh, a national accounting firm.

EXHIBIT
JOINT-09

28 **Q. What positions have you held during your career at Highmark?**

29 **A.** Since joining Highmark, I have served as the Manager, Accounting Procedures &
30 Reporting at HM Insurance Group (formerly known as Transgeneral Insurance
31 Company), a wholly owned subsidiary of Highmark. I then transferred to the Highmark
32 Corporate Finance Department and since have served as the Manager, Financial
33 Accounting & Reporting, Director, Forecast & Analysis, Assistant Controller, Forecast &
34 Analysis, Vice President, Financial Planning & Analysis and am currently the Senior
35 Vice President, Financial Planning & Analysis.

36 **Q. Please describe the scope of your duties as Senior Vice President for Financial**
37 **Planning & Analysis at Highmark?**

38 **A.** As Senior Vice President, Financial Planning & Analysis, I oversee the forecasting,
39 financial planning, financial analysis and administrative budget and cost areas for
40 Highmark. I also oversee the tax compliance and planning activities.

41 **Q. To whom do you report at Highmark and to whom does that person report?**

42 **A.** I report to Nanette P. DeTurk, Highmark's Treasurer and CFO. Nanette reports directly
43 to Dr. Kenneth R. Melani, Highmark's Chief Executive Officer.

44 **Q. Would you please describe Highmark Inc.'s corporate nature and the type of**
45 **business in which it is engaged?**

46 **A.** Highmark is a Pennsylvania non-stock, nonprofit corporation organized under the
47 Pennsylvania Nonprofit Corporation Law of 1988, with origins dating back to the 1930s.
48 Highmark, as it is constituted today, was created through the 1996 consolidation of Blue
49 Cross of Western Pennsylvania and Pennsylvania Blue Shield. It does business as
50 Highmark Blue Cross Blue Shield in western Pennsylvania and Highmark Blue Shield in
51 the remainder of Pennsylvania. Highmark is authorized by the Pennsylvania Insurance
52 Department to operate a hospital plan and a professional health services plan in
53 Pennsylvania pursuant to Pennsylvania's Health Plan Corporations Act. Under this
54 authority, Highmark provides traditional indemnity, or "fee for service," health care
55 insurance coverage to groups and individuals in Pennsylvania. In addition to its
56 indemnity coverage, Highmark also offers health insurance coverage in 49 of
57 Pennsylvania's 67 counties, through a preferred provider organization, or "PPO"
58 program. Highmark is also an administrative services only, or "ASO," provider for
59 certain self-insured groups.

60 As a party to joint operating agreements, Highmark also provides professional health
61 services coverage, in conjunction with hospital coverage provided by Blue Cross of
62 Northeastern Pennsylvania in northeastern Pennsylvania, and in conjunction with hospital
63 coverage provided by Independence Blue Cross in southeastern Pennsylvania. Highmark
64 also offers Medicare Advantage products, as well as Medicare supplemental products, to
65 the individual and group markets in western Pennsylvania, central Pennsylvania and parts
66 of northeastern Pennsylvania. In northeastern Pennsylvania, the supplemental products
67 are jointly underwritten with Blue Cross of Northeastern Pennsylvania.

68 Highmark is one of the 10 largest health insurance companies in the United States in
69 terms of membership, with a total health membership of over 4.8 million. It is also the
70 largest, in terms of total revenue, of those Blue Cross Blue Shield plans in the U.S. that
71 remain not-for-profit.

72 **Q. Highmark also owns or is affiliated with a number of other businesses, as reflected**
73 **in Highmark’s corporate chart, which is Exhibit 6 to the Statement of Affiliation or**
74 **“Form A” filed with the Delaware of Insurance seeking approval of the affiliation, is**
75 **that correct?**

76 **A.** Yes.

77 **Q Please describe the scope of business activities in which these various subsidiaries**
78 **and affiliates of Highmark Inc. are engaged.**

79 **A.** Highmark’s wholly owned subsidiary, Keystone Health Plan West, Inc., offers health
80 maintenance organization (HMO) coverage in western Pennsylvania to both the group
81 and individual insurance markets. Highmark has two other insurance subsidiaries which
82 provide group and individual Medicare products: Highmark Senior Resources Inc.,
83 which offers Medicare Part D prescription drug coverage in Pennsylvania and West
84 Virginia, and HM Health Insurance Company d/b/a Highmark Health Insurance
85 Company (“HHIC”), which offers Medicare Advantage plans in West Virginia. HHIC
86 also recently began offering small group coverage (for employers with 50 or fewer
87 employees) in certain counties of Pennsylvania.

88 In addition to its health insurance operations in Pennsylvania, Highmark has a number of
89 affiliated insurers and dental and vision care affiliates doing business in that state and in
90 other jurisdictions, including:

- 91 • HM Insurance Group, Inc. (“HMIG”) which, through its subsidiaries, HM Life
92 Insurance Company and HM Life Insurance Company of New York, is a
93 recognized leader in stop loss and reinsurance. HMIG’s subsidiaries, which also
94 include Highmark Casualty Insurance Company and HM Casualty Insurance
95 Company, hold insurance licenses in 50 states and the District of Columbia and
96 maintain 25 regional sales offices across the country to sell, primarily, limited
97 benefit medical plans, stop loss, reinsurance and workers’ compensation
98 coverage.
- 99 • United Concordia Companies, Inc. and its subsidiaries, which offer a broad range
100 of dental insurance products and services to members nationwide, employing
101 more than 1,300 people in 30 offices located throughout the United States.
- 102 • HVHC Inc. which, as the owner of Davis Vision, Inc. (“Davis Vision”), Viva
103 Optique, Inc. (“VIVA”) and Eye Care Centers of America, Inc. (“ECCA”),
104 comprises one of the nation’s largest vision companies. Davis Vision provides
105 comprehensive vision benefits to more than 55 million members nationwide.
106 VIVA is a worldwide leader in ophthalmic frames and sunglass distribution and

107 manufacturing. ECCA, with more than 400 retail stores in 36 states, is the third
108 largest retail optical chain in the U.S.

109 Non-insurance subsidiaries of Highmark include its wholly owned subsidiary, Highmark
110 Medicare Services Inc. (“HMS”). With offices in Pennsylvania and Maryland, HMS acts
111 as a Medicare Administrative Contractor under a contract with the Centers for Medicare
112 & Medicaid Services, performing Medicare Part A and Part B fee-for-service claims
113 adjudication and other administrative services for hospitals, other institutional providers,
114 physicians and other health care practitioners in Delaware, Maryland, New Jersey and
115 Pennsylvania, as well as the District of Columbia.

116 Finally, perhaps the most noteworthy of Highmark’s affiliates as regards to these
117 proceedings, is Highmark West Virginia Inc. d/b/a Highmark Blue Cross Blue Shield
118 West Virginia (which I refer to in the remainder of my testimony as Highmark West
119 Virginia), a West Virginia nonprofit health services corporation. Highmark West
120 Virginia, which offers a variety of health insurance products and services to customers in
121 West Virginia, began its relationship with Highmark in 1999. In 2004, Highmark became
122 the sole member of Highmark West Virginia pursuant to a business affiliation agreement
123 similar to the Affiliation Agreement between Highmark and BCBSD which is the subject
124 of this proceeding. Highmark West Virginia’s Articles of Incorporation and Bylaws
125 provide Highmark with the power to elect all of the members of the Highmark West
126 Virginia Board of Directors (subject to certain restrictions), and Highmark is the primary
127 Blue Cross Blue Shield Association (“BCBSA”) licensee for West Virginia, with
128 Highmark West Virginia being a “controlled affiliate” of Highmark in that state.

129 **Q. Does Highmark have any contractual relationships with any other BCBS Plans?**

130 **A.** Highmark has contractual relationships with several BCBS plans to serve as the
131 administrator for portions of their health business. Some of these plans include Blue
132 Cross and Blue Shield of Louisiana, Blue Cross and Blue Shield of Florida, Inc., Blue
133 Cross Blue Shield of Nebraska, Blue Cross and Blue Shield of Arizona, and Excellus
134 Blue Cross Blue Shield. In each of these cases, Highmark is providing services for a
135 limited portion of each plan’s business, primarily national account business. In other
136 cases, Highmark provides a much more limited offering of merely sharing a secure data
137 center environment with a company not interested in making this type of capital
138 commitment on its own. Our subsidiaries also have contractual relationships with many
139 BCBS plans, which can vary widely in their scope of services.

140 **Q. In the course of your duties as Senior Vice President for Financial Planning and**
141 **Analysis at Highmark, did you become involved in the review and analysis by**
142 **Highmark of the proposed affiliation between Highmark and Blue Cross Blue**
143 **Shield of Delaware, which I will refer to as BCBSD?**

144 **A.** Yes

145 **Q. Please describe the role you have played with regard to the proposed affiliation, and**
146 **in doing so, please also describe the overall process Highmark has followed in**

147 **reaching the point Highmark is at today in seeking the Delaware Insurance**
148 **Commissioner's approval of the affiliation.**

149 A. I became involved in the affiliation process very early on, as a member of the Highmark
150 team that prepared the response to BCBSD's request for proposal. Highmark received
151 the request for proposal from BCBSD in August 2009 and responded to it in October
152 2009, including a presentation to BCBSD's management at that time. Over the next
153 several months, I participated in the team that prepared the term sheets and the
154 subsequent definitive agreements and oversaw the extensive due diligence process.
155 Between October 2009 and the signing of the definitive agreements in August 2010
156 BCBSD and Highmark management had several meetings, including a meeting with the
157 executive management and a Board member of Highmark West Virginia. Highmark's
158 Board of Directors was briefed on the status of the affiliation on a few occasions as the
159 discussions progressed. Highmark's Board of Directors approved the execution and
160 delivery of the Business Affiliation Agreement on July 28, 2010.

161 I also worked with Jim Hynek, BCBSD's Chief Financial Officer, in preparing the
162 financial pro formas that would subsequently be filed with the Delaware Department of
163 Insurance. I'll subsequently refer to the Delaware Department of Insurance as DOI.
164 These pro formas project the financial results of BCBSD on both a stand-alone and an
165 affiliation (with Highmark) basis through the year 2015, and are identified as Exhibit 9 to
166 Highmark's Statement of Affiliation or "Form A" filing with the Delaware DOI. From a
167 Highmark perspective, preparation of the pro formas involved review of the assumptions
168 utilized in the development of the pro formas and the related outcomes. The primary
169 input that Highmark had in the development of the pro formas were the integration costs,
170 ongoing costs to be allocated from Highmark and synergies associated with the
171 affiliation.

172 Subsequent to the filing with the DOI of the Statement of Affiliation, seeking approval of
173 the affiliation, Highmark and BCBSD agreed to embark on a planning process to identify
174 the scope, timing and cost of the work that would need to take place to execute the
175 technology and business process integration between BCBSD and Highmark. A number
176 of affiliation teams were formed to ensure adequate focus on each area. Finance was one
177 of the workgroups within the affiliation planning process and I provided executive
178 guidance for the finance team. The affiliation planning process also included
179 accumulating a refined estimate of the integration costs and synergies associated with the
180 affiliation. Highmark's Cost & Budget department, which reports to me, was integral in
181 analyzing the results of the work that the teams completed in those areas. Ultimately, the
182 results of this work were incorporated into the final set of financial pro formas that were
183 completed in conjunction with the affiliation and submitted to the DOI. Most recently,
184 the pro formas were updated as of August 31, 2011 and filed with the DOI as Revised
185 Exhibit 9 to the Statement of Affiliation.

186 As the DOI's and the Department of Justice's staff, Blackstone and KPMG completed
187 their work, I also participated on the team that supplied information to assist with the
188 consultants' review. That brings us to the current time and my participation in today's
189 hearing.

190 **Q. Why is Highmark interested in this affiliation with BCBSD? What does Highmark**
191 **hope to gain?**

192 **A.** The primary economic benefit of this transaction for Highmark is that it allows us to
193 lower our cost structure per member, as we will have more members processing on our
194 infrastructure – essentially, it adds to our scale. The full value of the benefit to Highmark
195 upon full integration is estimated to be \$18.8 million annually which equates to 25¢ per
196 member/per month. This is critical when you are competing against much larger
197 insurance companies that operate nationally and capture membership from throughout the
198 country. The affiliation also allows Highmark to market our ancillary products, primarily
199 dental, vision and stop loss, with a partner with which we have a very cohesive
200 relationship to promote sales of these products, increasing availability of these products
201 for Delawareans and making the administration of the products simpler for our
202 customers.

203 Lastly, as demonstrated by our successful affiliation with the West Virginia Blue Plan,
204 affiliating with like-minded not-for-profit Blue plans supports our respective missions
205 and allow us to each continue to provide value to the communities we serve.

206 **Q. Were you present for testimony of Mr. Constantine regarding the proposed**
207 **affiliation transaction and do you agree with Mr. Constantine’s description of the**
208 **key elements of the proposed affiliation transaction, including the amendment to**
209 **BCBSD’s certificate of Incorporation and By-laws, and the implementation of the**
210 **Administrative Services Agreement and the Line of Credit Agreement between**
211 **BCBSD and Highmark?**

212 **A.** Yes

213 **Q. With that in mind, can you please describe the nature and purpose of the**
214 **Administrative Services Agreement.**

215 **A.** Under the Administrative Services Agreement (“ASA”), Highmark will provide a broad
216 range of services including infrastructure, technology and software and hardware support
217 to BCBSD at cost, including a reasonable allocation of administrative overhead but not
218 including any provision for profit to Highmark.

219 **Q. Are you aware of any terms contained in the Administrative Services Agreement**
220 **that are not fair and reasonable as to BCBSD? Please explain your answer.**

221 **A.** No. The terms in the ASA are fair and reasonable to BCBSD. The terms contained in
222 the ASA are essentially the same as with those included in the ASA with Highmark West
223 Virginia. The ASA calls for BCBSD to pay its allocable share of the costs of the services
224 provided to it, which includes a cost for services such as executive oversight, strategic
225 planning, procurement and other corporate services, which are sometimes referred to as
226 “corporate overhead”. BCBSD’s allocable share of the costs will be based on
227 Highmark’s established cost accounting practices, which will be used consistently across
228 all of the business lines for which Highmark is providing services. This includes all of
229 Highmark’s health business, the business with Highmark West Virginia, Highmark’s

230 ancillary subsidiaries, such as dental, vision and stop loss, and external parties that utilize
231 Highmark’s systems. The ASA does not include any profit margin to be paid to
232 Highmark – BCBSD will receive the services and access to Highmark businesses that I
233 mentioned – and simply must pay Highmark for the allocated cost of those services.

234 **Q. Ms. Hanlon, you mentioned the ASA’s reference to cost allocation and to**
235 **Highmark’s cost accounting practices. Are you familiar with that subject or would**
236 **you defer to another Highmark representative as to any questions on Highmark’s**
237 **cost allocation and cost accounting methodology?**

238 **A.** Yes, I am generally familiar with that subject, but I would defer to Highmark’s next
239 witness, Mr. Ken Gebhard, on that issue, as Ken is the more knowledgeable person in
240 that area.

241 **Q. Ms. Hanlon, attached as Schedule 1 to the Administrative Services Agreement is a**
242 **document entitled “Plan of Systems Conversion and Integration.” Please explain**
243 **the purpose and content of this document.**

244 **A.** This document is a byproduct of an extensive affiliation planning process. The purpose
245 of this schedule is to memorialize in the ASA the planned scope, approach, and timing of
246 the integration plan. As I mentioned earlier, Highmark and BCBSD began integration
247 planning efforts in earnest as soon as the Business Affiliation Agreement was signed.
248 The process was designed to identify the projects that must be undertaken to integrate
249 business areas and systems, and potential business value to be realized through the
250 affiliation. Planning efforts extended into estimating the costs of each project and
251 capturing interdependencies across teams. Projects were sequenced over the 2 year
252 affiliation timeframe based on estimated effort, priority and predecessor/successor
253 relationships. Project Summaries were prepared to include a description of each project,
254 identification of major milestones and activities, key risks/assumptions and issues, work
255 estimates, planned delivery dates and identified dependencies. These Project Summaries
256 are contained in Schedule 1. As a result of this effort, both Highmark and BCBSD are
257 prepared to immediately move forward with implementation of the migration and
258 integration as soon as the closing of the affiliation occurs, which is a critical factor as far
259 as BCBSD and Highmark are concerned.

260 **Q. Please summarize how BCBSD employees, subscribers, providers and the insurance**
261 **buying public in Delaware will be affected as of the first day the affiliation becomes**
262 **effective and how and when the effects will expand over time?**

263 **A.** The first day the affiliation becomes effective, virtually nothing will change from the way
264 it exists at BCBSD today. Providers, subscribers, group customers and the insurance
265 buying public in Delaware will continue to receive services from BCBSD as they do
266 today. They will not interact with BCBSD any differently. The only impact to
267 employees on the first day the affiliation becomes effective will be that a very limited
268 number of executives will begin to report, organizationally, to an executive at Highmark.
269 For example, Tim Constantine will report to Highmark’s Executive Vice President,
270 Health Services day one after the affiliation is effective. Likewise, Jim Hynek, the CFO

271 at BCBSD, will report organizationally to me at Highmark. All of the remaining finance
272 employees at BCBSD will continue to report to Jim though on day one, as they do today.
273 So, the organizational changes across the employee base will be very limited at first.
274 Over time, the leader of each BCBSD “market facing” function will report to Tim
275 Constantine, while the BCBSD leaders of other functions will report to supervisors at
276 Highmark. Thus, even over time, the “market facing” functions – which involve the most
277 interaction with Delaware consumers and policyholders – will still report to the President
278 of BCBSD.

279 As business systems and processes are integrated between Highmark and BCBSD, over a
280 period of 18 to 24 months, most constituents will see a change – in our opinion for the
281 better. The affiliation planning documents provide a roadmap for what changes will
282 occur and an estimate of when the changes will occur. Upon completion of the
283 integration, subscribers, group customers and the insurance buying public will continue
284 to have the same benefits and coverage that they have today, but their business will be
285 administered on a more automated, advanced technology platform. They will have
286 access to member and group customer portals that were not previously available to them
287 and in some cases, will be able to complete transactions electronically that would have
288 previously been manually processed. They will also notice over time the change of the
289 BCBSD name in the market to Highmark BCBSD and most likely, new products in the
290 market that BCBSD will be able to offer because of its affiliation with Highmark.

291 Employees will also have access to better on-line tools to assist in completing their
292 functions. This includes things like all of the operational systems – claims processing;
293 customer service; sales automation tools; billing and financial systems; along with
294 Highmark’s intranet site for employees; management tools and more.

295 The technology and business process changes will ultimately enable BCBSD to operate
296 more efficiently.

297 **Q. Please explain the purpose of the Line of Credit Agreement and why you believe its**
298 **terms are fair and reasonable to BCBSD.**

299 **A.** Highmark is providing to BCBSD liquidity with which to pay the integration costs, if
300 needed, through the line of credit. Borrowing on the line of credit is at the discretion of
301 BCBSD and the funds drawn from the line of credit may only be used for integration
302 costs. The line of credit is for up to \$45 million and has an interest rate of the lesser of 1-
303 month LIBOR plus 350 basis points, or the US Prime Rate. The amount on the line of
304 credit comes due on the seventh anniversary of the agreement. There is no prepayment
305 penalty and there are no fees for unused balances under the line of credit, which would be
306 a standard provision within a third party credit agreement.

307 **Q. What plans does Highmark have with regard to “branding” of BCBSD?**

308 **A.** Highmark and BCBSD are preparing a brand recognition campaign in the event the
309 affiliation is approved. The brand recognition campaign will introduce BCBSD

310 stakeholders to the Highmark organization and the Delaware affiliate's new brand:
311 Highmark Blue Cross Blue Shield Delaware, or Highmark BCBS Delaware.

312 The rebranding of BCBS of Delaware to Highmark BCBS Delaware is being prepared to
313 effectively communicate the change to the market in a way that results in minimal
314 disruption to members, providers, and employees. The rebranding effort will consist of
315 several stages. The start and end dates are dependent on the transaction close date and
316 the integration schedule.

317 In the early stages, items such as the corporate advertisements, website, envelopes and
318 letterhead, some marketing materials, and forms which can be re-branded quickly will
319 reflect the Highmark BCBS Delaware name. This would be accompanied by a supporting
320 brand recognition campaign that would explain that the name has changed, but nothing
321 else has - the same great service, coverage and employees from BCBSD remain.

322 Regarding the brand name, references to "Blue Cross Blue Shield of Delaware" will
323 eventually be replaced with "Highmark Blue Cross Blue Shield Delaware". References
324 to 'Delaware' will be replaced with 'Highmark Delaware'. References to BCBSD will be
325 replaced with Highmark DE or Highmark BCBS DE.

326 This brand strategy is consistent with the strategy recently deployed successfully in West
327 Virginia.

328 **Q. What is the desired timeframe for closing of the Affiliation and why is timing**
329 **important?**

330 **A.** Highmark and BCBSD believe that the closing of the affiliation needs to occur by year
331 end 2011 so that BCBSD is able to fully comply with a new federal mandate known as
332 ICD-10, which was mentioned earlier by Mr. Constantine, by the October 2013 deadline.
333 ICD stands for International Classification of Diseases. Currently, health care
334 transactions are completed in a standard format known as ICD-9. The federal
335 government is requiring that all entities processing health care transactions do so in an
336 expanded format, known as ICD-10, effective October 1, 2013. The work to transition
337 from ICD-9 to ICD-10 is extensive and if the closing of the affiliation is delayed beyond
338 year end 2011, BCBSD is going to need to begin the work to comply with ICD-10 on a
339 stand alone basis. That work, estimated by BCBSD at \$2-\$2.5 million, would all be
340 discarded if the affiliation with Highmark was ultimately approved and BCBSD migrated
341 to Highmark's systems.

342 **Q. In your opinion, Ms. Hanlon, is the financial condition of Highmark such as might**
343 **jeopardize the financial stability of BCBSD, or prejudice the interest of its**
344 **policyholders? If not, what is the basis for your answer?**

345 **A.** No. Highmark has an "A" rating from both A.M. Best and Standard & Poors. As of
346 December 31, 2010, Highmark's statutory financial statement reflected that Highmark
347 had over \$3.7 billion in surplus and that its net income for 2010 was over \$281 million.
348 As of December 31, 2010, Highmark's RBC was at the higher end of the range defined as
349 "sufficient" (550% to 750% of authorized control level) by the Pennsylvania Insurance

350 Department. As of June 30, 2011, Highmark’s quarterly financial statements reflected
351 that Highmark had over \$4.0 billion in surplus, and that its net income was over \$138.5
352 million. In addition, we project that BCBSD’s surplus will be significantly higher if
353 BCBSD affiliates with Highmark versus if BCBSD remains a standalone entity.

354 **Q. What plans, if any, does Highmark have to liquidate BCBSD, sell its assets or**
355 **consolidate or merge it with any person, or to make any other material change in its**
356 **business or corporate structure or management?**

357 **A.** First, Highmark has no plans or proposals to liquidate BCBSD, sell its assets or
358 consolidate or merge it into any other person or entity. As previously stated, after the
359 affiliation, BCBSD will remain, as it is now, a Delaware not-for-profit corporation and a
360 totally separate entity from Highmark or any other Highmark subsidiary or affiliate.
361 BCBSD will continue to provide health insurance products under the BCBS brand in
362 Delaware and will continue to be regulated as a “health services corporation” by the DOI.
363 Its corporate structure will change only in the manner previously described as to the
364 Business Affiliation Agreement, with its Certificate of Incorporation and By-laws
365 amended to provide that Highmark shall become the sole “member” and therefore
366 becoming the sole person with the right to elect BCBSD’s Board of Directors. Therefore,
367 post Affiliation, Highmark will “control” BCBSD from a corporate structure standpoint
368 and BCBSD will become a member of Highmark’s insurance holding company structure
369 as reflected in the Post-Affiliation organization chart, which is attached as **Exhibit 7** to
370 the Statement of Affiliation.

371 Highmark has no current plans to replace the current officers of BCBSD as a result of the
372 Affiliation. The present officers of BCBSD will remain in place, including Tim
373 Constantine, its President, who will also become a member of BCBSD’s Board as the
374 “President Director.” Mr. Constantine will report directly to Deborah Rice, Executive
375 Vice President, Health Services of Highmark, who is one of eight Highmark senior
376 officers that report directly to Highmark’s CEO, Dr. Kenneth Melani. Importantly
377 though, as a result of the affiliation, BCBSD will have access to the expertise of the
378 broadly experienced management team at Highmark.

379 The “business” of BCBSD will remain focused as it is today, providing individual and
380 group health insurance coverage and administrative services for self-insured health plans
381 throughout the state of Delaware. Highmark however, will bring to BCBSD the ability to
382 introduce new and innovative products to the Delaware marketplace. Some of these
383 products will be offered directly by BCBSD as the insurer, and others will be products
384 issued by other Highmark affiliates. These products may include Medicare Advantage
385 coverage (a managed care option for Medicare recipients), additional Medicare
386 supplement product offerings, and Medicaid coverage. BCBSD will also be in a position
387 to facilitate the availability of other ancillary health benefit products that are offered by
388 other Highmark subsidiaries or affiliates. These products may include dental, vision and
389 stop loss coverages, which are provided through United Concordia Companies, Inc,
390 Davis Vision and HM Insurance Group, respectively.

391 The affiliation will bring other significant and substantial benefits to BCBSD. Among
392 those benefits are:

393 **1. Maintenance of Delaware Presence.** Highmark and BCBSD have committed to
394 maintaining a significant Delaware presence and to maintain the BCBSD
395 corporate headquarters in Delaware. Furthermore, the parties have agreed to use
396 commercially reasonable efforts to maintain employment levels that are
397 proportionate to those in other Highmark service areas for health business.
398 Confirming this, Highmark is committed to the following regarding employment
399 stability for BCBSD if the affiliation is approved:

400 • Highmark will assure the total full time employee (“FTE”) positions in
401 Delaware will be the same after implementation of the affiliation is complete
402 (approximately 18 months) as it was at the start of the affiliation integration
403 activities. The positions will be either BCBSD positions or Highmark
404 positions located in Delaware. Provided however, Highmark will not be
405 responsible to replace any lost positions resulting from a significant decrease
406 in BCBSD’s enrollment or market share during the implementation period
407 (*i.e.*, from the loss of a large customer) that results in any lost positions.

408 • Any BCBSD employees whose positions are eliminated due to the
409 implementation will be given the first opportunity to fill any new positions
410 that are created in Delaware.

411 • Highmark will also make good faith efforts to locate additional FTE positions
412 in Delaware as Highmark’s business opportunities arise.

413 • Highmark has also agreed, as a condition to the approval of the affiliation, that
414 it will, for 4 years after the effective date of the Affiliation, take such actions
415 as necessary to ensure that there is not a material decrease in the quality of
416 BCBSD’s provision of account and broker management, customer service,
417 and provider service to Delaware customers by Delaware-based staff under
418 the immediate supervision of Delaware-based staff, it being understood,
419 however, that additional support may be provided by Highmark or other
420 Highmark affiliates during periods of additional need as deemed to be
421 necessary or appropriate to drive optimum client satisfaction.

422 **2. Reduced IT Investment Costs.** With the Highmark affiliation, BCBSD would
423 expect to invest approximately \$35 million between 2011 and 2015 to migrate
424 onto Highmark technology and business platforms. This represents a substantial
425 savings to BCBSD and its stakeholders from the estimated \$130 million in capital
426 expenditures that the BCBSD’s consultant, Deloitte, has indicated the company
427 would need to expend on IT upgrades as an independent health insurer.

428 **3. Claims Guarantee.** Under the Affiliation, Highmark must, pursuant to BCBSA
429 rules, guarantee to the full extent of its assets, all of the contractual and financial
430 obligations of BCBSD to its customers, as BCBSD would become a controlled

431 affiliate of Highmark. This guarantee will provide an extra layer of protection for
432 BCBSD's customers.

433 **4. Benefits to Particular Delaware Stakeholders.** Particular Delaware
434 stakeholders will greatly benefit from Highmark's state-of-the-art technology and
435 systems, including the following:

436 **a. Members.** BCBSD's members will have access to Highmark's member
437 portals – My Blue Link, a web-based resource center, and Blues On Call, by
438 which a “health coach,” a registered nurse, provides information about
439 specific health-related topics.

440 **b. Employers.** BCBSD's employer groups will have access to Highmark's
441 employer portal – Highmark Online, which allows them to:

442 (1) View membership and group information

443 (2) Update eligibility

444 (3) View their claims bill online

445 (4) E-mail customer service, and

446 (5) Leverage online reporting functionality to track employee FSA and HRA.

447 **c. Providers.** BCBSD's providers will have access to Highmark's provider
448 portal – NaviNet, which enables providers to:

449 (1) Obtain information regarding fee schedules

450 (2) Check member eligibility of claim status, and

451 (3) Submit changes resulting in direct updates into the appropriate system.

452 Providers will also greatly benefit from Highmark's Real-Time solutions,
453 which include (i) Real-Time Estimation, which allows providers to determine
454 accurate member liability, (ii) Real-Time Claim Adjudication, which allows
455 providers to submit a claim that is processed in real-time at the point of
456 service, and (iii) Accelerated Payment, which increases speed of payment to
457 providers if they participate in Real-Time and EFT/paperless programs.

458 **d. Producers.** BCBSD's brokers and agents will have access to Highmark's
459 producer portal through which they may:

460 (1) Use the Small Group quoting tool for prospective Small Group business

461 (2) Obtain online quotes and applications for individual products, and

462 (3) Leverage online commission statements and agency related reporting.

463 **5. Lower Premium Increases.** Current projections anticipate that premiums will
464 increase in the Delaware health insurance marketplace regardless of the affiliation
465 status of BCBSD. However, BCBSD and Highmark have projected in the
466 financial pro formas that these rate increases will be lower (about 3%) under the
467 affiliation scenario than if BCBSD were to continue on a standalone basis.
468 BCBSD and Highmark do not project any changes in the costs charged by
469 providers to their patients or their patient’s insurers as a result of the Affiliation.

470 **6. Fortification of BCBSD Financial Condition Long-Term.** The pro forma
471 financial projections also demonstrate the positive impact that the affiliation is
472 expected to have on BCBSD’s financial position long-term.

473 **Q. What impact will the affiliation have on BCBSD’s continued commitment to**
474 **community support and charitable activity?**

475 **A.** The affiliation will not interfere with BCBSD’s ongoing community support and
476 charitable activity commitments. Highmark will work with BCBSD to develop programs
477 that leverage the lessons learned by both parties in community and charitable initiatives.

478 **Q. Does Highmark have any plans or intentions whatsoever to gain access to BCBSD’s**
479 **assets or to transfer any of BCBSD’s assets to Highmark or any subsidiary or**
480 **affiliate of Highmark?**

481 **A.** No, Highmark has no plans or intentions to gain access to BCBSD’s assets or to transfer
482 any of BCBSD’s assets to Highmark or any subsidiary or affiliate of Highmark. Further,
483 upon affiliation, pursuant to recent Delaware legislation, BCBSD will become subject to
484 the Delaware Insurance Holding Company System Registration Act and its provisions
485 with regard to filing and approval of material inter-affiliate agreements and transactions
486 with the Delaware Department of Insurance. In addition, there are agreed-to conditions
487 whereby the Department of Insurance will review and approve the estimated cost
488 allocation charges using a “fair and reasonable” standard, and will approve any overages
489 exceeding \$500,000.

490 In addition, Highmark and BCBSD have agreed, as a condition to the affiliation, that
491 Highmark shall not improperly use the assets of BCBSD for the benefit of Highmark
492 rather than the benefit of BCBSD and its subscribers. This condition specifically
493 provides that the only economic transfers that BCBSD is permitted to make to Highmark
494 are: (1) payments for BCBSD’s integration to Highmark’s system; (2) ongoing payments
495 under the Administrative Services Agreement; and (3) payments pursuant to the Line of
496 Credit.

497 Contrary to causing the removal of assets out of BCBSD, the affiliation, by partnering
498 BCBSD with a much larger not for profit entity having a state-of-the-art information
499 technology platform, will enable BCBSD to preserve tens of millions of dollars that it
500 would otherwise expend making IT capital improvements and other capability
501 enhancements. By the end of 2015, the parties project that BCBSD’s surplus will be
502 \$226 million on an “affiliation basis” versus \$89 million on a “stand alone basis.”

503 **Q. Would you please comment regarding the competence, experience and integrity of**
504 **the persons who would control the operation of BCBSD after the Affiliation.**

505 **A.** The qualifications of Highmark’s board of directors and executive management team are
506 described in the biographical affidavits filed with the Statement of Affiliation. These
507 affidavits demonstrate that the Highmark board of directors and management team is
508 highly qualified to competently govern and manage Highmark and all of its affiliates.

509 Timothy Constantine, the current President of BCBSD, will continue to fill this role post
510 closing. With regard to the BCBSD board of directors post affiliation, the four Class A
511 directors will each be selected by BCBSD from the members of the present BCBSD
512 board, all of whom are prominent Delawareans and who have successfully governed
513 BCBSD for many years.

514 Three of the four proposed BCBSD Class B directors, Highmark CEO, Dr. Kenneth
515 Melani, Highmark Treasurer and CFO, Nanette DeTurk, and Highmark Executive Vice
516 President of Health Services, Deborah Rice, will come from the ranks of Highmark’s
517 experienced executive management. The final Class B director, which must be a
518 Delaware resident, will be named in the near future.

519 **Q. Ms. Hanlon, do you know of any reason why the proposed Affiliation might likely be**
520 **hazardous or prejudicial to the Delaware insurance buying public?**

521 **A.** I do not.

522 **Q. What is the basis for your response?**

523 **A.** For all the reasons I have previously stated, I believe the affiliation will be extremely
524 beneficial to the Delaware insurance buying public. BCBSD will significantly upgrade
525 its infrastructure while gaining access to the efficiencies and scale associated with a
526 larger company. The alternative of pursuing the infrastructure upgrades on a stand-alone
527 basis is far less beneficial to the Delaware insurance buying public. Additionally,
528 Highmark’s resources allow it to focus significant attention on broader issues such as
529 compliance with federal and state health care reform initiatives. For example, Highmark
530 presently has an office of Health Care Reform and multiple work teams and consultants
531 dedicated to the study and analysis of, and compliance with, health care reform
532 requirements imposed by President Obama’s recent health care reform legislation.
533 BCBSD will get access to all of the knowledge gained by these efforts. All of these facts
534 combined will allow BCBSD to continue to offer innovative, cost effective products in
535 the Delaware market.

536 Perhaps the best evidence of the likelihood that the Affiliation will be of significant
537 benefit to the Delaware insurance buying public is the demonstrable success of the
538 similar affiliation of Highmark and Highmark West Virginia. In the time that Highmark
539 West Virginia has been affiliated with Highmark, it has improved significantly
540 financially, grown enrollment, gained efficiencies and has been able to offer new
541 products and programs that it otherwise would not have been able to offer its customers.

542 Lastly, but importantly, Highmark has agreed with the DOI to a number of proposed
543 conditions to approval of the affiliation. These proposed conditions are responsive to
544 concerns raised by DOI's consultants, Blackstone and KPMG, and would impose
545 restrictions and requirements post-affiliation that will be in addition to those already
546 applicable under Delaware insurance laws and regulations.