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**BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE
OFFICE OF THE STATE AUDITOR
STATE OF MONTANA**

**IN THE MATTER OF
THE CONVERSION OF BLUE CROSS AND
BLUE SHIELD OF MONTANA, INC. AND CASE NO. INS-2012-238
THE ALLIANCE WITH HEALTH CARE
SERVICE CORPORATION**

APPLICANTS' PREHEARING MEMORANDUM

Blue Cross and Blue Shield of Montana, Inc. ("BCBSMT"), a Montana nonprofit health service corporation organized under Montana Code Annotated Title 33, chapter 30, and Health Care Service Corporation, an Illinois Mutual Legal Reserve Company ("HCSC") (jointly "the Applicants"), respectfully submit this Pre-Hearing Memorandum in support of their Application for Approval of Alliance ("Application"). This Pre-Hearing Memorandum pertains to the Applicants' request for approval of a proposed alliance ("Alliance") pursuant to Montana Code Annotated §§ 35-2-609, 35-2-617 and Title 50, Chapter 4, part 7 ("Conversion Statute").¹

¹ BCBSMT and HCSC have stipulated, solely for purposes of the Application and this transaction only, that the Conversion Statute applies to the transaction even though the assets proposed to be conveyed by BCBSMT and acquired by HCSC will not be transferred to a for-profit entity. See *infra* at fn. 2 for further explanation.

INTRODUCTION

I. THE APPLICANTS

A. BCBSMT

BCBSMT is a non-investor owned (“NIO”), nonprofit health service corporation, providing comprehensive health insurance and third-party administration services throughout Montana. Historically, Blue Cross (the Hospital Service Association) entered Montana in 1940 and Blue Shield (Montana Physicians’ Service) entered Montana in 1946. In 1986, the two companies merged to form BCBSMT. As such, in some form, BCBSMT is Montana’s oldest and largest health insurer and has operated in Montana for more than 70 years as an independent licensee of the Blue Cross and Blue Shield Association (“BCBSA”). BCBSMT is organized as a nonprofit mutual benefit corporation under Montana’s nonprofit corporation code, and is also licensed as a health service corporation under Montana’s Health Service Corporation code. BCBSMT offers a range of fully insured products, as well as third-party administration services for self-insured plans.

As of December 31, 2012, BCBSMT had approximately 271,152 members. BCBSMT has a provider network consisting of approximately 2,200 physicians, 60 Montana hospitals (representing all the hospitals in Montana), and 3,480 allied health care providers. BCBSMT currently has an A.M. Best rating of B++, which represents a downgrade from the past, based on BCBSMT’s significant underwriting losses as well as other financial performance issues.

BCBSMT also owns Combined Benefits Management, Inc. (“CBMI”). CBMI owns three subsidiaries: (1) Insurance Coordinators, Inc. (“ICMI”); (2) Health-e-Web, Inc. (“HeW”); and (3) Western States Insurance Agency (“WSIA”). ICMI owns a 49% ownership interest in Peak1 and the other 51% ownership interest is held by Blue Cross of Idaho. WSIA is in the process of winding down. In addition, BCBSMT owns a small interest in Prime Therapeutics

and Regional Advantage Services, LLC. BCBSMT also has two charitable foundations: the BCBS Foundation for Healthy Montanans and the Caring Foundation of Montana, Inc. Both of these Foundations are 501(c) organizations and licensed affiliates of the BCBSA.

B. Health Care Service Corporation (“HCSC”)

HCSC is a NIO mutual legal reserve company doing business as a nonprofit health care service plan. HCSC was organized in Illinois in 1936 as a nonprofit health care service plan, and in 1982 reorganized as a mutual insurance company domiciled in Illinois.

Under Illinois law, insurance companies can organize only as stock companies or mutual legal reserve companies. A mutual legal reserve company is a member owned company that operates for the mutual benefit of its members. Since HCSC is not a stock company, it operates as a nonprofit member owned company, and is legally referred to as a mutual legal reserve company.² HCSC’s Articles of Incorporation state that the company was founded as a “non-profit health care service plan.” Article IX of HCSC’s Bylaws states that HCSC shall operate on a not-for-profit basis. Its organizational documents prohibit any person from receiving any HCSC profits. HCSC has always operated as a nonprofit and has a strong commitment to continue to do so.

HCSC currently operates the Blue Cross and Blue Shield (“Blue”) Plans in Illinois, New Mexico, Oklahoma, and Texas. It is an independent licensee of the BCBSA. HCSC is the country’s largest NIO health insurer and fourth largest health insurer overall. It currently has more than 13 million members in its Blue Plans across its four states. HCSC has grown steadily

² It is precisely because of this unique classification under Illinois law that requires HCSC, although operating as a nonprofit entity, to be a mutual legal reserve company that the exceptions to the Conversion Statute do not appear to technically apply to the proposed transaction. As a result, and in furtherance of the public interest, the Applicants stipulated, solely for purposes of the Application and the transaction, that the Conversion Statute applies to the transaction even though the assets proposed to be conveyed by BCBSMT and acquired by HCSC will not be transferred to a for-profit entity.

in all of its states by offering traditional and innovative health insurance products and services to individual members and group customers.

HCSC offers a variety of fully-insured products, and also offers administrative services for self-funded benefit plans. HCSC's products include individual and group plans of various types, including managed care products. HCSC also participates in government programs such as Medicare Advantage, Medicaid, and the Federal Employee Health Benefit Program ("FEP"). HCSC reaches virtually all segments of the health insurance market.

HCSC formed alliances with the Texas, Oklahoma and New Mexico Blue plans that were similar to the proposed Alliance with BCBSMT. Between 1996 and 1998, HCSC consolidated the claims, customer service and technology organizations in Illinois and Texas. In 2001 and 2002, HCSC consolidated the same business units between HCSC and New Mexico Blue Cross and Blue Shield ("NMBCBS"). In 2005 and 2006, HCSC consolidated business units between HCSC and Blue Cross and Blue Shield of Oklahoma ("BCBSOK"). As the New Mexico, Oklahoma, and Texas alliances demonstrate, HCSC has a history of successfully bringing together operations in other states and incorporating them into existing HCSC operations. At present, over 6 million HCSC members and over 7,000 of its 16,000 employees reside outside of Illinois. A significant factor in HCSC's success in these other states has been its commitment to maintaining local executive leadership and an emphasis on strong local presence with community roots and involvement.

C. The Blue System

The BCBSA is a national association of 38 independent, community-based and locally operated Blue Cross and Blue Shield companies (collectively "BCBS"). The BCBSA owns and manages the BCBS trademarks and names in more than 170 countries and territories around the

world. The BCBSA grants licenses pursuant to a license agreement to independent companies to use the BCBS trademarks and names in exclusive geographic areas.

The BCBS system is the nation's oldest and largest family of health benefits companies. In the mid-1970s, there were nearly 130 independently operated BCBS companies in the system. As a result of consolidation to compete with nationally based, for-profit insurance carriers, the number of independently operated BCBS companies fell to less than 60 by the end of the 1990s. There are 38 independently operated BCBS companies today. Collectively, the 38 BCBS companies provide healthcare coverage for nearly 100 million people -- one-third of all Americans -- in all 50 states, the District of Columbia and Puerto Rico. Nationwide, more than 96% of hospitals and 91% of professional providers contract directly with the BCBS companies.

Through a program called "BlueCard," the independent BCBS licensees offer their members nationwide coverage and access to a vast network of providers. An integrated electronic network for claims processing and reimbursement enables BCBS members to obtain healthcare services while traveling or living anywhere across the United States. This network and its national scope are critical to ensuring independent Blues plans can compete with national carriers.

As an independent licensee of BCBSA, BCBSMT has been granted an exclusive license to use the BCBS trademarks and names in Montana, meaning no other health insurer is allowed to use those trademarks and names to actively market or sell health insurance business in Montana. The BCBSA license agreement prohibits the sale or transfer of the BCBSA license and marks to another insurer without the approval of the BCBSA. In addition, the BCBSA imposes minimum risk based capital ("RBC") requirements on Blue plans which are typically stricter than state statutory RBC requirements.

II. HISTORY OF THE ALLIANCE TRANSACTION

Facing an uncertain and increasingly competitive health insurance market along with its already strained financial and operating position, BCBSMT determined that a business alliance with another BCBS Plan would best allow BCBSMT to serve the residents of Montana. BCBSMT began to consider an alliance partner in 2012 after it had already pursued aggressive cost cutting measures but continued to incur underwriting losses, escalating claims, membership losses and a declining level of RBC. Under these circumstances, it was the judgment of management that it could not afford or access the capital it needed to fund capital improvements it needed to operate in the new post-health care reform marketplace. Moreover, BCBSMT knew that it even if it could fund these capital improvements or obtain them through an outsourcing arrangement, it would still struggle to keep up with its competitors. As a small Blue plan, with significant current and future financial challenges and risks, it would not be able to achieve the same economies of scale that large national carriers or large Blue plans could achieve.

Once it decided to pursue an alliance, BCBSMT focused on identifying the best potential partner. Because only other licensees of BCBSA may hold the licenses of other Blue plans with the consent of the BCBSA, it was important to the BCBSMT Board that BCBSMT align with another BCBS Plan. BCBSMT believed that the partner would need to be a nonprofit, NIO entity that would continue the use of the BCBS name and its legacy of local nonprofit presence. In addition, BCBSMT was concerned about the risk of having to go through another alliance in the near future. Therefore, it wanted to align with an NIO Blue company that was as financially strong as possible and could achieve the scale necessary to both address BCBSMT's immediate infrastructure and cost structure needs and compete with national for-profit carriers. Finally, BCBSMT wanted a partner that shared a similar corporate culture, and demonstrated

commitment to compliance, nonprofit operations and maintenance of local management presence.

Once it identified these key factors, BCBSMT quickly narrowed the list of potential partners to HCSC and one other multistate Blue Plan. BCBSMT engaged in discussions with both companies, and at the end of that process, the BCBSMT Board decided that HCSC best aligned with its goals. HCSC is a mutual legal reserve company doing business for 70 years as a member-owned nonprofit healthcare service plan. HCSC also operates health plans in four other states and has a proven track record of successfully aligning with other Blue Plans while maintaining a strong local presence in each state. Most importantly, HCSC is the fourth largest health insurance company in the country, the largest non-investor owned health insurer and is currently one of the strongest Blue Plans in the United States, both operationally and financially.

III. THE STRUCTURE OF THE TRANSACTION

The Applicants are seeking approval of a transaction whereby HCSC will acquire the insurance and Administrative Services Only (“ASO”) or self-funded operations and related assets (“Acquired Business”) and specified associated liabilities of BCBSMT (“Acquired Liabilities”). After the Alliance, HCSC will operate the Acquired Business of BCBSMT as a division of HCSC in Montana and do business as BCBSMT. BCBSMT policyholders will become HCSC policyholders without a break in coverage, benefits, or services. The old BCBSMT entity will not be operated as a health insurance business, but will instead operate for the purpose of satisfying or otherwise discharging its remaining liabilities so that the old BCBSMT can eventually be wound down and dissolved. The proceeds paid by HCSC to BCBSMT for the Acquired Business will be deposited to a foundation. The assets remaining after the wind down of the old BCBSMT will also be paid to the foundation.

Because HCSC is interested in acquiring only BCBSMT's core insurance business, HCSC and BCBSMT have entered into an Asset Purchase Agreement ("APA") that specifies the assets and liabilities to be transferred and the other terms of the transaction. (*See* Consideration of Exchanges, App. at Ex. 2; APA, App. at Ex. 3). Pursuant to the APA, HCSC will acquire certain assets owned by BCBSMT, including its insurance and ASO contracts, provider contracts and rights to use its Blue Cross and Blue Shield marks. HCSC will also assume specified liabilities of BCBSMT, including claims liabilities under insurance and ASO contracts, provider contracts and specified pension liabilities. Certain assets that are not primarily related to BCBSMT's core insurance business are excluded from the transaction, including BCBSMT's surplus, its principal subsidiary holding company CBMI, current buildings and certain other assets. Also excluded are certain preclosing liabilities ("Excluded Liabilities"), such as litigation. In total, HCSC will assume liabilities of BCBSMT of approximately \$180 million and at closing BCBSMT will transfer to HCSC approximately \$180 million in assets and cash to support the liabilities.

In consideration of the sale of the Acquired Business, HCSC will pay the amount of \$17.6 million, which was determined solely by independent expert valuation. No part of the consideration at issue will inure directly or indirectly to an officer, director, or trustee of BCBSMT or to an officer, director, trustee, or employee of HCSC.

The evidence presented in testimony and at the hearing on this matter will demonstrate that the Alliance and the transaction through which it will be implemented are in the public interest and satisfy all of the mandatory criteria for approval to be considered by the Montana State Auditor, *ex officio* Commissioner of Insurance ("Commissioner") and the Montana Attorney General. Therefore, the Applicants' Application should be approved.

The Proposed Transaction Is In The Public Interest of the State of Montana.

I. The Proposed Transaction Satisfies The Criteria Enumerated in Montana Code Annotated Conversion Statute Requirements § 50-4-715.

As set forth below and in the evidence presented, this transaction is in the public interest, as required by the Conversion Statute, and should be approved. Mont. Code Ann. §§ 50-4-715, 50-4-717. The proposed transaction satisfies the mandatory criteria that the Attorney General must consider. Mont. Code Ann. § 50-4-715.

A. The fair market value of public assets is preserved and protected (Mont. Code Ann. § 50-4-715 (2)(a)).

Fair market value is defined by the Conversion Statute as “the fair market value as of the date of the transaction or proposed transaction as determined by an independent appraisal of the assets or operations performed and communicated by a qualified appraiser according to applicable professional appraisal standards.” Mont. Code Ann. § 50-4-701(4). As set forth below, both the structure and the financial terms of the transaction, as determined and agreed by the Applicants, preserve and protect the fair market value of BCBSMT’s public assets.

Of key consideration to HCSC in entering into the transaction was the fact that it be structured as an asset purchase arrangement under which HCSC would acquire only those assets that are part of BCBSMT’s core insurance business and related liabilities. The resulting transaction is structured as such and is governed by the terms of the APA.

Under the APA, in consideration for the Acquired Business, the parties agreed that HCSC would pay the fair market value of that Acquired Business as determined solely by an independent expert appraisal. To establish that value, BCBSMT engaged two independent valuation experts, one to determine the fair market value of BCBSMT’s core insurance business – the Acquired Business, and the other to determine the overall value of the company.

The purchase price for the core insurance business was determined by the independent expert actuarial analysis performed by James Galasso, FSA, MAAA, of Actuarial and Financial Modeling Inc. (“ActMod”), a firm with specialized expertise in valuing insurance businesses. BCBSMT retained ActMod to analyze the value of BCBSMT’s primary insurance business lines. ActMod determined that the present value of the residual income streams from those lines, and thus the value of BCBSMT's core business as of June 30, 2012, was \$17.6 million. (App. at Ex. 5, ActMod Rep.) In conducting his valuation, Mr. Galasso relied on historical financial and company information, industry data and projections from, and discussions with, BCBSMT management. Mr. Galasso took a conservative approach to the valuation. For example, he estimated a conservative amount for capital expenditures BCBSMT needed to maintain its viability. (J. Galasso Direct Test. 7:19-8:9.) As such, ActMod’s estimate represents a high-end estimate of the core business value. The Applicants each accepted that valuation as the fair market value purchase price, with HCSC agreeing to pay that amount at the closing of the transaction.

BCBSMT also engaged Calvin Swartley, CFA, ASA, of Moss Adams LLP, another independent valuation expert, to perform a broader fair market value appraisal of BCBSMT’s entire business as of June 30, 2012. (App. at Ex. 7, Moss Adams Rep.) In performing his valuation, Mr. Swartley relied on historical financial information, industry data and projections from, and discussions with, BCBSMT management. He also relied on Mr. Galasso’s expert actuarial valuation of \$17.6M assigned to BCBSMT’s core insurance business - the Acquired Business. Mr. Swartley valued BCBSMT’s entire business at \$166.2 million. (App. at Ex. 7, Moss Adams Rep. at 39.)

As set forth above, the independent expert valuations relied upon by the Applicants to set the financial terms of the transaction were prepared in accordance with accepted valuation and actuarial methods, with critical inputs from BCBSMT management who were most familiar with their company, the current and post-health care reform marketplace and their operating constraints and challenges. The valuations were prepared independently and objectively. Both experts formed their opinions without influence by BCBSMT and without contact with HCSC. (J. Galasso Direct Test. 8-12-21; C. Swartley Direct Test. 11:3-12.) As such, the terms and structure of the transaction properly reflect fair market value and preserve and protect the fair market value of public assets.

The Montana Department of Justice also commissioned a fair market valuation report by Timothy Blackmer of Medical Development Specialists (“MDS”) to “assess the fair market value standard when applied to an arm’s length acquisition of a 100% controlling ownership interest in the net operating assets of BCBSMT.” (MDS Rep. at 3.) MDS calculated BCBSMT’s fair market value (defined in the report as the “rounded estimate of surplus value”) at \$196.3 million. (MDS Report at 4.) Because a separate value for the Acquired Business (equivalent to Mr. Galasso’s valuation of BCBSMT’s core insurance business at \$17.6 million) is not specified in MDS’s report, Applicants infer that the \$196.3 million represents MDS’ estimate of the fair market value of BCBSMT’s entire business.

In addition to omitting any valuation of the Acquired Business, Applicants will show at Hearing that there are key foundational problems with the MDS Report. MDS inexplicably chose to utilize some of management’s projections and assumptions, as well as historical results, while ignoring or changing others, often without further discussion with management.

Applicants respectfully suggest, at the very least, that the MDS valuation results are suspect as they are based on key assumptions that are unsupported and inconsistent with the realities of BCBSMT's business challenges and its current and future marketplace.

B. The fair market value of public assets is expended or invested with reasonable and prudent consideration of the potential risk of financial loss associated with the conversion transaction.

The \$17.6M consideration to be paid by HCSC for the Acquired Business under the APA will be deposited into a foundation that meets the criteria enumerated in Montana Code Annotated § 50-4-720. Mont. Code Ann. § 50-4-715(2)(c). After wind down of its operations, BCBSMT will distribute the remaining assets of the old BCBSMT entity to the same foundation, resulting in an estimated total funding of more than \$120M. This amount will be used for a purpose that aligns as closely as possible with BCBSMT's mission, namely, to provide financial support to improve the quality, availability and awareness of health care programs and services in Montana. (App. at 9; Mont. Code Ann. § 50-4-720(1)(b).)

The BCBSMT Board of Directors will exercise its fiduciary duty to oversee the assets until the appropriate foundation is determined through the hearing process. (M. Burzynski Direct Test. 29:20-30:4; *see also supra* I, A; App. at 7 and Ex. 3).

C. The fair market value of the public assets of a nonprofit health entity will be distributed as provided in Mont. Code Ann. § 50-4-720.

Pursuant to the Supplemental and Amended Prehearing Schedule and Procedural Order, the issue pertaining to the distribution of the public assets will be address at a separate hearing to be scheduled. (Supplemental and Amended Prehearing Schedule and Procedural Order, Feb. 13, 2013 at ¶ 6).

- D. No part of the public assets of the transferor inure directly or indirectly to an officer, director, or trustee of the transferor or to the transferee or an officer, director, trustee, shareholder, or employee of the transferee or to any other person that is not a foundation or nonprofit organization approved to receive the assets by the attorney general.**

No part of the consideration will inure directly or indirectly to an officer, director, or trustee of BCBSMT, to an officer, director, trustee, or employee of HCSC, or to any other person that is not a foundation approved to receive the assets by the Attorney General. (App. at 8; Mont. Code Ann. § 50-4-715(2)(d).) Maurice Smith, Divisional Senior Vice President, Business Development and Subsidiary Management of HCSC, Michael Frank, President and Chief Executive Officer of BCBSMT and Mark Burzynski, Senior Vice President and Chief Financial Officer of BCBSMT, will testify in support of this statement. (M. Smith Direct Test. 13:1-7; M. Frank Dir. Test. 40:3-8; M. Burzynski Direct Test. 30:5-10.)

- E. An officer, director, or trustee of the nonprofit health entity does not receive any immediate or future remuneration as a result of a proposed conversion transaction except for the reasonable value of services rendered pursuant to a valid contract between the officer, director, or trustee and the nonprofit health entity.**

No officer, director, or trustee of BCBSMT will receive any immediate or future remuneration from HCSC as a result of a proposed Transaction except for the reasonable value of services rendered pursuant to a valid contract between the officer, director, or trustee and BCBSMT. (App. at 25; Mont. Code Ann. § 50-4-715(2)(e).) Colleen Reitan, Maurice Smith and Michael Frank will testify in support of this statement. (C. Reitan Direct Test. 20:6-15; M. Smith Direct Test. 13:8-14; M. Frank Direct Test. 40:9-16.)

II. The Proposed Transaction Satisfies The Criteria Enumerated in Montana Code Annotated Conversion Statute Requirements § 50-4-717.

The proposed transaction also satisfies the statutory criteria that the Commissioner must consider.

A. BCBSMT exercised due diligence in deciding to engage in a conversion transaction, selecting the transferee, and negotiating the terms and conditions of the transaction.

BCBSMT exercised due diligence in deciding to engage in a conversion transaction, selecting HCSC as the transferee, and negotiating the terms and conditions of the transaction. (App. at 10-21; Mont. Code Ann. § 50-4-715(2)(a).)

BCBSMT decided to form a business alliance with another entity in the face of ongoing financial challenges and an increasingly competitive market. BCBSMT's Board of Directors and executive management explored alliances exclusively with NIO Blue plans, including HCSC, to preserve BCBSMT's non-profit history in Montana. (App. at 10.) BCBSMT was focused on four factors in deciding to pursue a business alliance: cost structure changes brought on by a lack of scale; increased competition in Montana; insufficient access to capital to expand capabilities and services; and increased risk exposure. (App. at 11-20.)

In choosing HCSC for a business alliance, BCBSMT conducted extensive due diligence. In the course of its assessment, BCBSMT examined HCSC's information technology; privacy and security; internal audit; legal; finance; operations; medical and behavioral care medical management; analytics and information management; sales and marketing; health care services; compliance and human resources; and corporate culture. (App. at 21.) The primary factors that led to BCBSMT's decision to form an alliance with HCSC included HCSC's financial strength, dedication to the NIO model, shared commitment to provide coverage to as many people as possible, a culture that emphasizes the importance of being local, size and scale, employment growth opportunities, proven track record integrating Blue plans, and strong technology and capabilities. (App. at 21-23; Business Case, App. at Ex. 8; M. Burczynski Direct Test. 10:11-12:2, 24:3-25:15; M. Frank Direct Test. 10:11-11:3, 12:6-14:2, 15:15-16:9, 17:13-18:11.)

BCBSMT's exercise of due diligence in negotiating the terms and conditions of the transaction are evidenced by the Asset Purchase Agreement. (App. at Ex. 3.) Michael Frank and Mark Burzynski will testify in support of BCBSMT's due diligence efforts.

B. BCBSMT and HCSC used appropriate expert assistance in negotiating the transaction.

As previously demonstrated, appropriate expert assistance was used in negotiating the transactions. (App. at Ex. 4-7; Mont. Code Ann. § 50-4-715(2)(b).) Michael Frank of BCBSMT will testify that BCBSMT hired the law firm of Graham &Dunn PC to represent and assist BCBSMT in negotiations of the APA with HCSC, to advise on due diligence issues, and other associated issues. (M. Frank Direct Test. 38:8-19.) He will further testify that with respect to the purchase price, the parties agreed to obtain an independent, third party valuation of the fair market value of BCBSMT as specified in the Montana Conversion Statute. As Mr. Frank will explain, BCBSMT retained ActMod to perform an independent actuarial valuation of BCBSMT's core health insurance business. (App. at Ex. 5.) BCBSMT further engaged Moss Adams to complete a valuation analysis of the fair market value of the total surplus of BCBSMT. (App. at Ex. 7; M. Frank Direct Test. 24:12-21.) Finally, BCBSMT commissioned NERA Economic Consulting ("NERA") to produce an independent Financial and Community Impact Report (App. at Ex. 4) to evaluate the community impact and an Antitrust Report (App. at Ex. 6) to evaluate any potential antitrust implications of the transaction.

C. All conflicts of interest were disclosed, including conflicts of interest of board members, executives, and experts retained by the transferor, transferee, or any other parties to the conversion transaction.

Colleen Reitan of HCSC and Michael Frank of BCBSMT will testify that no conflicts of interest were discovered among board members, executives or experts retained by the

Applicants. (App. at 27; Mont. Code Ann. § 50-4-717(2)(c); C. Reitan Dir. Test. 13:15-18; M. Frank Direct Test. 38:1-7).

D. The conversion does not have the likelihood of creating a significant adverse effect on the availability or accessibility of health care services or health insurance coverage in the affected community.

The parties agree that the transaction is unlikely to create a significant adverse effect on the availability or accessibility of health care services or health insurance coverage in the affected community. Mont. Code Ann. § 50-4-717(2)(d). The Commissioner's Antitrust and Community Impact expert, Dr. Timothy Tardiff of Advanced Analytical Consulting Group, Inc., confirms that "the transaction is not expected to adversely impact accessibility, availability and affordability of health care in Montana." (Advanced Analytical Report, hereinafter "AA Rep.," at 6.) Michael Frank of BCBSMT will testify to his view that the transaction will increase Montanans' access to health insurance coverage and health care services. (M. Frank Direct Test. 33:12-34:4, 37:21-22.)

E. The conversion transaction includes sufficient safeguards to ensure that the affected community will have continued access to affordable health care.

The parties agree that the transaction includes sufficient safeguards to ensure that the affected community will have continued access to affordable health care. Mont. Code Ann. § 50-4-717(2)(e). The Commissioner's Antitrust and Community Impact expert report concludes that the transaction is unlikely to adversely impact affordable health care in Montana. (AA Rep. at 6.)

F. Any management contract under the conversion transaction is for reasonable value.

As Michael Frank of BCBSMT will testify, there are no management contracts being transferred to HCSC by BCBSMT as part of the transaction. (M. Frank Direct Test. 41:12-14.)

G. The transaction is equitable to the public interest, enrollees, insureds, shareholders, and certificate holders, if any, of the transferor.

The parties agree that the transaction is equitable to the public interest, enrollees, insureds, shareholders, and certificate holders, if any, of the transferor. (App. at 28; Mont. Code Ann. § 50-4-717(2)(g)(i).) The Commissioner’s Antitrust and Community Impact expert report states that “the conversion transaction is equitable to the public interest, enrollees, insureds, shareholders and certificate holders, if any, of the transferor.” (AA Rep. at 40.)

H. The transaction is in compliance with Title 33, chapters 30 and 31.

The transaction is compliant under Title 33, chapters 30 and 31. (App. at 27; Mont. Code Ann. § 50-4-717(2)(g)(ii).)

I. The transaction ensures that the transferee will possess surplus in an amount sufficient to comply with the surplus required under law and provide for the security of the transferee's certificate holders, if any, and policyholders.

HCSC will possess surplus in an amount sufficient to comply with the surplus required under law and provide for the security of HCSC’s certificate holders, if any, and policyholders. (App. at 25; Mont. Code Ann. § 50-4-717(2)(g)(iii).) Maurice Smith, Divisional Senior Vice President, Business Development and Subsidiary Management of HCSC, will testify that HCSC’s surplus well exceeds the risk-based capital requirements under Montana law. (M. Smith Direct Test. 5:6-9, 12:6-12.)

J. The transaction will not result in inefficient economies of scale.

The parties agree that the transaction will not result in inefficient economies of scale. (App. at 28; Mont. Code. Ann. § 50-4-717(3)(a).) In the independent Financial and Community Impact expert report submitted by NERA, Dr. McCarthy concluded that “the proposed alliance will result in real and significant economies of scale.” (NERA Rep. at 11.) Similarly, the Commissioner’s Antitrust and Community Impact expert report concludes that “we do not expect

this alliance to result in inefficient economies of scale.” (AA Rep. at 6. *See also* Tardiff Dep. 16:13-17:3.) Indeed, one of the driving factors for the Alliance is the opportunity for BCBSMT and its insureds to benefit from the significant operational and financial scale of HCSC. (M. Frank Direct Test. 18:22-21:2; M. Burzynski Direct Test. 9:14-17, 10:12-12:2; 17:18-18:3; 24:3-25:16.)

K. The transaction would not violate federal or state antitrust laws.

The parties agree that the transaction would not violate federal or state antitrust laws. (App. at 28; Mont. Code Ann. § 50-4-717(3)(b).) The independent experts on antitrust implications, Dr. McCarthy of NERA on behalf of Applicants and Dr. Tardiff of MDS on behalf of the Montana Department of Justice, both reached the conclusion that the proposed transaction does not raise competition concerns. (NERA Antitrust Report at 2-3; AA Rep. at 5-6.) In addition, the U.S. Department of Justice’s Antitrust Division has granted BCBSMT’s and HCSC’s request for early termination of the waiting period under the Hart-Scott-Rodino Antitrust Act based on the finding that the transaction would cause no antitrust concerns.

CONCLUSION

For the foregoing reasons, the Applicants respectfully request that the Hearing Examiner recommend that the Montana State Auditor, *ex officio* Commissioner of Insurance, and the Montana Attorney General approve the Application for Approval.

Respectfully submitted this 11th day of March, 2013.

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CERTIFICATE OF SERVICE

I, Jacqueline T. Lenmark, KELLER, REYNOLDS, DRAKE, JOHNSON & GILLESPIE, P.C., certify that on March 11, 2013, I served a true and correct copy of the foregoing **APPLICANTS' PREHEARING MEMORANDUM**, by mailing it first class postage prepaid to:

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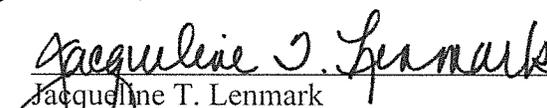
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