

of the public provided testimony at that hearing, but none subjected themselves to cross-examination. Another public hearing on the proposed alliance was held on March 12 - 14, 2013 in the Montana Supreme Court chambers. Public comment was accepted in writing prior to and during the hearing and public testimony was taken at the hearing. Some of the public testimony offered at the March hearing was subject to cross-examination. Only factual information provided in public comment which is subject to cross-examination by the parties is allowed to be considered in issuing these Findings of Fact and Conclusions of Law, or in the approval or disapproval of the transaction by the Attorney General or the Commissioner of Securities and Insurance (CSI). (Mont. Code Ann. § 50-4-711(2).) The majority of the public comments received expressed the opinion that the proposed transaction would be in the public interest.

3. At the March 2013 hearing, the Applicants provided testimony, subject to cross examination, of several company executives from HCSC, including James Kadela, Maurice Smith, Janice Knight and Colleen Reitan. BCBS also offered testimony of its employees, Michael Frank, Mark Burzynski and Jim Spencer, subject to cross examination. The Applicants jointly offered expert testimony of Thomas R. McCarthy, Ph.D., with respect to the community impact of the proposed transaction. The Applicants also offered testimony regarding the fair market value of BCBS and of the assets to be acquired under the transaction from Dr. James P. Galasso of Actuarial Services and Financial Modeling, Inc. and Calvin Swartly of Moss-Adams, LLP.

4. The Attorney General presented the expert testimony of Timothy Blackmer (Blackmer) of MDS Consulting, Inc. with respect to the fair market value of BCBS as of June 30, 2012. (Hearing transcript at 508-509.)

5. The CSI presented testimony from Steve Matthews, an actuary employed by the CSI. The CSI also offered expert testimony from Timothy Tardiff with respect to the community impact of the proposed transaction.

6. BCBS is a nonprofit health service corporation, registered in Montana as a mutual benefit corporation with members and organized under Montana Code Annotated Title 33, chapter 30. Its principle place of business is Montana. (Application for Approval of Alliance (Application), Nov. 15, 2012, at 4.)

7. The assets of BCBS are public assets as defined in the Conversion Statute, including the assets and liabilities that will be purchased by HCSC, as listed on Schedule 1.01 of the Application, and the assets that remain in the old BCBS entity after liabilities have been satisfied. (Application at 24; Application Schedule 1.01.)

8. BCBS's mission is to provide financial support to improve the quality, availability and awareness of healthcare programs and services in Montana. (Application at 2.)

9. HCSC is organized as a mutual legal reserve company domiciled in Illinois. HCSC's Articles of Incorporation provide that the company is founded as a "non-profit health care service plan and provide that HCSC shall operate on a not-for-profit basis. HCSC's Bylaws prohibit any person from receiving HCSC profits. (Application at 5.)

10. HCSC seeks to acquire certain assets of BCBS, including insurance and ASO contracts, provider contracts, and rights to use its Blue Cross and Blue Shield marks. HCSC will also acquire certain specified liabilities of BCBS associated with the insurance business it is acquiring, as well as specified pension liabilities. HCSC and BCBS have executed an Asset Purchase Agreement containing the details of the proposed transaction. (Application at 7-8 and Ex. 1-3.)

11. HCSC has agreed to pay \$40.2 million as consideration for the purchased assets under the Asset Purchase Agreement and HCSC has admitted that \$40.2 is a fair market value for the purchased assets. (Stipulation between Applicants and Attorney General, March 11, 2013.) The purchase price paid by HCSC is a public asset and will be distributed to an existing or new foundation or other nonprofit corporation in accordance with the requirements of Mont. Code Ann. § 50-4-720. (Application p. 2; Direct Testimony of Michael E. Frank (Frank Direct), March 5, 2013, at 30.)

12. BCBS will retain any assets and liabilities not acquired by HCSC. (Application at 8.)

13. Assets retained by BCBS after the conversion transaction will be used to discharge any remaining liabilities of the corporation. All remaining assets after liabilities are discharged will be liquidated and distributed to an existing or new foundation or other nonprofit corporation in accordance with the requirements of Mont. Code Ann. § 50-4-720. (Application p. 9; Frank Direct at 30.)

FAIR MARKET VALUE

14. Under the Conversion Statute, the Attorney General must evaluate whether the proposed transaction is in the public interest. To determine whether the transaction is in the public interest, the statute provides three specific criteria concerning the fair market value of public assets, which the Attorney General shall require before approval: the fair market value of public assets is preserved and protected; 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; and the fair market value of the public assets of a

nonprofit health entity will be distributed as provided in 50-4-720. (Mont. Code Ann. § 50-4-715(1) and (2)(a) - (c).)

15. The fair market value as of the date of the transaction or proposed transaction must be “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).)

16. Fair market value is defined in U.S. Treasury Department Revenue Ruling 59-60 as “the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.” This standard was used in all valuation reports pertinent to the proposed transaction. (Fair Market Valuation of BCBS as of June 30, 2012, MDS Consulting, Inc., issued Feb. 26, 2013 (MDS Report), AG Ex. I, at 5; Valuation Analysis Blue Cross Blue Shield of Montana as of June 30, 2012, Moss-Adams LLP, issued Nov. 12, 2012 (Moss-Adams Report), Applicant’s Ex. 7, at 1.)

17. Factors relevant in determining fair market value include, but are not limited to: (a) the value of the nonprofit health entity or the assets of a nonprofit health entity that are determined as if the nonprofit health entity had voting stock outstanding and 100% of its stock was freely transferable and available for purchase without restriction; (b) the value as a going concern; (c) the market value; (d) the investment or earnings value; (e) the net asset value; and (f) a control premium, if any. (Mont. Code Ann. § 50-4-716(3).)

18. With respect to the value of the company, BCBS executives testified about declining financial performance of BCBS, the necessity of obtaining additional capital and resources in order to comply with the federal Affordable Care Act, and the uncertainties of the

future health insurance market. (Direct Testimony of Mark A. Burzynski (Burzynski Direct), March 5, 2013, at 4-8; Frank Direct at 8-10) BCBS executives further testified about the potential risk of financial loss associated with the failure to consummate the proposed transaction as well as the expected benefits of completing the transaction. (Frank Direct at 33-39; *see generally* Burzynski Direct.)

19. The Attorney General retained MDS Consulting, Inc. to perform a fair market valuation of BCBS as of the time of the proposed transaction. (Direct Expert Testimony of Timothy J. Blackmer on Fair Market Valuation on Behalf of the State of Montana (Blackmer Direct) at 2.)

20. Blackmer performed the fair market valuation for MDS Consulting. He has a Masters degree in Business Administration, with an emphasis in Finance, from the University of Nevada. He is a Certified Public Accountant licensed in California and Washington State. Blackmer holds several accreditations in business valuation, including Accredited Business Valuation (ABV) from the American Institute of CPAs, Certified Business Appraiser (CBA) from the Institute of Business Appraisers, and Accredited Senior Appraiser (ASA) from the American Society of Appraisers. He has instructed undergraduate courses and seminars on issues pertinent to valuing businesses. Blackmer has completed valuations of asset portfolios for principals with annual gross revenues ranging from \$100,000 to over \$800 million. He has prepared hundreds of net tangible and intangible asset appraisals, including some in the healthcare and insurance industries. Blackmer's credentials as a qualified, independent valuation expert are substantial and undisputed. (Blackmer Direct at 1, 2; MDS Report at 60-61.)

21. In forming his expert opinion, Blackmer reviewed a large volume of written materials, including financial statements, tax returns, general ledger detail and other financial

data, operating data and information about the company. He conducted a site visit of BCBS, toured buildings, and had extensive discussions with BCBS management and key personnel about the history of the company and their expectations for the future. Blackmer also considered factors relating to the broader competitive environment of the healthcare business, including national and regional trends in healthcare and medical insurance, current local and national economic conditions, and characteristics of health and medical insurer businesses. (Blackmer Direct at 7-9; MDS Report at 7-9.)

22. Blackmer analyzed the value of BCBS as a going concern, which is the value of a business enterprise that is expected to continue to operate in to the future. (Blackmer Direct at 10.) He considered BCBS's value to a hypothetical purchaser of a 100% controlling ownership interest of all net tangible and intangible assets of the company. (MDS Report at 3; Blackmer Direct at 33.)

23. Blackmer analyzed the value of BCBS using several valuation methods, including the Income Approach, the Cost Approach, and the Market Approach. (MDS Report at 40-41.) The three approaches resulted in a range of value for BCBS between a minimum of \$182,500,000 and a high range of \$210,600,000 for all of the tangible and intangible assets of the company. (MDS Report at 3, 55.) The conclusion of value reached under each approach was assigned an equal weight of reliability, 33 percent, and the weighted indications of value from each approach were added to achieve a conclusion of value for BCBS of \$193,800,000 (rounded). (*Id.*)

24. The Moss-Adams report expressed a fair market value of \$166,200,000 for BCBS as of June 30, 2012. (Moss-Adams Report at 39.) Included in the Moss-Adams valuation was an appraisal of the purchased assets performed by Dr. James Galasso of Actuarial Services and

Financial Modeling, Inc. (Moss-Adams Report at 31, Ex. 21.) The Galasso appraisal valued the purchased assets, essentially the core insurance business of BCBS, at \$17.6 million as of June 30, 2012. (Moss-Adams Report at Ex. 21; Actuarial Appraisal of Certain Health Care Contracts with Appraisal Dates of Jan. 1, 2013 and June 30, 2012, Actuarial Services & Financial Modeling, Inc., issued Nov. 9, 2012 (Galasso Appraisal), at 19.)

25. In reaching the agreed-upon purchase price of \$40.2 million for the assets HCSC seeks to acquire, the parties utilized or relied upon the MDS Report, Moss-Adams Report, and Galasso Appraisal. (Hearing Transcript, Smith Testimony at 273-275.)

26. In Blackmer's opinion, \$40.2 million is a reasonable fair market value for the core insurance business HCSC is proposing to acquire from BCBS. (Hearing Transcript, Blackmer Testimony at 509.) Blackmer is qualified by education and experience to offer expert testimony regarding the fair market value of the public assets involved in the proposed transaction. Blackmer's testimony was credible and is supported by the facts and data underlying his opinion.

27. No evidence was presented to contradict the range of fair market value of BCBS presented in the MDS report. (Stipulation between Applicants and Attorney General, March 11, 2013.)

NO INAPPROPRIATE REMUNERATION OR COMPENSATION TO RELATED PARTIES

28. Under the Conversion Statute the Attorney General must also require that:

(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; and

(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.

(Mont. Code Ann. § 50-4-775(2).)

29. Michael Frank, President and Chief Executive Officer of BCBS, testified regarding compensation, benefits, and employment contracts between BCBS and certain of its employees. (Frank Direct at 41-42.) He testified that no employee, officer, or director would receive remuneration as a result of the proposed conversion transaction. (*Id.*) Nor would any public assets of BCBS inure directly or indirectly to any officer, director, or employee of BCBS or HCSC. (*Id.*) He was unaware of any conflicts of interest at issue with anyone at BCBS or HCSC. (*Id.*)

30. Colleen Reitan, Executive Vice President and Chief Operating Officer of HCSC, testified that no representations had been made to any employee of BCBS with regard to merger bonuses based on the proposed transaction. (Hearing Transcript, Reitan Testimony p. 69.) Further, no other compensation or bonuses has been offered to anyone as a result of the consummation of the transaction. (*Id.*)

31. The Applicants and the Attorney General entered a Stipulation on March 12, 2013 in which HCSC provides assurances that BCBS employees who will be retained by HCSC under the Asset Purchase Agreement have not been promised any bonuses or increases to their compensation if the proposed transaction is approved. Further, BCBS agreed not to further

increase base annual compensation of any employee prior to closing the proposed transaction. BCBS also provided assurances that no immediate or future remuneration would flow to any of its officers, directors, or trustees as a result of the proposed transaction, except for compensation owed pursuant to any existing contracts or agreements. (Stipulation between Applicants and Attorney General, March 12, 2013.)

32. There is no evidence that inappropriate payments or remuneration have been promised or granted, or will be promised or granted, as a condition of the approval of the proposed transaction.

CONCLUSIONS OF LAW

1. The Conversion Statute applies to the transaction between BCBS and HCSC. (Application stipulation p. 3)
2. The assets of BCBS, including the assets to be purchased by HCSC through the proposed transaction and the assets to be retained by BCBS after the transfer, are public assets for purposes of the Conversion Statute.
3. Blackmer has the requisite knowledge, skill, experience, training and education to express an expert opinion on the business valuations.
4. Blackmer gathered written materials, interviewed BCBS employees, conducted a site visit and researched economic and industry factors to inform his opinion of the fair market value of BCBS. Blackmer is a qualified appraiser who performed an independent appraisal of the assets and operations of BCBS in accordance with Mont. Code Ann. § 50-4-701(4).
5. Blackmer used a fair market value standard to determine the value of the company, which is an appropriate professional appraisal standard in accordance with Mont. Code Ann. § 50-4-701(4).

6. Blackmer considered relevant factors in valuing BCBS, specifically its value as a going concern in which 100% controlling ownership interest in the net tangible and intangible assets would be available for purchase without restriction in satisfaction of Mont. Code Ann. § 50-4-716(3).

7. The fair market value of BCBS is between \$182,500,000 and \$210,600,000.

8. A reasonable fair market value for the assets that HCSC proposes to purchase is at least \$40.2 million.

9. HCSC has agreed to a purchase price of \$40.2 million for the assets it seeks to acquire. Because \$17.6 million is already factored into the Moss-Adams valuation as a purchase price for the assets that HCSC seeks to acquire, adding \$22.6 million (the difference between the agreed purchase price and the price already accounted for in the report) to the Moss-Adams fair market value of \$166,200,000 results in a total value of \$188,800,000 million. The resulting value is within the range of fair market value for the assets of BCBS.

10. The \$40.2 million purchase price similarly increases the resulting fair market value under the Blackmer analysis. The \$40.2 million purchase price represents the value of the intangible assets of BCBS, including the Contracts, Brands, Community Goodwill, and the value of the Trained and Assembled Workforce. Blackmer's opinion of the value of these intangible assets was \$24,960,000. (MDS Report at 4.) By substituting the actual stipulated purchase price of \$40.2 million for the estimated value of the intangible assets in Blackmer's analysis, the resulting bottom line Rounded Estimate of Surplus Value increases to \$209,040,000. The resulting value is well within the range of fair market value for the assets of BCBS.

11. The agreed purchase price of \$40.2 million preserves and protects the fair market value of the purchased assets, as required by Mont. Code Ann. § 50-4-715(2)(a).

12. Considering BCBS's declining financial performance, its need to access capital and resources to comply with new federal regulations, and the uncertainty of the future health insurance market, the fair market value of the public assets of BCBS have been maintained with reasonable consideration of the potential risks of financial loss associated with the conversion transaction or the failure to consummate the transaction, in accordance with Mont. Code Ann. § 50-4-715(2)(b).

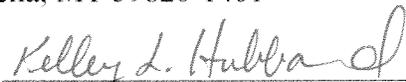
13. The fair market value of the public assets of BCBS will be distributed to an existing or new foundation or other nonprofit corporation in accordance with Mont. Code Ann. § 50-4-720, as required by Mont. Code Ann. § 50-4-715(2)(c).

14. No part of the BCBS's public assets will inure directly or indirectly to an officer, director, trustee or employee of BCBS or HCSC, as required by Mont. Code Ann. § 50-4-715(2)(d).

15. No officer, director, or trustee of BCBS will receive immediate or future remuneration as a result of the proposed transaction, except for reasonable compensation paid pursuant to a valid contract, as required by Mont. Code Ann. § 50-4-715(2)(e).

Respectfully submitted this 19th day of April, 2013.

TIMOTHY C. FOX
Montana Attorney General
215 N. Sanders
P.O. Box 201401
Helena, MT 59620-1401

By: 

KELLEY L. HUBBARD
Assistant Attorney General

CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was mailed on the 19th day of April, 2013, by US mail, first-class postage paid, to the following:

Ms. Sybil Shults
Office of the Commissioner of Securities and
Insurance, Montana State Auditor's Office
840 Helena Ave.
Helena, MT 59601

Honorable W. William Leaphart
1772 University Ave.
Helena, MT 59601

Jacqueline T. Lenmark
Keller, Reynolds, Drake,
Johnson & Gillespie, P.C.
50 South Last Chance Gulch, Suite 4
P.O. Box 598
Helena, MT 59624

Stanley T. Kaleczyc
Browning, Kaleczyc, Berry, & Hoven, P.C.
P.O. Box 1697
Helena, MT 59624

Helen E. Witt
Kirkland & Ellis LLP
300 North LaSalle St.
Chicago, IL 60654

Michael McMahan
McMahan, Wall & Hubley, PLLC
212 N. Rodney
Helena, MT 59601

Jesse Laslovich
Nick Mazanec
Office of the Commissioner of Securities
and Insurance, Montana State Auditor
840 Helena Avenue
Helena, MT 59601

Jay Angoff
Mehri & Skalet, PLLC
1250 Connecticut Ave. NW, Ste. 300
Washington, DC 20036