

**In Re:**

*In the Matter of the Conversion of  
Blue Cross and Blue Shield of Montana*

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*Transcript of Proceedings*

*Vol. I*

*March 12, 2013*

***CONFIDENTIAL PORTIONS REDACTED***

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***LESOFSKI COURT REPORTING & VIDEO CONFERENCING***

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1 BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE

2 MONTANA STATE AUDITOR

3 IN THE MATTER OF THE CONVERSION )  
 4 OF BLUE CROSS AND BLUE SHIELD OF ) Case No.  
 MONTANA, INC., AND ALLIANCE WITH ) INS-2012-238  
 5 HEALTH CARE SERVICE CORPORATION )  
 )  
 6 Applicants, )

7

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9 TRANSCRIPT OF PROCEEDINGS

10 VOLUME I

11 \*\*\*CONFIDENTIAL PORTIONS REDACTED\*\*\*

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14 Taken at:  
 15 Montana Supreme Court  
 215 North Sanders  
 16 Helena, Montana  
 March 12, 2013

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18 W. WILLIAM LEAPHART, Presiding

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1	I N D E X	
2	EXAMINATION OF JOE UNTERREINER: By Mr. Laslovich	64
3		
4	EXAMINATION OF BRETT DONEY: By Mr. Laslovich	69
5		
6	EXAMINATION OF RICHARD MILTENBERGER: By Mr. McMahon By Mr. Laslovich	81 82
7		
8	EXAMINATION OF STEPHANIE LARSEN: By Mr. McMahon By Mr. Kaleczyc By Mr. Laslovich By Mr. Hubbard	91 96 98 100
9		
10	EXAMINATION OF MICHAEL FRANK: Direct By Mr. McMahon	102
11	Cross By Mr. Angoff Confidential Portion	105 137-166
12	Direct by Mr. McMahon (Continued) Cross by Mr. Angoff (Continued) Cross by Mr. Kaleczyc	186 195 196
13		
14	EXAMINATION OF MARK BURZYNSKI: Direct by Mr. McMahon	198
15	Cross by Mr. Angoff Confidential Portion	199 210-223
16	Cross by Ms. Hubbard Direct by Mr. McMahon (Continued) Cross by Mr. Angoff (Continued) Cross by Mr. Kaleczyc Redirect by Mr. McMahon	217 217 218 235 236
17		
18		
19	EXAMINATION OF JAMES KADELA: Direct by Mr. Kaleczyc Cross by Mr. Angoff Redirect by Mr. Kaleczyc	242 243 249
20		
21		
22	EXAMINATION OF MAURICE SMITH: Direct by Mr. Kaleczyc Cross by Mr. Laslovich Redirect by Mr. Kaleczyc	254 255 276
23		
24	EXHIBITS:	Admitted:
	Applicant 9	103
25	Commissioner A	180

1           HEARINGS OFFICER LEAPHART: Good morning  
2           everybody. The first order of business I want  
3           to point out is that the clock on the back of  
4           the wall appears to be on Pacific time, so  
5           don't get misled if we take a recess and you're  
6           supposed to be in at a certain time, the clocks  
7           haven't been changed.

8           I've been up here before but never as the  
9           Lone Ranger like this so it's going to be  
10          lonely. This courtroom was not designed for  
11          the taking of testimony so it doesn't have a  
12          witness stand as such, so what we're going to  
13          do is use the judge's seat on the far left-hand  
14          side of the bench, your right hand, my left,  
15          that will be our witness stand. And the  
16          attorneys, if you would, when addressing the  
17          Hearings Officer can use the podium here in the  
18          middle and everybody speak up so that you're  
19          being recorded because we need the record.

20          This is the time and the place for the  
21          continuation of the public hearing on Blue  
22          Cross Blue Shield of Montana's and Health Care  
23          System Service Corporation's application for a  
24          conversion transaction. My name is William  
25          Leaphart, I'm acting as the Hearings Officer.

1 I will conduct the hearing and then once all of  
2 the evidence testimony and the comments are in  
3 I will make proposed findings of fact and  
4 conclusions of law addressing the question of  
5 whether the proposed transaction meets various  
6 statutory criteria, including whether the  
7 transaction would be in the public interest.  
8 The Commissioner and the Attorney General's  
9 Office will then review my proposed findings  
10 and conclusions and make the final  
11 determination.

12 Participants should be aware that this  
13 hearing is the first of what potentially will  
14 be a two-hearing process. The bulk of the  
15 testimony and evidence will be introduced in  
16 this week's hearing. The hearing commencing  
17 today is focused solely on the question of  
18 whether the proposed transaction is in the  
19 public's interest. If the application is  
20 approved there will be a subsequent hearing  
21 addressing the question of how the funds  
22 generated from the transaction will be  
23 distributed. That hearing will not be  
24 scheduled until such time as the application  
25 decision is made.

1           The order of business will be as follows:  
2           We will have opening statements from the  
3           parties with the Applicants going first,  
4           followed by the Commissioner, followed by the  
5           Attorney General. Each party has up to 45  
6           minutes to present their opening. After the  
7           opening statements members of the public will  
8           have an opportunity to present comments.  
9           Montana's governing statutes, statute 50-4-711,  
10          provides that in presenting public comment you  
11          as a witness have the option of whether or not  
12          to submit yourself to cross-examination. If  
13          you do not submit to cross-examination your  
14          testimony cannot be used by me, the  
15          Commissioner or the Attorney General in making  
16          our decision. If you do submit to  
17          cross-examination then your testimony can be  
18          used in the decision-making process.

19          You should also be aware that you have a  
20          choice as to the timing of your public comment.  
21          You can comment today at the conclusion of the  
22          opening statements or you can wait until the  
23          evidence and testimony has been presented and  
24          make your comments at that time. You should be  
25          aware that there is a good chance that the

1 taking of testimony and presenting of evidence  
2 may not come to a conclusion until tomorrow or  
3 even the next day, so you have to weigh that in  
4 terms of how long you want to stick around and  
5 listen to this hearing.

6 After receiving public comment today we  
7 will proceed with the taking of testimony from  
8 the parties, again, with the Applicants going  
9 first, followed by the Commissioner and the  
10 Attorney General. The parties for the most  
11 part have had their respective witnesses  
12 prefile their direct testimony in written form.  
13 That testimony is on file and open to the  
14 public. Those witnesses will take the stand,  
15 adopt their prefiled direct testimony and we  
16 will proceed with cross-examination.

17 Unless there are any procedural questions  
18 at this point we will start with the  
19 Applicant's opening statements but first I  
20 would ask that counsel introduce themselves for  
21 the record, identify themselves and who they  
22 represent. The Applicants?

23 MS. LENMARK: Your Honor, for the record I  
24 am Jacqueline Lenmark, I practice with the firm  
25 of Keller, Reynolds, Drake, Johnson &

1 Gillespie. I represent today jointly the  
2 Applicants in this case, Blue Cross Blue Shield  
3 of Montana and Health Care Service Corporation,  
4 which I'm sure we'll be referring to in brief  
5 throughout the proceeding as Blue Cross,  
6 perhaps with the addition of Montana or not,  
7 and HCSC.

8 I also am joining in representation this  
9 morning by Mike McMahon on behalf of Blue Cross  
10 and Blue Shield of Montana, Stan Kaleczyc on  
11 behalf of HCSC and Helen Witt on behalf of  
12 HCSC.

13 Your Honor, my clients and I have been --

14 HEARINGS OFFICER LEAPHART: Excuse me,  
15 before you start your opening let me do some  
16 more introductions.

17 MS. LENMARK: Certainly, Your Honor.

18 Would you like me to --

19 HEARINGS OFFICER LEAPHART: Let's have  
20 Mr. Laslovich go ahead.

21 MR. LASLOVICH: Good morning, Your Honor,  
22 I appreciate it. Jesse Laslovich on behalf of  
23 the Commissioner of Securities and Insurance.  
24 I'm joined by Jay Angoff on behalf of the  
25 Commissioner of Securities and Insurance and

1 also Nick Mazanec on behalf of the Commissioner  
2 of Securities and Insurance.

3 HEARINGS OFFICER LEAPHART: And the  
4 Attorney General's office?

5 MS. HUBBARD: Your Honor, I'm Kelley  
6 Hubbard for the Office of the Attorney General,  
7 I'm joined by my colleague, Michael Black.

8 HEARINGS OFFICER LEAPHART: Thank you.  
9 Have I omitted anybody as far as introductions?  
10 If not, you can proceed with your opening  
11 statement, Miss Lenmark.

12 MS. LENMARK: Thank you, Your Honor. Your  
13 Honor, my clients and I have been looking  
14 forward to today. We think that you will be  
15 hearing a great story, a story of corporate  
16 responsibility and citizenship at its very  
17 best. We are seeking approval of the  
18 transaction that we believe is truly in the  
19 public interest and promises enormous value to  
20 the state of Montana.

21 I'd like to start with just a little bit  
22 of history to orient you to where we are today.  
23 When Mike Frank, who is the current president  
24 and CEO of Blue Cross Blue Shield of Montana,  
25 stepped into the shoes of his predecessor he

1 joined a leadership team, his board and his  
2 executive management team that shared a  
3 commitment to the 70-plus year legacy of Blue  
4 Cross Blue Shield of Montana and its mission to  
5 provide accessible, affordable health care  
6 insurance to Montana citizens. But he also  
7 inherited a company that was grappling with  
8 oncoming change on the landscape of health care  
9 as we knew it and was in a strained financial  
10 and operating position as a result of the  
11 uncertain and increasingly competitive health  
12 insurance market. Mike, the board and his  
13 executive management team however shared a  
14 vision, they shared a vision of what the  
15 company could be, what it could become.

16 To protect Blue Cross Blue Shield  
17 Montana's legacy and to address its financial  
18 position so that the company could continue in  
19 its mission, Blue Cross leadership determined  
20 that a business alliance with another Blue plan  
21 would best allow Blue Cross Blue Shield Montana  
22 to serve the residents of Montana for these  
23 following reasons: First, Blue Cross Blue  
24 Shield Montana had already pursued aggressive  
25 cost-cutting measures but it continued to incur

1           underwriting losses, escalating claims,  
2           membership losses and a declining level of RBC.  
3           It could not afford capital that it needed to  
4           fund the capital improvements it needed to  
5           operate in the new post-ACA, post-health care  
6           reform marketplace. And, third, as a small  
7           Blue plan it would not be able to achieve the  
8           same economies of scale that large national  
9           carriers or large Blue plans could achieve.

10           Having determined that it was necessary to  
11           pursue some sort of an alliance Blue Cross then  
12           focused on identifying the best potential  
13           partner for its operation here in Montana. The  
14           criteria that the leadership used were the  
15           following: First, any alliance partner must be  
16           a plan that was another Blue plan; in other  
17           words, its license could only be transferred to  
18           another Blue plan within the Blue Cross Blue  
19           Shield association, the national association  
20           for Blue Cross plan members; second, it was  
21           critically important that the partner be a  
22           nonprofit; third, it was to allow for the  
23           continued use of Blue Cross Blue Shield of  
24           Montana's name, in other words, not become  
25           known by a name that didn't include the

1 designation Montana, the designation Blue Cross  
2 and Blue Shield. Importantly, it had to be  
3 financially strong enough to meet the immediate  
4 infrastructure and cost needs of Blue Cross  
5 Blue Shield of Montana, so that Blue Cross Blue  
6 Shield of Montana would not risk going through  
7 another transaction at another future time and  
8 also a partner that would have sufficient scale  
9 that Blue Cross to compete with national  
10 for-profit carriers.

11 Finally, Blue Cross wanted a partner that  
12 shared a similar corporate culture and  
13 demonstrated commitment to compliance,  
14 nonprofit operations, maintenance of local  
15 management presence. Those criteria enabled  
16 Blue Cross and Blue Cross's Montana leadership  
17 to quickly narrow their search for an  
18 appropriate partner to two Blue companies.  
19 Their ability to do so so quickly was informed  
20 by the intimate knowledge that they had of  
21 other Blue plans in the unique Blue Cross Blue  
22 Shield association of plans nationwide.

23 Ultimately Blue Cross Blue Shield Montana  
24 leadership determined to pursue a path of due  
25 diligence with HCSC. They chose HCSC because

1           it best aligned with Blue Cross Blue Shield  
2           Montana goals. It had been doing business for  
3           70-plus years as a nonprofit service plan in  
4           the same way that Blue Cross Blue Shield  
5           Montana had. It operated health plans in four  
6           other states, it had a proven track record of  
7           successfully aligning other Blue plans and  
8           maintaining a strong local presence in each  
9           state. It is the fourth largest health  
10          insurance company in the country and one of the  
11          strongest Blue plans in the United States both  
12          operationally and financially.

13                 Allow me to briefly summarize the  
14          structure of the transaction on which the  
15          Applicants are seeking approval. In this  
16          transaction HCSC will acquire the insurance and  
17          self-funded operations and related assets and  
18          liabilities of Blue Cross Blue Shield of  
19          Montana. Those assets generally are the  
20          insurance contracts and the self-funded  
21          administrative services contracts, provider  
22          contracts and rights to use the Blue Cross Blue  
23          Shield marks. The liabilities will be  
24          primarily the claims liabilities under their  
25          insurance and self-funded contracts, the

1 provider contracts and then the pension  
2 liabilities for the Blue Cross Blue Shield  
3 Montana employees.

4 After the alliance HCSC will operate the  
5 insurance business of Blue Cross Blue Shield  
6 Montana as a division of HCSC in Montana and  
7 will continue to do business as Blue Cross Blue  
8 Shield Montana. Blue Cross policyholders will  
9 become policyholders of HCSC without any break  
10 in coverage, benefits or services. The old  
11 Blue Cross Blue Shield Montana entity will not  
12 be operated as health insurance business any  
13 longer but instead will continue to operate for  
14 the purpose of satisfying and otherwise  
15 discharging its remaining liabilities so that  
16 the old Blue Cross company can eventually be  
17 wound down and dissolved.

18 The proceeds from this transaction will be  
19 deposited to a foundation as provided under the  
20 statute. The assets remaining after the wind  
21 down of the old Blue Cross Blue Shield Montana  
22 will also be paid into or transferred to that  
23 foundation.

24 The assets that are not primarily related  
25 to Blue Cross' core insurance business have

1           been excluded from the transaction purposefully  
2           and they will go to the foundation, including  
3           Blue Cross' surplus, its principal subsidiary  
4           holding company, buildings and certain other  
5           assets. There are also some excluded  
6           liabilities that will remain with the old Blue  
7           Cross company.

8                     In total, HCSC will be assuming  
9           liabilities of Blue Cross Blue Shield Montana  
10          at approximately \$180 million at closing and  
11          will transfer \$180 million of assets and cash  
12          to support those liabilities.

13                    In consideration of the sale of the  
14          acquired business HCSC was to pay the sum of  
15          \$17.6 million which had been determined solely  
16          by independent expert valuation. HCSC has  
17          stipulated with the Montana Attorney General,  
18          however, that it will pay \$40.2 million for the  
19          insurance business it will assume from Blue  
20          Cross Blue Shield of Montana if this  
21          transaction is approved.

22                    Why is this transaction in the public  
23          interest? First I would note the creation of  
24          the foundation that I mentioned. It will be  
25          funded with an approximate amount of \$120

1 million, perhaps even greater depending upon  
2 the value of the assets on closing. Key to  
3 this foundation is the fact that it will retain  
4 the surplus of Blue Cross Blue Shield of  
5 Montana. Continuity of provider networks and  
6 their compensation rates are critically  
7 important in the public interest. HCSC will be  
8 assuming all of the provider contracts and they  
9 will continue seamlessly as the insurance  
10 coverage benefits that I had mentioned before.

11 Continuity of producer networks. Blue  
12 Cross Blue Shield Montana relies heavily upon  
13 its agent insurance producer workforce and that  
14 workforce, that agent force will continue under  
15 this transaction.

16 Very important as a benefit to the public  
17 interest is the expertise that Blue Cross will  
18 gain with ACA compliance. HCSC's resources,  
19 its actuarial resources, its legal resources,  
20 its technological resources are prodigious.

21 And then there is HCSC's history of  
22 community participation. There is a very  
23 strong record of community support, community  
24 contribution and participation in community  
25 charitable causes.

1           Maybe one of the most important benefits,  
2           however, to the public interest are jobs. Blue  
3           Cross Blue Shield employees will all be  
4           maintaining their current employment, they will  
5           be paid at their current salaries. There is a  
6           potential in the future for those salaries to  
7           grow but they can look at this transaction with  
8           the confidence that each of them will be  
9           keeping their jobs and continue to be  
10          compensated at their current level.

11          And then there is also the commitment that  
12          HCSC has made to put in a sales, a call center  
13          in Great Falls, Montana, and that portends the  
14          employment of at least 100 new Montana  
15          employees, not employees from the current Blue  
16          Cross Blue Shield, these are 100 additional  
17          employees that this alliance will enable  
18          employment for.

19          Why is the alliance a benefit to Blue  
20          Cross and its insureds? First probably is  
21          capital and surplus. This alliance will give  
22          Blue Cross access to increased capital and it  
23          will allow it to also access the surplus of  
24          HCSC that will give it the financial stability  
25          that it needs. The alliance is going to allow

1 Blue Cross Blue Shield to lower its  
2 administrative costs critical to its efficient  
3 operation and its going to gain, again, I'll  
4 use the word prodigious assistance, transition  
5 assistance under ACA and as we go into the new  
6 health care environment.

7 All of these things that I have cited  
8 translate to a more efficient operation, better  
9 service, lower premiums or slowed increases in  
10 premiums as the cost of health care continues  
11 to rise.

12 The maintenance of jobs within the company  
13 is important and I had mentioned that as a  
14 benefit in the public interest, but  
15 specifically to Blue Cross Blue Shield  
16 employees I need to mention that they also will  
17 be maintaining their retirement and  
18 transitioning to retirement plans at the same  
19 or similar level. Critical to that is that  
20 they will be transitioning and be credited for  
21 all of the time that they have already earned  
22 as Blue Cross Blue Shield employees.

23 Finally, I'd like to address how the  
24 alliance is going to be beneficial to HCSC, an  
25 important party here in this transaction, and

1 that is that this alliance is going to allow  
2 them to add a partner in their family of  
3 companies with consistent core values and an  
4 equally long nonprofit legacy. They also will  
5 have access to the Montana workforce, a trained  
6 workforce and then access to a pool of Montana  
7 residents who can be potential employees, good  
8 potential employees for the company and  
9 finally, again, I will mention their tradition  
10 of community involvement and the opportunity to  
11 participate in a Montana culture and the  
12 Montana community.

13 Your Honor, this is a unique proceeding as  
14 you know. We have joint approval authority  
15 here with the Attorney General and the  
16 Commissioner of Insurance and each of those  
17 regulators must approve the transaction before  
18 it can become a final alliance. Each of those  
19 regulators must focus on different criteria and  
20 come to a separate and different conclusion and  
21 then join together with the approval.

22 I am honored to be chosen to bring the  
23 transaction before you. It is a compliment I  
24 think to Montana that HCSC was so readily  
25 interested in exploring a partnership with us

1 and I think it's a compliment to HCSC that  
2 Montana found its values so closely aligned --  
3 excuse me, that HCSC found its values so  
4 closely assigned with Montana values.

5 The applicants before you are confident  
6 that this alliance and its transaction is in  
7 the public interest. We think that our  
8 evidence will demonstrate that but we also  
9 invite the hard questions so that we can ensure  
10 that confidence is shared by you and the  
11 ultimate decision-makers.

12 We believe the evidence today will  
13 demonstrate that the alliance and the  
14 transaction through which it will be  
15 implemented will satisfy all of the mandatory  
16 criteria under the statute for approval, that  
17 it is in the public interest and that you may  
18 recommend to each the Attorney General and the  
19 Commissioner of Insurance that they approve  
20 this transaction for Montana. Thank you.

21 HEARINGS OFFICER LEAPHART: Thank you.  
22 Any further opening from Applicants?  
23 Mr. Kaleczyc?

24 MR. KALECZYC: Thank you, Justice  
25 Leaphart. You have just heard Ms. Lenmark

1 describe for you the proposed transaction and  
2 summarize for you the reasons why Blue Cross  
3 Blue Shield of Montana has sought an alliance  
4 partner and why in particular they have sought  
5 to partner with Health Care Services  
6 Corporation to help it meet both today's and  
7 tomorrow's challenges to bring affordable  
8 health care to the people of Montana.

9 What I would like to do in just a very few  
10 minutes is introduce you and the public a  
11 little bit more to who Health Care Services  
12 Corporation is and elaborate upon why Health  
13 Care Services Corporation, HCSC, is willing to  
14 make a commitment to Montana in the proposed  
15 alliance.

16 As you know from the prefiled testimony,  
17 HCSC is the largest non-investor owned health  
18 insurance company in the United States. It is  
19 comprised of an alliance of four Blue Cross  
20 Blue Shield programs operating in four separate  
21 states, Illinois, Texas, Oklahoma and New  
22 Mexico. HCSC has over 13 million members in  
23 those four states and it has a surplus of over  
24 \$9 billion, which provides financial stability  
25 to its members in the case of catastrophic

1 events such as a pandemic, expensive  
2 innovations in medical care such as new but  
3 expensive vaccines that might be available to  
4 the public and also provides a cushion against  
5 the uncertainties as the next changes of the  
6 Affordable Care Act are implemented.

7 James Kadela, who is the Division Senior  
8 Vice-President for Financial Services and  
9 Internal Operations for HCSC, will testify that  
10 HCSC has the experience and the track record to  
11 successfully integrate the business operations  
12 and technology of Blue Cross Blue Shield  
13 Montana into the HCSC business model. To these  
14 ends HCSC is prepared to spend significant  
15 resources to successfully integrate and upgrade  
16 Blue Cross Montana's information technology  
17 systems, upgrades which are critical to  
18 compliance with the Affordable Care Act and  
19 which will improve and enhance services to  
20 customers in Montana.

21 Maurice Smith, who is the Division Senior  
22 Vice-President for Business Development and  
23 Subsidiary Management for HCSC, will testify  
24 that HCSC has the financial strength which will  
25 allow the proposed allowance to benefit both

1 present and future Montana consumers of health  
2 insurance even in light of the underwriting  
3 losses the Montana plan has recently sustained  
4 and in the face of the costs of compliance with  
5 the Affordable Care Act which all health  
6 insurers currently face.

7 The second question, Justice Leaphart, is  
8 why is HCSC interested in Montana and willing  
9 to make the commitments to make the proposed  
10 alliance work. You will hear from Colleen  
11 Reitan, the Executive Vice-President and Chief  
12 Operating Officer for HCSC, as she will testify  
13 first and most fundamentally, HCSC and Blue  
14 Cross Montana share the same core value,  
15 namely, a commitment to the not-for-profit form  
16 of doing business and the business specifically  
17 of the delivery of affordable health care to  
18 its members. Because they do not have  
19 shareholders both HCSC and the Montana plan as  
20 alliance partners can focus on the long-term  
21 wellness and financial security of their  
22 members. Because they share the same core  
23 values and will share the same core model,  
24 business model if the alliance is approved,  
25 both HCSC and Blue Cross Montana will share the

1 economies and benefits of scale as explained in  
2 the testimony of several witnesses. And HCSC  
3 will enjoy the benefit of increased membership  
4 which will contribute to that scale and the  
5 benefit of the work ethic of the Montana  
6 workforce, both the current workforce of over  
7 500 employees, as Ms. Lenmark explained to whom  
8 continued employment is guaranteed under the  
9 alliance, and to an additional 100 new  
10 employees if the alliance is timely approved.

11 Finally, because the two alliance partners  
12 share the same core values, HCSC and its  
13 alliance partner shall continue their  
14 commitment to charitable and special causes and  
15 community involvement in the state of Montana,  
16 a tradition which Blue Cross Montana has had  
17 and HCSC has had to the states in which it  
18 operates and it is a commitment to continue  
19 that tradition in our state as we go forward.

20 HCSC and Blue Cross Montana believe that  
21 the evidence will support the conclusion and  
22 allow you to make the recommendation that the  
23 proposed alliance meets the statutory  
24 requirements for approval of the transaction  
25 and that this alliance is in the best interest

1 of the Applicants, is in the best interest of  
2 Montana insureds and is in the best interests  
3 of the public in the state of Montana. Thank  
4 you.

5 HEARINGS OFFICER LEAPHART: Thank you.  
6 Commissioner, Mr. Laslovich?

7 MR. LASLOVICH: Good morning, Your Honor.  
8 I have to say before I begin how much an honor  
9 it has been the last few months for me  
10 personally to work with some of Montana's  
11 finest lawyers, the folks who are representing  
12 the Applicants in this matter, and I have to  
13 say too it has equally been an honor to work  
14 with the folks of Blue Cross Blue Shield of  
15 Montana, many of whom I've had the chance to  
16 work with personally the last three years and  
17 it's also been very nice, Judge, to work with  
18 and learn from the folks at HCSC, even though  
19 some of them are Dallas Cowboy fans, Your  
20 Honor, and you'll know which witness it is.

21 Without trying to sound overly dramatic,  
22 today we are faced with one of the biggest  
23 decisions in our state's history, a decision  
24 that surely will have profound impacts on  
25 Montanans for generations to come and at least

1 from our office's perspective we are required  
2 to determine if this is ultimately in the  
3 public interest, as Ms. Lenmark and  
4 Mr. Kaleczyc referenced.

5 We are guided by Title 50, Chapter 4,  
6 Part 7, which I'll refer to, Your Honor, as the  
7 conversion statute which lays out the criteria  
8 that our office will determine whether they're  
9 met and ultimately whether this is in the  
10 public's interest.

11 Prior to briefly addressing those  
12 criteria, Your Honor, I believe we owe it to  
13 the people who are here today and also those  
14 who aren't here, frankly, to provide some  
15 background as to what their government has done  
16 as it relates to our office thus far to analyze  
17 this transaction.

18 I want to preface my remarks by saying  
19 that at this point in these proceedings the  
20 Commissioner's Office is not urging approval,  
21 nor is it urging disapproval but rather that  
22 prior to the important decision being made  
23 questions need to be answered, the record needs  
24 to be developed and our concerns need to be  
25 addressed.

1           First, for purposes of the conversion  
2           statute Blue Cross Blue Shield of Montana is a  
3           nonprofit health entity as it's defined in the  
4           conversion statute and it's been represented to  
5           us in the application and certainly in the  
6           opening statements from Mr. Kaleczyc and  
7           Ms. Lenmark that HCSC is a mutual legal reserve  
8           company under Illinois law that operates on a  
9           not-for-profit basis pursuant to their articles  
10          of incorporation and their by-laws.

11          You'll hear testimony from HCSC that they  
12          are committed to the not-for-profit model and  
13          from our office's perspective, Your Honor, we  
14          appreciate it.

15          Both Blue Cross and HCSC have stipulated  
16          to the applicability of the conversion statute  
17          even though, as the application states, the  
18          assets being acquired will not be going to a  
19          for-profit entity. But for purposes of this  
20          transaction, Your Honor, for our office's  
21          consideration we must assume under the  
22          conversion statute that the assets being  
23          acquired are being acquired by an entity other  
24          than a nonprofit entity as defined in the  
25          conversion statute.

1           Why is that important? Well, it's  
2           important because if this is approved this is  
3           the one shot that the state has relative to  
4           Blue Cross Blue Shield in saying to the people  
5           of Montana that it's in fact in their public  
6           interests for Blue Cross Blue Shield of  
7           Montana, our state's oldest and largest health  
8           insurer, to convert to an entity other than a  
9           nonprofit health entity as defined by the  
10          conversion statute. Is this in the public's  
11          interest? We're here to find that out.

12          The application, as you know, Your Honor,  
13          was filed on November 15th, 2012 and we had 90  
14          days after that was filed to hold a public  
15          hearing. One was held on February 12th, Your  
16          Honor, solicited public comment and today the  
17          parties will start putting on their respective  
18          cases.

19          What has the Commissioner's Office done in  
20          analyzing this transaction thus far? Well,  
21          we've solicited the expertise of two entities  
22          to assist us in analyzing the transaction, both  
23          of whom you'll hear from during the course of  
24          this. One, Advanced Analytical Consulting  
25          Group, analyzed the impact on the community and

1 performed an anti-trust analysis and the other  
2 performed evaluation of Blue Cross Blue Shield  
3 of Montana and that firm was MDS Consulting.

4 Suffice it to say that AACG's conclusions  
5 were consistent with the conclusions of the  
6 experts that Blue Cross Blue Shield of Montana  
7 had retained. MDS Consulting's conclusions,  
8 however, were not completely consistent with  
9 the conclusions of the valuation of the company  
10 that Moss Adams conducted on behalf of Blue  
11 Cross Blue Shield of Montana. We'll be getting  
12 into those differences, Your Honor, but suffice  
13 it to say that the MDS Consulting numbers were  
14 higher than the numbers of Moss Adams.

15 Included within the Moss Adams report was  
16 complete reliance on a report conducted by  
17 James Gallaso, Dr. James Gallaso. He's an  
18 actuary who works for Actuarial and Financial  
19 Modeling, Inc. based in Georgia. He's a really  
20 sharp man, a good man, with extensive  
21 experience with health insurance, certainly,  
22 frankly, Your Honor, more than the Moss Adams  
23 and MDS folks, and he's done a lot of work for  
24 Blue Cross Blue Shield plans all over the  
25 country.

1 Dr. Gallaso valued Blue Cross Blue Shield  
2 of Montana's primary insurance business lines.  
3 The value as of June 30th, 2012 was the number  
4 that Miss Lenmark referenced of \$17.6 million.  
5 As of January 1st of this year, 2013, that  
6 value was \$18.6 million and up until yesterday  
7 the Applicants have always argued that the  
8 purchase price was \$17.6 million. But really  
9 obviously that point is moot, as Miss Lenmark  
10 referenced, the Attorney General's Office and  
11 HCSC and Blue Cross Blue Shield have stipulated  
12 to a purchase price of \$40.2 million.

13 Our office refused to join that  
14 stipulation, Your Honor, because we thought it  
15 was premature to enter into it prior to the  
16 hearing and we, frankly, wanted the public to  
17 benefit from the testimony that would be  
18 elicited at the hearing.

19 So why is this important? It's important  
20 because it leads to the question of whether  
21 Blue Cross Blue Shield of Montana conducted  
22 proper due diligence in negotiating the terms  
23 of the transaction. The Applicants argue in  
24 their prehearing memorandum that they've  
25 conducted due diligence because the statute

1           only requires a fair market valuation. Our  
2           office believes it requires more than that,  
3           Your Honor, and, in fact, our office believes  
4           that the Applicant should have negotiated the  
5           purchase price.

6           You'll hear and the prefiled reflects that  
7           there were no such negotiations, none. And we  
8           also believe that negotiations should have been  
9           conducted, could have been conducted with  
10          perhaps multiple potential buyers. You'll hear  
11          and the prefiled testimony certainly reflects  
12          that Blue Cross Blue Shield of Montana narrowed  
13          its list of potential acquirers down to HCSC  
14          and one other multistate Blue plan, yet, there  
15          are no negotiations with the other Blue plan  
16          about a possible purchase price. We believe  
17          that the State and ultimately the people of  
18          Montana should have the benefit of what the  
19          market would pay for Blue Cross Blue Shield of  
20          Montana's core business and ultimately, Your  
21          Honor, this boils down to the duty that Blue  
22          Cross Blue Shield of Montana owes to the people  
23          of Montana, to whom does the board of directors  
24          of Blue Cross Blue Shield of Montana owe a  
25          fiduciary duty.

1           For purposes of this transaction pursuant  
2           to a consent order entered into with Blue Cross  
3           Blue Shield of Montana and our office in  
4           November of 2005, Blue Cross Blue Shield  
5           stipulated that it was as a public benefit  
6           corporation, so the duty is to the people of  
7           Montana. To fulfill this fiduciary duty it  
8           must obtain the highest possible price for the  
9           company and the question for us today and in  
10          the coming weeks is did they. And all of this  
11          is particularly important, Your Honor, because  
12          of the stipulation.

13                 Despite the valuations conducted by Moss  
14                 Adams and Dr. Gallaso HCSC has agreed to pay  
15                 more than double the valuation that Dr. Gallaso  
16                 determined and while we appreciate the fact  
17                 that HCSC has agreed to do that, their  
18                 willingness to stipulate to a substantially  
19                 higher amount only magnifies our concern about  
20                 having the benefit of negotiations between Blue  
21                 Cross Blue Shield of Montana and prospective  
22                 buyers, even if there are only two.

23                 Leading up to today, Your Honor, we've  
24                 been engaged in a very extensive discovery  
25                 process, we've deposed all of their experts as

1 well as top executives of Blue Cross Blue  
2 Shield and HCSC, we've received thousands upon  
3 thousands of pages of documents that we've  
4 requested from Blue Cross Blue Shield of  
5 Montana and HCSC and we received, as late as  
6 after March 1st, Your Honor, we received many  
7 of those documents.

8 After review of all of them to the extent  
9 we could review them in the way we wanted to  
10 review them and numerous discussions with the  
11 Applicants, I offer the following brief  
12 comments for your consideration as we proceed  
13 through the hearing and my comments, Your  
14 Honor, will be tailored to the criteria that  
15 are outlined in the conversion statute for the  
16 purposes of our office, our office's analysis.

17 The first is due diligence and part of due  
18 diligence is Blue Cross Blue Shield's decision  
19 to engage in the transaction. You'll hear and  
20 you've read the prefiled testimony about why  
21 Blue Cross Blue Shield of Montana decided to  
22 engage in the transaction. Four reasons were  
23 identified in the Applicant's prehearing  
24 memorandum, lack of scale, increased  
25 competition in Montana, insufficient access to

1 capital and increased risk exposure, all of  
2 which Miss Lenmark referenced in her opening.

3 The second part of the due diligence  
4 analysis is selecting the acquirer, in this  
5 case HCSC. You'll hear and you've read in the  
6 prefiled testimony that Blue Cross Blue Shield  
7 of Montana narrowed their choices to two Blue  
8 plans, one of them being HCSC. At this point  
9 in the proceedings, Your Honor, we are unsure  
10 if there -- there should have been more Blue  
11 plans that Blue Cross Blue Shield of Montana  
12 could have or should have reached out to.

13 The next two criteria, expert assistance  
14 and conflicts of interest I will combine and  
15 just simply say that these must be analyzed as  
16 we proceed during this hearing process.

17 I'll also combine the next two regarding  
18 the significant adverse effect on the  
19 availability or accessibility of health care if  
20 there is a significant adverse effect on the  
21 availability or accessibility of health care  
22 and the access to affordable health care, and  
23 I'll combine these as I said.

24 You certainly saw the report that was  
25 submitted by HCSC, the expert that we utilized,

1 and you'll hear from Dr. Tardiff about it and  
2 the Applicants certainly pointed it out in  
3 their prehearing memorandum that AACG didn't  
4 express concerns about these criteria if the  
5 transactions were approved but we believe it's  
6 more than that, Your Honor. In particular,  
7 these two criteria are some of the most  
8 important that you will analyze and ultimately  
9 the Commissioner and the Attorney General when  
10 you're deciding on whether this should be  
11 approved or not. That is on a going-forward  
12 basis we want Montanans to have access to  
13 affordable care and to minimize any adverse  
14 effects on availability or accessibility of  
15 health care, and with regard to the latter the  
16 Affordable Care Act certainly helps with access  
17 and the availability of health care, provisions  
18 relating to coverage being offered to those who  
19 can stay on their parents' policy up to age 26,  
20 no pre-existing condition exclusions, no annual  
21 lifetime limits, no copays for preventative  
22 care, these will happen whether or not the  
23 transaction is approved. The question though  
24 is will the affordability of health care be  
25 better for Montanans if it is approved or if it

1 is disapproved. This is something we've  
2 explored the last few weeks, Your Honor, and  
3 that we will continue to explore during in this  
4 hearing.

5 Prior to doing that I'll offer the  
6 following. In some form or another, as stated  
7 in the prehearing memorandum by the Applicants,  
8 Blue Cross Blue Shield has been the largest  
9 health insurance company in Montana for around  
10 70 years. At least in the last decade Blue  
11 Cross Blue Shield of Montana has not tried to  
12 be a hugely profitable company as evidenced,  
13 Your Honor, by their underwriting losses, which  
14 you'll hear about. You'll also hear testimony  
15 that it has targeted an underwriting profit for  
16 at least large groups of 1 and a half to 2  
17 percent annually. It seeks to earn a profit on  
18 its insurance business of 1 and a half to 2  
19 percent of premium, which when combined with  
20 the substantial investment income and income  
21 from subsidiaries it earns every year enables  
22 the company to earn a profit.

23 Even when it has not met those targets,  
24 and it certainly hasn't in many of the years in  
25 the past decade, it still has almost always had

1 a profit, net profit due to its investment  
2 income and other income. In fact, just last  
3 year Blue Cross Blue Shield of Montana lost  
4 over \$10 million in underwriting, yet made a  
5 net profit of approximately \$2 million due to  
6 other sources of income, particularly  
7 investment income. By limiting its  
8 underwriting profit, the profit it makes on its  
9 insurance business to a minimum, Blue Cross  
10 Blue Shield of Montana has carried out the  
11 traditional nonprofit, not-for-profit Blue  
12 Cross mission of providing health insurance to  
13 as many people as possible at the lowest rates  
14 possible.

15 During the course of these proceedings  
16 we've been attempting to contrast or trying to  
17 contrast Blue Cross Blue Shield of Montana's  
18 approach with HCSC's approach. The record will  
19 show that in the last three years in addition  
20 to the average of \$125 million annually in  
21 investment income that HCSC has earned, it has  
22 had underwriting profits of 5 percent, 7.6  
23 percent and 6.3 percent or in dollars \$1  
24 billion, \$1 and a half billion and \$1.2  
25 billion.

1           Additionally, related to this, because  
2           HCSC can spread its expense over a much broader  
3           base than Blue Cross Blue Shield of Montana,  
4           its administrative expenses are lower than Blue  
5           Cross Blue Shield of Montana and you heard that  
6           in the opening statements.

7           So the question for us to determine, Your  
8           Honor, during this hearing is what's the impact  
9           on the Montana consumer, what the difference is  
10          between HCSC's profit philosophy and Blue  
11          Cross' profit philosophy, what those  
12          differences are and how those differences are  
13          harmonized, if at all, with HCSC's  
14          administrative cost history and Blue Cross Blue  
15          Shields' administrative cost history.

16          To the extent the higher profits of an  
17          HCSC owned Blue Cross Blue Shield of Montana  
18          exceed the lower administrative expenses of an  
19          independent Blue Cross Blue Shield of Montana,  
20          Montanans may pay higher premiums and that's  
21          something we need to get into during the course  
22          of this hearing. Miss Lenmark said in her  
23          opening that if this is approved the premiums  
24          won't go up as much and we want to explore  
25          that, Your Honor.

1           I want to emphasize despite the foregoing  
2           our office doesn't have an opinion yet on this  
3           but we raise these as concerns that we have and  
4           that must be addressed during the course of the  
5           hearing.

6           The next one is management contracts for  
7           reasonable value and I believe we'll hear from  
8           Mike Frank that no contracts will be testified  
9           at HCSC, so that's straightforward criterion.

10          The next one, Your Honor, is another big  
11          one, equitable, whether it's equitable to the  
12          public interest and various other stakeholders,  
13          including the insureds. My previous points  
14          would also be applicable here but I raise two  
15          more. First, as you've heard today and as you  
16          certainly saw in the prefiled testimony from  
17          the two Blue Cross Blue Shield executives,  
18          Mr. Frank and Mr. Burzynski, that there is the  
19          real potential for loss of jobs by some of the  
20          current Blue Cross Blue Shield of Montana  
21          employees if this transaction is disapproved.

22          And to be sure, a benefit of it is what  
23          Miss Lenmark and Mr. Kaleczyc talked about,  
24          that those jobs would be maintained at the same  
25          or higher salaries compensation packages and

1           there will be an additional at least 100 jobs  
2           in Great Falls. It weighs on us heavily, Your  
3           Honor, and I can't overemphasize that, that as  
4           part of this decision is the possibility that  
5           people may lose jobs if it's disapproved.

6           As part of this analysis, Your Honor, the  
7           prefiled testimony also reflects that Blue  
8           Cross Blue Shield of Montana has continually  
9           tried to lower its administrative costs and,  
10          frankly, can't go much more. We'll hear their  
11          testimony today regarding that but we need to  
12          explore that in terms of the administrative  
13          costs, can they cut administrative costs more  
14          without laying people off and obviously the  
15          prefiled testimony indicates that they cannot.

16          Secondly, another important consideration  
17          is this, that Blue Cross Blue Shield of Montana  
18          is a Montana corporation with a Montana CEO, a  
19          Montana board of directors and Montana lawyers  
20          headquartered right here in Helena. The  
21          Montana Department of Insurance, our office, is  
22          Blue Cross Blue Shield's financial regulator  
23          and ensures that Blue Cross has an appropriate  
24          level of surplus and the Commissioner and her  
25          staff can ask any questions of Blue Cross at

1 any time by simply picking up the phone and  
2 calling them and sometimes, Your Honor, that  
3 includes the CEO of Blue Cross Blue Shield of  
4 Montana. The uniqueness of this transaction is  
5 that that local control will be maintained, and  
6 to the credit of the board of directors of Blue  
7 Cross Blue Shield of Montana that was an  
8 important consideration as part of their due  
9 diligence analysis.

10 To be clear though, if this transaction is  
11 approved Blue Cross Blue Shield of Montana will  
12 become a division of Health Care Services  
13 Corporation, an Illinois company. The HCSC  
14 Montana division no longer has a CEO who is  
15 ultimately responsible for the company's  
16 operations but rather a division president who  
17 reports to an HCSC executive vice-president,  
18 who in turn reports to the HCSC CEO. There is  
19 no longer a Montana board of directors that  
20 controls Blue Cross Blue Shield of Montana,  
21 rather it's an advisory board and it will be  
22 the 13 member HCSC board based in Chicago upon  
23 which the HCSC Montana division will have one  
24 seat that will make any ultimate final says  
25 about the Montana division if this is approved.

1           And our office would no longer be the financial  
2           regulator of HCSC, the Montana division for  
3           HCSC, since there is no longer a Blue Cross  
4           Blue Shield of Montana corporation, obviously  
5           that will be wound down, and the Montana  
6           division will not have its own surplus. The  
7           HCSC holding company in Chicago will maintain  
8           its own one big surplus amount for its four  
9           states and then if this is approved its fifth,  
10          all of which will be regulated by the Illinois  
11          Department of Insurance.

12                    Again, is this a good idea? And that's  
13           part of what we're going to try to find out  
14           during the course of this hearing.

15                    The next criteria is compliance with  
16           Health Service Corporation, an HMO statute  
17           which is relatively very straightforward. The  
18           Applicants have said they've met it very  
19           conclusory, Your Honor. Frankly, I don't know  
20           what further information is necessary to ensure  
21           this criterion is met but that's certainly  
22           something that we'll have to determine for  
23           purposes of our analysis.

24                    The next criteria is if the surplus is  
25           sufficient. Well, this is a resounding yes and

1 the surplus being the HCSC surplus. As you  
2 heard in the opening statements and certainly  
3 in the prefiled testimony in the application  
4 that HCSC's RBC ratio, and we'll get into what  
5 that is, was approximately 1,227 percent at the  
6 end of 2011. And as Mr. Kaleczyc said or Miss  
7 Lenmark, one or the other, that the surplus is  
8 close to over \$9 billion as of September 30,  
9 2012.

10 The risks of the transaction considered is  
11 the next criterion, inefficient economies of  
12 scale and whether there are anti-trust  
13 concerns. AACG helped us with this.  
14 Essentially there was a common understanding  
15 between our expert and theirs and certainly,  
16 Your Honor, there are benefits to the scale,  
17 benefits to this transaction to the state as a  
18 result of HCSC's scale.

19 And then finally the liquidated damages  
20 provision if applicable we would have to  
21 analyze.

22 I'll close with this, Your Honor. I don't  
23 know what the outcome of this hearing will be  
24 but I do know that our office is working  
25 diligently to decide if this is the best for

1 the, if this is in the best interests of the  
2 people of Montana, not just in the short term  
3 but the long term as well. And it's more than  
4 just a bunch of money going into a foundation,  
5 it's more than the purchase price, the  
6 stipulation that has been entered between the  
7 Attorney General's Office and the Applicants.  
8 At the end of the day will this be good for  
9 Montana consumers, is it in their interest,  
10 will it be good for the rates that they pay,  
11 will it ensure that their claims are paid, will  
12 they be getting a company that is more focused  
13 on profit than Blue Cross Blue Shield of  
14 Montana or will they not, will they get more  
15 competition if this transaction is approved or  
16 if it's disapproved? Our office is ready to  
17 explore those answers, Your Honor, and we're  
18 ready to get started. Thank you.

19 HEARINGS OFFICER LEAPHART: Thank you.  
20 Attorney General, Miss Hubbard?

21 MS. HUBBARD: The Attorney General is a  
22 party to this matter through the statutory  
23 authority granted by the health entity  
24 conversion statute, most importantly, this  
25 transaction must be in the public interest.

1 This is a very broad mandate and it's one that  
2 the Attorney General takes very seriously.

3 To analyze whether the transaction is in  
4 the public interest the statute provides a list  
5 of five criteria that the Attorney General's  
6 approval of a conversion transaction must be  
7 based upon. These criteria are much more  
8 narrowly focused than those that the  
9 Commissioner has to work with. The Attorney  
10 General shall require that, number one, the  
11 fair market value of Blue Cross Blue Shield's  
12 public assets is preserved and protected.

13 Number two, that the fair market value of  
14 the public assets is expended or invested with  
15 reasonable and prudent consideration of the  
16 potential risks of financial loss associated  
17 with the conversion transaction, number three,  
18 that the fair market value of the public assets  
19 will be distributed in accordance with the  
20 statute dealing with the distribution of the  
21 proceeds of the transaction to a new foundation  
22 or nonprofit organization.

23 Number four, that no part of the public  
24 assets of Blue Cross Blue Shield will inure  
25 directly or indirectly to any person but

1 particularly those closely associated with  
2 either company, including their officers,  
3 directors, trustees or employees.

4 And number five, that no immediate or  
5 future remuneration is provided to an officer,  
6 director or trustee of Blue Cross Blue Shield  
7 as a result of the proposed transaction except  
8 that the reasonable value of services rendered  
9 pursuant to a valid contract between the  
10 officer, director or trustee and the nonprofit  
11 held entity.

12 With that understanding of the criteria by  
13 which the Attorney General analyzes the  
14 proposed transaction let's turn to the  
15 particular efforts made to determine a fair  
16 market value of Blue Cross Blue Shield of  
17 Montana with respect to the proposed  
18 transaction.

19 Blue Cross hired an expert, the firm Moss  
20 Adams, to conduct a fair market valuation of  
21 their company, which was included in the  
22 application materials. Moss Adams concluded  
23 that the value of the whole company as of  
24 June 30th, 2012 was \$166.2 million. Included  
25 in that valuation was an assessment of the

1 value of the core insurance business that would  
2 be sold to HCSC. This actuarial appraisal of  
3 the core insurance business was performed by  
4 Dr. Galasso of Actuarial Services & Financial  
5 Modeling, Inc. and represented the agreement  
6 upon purchase price of the transferring assets.  
7 The Galasso report valued the core business  
8 assets at \$17.6 million as of June 30th, 2012.

9 The Attorney General had serious concerns  
10 with the values proposed by both of these  
11 reports. Based on the assumptions made in  
12 reaching the conclusions of value in each  
13 report, the treatment of service assets and  
14 normalizing adjustments made to them and the  
15 probabilities assigned to different approaches,  
16 all of which had a dramatic impact on the  
17 concluded value.

18 For instance, we were concerned that some  
19 figures included in the reports were particular  
20 to the expected alliance between Blue Cross  
21 Blue Shield and HCSC and did not accurately  
22 represent or reflect what would be expected as  
23 to the market as a whole, which is required  
24 under a fair market valuation as opposed to a  
25 liquidated value or an investment value of the

1 company.

2 The Attorney General retained its own  
3 independent expert to determine a fair market  
4 value of the entire company. Our experts, MDS  
5 Consulting, reviewed financial data, made a  
6 site visit to Blue Cross Blue Shield of Montana  
7 in January, had conversations with Blue Cross  
8 Blue Shield management and examined the  
9 marketplace and health care industry in  
10 reaching their conclusion of value.

11 Our experts likewise determined a fair  
12 market value as of June 30th, 2012. The  
13 Attorney General's expert presented a range of  
14 value for Blue Cross Blue Shield from a floor  
15 of at least \$182.5 million to a high value  
16 based upon certain projections and assumptions  
17 in value of \$210.6 million.

18 Mr. Tim Blackmer authored the MDS  
19 Consulting report and he is present today to  
20 provide testimony about his fair market  
21 valuation report.

22 Recognizing the serious disagreement  
23 between the experts regarding the fair market  
24 value of the company, for the past six weeks  
25 the parties have taken depositions and had many

1 discussions about the differences in the two  
2 valuation reports. Through the course of those  
3 discussions HCSC has agreed to increase the  
4 amount of the purchase price of the assets that  
5 it is acquiring from the \$17.6 million figure  
6 reflected in the Gallaso report and in the  
7 application materials to \$40.2 million. This  
8 increase in purchase price reflects a roughly  
9 \$22.6 million increase in the overall fair  
10 market value of the company than their own  
11 experts' conclusion of value.

12 Based upon Blue Cross Blue Shield's expert  
13 valuation analysis and adding the stipulated  
14 purchase price results in a total fair market  
15 value of \$188.8 million. The Attorney General  
16 believes that \$188.8 million represents an  
17 achievement of a fair market value of Blue  
18 Cross Blue Shield of Montana. The figure is  
19 well within the range of numbers determined by  
20 our expert, the Applicants and the Attorney  
21 General have entered a stipulation to this  
22 purchase price and that's before the Court as  
23 of yesterday evening.

24 Beyond the valuation piece the stipulation  
25 between the Attorney General and the Applicants

1 provides a good faith commitment that HCSC will  
2 maintain its nonprofit status for five years  
3 and the stipulation requires HCSC to follow  
4 through on its commitment to open a call center  
5 in Great Falls and hire at least 100 employees.

6 These requirements are dependent upon a  
7 commitment of approval of the transaction by  
8 the end of this month. And each of these  
9 commitments is an important consideration in  
10 determining whether this transaction is in the  
11 public interest.

12 At the conclusion of the hearing we will  
13 be asking the Court to enter findings  
14 consistent with the range of valuation  
15 presented in the MDS Consulting report. We  
16 look forward to a hearing.

17 HEARINGS OFFICER LEAPHART: Thank you.  
18 Okay, at this point as I indicated in my  
19 opening remarks, we will entertain any comments  
20 that members of the public wish to make and I  
21 also mention that you have to bear in mind  
22 whether or not you want to subject yourselves  
23 to cross-examination. If you do your testimony  
24 can be used in the decision-making process. If  
25 not, it will become of record but cannot be

1 used directly by the decision-makers.

2 So let's start with inviting any members  
3 of the public who wish to testify and do not  
4 wish to subject themselves to  
5 cross-examination. Any members of the public  
6 wish to make a comment at this time feel free  
7 to come forward and if you would take a seat  
8 here on my left.

9 MS. LEWIS: Thank you, Your Honor. My  
10 name is Melissa Lewis, that is spelled  
11 M-e-l-i-s-s-a, L-e-w-i-s. Thank you.

12 I am here today to submit a letter signed  
13 by 11 state Senators and state Representatives  
14 of the Great Falls area. With your permission,  
15 Your Honor, I would like to read the letter.  
16 It is very brief.

17 HEARINGS OFFICER LEAPHART: Go ahead.

18 THE WITNESS: Thank you. "Dear  
19 Mr. Laslovich: On behalf of the Great Falls  
20 region we stand in support of the jobs and  
21 economic development that could result from the  
22 proposed alliance between Blue Cross Blue  
23 Shield of Montana and Health Care Service  
24 Corporation. Please consider our support for  
25 these jobs and resulting benefits as you review

1 the proposed alliance.

2 Sincerely, Jesse O'Hara, House District  
3 18; Steve Fitzpatrick, House District 20; Casey  
4 Schreiner, S-c-h-r-e-i-n-e-r, House District  
5 22; Brian Hoven, House District 24; Robert  
6 M-e-h-l-a-h-o-f-f, House District 26; Anders  
7 Blewett, B-l-e-w-e-t-t, Senate District 11;  
8 Edward Buttrey, B-u-t-t-r-e-y, Senate District  
9 13; Roger Hagan, House District 19; Jean Price,  
10 J-e-a-n, P-r-i-c-e, House District 21; Tom  
11 Jacobson, House District 25, Carlie Boland,  
12 House District 23." Thank you.

13 HEARINGS OFFICER LEAPHART: Thank you,  
14 Miss Lewis. Any other members of the public?

15 MS. KENYON: Good morning. My name is  
16 Tracie Kenyon, that's T-r-a-c-i-e, K-e-n-y-o-n.  
17 I'm the president and CEO of the Montana Credit  
18 Union Network and also chairperson of the  
19 Montana Credit Union League Group Benefit  
20 Trust. We partner with Blue Cross Blue Shield  
21 Montana as they're a third-party administrator  
22 and I sit, well, I was going to say stand, but  
23 I sit in support of the consolidation of Blue  
24 Cross Blue Shield of Montana as it creates  
25 efficiencies while preserving jobs right here

1 in our state. In addition, this move creates a  
2 special fund for care for Montanans, which is  
3 especially important as we begin to navigate  
4 the unknown waters of the health care reform.

5 Blue Cross Blue Shield remains a local  
6 presence but combines back office efficiencies  
7 with the fourth largest insurer in our country,  
8 a move that should result in increased dollars  
9 spent on claims and fewer dollars spent on  
10 expensive but certainly necessary technology.  
11 Mergers often provide an environment to reduce  
12 redundancy and I trust that this opportunity to  
13 increase operational efficiencies will be  
14 successful in that manner. Thank you.

15 HEARINGS OFFICER LEAPHART: Thank you,  
16 Ms. Kenyon. Hello.

17 MR. BOND: Hello, Your Honor. My name is  
18 Rhett, R-h-e-t-t, B-o-n-d, and I'm here to  
19 submit a letter signed by State Senator  
20 Jonathan Windy Boy representing Senate District  
21 16, which is located in Box Elder. With your  
22 permission, Your Honor, I would like to read to  
23 letter, it is short.

24 HEARINGS OFFICER LEAPHART: Go ahead.

25 MR. BOND: "Mr. Laslovich, I would like to

1 express my support for the anticipated alliance  
2 between HCSC and Blue Cross Blue Shield of  
3 Montana. It is my understanding that HCSC  
4 proposes to bring to scale fiscal strength,  
5 cutting edge technology and leading customers  
6 service practices to Montana. With those  
7 assets we should be able to anticipate a number  
8 of benefits when the alliance is approved,  
9 including jobs and improved access to care. In  
10 addition, I hear the alliance will result in  
11 the formation of a charitable foundation that  
12 is to provide up to \$120 million to keep  
13 Montanans healthy. I certainly would like to  
14 see a portion of these dollars set aside for  
15 Native American health programs. Please keep  
16 me apprised as the regulatory process advances.  
17 Thank you."

18 HEARINGS OFFICER LEAPHART: Thank you,  
19 Mr. Bond. Good morning.

20 MR. KUNTZ: Good morning, your Honor. My  
21 name is Ray Kuntz, K-u-n-t-z, and I'm the CEO  
22 of Watkins & Shepard Trucking. We operate in  
23 about 20 states with employees and Blue Cross  
24 Blue Shield has been our third-party  
25 administrator and they also design and

1 administer our wellness program and provide  
2 reinsurance for close to ten years.

3 Our analysts believe that this merger will  
4 be good for our program for a few different  
5 reasons. To begin with, the IT systems we  
6 understand of HCSC are much stronger and a lot  
7 more sophisticated for administrating than what  
8 the current Blue Cross Blue Shield of Montana  
9 has. We believe that should bring some  
10 efficiency in the admission and hopefully a  
11 lower administrative cost to administer our  
12 claims.

13 The other area that plays a big role is in  
14 managing our wellness. The current IT systems  
15 again aren't strong enough to provide the kind  
16 of information that we would like to have it.  
17 We believe that information will be a lot  
18 stronger with HCSC and really health care costs  
19 are more about wellness than almost anything.  
20 If you can keep one person from becoming  
21 diabetic or one diabetic from needing dialysis  
22 administrative costs look small in comparison.  
23 So better information.

24 And the last issue is that the fees that  
25 we pay and the outside states for use of their

1 BlueCard network, it's our understanding that  
2 those fees will go away in the four states that  
3 HCSC controls that and there is some  
4 significant, there is a possibility that  
5 they'll go away in other states also, but for  
6 sure those four states we understand it. For  
7 those reasons we think that this merger is good  
8 for Watkins Shepard's 700 people that are being  
9 managed by Blue Cross right now. Thank you.

10 HEARINGS OFFICER LEAPHART: Thank you,  
11 Mr. Kuntz.

12 MR. DONEY: Good morning, Your Honor. My  
13 name is Brett Doney with the Great Falls  
14 Development Authority. I've been asked to read  
15 a letter on behalf of the Great Falls Area  
16 Chamber of Commerce if I could.

17 HEARINGS OFFICER LEAPHART: Could you  
18 spell your name for the record, please?

19 MR. DONEY: Brett, B-r-e-t-t, Doney,  
20 D-o-n-e-y. And then I'll be testifying later  
21 on behalf of the Great Falls Development  
22 Authority.

23 HEARINGS OFFICER LEAPHART: And your  
24 letter is on behalf of who?

25 THE DONEY: The Great Falls Area Chamber

1 of Commerce. This letter was sent to  
2 Commissioner Lindeen and Attorney General Fox.  
3 It reads, "The proposed alliance between Blue  
4 Cross Blue Shield of Montana and Health Care  
5 Services Corporation means great things for  
6 Great Falls, a stronger Montana economy and an  
7 even better health insurer for Montanans.

8 As you know, Great Falls is one of  
9 Montana's key economic centers, serving as the  
10 hub for Montana's Golden Triangle, home of  
11 Malmstrom Force Base. The Great Falls area  
12 Chamber of Commerce wants to keep Great Falls  
13 in the forefront of Montana's economy. It is  
14 for this reason that we are enthusiastically  
15 supporting the proposed alliance between Blue  
16 Cross Blue Shield of Montana and Health Care  
17 Service Corporation.

18 On January 8th the Great Falls community  
19 learned that HCSC is looking to create over 100  
20 new jobs in the Great Falls area. These are  
21 good paying, stable jobs that could benefit  
22 Great Falls for years to come. As business  
23 leaders in the Electric City, we are always  
24 looking forward for ways to encourage the  
25 diversification of our community's economy. We

1 are happy to see that HCSC is dedicated to  
2 making Montana home by bringing jobs to its  
3 city and the surrounding areas.

4 We believe this new partnership will mean  
5 new jobs, controlled costs, improved access to  
6 health care insurance and better customer  
7 service. Additionally, after examining HCSC's  
8 alliances with Blues in other states we are  
9 encouraged by the fact that those states saw  
10 expanded job growth. We are confident that the  
11 same will be true for Montana, which means more  
12 jobs for Big Sky Country in addition to the  
13 hundreds of jobs that Blue Cross Blue Shield  
14 already has in the state."

15 And this letter is signed by David  
16 Wiseman, Chair of the Board of Directors.

17 HEARINGS OFFICER LEAPHART: Thank you,  
18 Mr. Doney. Good morning.

19 MS. COWEE: Good morning, Your Honor. My  
20 name is Lora Cowee. It's L-o-r-a, C-o-w-e-e.  
21 I'm here to read a letter on behalf of the CEO  
22 of Intermountain. Intermountain is an  
23 organization that provides a variety of  
24 children's mental health services across the  
25 state of Montana to children and families

1 ranging from residential inpatient care to  
2 outpatient-type services.

3 "Dear Commissioner Lindeen: I am writing  
4 to you today on behalf of Intermountain to  
5 offer our support for the proposed transaction  
6 between Blue Cross Blue Shield of Montana and  
7 Health Care Service Corporation. I understand  
8 the office has the important duty of reviewing  
9 and approving this alliance. Montana and Blue  
10 Cross Blue Shield of Montana has to adapt to a  
11 changing world but in this alliance with HCSC  
12 we see many benefits, not the least of which is  
13 the establishment of the charitable foundation  
14 to improve access, quality and awareness of  
15 health care programs of all kind across  
16 Montana.

17 The companies have proposed setting aside  
18 approximately 120 million for health care  
19 related programs and as an organization that  
20 deals specifically with the many needs of  
21 children that are often tied directly to the  
22 health care system we are supportive of the  
23 establishment of this foundation and we are  
24 relieved too that under the proposal that Blue  
25 Cross Blue Shield Montana itself would continue

1 to operate as a not-for-profit and would retain  
2 local leadership, at the same time becoming a  
3 part of the HCSC team allows Blue Cross Blue  
4 Shield to take advantage of that company's  
5 scale and remain a viable, competitive entity  
6 in a rapidly changing industry.

7 In short, this is a win-win from our point  
8 of view. Blue Cross Blue Shield of Montana  
9 continues to operate with local leadership but  
10 with access to greater fiscal strength and  
11 cutting edge technology and the entire state  
12 gets the benefit of a substantial charitable  
13 foundation to help us improve the health care  
14 of all Montanans." Sincerely, Jim Fitzgerald,  
15 CEO of Intermountain.

16 HEARINGS OFFICER LEAPHART: Thank you.  
17 Any other members of the public wishing to make  
18 a statement not subject to cross-examination?  
19 Seeing none, then next we would have comments  
20 from the public from individuals who are  
21 willing to testify subject to  
22 cross-examination. Good morning.

23 MR. UNTERREINER: Good morning. Your  
24 Honor, my name is Joe Unterreiner. Unterreiner  
25 is spelled U-n-t-e-r-r-e-i-n-e-r. I'm the

1 President of the Kalispell Chamber of Commerce.

2 Your Honor, today I'd like to be here  
3 today to support the proposed merger for  
4 several reasons. Your Honor, the health care,  
5 both quality and cost, is a top three issue for  
6 the members of the Kalispell chamber. Our 650  
7 members employ over 60 percent of the workforce  
8 in Flathead County, Montana and both the  
9 quality and cost of health care for our members  
10 is a critical component for a competitive  
11 workforce for both us and I believe the entire  
12 state.

13 For several other reasons I think are  
14 important for our membership, the opportunity  
15 for this merger offers scaling opportunities  
16 that I think will drive down health care costs,  
17 an important component of the Affordable Care  
18 Act is a conversion over to electronic  
19 implementation of technology. I believe that  
20 the scale that this merger brings will make a  
21 beneficial contribution to that.

22 The access to capital I think from a  
23 larger component is also important for several  
24 of the issues that we see implemented by the  
25 Affordable Care Act, so that is important for

1 us. But also just for the jobs that are  
2 retained here in the state, the new jobs that  
3 are proposed to be created in Great Falls, also  
4 the commitment to retain the employment of the  
5 current employees of Blue Cross Blue Shield for  
6 Montana I think will contribute to just the  
7 beneficial workforce environment, slow premium  
8 increases, keeping the employees and also the  
9 benefit for our own workforce of the retention  
10 of credit for time earned for the existing  
11 employees.

12 For all of those job creation reasons and  
13 for the improvement to the overall workforce  
14 environment for the state, the Kalispell  
15 Chamber is in support of this proposed merger.

16 HEARINGS OFFICER LEAPHART: Thank you.  
17 Sir. You're subjecting yourself to  
18 cross-examination so I have to ask if anybody  
19 has any questions for you. Any from the  
20 Applicant?

21 MR. MCMAHON: No, Your Honor.

22 HEARINGS OFFICER LEAPHART: Commissioner?

23 MR. LASLOVICH: Yes.  
24  
25

1 EXAMINATION OF JOE UNTERREINER

2 BY MR. LASLOVICH:

3 Q Good morning, Mr. -- I'm sorry?

4 A Unterreiner.

5 Q It's Unterreiner?

6 A Yes, it is.

7 Q I appreciate you coming this morning and  
8 your testimony. I just have a few questions in  
9 light of what you said.

10 Can you tell me, Mr. Unterreiner, what you  
11 have reviewed relative to this transaction?

12 A I've seen an outline of some of kind of  
13 the main points of the agreement. I'm not sure what  
14 the origination or what the, where that draft came  
15 from.

16 Q Do you know who gave you the outline?

17 A That was from the Webb Brown, Montana  
18 Chamber.

19 Q Have you read the application?

20 A I have not.

21 Q Have you reviewed any of the pleadings  
22 that are posted on the Commissioner's website?

23 A No, sir.

24 Q Have you reviewed anything else besides  
25 the outline that was given to you by Mr. Brown?

1 A No.

2 Q You referenced the quality and cost of  
3 health care for your members. Can you tell me  
4 specifically how this transaction would reduce the  
5 cost or limit the increases to costs for your  
6 members?

7 A The scaling opportunities appear to be  
8 beneficial in reducing overall administrative costs.  
9 I think we've got a fine quality of health care in  
10 northwest Montana and if there is an opportunity to  
11 scale, to reduce administrative costs I think that's  
12 a benefit for our members, our employees in  
13 northwest Montana.

14 Q Do you know, do your employers in  
15 northwest Montana if they're typically insured by  
16 Blue Cross Blue Shield of Montana?

17 A I know many are.

18 Q And are they satisfied with Blue Cross  
19 Blue Shield of Montana?

20 A I believe so.

21 Q And then the only other issue I'd like to  
22 just ask you, Mr. Unterreiner, is the slow premium  
23 increases that you referenced in your testimony.  
24 Who told you that?

25 A Just from the testimony we heard this

1 morning.

2 Q Have you verified it independently?

3 A I look at the issues of kind of scaling  
4 and see that that just economies of scale I think  
5 are important and will contribute to that. That's  
6 just my personal opinion from the observation of  
7 health care systems and how the employers I work  
8 with have reacted to those for the past 16 years as  
9 my tenure as the chamber executive in Kalispell,  
10 Montana.

11 Q I appreciate that. Thanks.

12 HEARINGS OFFICER LEAPHART: Thank you. I  
13 neglected to swear you in since you're subject  
14 to cross-examination so we'll do it  
15 retroactively here.

16 (Witness sworn.)

17 HEARINGS OFFICER LEAPHART: Thank you.  
18 Any questions from the Attorney General's  
19 office?

20 MS. HUBBARD: We have none, Your Honor.

21 HEARINGS OFFICER LEAPHART: Thank you.  
22 You may step down. Any other members of the  
23 public?

24 MR. DONEY: My name is Brett Doney. I am  
25 representing the Great Falls Development

1 Authority.

2 (Witness sworn.)

3 MR. DONEY: We support this for four  
4 reasons, one is access to World-Class and cost  
5 effective health care requires access to  
6 World-Class and cost effective health  
7 insurance. The second reason is that we  
8 believe as the health care insurance industry  
9 rapidly changes it's not a question of whether  
10 to merge but finding the right partner.  
11 Montana just can't continue being such a small  
12 provider and keep up with all of the technology  
13 that is needed to be cost effective. We very  
14 much like the fact that the proposal is to  
15 merge with a policyholder owned entity as  
16 opposed to a for-profit entity.

17 The third reason is jobs. We've been  
18 working with representatives, site selection  
19 companies that Health Care Service Corporation  
20 retained since October 2nd when we were first  
21 contacted. They retained one of the best site  
22 selection consultants I believe in the company,  
23 the Wadley-Donovan Group out of New Jersey,  
24 that conducted a very thorough process that was  
25 driven entirely by workforce. They narrowed it

1 down to several Montana communities and then  
2 they brought a consultant in that visited those  
3 communities and then interviewed human resource  
4 managers in the different cities, including a  
5 number of them over two days in Great Falls.

6 This showed to us that Health Care Service  
7 Corporation is not only well managed but very  
8 serious about its commitment to creating good  
9 jobs and retaining good jobs in Montana.

10 There has been some concern about jobs  
11 moving or going away. We have put on the table  
12 with Health Care Service Corporation two  
13 different state incentive programs which we  
14 offer to companies that are looking to bring  
15 new jobs to the state, one is the Primary  
16 Worker Training Program, the other is the Big  
17 Sky Trust Fund, both of these are managed by  
18 the Montana Department of Commerce. And they  
19 both by state statute require that they only  
20 count jobs that are new jobs to the state, so  
21 if you move a job from one community to another  
22 or if you cut jobs in one community you can't  
23 count new jobs in the other community, it has  
24 to be new. And from day one back on  
25 October 2nd the site selection consultants

1 involved have been steadfast that we are  
2 looking at all new jobs and in the Primary  
3 Worker Training grant application that has been  
4 submitted to the Montana Department of Commerce  
5 by Health Care Service Corporation they're  
6 looking at 138 net new jobs to the state and I  
7 might add that these are good paying jobs and  
8 have excellent benefits package.

9 Fourthly, we're supporting it because of  
10 Health Care Service Corporation's reputation in  
11 Chicago, Illinois, Richardson, Texas,  
12 Albuquerque, New Mexico, North Carolina and  
13 Tulsa, Oklahoma where they currently have  
14 operations. Thank you.

15 HEARINGS OFFICER LEAPHART: Thank you,  
16 Mr. Doney. Any questions from the Applicants?

17 MR. KALECZYC: No, Your Honor.

18 HEARINGS OFFICER LEAPHART: Questions from  
19 the Commissioner?

20 MR. LASLOVICH: Yes, Your Honor.

21  
22 EXAMINATION OF BRETT DONEY

23 BY MR. LASLOVICH:

24 Q Good morning, Mr. Doney. I appreciate you  
25 coming today. You look good up there, by the way.

1 Natural, like Justice Leaphart.

2 HEARINGS OFFICER LEAPHART: No robe.

3 Q (By Mr. Laslovich) I was interested to  
4 learn about your discussion regarding the site  
5 selection and your role in that process. Did I hear  
6 you say that HCSC hired the firm that you referenced  
7 to help with the site selection process and that  
8 they came and reviewed the sites, the potential  
9 sites in October of 2012, did I understand you  
10 correctly?

11 A They didn't visit in October. The first  
12 time we were contacted by the site selection  
13 consultant was actually on October 2nd and we were  
14 contacted both directly by the site selection  
15 consultant, Wadley-Donovan Group, as well as the  
16 Governor's Office of Economic Development and that  
17 started the process. We did not know for several  
18 months that it involved either Health Care Service  
19 Corporation or Blue Cross Blue Shield in any way.

20 Q So what was your understanding then in  
21 October, you knew it was associated with Blue Cross  
22 or HCSC or you just --

23 A No, not at all.

24 Q I'm sorry, so what was your understanding?

25 A That it was a customer service center,

1 call center operation in the health industry and  
2 that's all we knew until, and I don't have the date,  
3 but a representative of Blue Cross Blue Shield  
4 Montana was speaking at a Great Falls Area Chamber  
5 of Commerce breakfast event and mentioned there was  
6 some connection. Up until that time we didn't know  
7 that either companies were involved.

8 Q So is it fair then that in October you  
9 were notified that there is this potential and  
10 they're looking for a possible site for a customer  
11 service operation; is that fair?

12 A Yes.

13 Q And until -- well, let me ask this. Who  
14 was the person, that Blue Cross Blue Shield  
15 representative who announced this at the breakfast?

16 A I don't remember the name. I can get that  
17 for you, but...

18 Q Well, it's fine. So between the point in  
19 October and then this breakfast you heard nothing  
20 about a site selection in Great Falls; is that what  
21 I understood?

22 A No, we were working with a site selection  
23 consultant and this is normal in site selection, we  
24 rarely know who the client is that has retained the  
25 site selection.

1 Q And you mentioned 138 jobs. When did you  
2 learn that?

3 A That was over the last few weeks in  
4 preparing the, our staff assisted a consultant  
5 retained by Health Care Service Corporation in the  
6 preparation of a grant application for the Primary  
7 Worker Training Program to the Montana Department of  
8 Commerce.

9 Q And when was that application submitted,  
10 approximately?

11 A In the last week and a half, last two  
12 weeks.

13 Q And can you say again, I'm sorry,  
14 generally the purpose of the application?

15 A It's for workforce training money, it's a  
16 state program that can provide up to \$5,000 for new  
17 employees on a reimbursable basis for workforce  
18 training.

19 Q And to whom does that money go?

20 A That money gets reimbursed to the  
21 employer.

22 Q So in this instance the employer would be  
23 HCSC, is that what I understand?

24 A Yes, that's our understanding.

25 Q And so you submit the application. Does

1 the Department of Commerce then decide whether to  
2 accept or reject it?

3 A Yes, they have a committee, their staff  
4 looks at it first and then they have a committee  
5 that makes the decision and then if they do award  
6 they enter into a performance contract with the  
7 employer.

8 Q And when will we know, is there a time  
9 frame in the law that the Department of Commerce has  
10 to decide?

11 A Usually they're pretty quick. I don't  
12 know if there is a time frame in the law but they  
13 have been actively working on the application.

14 Q Do you have an anticipation date when you  
15 would hear from them?

16 A Probably sometime within the next month.

17 Q And then after that application is, let's  
18 just assume that it's approved, then what?

19 A Well, the way the program works is you  
20 have to create the job, you have to hire someone,  
21 you have to train them and then you submit a request  
22 for reimbursement and you can be reimbursed up to 80  
23 percent of the training cost.

24 Q So is the application your application or  
25 is the application's HCSC's application?

1           A       It's HCSC's application to the Montana  
2 Department of Commerce, we just helped, we help our  
3 clients in the preparation of them.

4           Q       Okay, so you assisted HCSC in the  
5 preparation of the application?

6           A       We assisted HCSC's site selection  
7 consultant.

8           Q       Okay. And as part of that application  
9 process do you know if there was a representation  
10 made as to when those jobs would begin?

11          A       I don't know the exact details of the  
12 schedule and the job creation.

13          Q       Do you have a general understanding?

14          A       I believe that the maximum for the program  
15 is over a two- or a three-year period but I don't  
16 remember whether it was two years or three years.

17          Q       But you don't know when those jobs would  
18 start during that two- or three-year period, is that  
19 what I understand?

20          A       No.

21          Q       Has anyone told you in this application  
22 process that this application that's pending before  
23 the Judge and ultimately the Commissioner and the  
24 Attorney General, that the decision needs to be made  
25 by a certain time frame as to whether it's approved

1 or disapproved?

2 A No, they've separated out, the site  
3 selection consultants haven't talked to us about  
4 this matter at all. We have been contacted by  
5 representatives of Blue Cross Blue Shield of Montana  
6 and their consultants about this matter.

7 Q If the application with the Department of  
8 Commerce is disapproved does that simply mean that  
9 HCSC wouldn't be reimbursed \$5,000, up to \$5,000 per  
10 job that's added?

11 A Right, they would not get the Primary  
12 Workforce Training grants fund.

13 Q Would it still prevent them to your  
14 knowledge from providing the jobs in Great Falls if  
15 the application is disapproved?

16 A No.

17 Q You reference, Mr. Doney, the reputation  
18 of HCSC in the four states. Did you talk to folks  
19 in those four states?

20 A Yeah, through the International Economic  
21 Council, which is our economic trade organization, I  
22 contacted people in those four states in those four  
23 communities. We also did a Google search, which we  
24 usually do, looking at local newspapers and things  
25 like that.

1 Q Did you talk to any of the HCSC insureds  
2 in those four states?

3 A No.

4 Q And then also, Mr. Doney, you referenced  
5 keeping up with the IT changes that are required.  
6 Who told you about the IT changes that would be  
7 necessary for Blue Cross Blue Shield of Montana?

8 A Two sources, when our public policy  
9 committee was looking at this matter we heard from  
10 several of our investors members that make up the  
11 development authority, including some local health  
12 care providers, including Benefis Health Care, and  
13 they were telling us about the IT that they've had  
14 to invest in.

15 Also, we're lucky enough to have a claims  
16 processing center of Centene Corporation in Great  
17 Falls, they're located there in, well, the new  
18 building opened in 2006 and representatives of  
19 Centene have been telling us how as health insurance  
20 is changing so rapidly how much they've had to  
21 invest. They just built a new data center outside  
22 of St. Louis.

23 Q So is it fair that the basis for your  
24 statement about keeping up with IT costs is in a  
25 general sense you talked to entities that are

1 involved in the health care industry and they're  
2 saying we need to keep up with IT; is that right?

3 A Yeah, they've just been telling us about  
4 the enormous cost involved in doing that.

5 MR. LASLOVICH: Thank you, Your Honor.

6 HEARINGS OFFICER LEAPHART: Thank you.

7 Any questions from the Attorney General?

8 MS. HUBBARD: Your Honor, we have none but  
9 I don't recall if you swore in the witness.

10 MR. LASLOVICH: You did.

11 HEARINGS OFFICER LEAPHART: Thank you.

12 You may be excused. Any other members of the  
13 public wishing to make a statement subject to  
14 cross-examination?

15 State your name and spell it, please.

16 MR. MILTENBERGER: Thank you. Richard  
17 Miltenberger, M-i-l-t-e-n-b-e-r-g-e-r.

18 (Witness sworn.)

19 MR. MILTENBERGER: Your Honor, I  
20 apologize, I had an eye doctor's appointment  
21 here this morning and I didn't mean to be here  
22 for what I think is the professional witness  
23 testimony but just as a member of the public.

24 HEARINGS OFFICER LEAPHART: Do you wish to  
25 subject yourself to cross-examination or not?

1           MR. MILTENBERGER: Yes, that's fine, I  
2           have no objection to that.

3           HEARINGS OFFICER LEAPHART: Because you  
4           have an option.

5           MR. MILTENBERGER: That's fine, I've  
6           already signed in. Again, Richard  
7           Miltenberger, I'm a partner with a company here  
8           in Helena called Mountain West Benefits  
9           Insurance Agency. I am active in an  
10          organization called the National Association of  
11          Health Underwriters and another professional  
12          association called United Benefit Advisors,  
13          both national organizations that are comprised  
14          of people in the health insurance consulting  
15          and advising and insurance agency business.

16          I should I guess state that I'm a former  
17          employee some years ago of Blue Cross Blue  
18          Shield of Montana.

19          I'm here to stand in support of this  
20          alliance. I have three primary reasons. We  
21          have a business associate we're close to in  
22          Oklahoma, Jim Consendine has an insurance  
23          agency in Tulsa, we've spoken with him and he  
24          speaks very highly of the Blue Cross Blue  
25          Shield of Oklahoma HCSC folks that have come in

1 and he's been involved both prior to the merger  
2 of Blue Cross Blue Shield of Oklahoma and then  
3 since then the insurance business in Oklahoma  
4 says that they're very insurance agent friendly  
5 as well as consumer friendly, a very  
6 progressive organization and said that they  
7 have first-rate technology that's been helpful  
8 to his clients. So after speaking with Jim  
9 that's one of the reasons I wanted to stand in  
10 support of this.

11 The second reason would be the financial  
12 support of HCSC. I think it's important that  
13 the Montana consumers have that kind of  
14 strength available to us. We don't have other  
15 national organizations that are active in the  
16 small group and individual marketplace in  
17 Montana and so having that kind of strength I  
18 think would be helpful to protect the consuming  
19 public.

20 Thirdly, technology, as mentioned with  
21 Mr. Consendine, we've looked into some of the  
22 opportunities for increased technological  
23 advance with this HCSC alliance and feel  
24 they're genuine and legitimate and I'd say  
25 would hold that in balance with what we would

1           perceive to be the potential that if the  
2           alliance or merger were not to be approved that  
3           there would probably be a need for a systems  
4           conversion here in Montana. In the past those  
5           have been fairly disruptive to our customers  
6           and so rather than have that undertaken here in  
7           Montana with limited resources we think that it  
8           makes sense to just plug into what HCSC has  
9           available nationally.

10           I would also say that we are not experts  
11           in valuation of insurance companies and so  
12           we -- and I say we because my partner Jim  
13           Edwards and I talked about this ahead of time  
14           and Jim could not be here -- but we are not  
15           commenting on the terms of the sale, Your  
16           Honor, in terms of the price tag that's been  
17           attached in the popular press and from what I  
18           can understand the cost basis that Blue Cross  
19           Blue Shield would be purchased at, we just are  
20           not competent to assess that, and we would  
21           encourage the regulators to do what they're  
22           doing here and just have good due diligence as  
23           to that amount because there is only one  
24           opportunity for the people to benefit from this  
25           at this time. So we are not commenting one way

1 or another on the terms of the sale but simply  
2 in favor of trying to make this happen for the  
3 people of Montana and for the employees of Blue  
4 Cross Blue Shield who we think without this  
5 merger could, in fact, be jeopardized if we  
6 have to go forward without the additional  
7 resources that HCSC brings to the market.

8 HEARINGS OFFICER LEAPHART: Thank you,  
9 Mr. Miltenberger. Any questions from the  
10 Applicants?

11 MR. MCMAHON: Just one, Your Honor.

12 HEARINGS OFFICER LEAPHART: Mr. McMahon?

13  
14 EXAMINATION OF RICHARD MILTENBERGER

15 BY MR. MCMAHON:

16 Q Mr. Miltenberger, thank you very much for  
17 coming today. Could you describe to Justice  
18 Leaphart the type of clients that your firm advises  
19 in Montana?

20 A We primarily advise associations and  
21 aggregations of smaller employers, Your Honor. We  
22 have I think 11 different associations and  
23 similar-type groups like the Taft-Hartley plans,  
24 which are union plans that have a multiple of  
25 employers who aggregate their buying power, as well

1 as an interlocal agreement, which is an association,  
2 if you will, that is not a true association of  
3 governmental entities in the school marketplace. So  
4 primarily associations and interlocal agreements.

5 MR. MCMAHON: One more, Your Honor, I know  
6 I promised one and here is two.

7 Q (By Mr. McMahan) Do you know how many  
8 members of those associations that your firm  
9 represents in the total number of membership?

10 A In and out of state about 50,000  
11 individuals, in Montana closer to 40,000.

12 MR. MCMAHON: Thank you, Your Honor.

13 HEARINGS OFFICER LEAPHART: Commissioner?

14 MR. LASLOVICH: Yes, sir.

15

16 EXAMINATION OF RICHARD MILTENBERGER

17 BY MR. LASLOVICH:

18 Q Good morning, Mr. Miltenberger. It really  
19 is always good seeing you. I appreciate you coming  
20 today.

21 A Mr. Laslovich.

22 Q I just have a few questions,  
23 Mr. Miltenberger, particularly with regard to your  
24 latter comments about not commenting on the terms of  
25 the transaction.

1 A Uh-huh.

2 Q Did I understand your testimony to be that  
3 if the terms perhaps were unfavorable, let me talk  
4 specifically about the purchase price, that that  
5 could change your testimony as to whether you're in  
6 support of this or not?

7 MR. MCMAHON: I'll object, no foundation.  
8 He's testified that he's come here today  
9 without any opinions with respect to the  
10 purchase price.

11 MR. LASLOVICH: Your Honor, I'm not  
12 talking about what his opinion is of what the  
13 purchase price is. He said specifically that  
14 he's not commenting on the purchase price but  
15 that needs to be considered and my simple  
16 question is how important is it in terms of  
17 whether he supports or does not support the  
18 purchase.

19 HEARINGS OFFICER LEAPHART: How important  
20 is the purchase price?

21 MR. LASLOVICH: Right.

22 HEARINGS OFFICER LEAPHART: You may go  
23 ahead and answer that.

24 A Well, it's very important and my latter  
25 comments were to the effect of I would hope that, I

1 think it's the Attorney General's Office and the  
2 Commissioner of Securities and Insurance that have  
3 oversight in this matter that they would represent  
4 the people of Montana well because the people of  
5 Montana's interests is in maximizing the funding of  
6 the foundation that's to be set up. And so, yes, if  
7 the purchase price were deemed to be inadequate I  
8 don't view the situation to be one where the car is  
9 just about out of gas and you've just got to get  
10 this thing sold no matter what or else it's just  
11 going to pull over to the side of the road and  
12 people would be left without recourse. I think that  
13 if it takes some time to get this done then it's  
14 better to get the right price from the buyers out of  
15 Chicago. So, yeah, so I would not support this  
16 alliance or merger if it went contrary to the  
17 professional advice that the Attorney General or  
18 Insurance Commissioner's Office received.

19 Q Thank you, sir.

20 HEARINGS OFFICER LEAPHART: Any questions  
21 from the Attorney General?

22 MS. HUBBARD: None, Your Honor.

23 HEARINGS OFFICER LEAPHART: Thank you.  
24 Any further questions?

25 MR. MCMAHON: No, Your Honor.

1 HEARINGS OFFICER LEAPHART: Thank you, you  
2 may step down. Any further public witnesses  
3 willing to subject themselves to  
4 cross-examination? Good morning.

5 MS. LARSEN: Good morning.

6 (Witness sworn.)

7 HEARINGS OFFICER LEAPHART: State your  
8 name and spell it for the record.

9 MS. LARSEN: Certainly. Stephanie Larsen,  
10 Stephanie is spelled S-t-e-p-h-a-n-i-e, Larsen  
11 is L-a-r-s-e-n.

12 HEARINGS OFFICER LEAPHART: Go ahead. You  
13 may proceed.

14 MS. LARSEN: Thank you. I'm here today  
15 representing the Center for Rural Affairs and  
16 we believe that the review process should give  
17 the 270,000 Montana customers at Blue Cross  
18 some say in this matter, that Health Care  
19 Service Corporation should welcome this, as  
20 they state on their website that they are  
21 customer owned and focused on their customer's  
22 needs.

23 This merger to me represents a substantial  
24 shift in mission from providing affordable care  
25 to Montanans as a nonprofit to doing well for

1           their policyholders and customers as a  
2           noninvestor owned entity, which is not governed  
3           as a nonprofit under Montana law.

4                       And I'm here today primarily because I  
5           have a lot of questions that I don't believe  
6           have been answered that absolutely must be  
7           addressed in my opinion before this merger  
8           occurs, which is why I believe we need a  
9           community impact study to study how this will  
10          impact Montanans. Perhaps some of this  
11          information is known and, if so, it needs to be  
12          made available in a way that's publically  
13          palatable. I've been following the media  
14          coverage of this and I don't have some of these  
15          questions answered.

16                      So, for example, I would like to know why  
17          this merger is necessary, I'd like to know what  
18          due diligence was done to solve the underlying  
19          problem of the merging necessary, if there was  
20          one. Did Blue Cross Blue Shield explore  
21          staying as a nonprofit, did they talk to other  
22          companies about acquisition, could they share  
23          the process of their decision making, was there  
24          competitive bidding and, if not, why?

25                      We've heard testimony this morning about

1           how the company was valued and I think that's a  
2           good thing, you obviously wouldn't sell your  
3           house without an appraisal, but given that  
4           there seemed be some questions about that  
5           appraisal I'm I think rightly skeptical about  
6           what that valuation is right now.

7           In addition, what will be the impact, the  
8           actual impact on Montanans of this merger,  
9           especially on the most vulnerable population  
10          such as rural and remote residents, low-income  
11          individuals, the elderly and those with chronic  
12          diseases. I'd like to know how will the change  
13          structure interact with the federally  
14          facilitated exchange which is being set up.  
15          Will there be a Blue Cross Blue Shield or  
16          Health Care Services Corporation plan available  
17          on the exchange? Obviously there is lots of  
18          Montana customers using Blue Cross Blue Shield  
19          right now so we want to make sure that they're  
20          still going to be on the exchange. How will  
21          rates change and what will the rate review  
22          process look like? Currently we lack a robust  
23          rate review in Montana, but at least Blue Cross  
24          Blue Shield of Montana had a mission to provide  
25          affordable access with their nonprofit status,

1 so how can I be assured that Montanans will not  
2 be priced out of the market?

3 The Center for World Affairs also believes  
4 that the track record of Health Care Service  
5 Corporation in other states does not inspire  
6 our trust immediately. For example,  
7 accumulation of large surpluses in other states  
8 suggest they may be charging too much for their  
9 customers and Health Care Service Corporation  
10 has a history of segregating healthy people  
11 from sick people in their risk pools.

12 An example is in Illinois, in the  
13 individual market in Illinois, according to  
14 their state insurance commissioner, Health Care  
15 Service Corporation charged people extra to  
16 renew the same policy as a way of segregating  
17 sick people from healthy people in risk pools.  
18 People with health conditions can't easily move  
19 to a new policy so they have to pay the charge  
20 and stick with their current policy. But  
21 healthy people can move to a new Health Care  
22 Service Corporation policy and at a lower cost  
23 to the risk pool and avoid that charge? We  
24 also understand that there is a very low  
25 medical loss ratio of 65 percent in Texas, both

1 of those things give me pause. So this is why  
2 I think there needs to be more information  
3 available to us before this merger goes  
4 through.

5 Finally, this merger would convert a  
6 nonprofit insurer away from their nonprofit  
7 status and not have the mission or obligation  
8 to provide health care access, affordable  
9 health care access to Montanans, which neither  
10 enhances choice nor provides more competition.  
11 So I wonder as a consumer why this would be  
12 good for Montanans. But if the merger proceeds  
13 the Center for Rural Affairs is keenly  
14 interested in the process of establishing a  
15 conversion foundation. Obviously we believe  
16 there must be an accurate independent  
17 evaluation of Blue Cross Blue Shield assets and  
18 that must be carefully regulated so as to not  
19 short circuit the process and transfer more  
20 than their fair share of resources to a private  
21 entity.

22 We believe the foundation should have some  
23 money set aside to prioritize rural health  
24 issues since much of the state of Montana is  
25 rural. The foundation should have a specific

1 mission governance process and that should be  
2 established before the final merger approval is  
3 approved and we don't believe that people  
4 associated with Blue Cross Blue Shield or  
5 Health Care Service Corporation should be on  
6 the board of such a foundation.

7 So to sum up, I have a lot of questions  
8 and I think the public needs the answers to  
9 these questions that I've outlined about this  
10 merger and about how this merger will impact  
11 Montanans before final approval is given.

12 I think that there needs to be an  
13 independent, an additional independent  
14 evaluation to protect and preserve the assets  
15 of Blue Cross Blue Shield of Montana and the  
16 questions that I've outlined must be studied  
17 and answered to give the Montanans the  
18 information they need to make an educated  
19 decision in part because of Health Care Service  
20 Corporation's track record in the state.

21 HEARINGS OFFICER LEAPHART: Thank you,  
22 Miss Larsen. Questions from the Applicant?  
23 Mr. McMahon?

24 MR. MCMAHON: Thank you, Your Honor.  
25

1 EXAMINATION OF STEPHANIE LARSEN

2 BY MR. MCMAHON:

3 Q Good morning, Miss Larsen. Thank you very  
4 much for coming today.

5 A You're welcome.

6 Q Could you explain to me what documents you  
7 reviewed prior to coming to testify today?

8 A Certainly. I looked at some of the media  
9 coverage in various local papers, I looked at some  
10 documents from the Commissioner's Office and I had  
11 some help from colleagues at Consumers Union.

12 Q When you indicate that you looked at some  
13 documents from the Commissioner's Office was that on  
14 the alliance website?

15 A I'm sorry, what alliance?

16 Q All the public documents that have been  
17 filed to date with the Commissioner of Insurance's  
18 Office, did you look at those documents?

19 A I'm not sure I understand your question.

20 Q Did you look at the application that was  
21 filed that's on public domain?

22 A I did not.

23 Q Did you look at the expert reports?

24 A I did not.

25 Q Did you look at the direct testimony that

1 will be filed that is filed for purposes of today's  
2 hearing?

3 A I did not.

4 Q Now, you have a lot of good questions and  
5 it's important for you to be here and ask those  
6 questions, but do you think had you taken the time  
7 to look at all of the documents that were filed on  
8 the website maybe some of those questions could have  
9 been answered?

10 A Indeed, which in part was why I suggested  
11 that they need to be in a publicly palatable way  
12 because Montanans need to have access to that  
13 information in a way that isn't, that's easy to  
14 understand, that isn't difficult to find, that's  
15 condensed in a way that makes sense to the average  
16 Montanans.

17 Q Now, with the website that for purposes of  
18 this transaction, do you understand it's on the  
19 Commissioner of Insurance's webpage?

20 A Yes, sir.

21 Q And you didn't go there, correct?

22 A Correct.

23 Q Are you familiar with the Affordable Care  
24 Act?

25 A I am.

1           Q     Some of the questions you had with respect  
2 to, well, let's just say the MLR that you mentioned,  
3 doesn't that all change under the Affordable Care  
4 Act?

5           A     Some of those provisions have not been,  
6 are not in effect right now, and I don't know the  
7 time line with which this merger could go through  
8 such that some of it will change and as we move  
9 through that process that's part of my question is  
10 how does Blue Cross Blue Shield of Montana and  
11 Health Care Services Corporation anticipate as they  
12 change both, as they merge and as the laws change  
13 with regards to the Affordable Care Act how they  
14 anticipate all of those things merging together.

15          Q     Now with respect to the Affordable Care  
16 Act, what is your understanding of when it goes into  
17 effect?

18          A     Some provisions are already in effect.  
19 The exchanges are set to be scheduled January 1st of  
20 2014.

21          Q     What is your understanding of the changes  
22 that have already gone into effect as of today?

23          A     There is lots. Could you give me a little  
24 bit of an idea of what you're looking for because  
25 there are lots of changes that are in effect now.

1 Q What is your understanding of what's  
2 already in effect today?

3 A For example, the medical loss ratio  
4 provisions are in effect, there are provisions --  
5 sorry, there is lots.

6 Q There are lots.

7 A Yes.

8 Q Would you agree with me that the health  
9 care industry is experiencing and will continue to  
10 experience substantial changes because of the  
11 Affordable Health Care Act?

12 A Absolutely.

13 Q And would you agree that it's important  
14 for the citizens of Montana to have a sound basis as  
15 this process goes forward to be in the best position  
16 available to get the best affordable care under the  
17 Affordable Care Act?

18 A Yes.

19 Q And would you agree with me that from a  
20 standpoint of size that HCSC has the ability and the  
21 track record to help Montana citizens, Montana  
22 insureds get through this uncertainty with respect  
23 to its scale, its technology capabilities; would you  
24 agree with me?

25 A Sorry, I wasn't sure that you were done

1 with your question. I believe that I need a lot  
2 more information before I could answer that  
3 question.

4 Q Did you speak to anybody at the  
5 Commissioner's Office prior to your testimony today?

6 A Yes.

7 Q Who did you talk to?

8 A I've spoken before with the Commissioner  
9 and with some of her staff, not about my testimony  
10 today, I'm sorry if that's what you were asking.

11 Q Did the Commissioner's Office suggest that  
12 you look at the website?

13 A No.

14 Q Did you inquire how the citizens of  
15 Montana can gain access to the information about  
16 this transaction?

17 A No.

18 Q And they didn't offer it to you, did they?

19 A Not to my recollection, no.

20 Q Ms. Larsen, I certainly appreciate you  
21 coming here and I certainly invite you to stay for  
22 the entire hearing so hopefully when you leave maybe  
23 you'll come back and say all my questions were  
24 answered. So thank you very much for coming.

25 A You're welcome.

1 HEARINGS OFFICER LEAPHART: Mr. Kaleczyc?

2

3 EXAMINATION OF STEPHANIE LARSEN

4 BY MR. KALECZYC:

5 Q Ms. Larsen, thank you for coming. I have  
6 a few questions related to the Center for Rural  
7 Affairs.

8 A Certainly.

9 Q Is that a Montana organization?

10 A We are a national organization, we're  
11 based in Nebraska.

12 Q Do you have members?

13 A We have supporters.

14 Q And when you say "supporters," what do you  
15 mean by supporters?

16 A I mean that we have individual donors and  
17 people who read our newsletters and who we  
18 correspond with. We are not organized as a  
19 membership organization so, for example, our board  
20 members are not voted on by members.

21 Q Are you a not-for-profit organization?

22 A We are a 501(c)(3) not-for-profit.

23 Q And you have no members, correct?

24 A In that sense, yes, correct, we have  
25 supporters, as I said.

1 Q Do you have supporters or contributors  
2 located in the state of Montana?

3 A Yes.

4 Q How many?

5 A Approximately 1,000.

6 Q And do you know where those 1,000 people  
7 are located?

8 A I could get that information to you. We  
9 have done that analysis, yes, all over the state.  
10 Most -- the majority of our supporters are in rural  
11 communities but they live all over the state.

12 Q And have your supporters in Montana  
13 written to you specifically about this proposed  
14 transaction?

15 A No, not that I recall.

16 Q Are any of the board of directors members  
17 of the Center for Rural Affairs Montanans?

18 A No.

19 Q Have you solicited the views of any of the  
20 people from Montana who have contributed to your  
21 organization, solicited their views about this  
22 transaction?

23 A I believe we've written about it in our,  
24 in some of our newsletter articles and I haven't  
25 gotten feedback from Montanans.

1 Q Are you the author of those articles that  
2 were in your newsletter?

3 A I expect that I would have been. It would  
4 either be in email transactions or newsletter  
5 articles and, yeah, I would have been the author of  
6 that.

7 Q But your information about this  
8 transaction does not come from your review of any of  
9 the documents that have been filed related to this  
10 transaction, correct?

11 A Yes.

12 Q I have no other questions.

13 HEARINGS OFFICER LEAPHART: Thank you.

14 Questions from the Commissioner?

15 MR. LASLOVICH: Yes, Your Honor.

16

17 EXAMINATION OF STEPHANIE LARSEN

18 BY MR. LASLOVICH:

19 Q Good morning.

20 A Good morning.

21 Q Miss Larsen, I too want to thank you for  
22 coming today. I don't know that we've met. Have we  
23 met?

24 A I don't believe so.

25 Q So good to meet you. Did I understand

1 your testimony to be that you have these questions,  
2 you want these questions answered and to the extent  
3 they're answered that consistently to your  
4 favorability that you would support this?

5 A Depending on the answers to the questions?

6 Q Yeah.

7 A Yeah, like we don't have an opinion on the  
8 merger right now. Like I said, we have a lot of  
9 questions. It is completely possible that would  
10 support the merger based on the answers to those  
11 questions.

12 Q Do you have the capability, Mr. McMahon  
13 urged you to sit through this entire hearing. Do  
14 you have that capability in light of your other  
15 duties?

16 A I don't.

17 Q Are you relying on your elected officials  
18 and the people that work for them, both the Attorney  
19 General's Office and the Commissioner of Securities  
20 and Insurance to assist in answering those  
21 questions?

22 A Yes.

23 Q Thank you.

24 HEARINGS OFFICER LEAPHART: The Attorney  
25 General's Office?

1 MS. HUBBARD: Yes, Your Honor.

2

3 EXAMINATION OF STEPHANIE LARSEN

4 BY MS. HUBBARD:

5 Q Thank you for coming, Miss Larsen. You  
6 discussed the necessity of having an independent  
7 valuation of the company to ensure the correct  
8 amount of public assets to the foundation; is that  
9 correct?

10 A Yes.

11 Q Are you aware that the Attorney's  
12 General's Office has hired someone to do such an  
13 evaluation?

14 A I am now.

15 Q Are you aware that that valuation can be  
16 found on the Attorney General of Montana's website?

17 A I am now.

18 Q I encourage you to have a look at it.

19 A If I could add that I prepared my  
20 testimony today prior to arriving and so I've  
21 definitely learned some things while listening. I  
22 was aware of the primary valuation, I was not aware  
23 of the one that the Attorney General's Office has  
24 done and I appreciate that. I'm looking forward to  
25 looking it over and seeing whether, and talking to

1 colleagues to see whether it seems to be  
2 appropriately independent.

3 Q And I understand that you haven't read the  
4 Attorney General's expert report yet, but do you  
5 have any reason to believe that the AG's expert  
6 report would not be an independent evaluation?

7 A I do not have an opinion.

8 Q Thank you.

9 HEARINGS OFFICER LEAPHART: Thank you.  
10 Any further questions?

11 MR. MCMAHON: No, Your Honor.

12 HEARINGS OFFICER LEAPHART: You may step  
13 down. Thank you for your testimony, Miss  
14 Larsen.

15 Any other members of the public wishing to  
16 make comment subject to cross-examination?  
17 Okay, seeing none, the next stage of our  
18 proceeding is getting into direct testimony.  
19 Why don't we take a break. My watch indicates  
20 five minutes after 11:00. Shall we reconvene  
21 at 11:15?

22 (Break taken.)

23 HEARINGS OFFICER LEAPHART: I would call  
24 upon the Applicants to call their first  
25 witness.

1 MR. MCMAHON: Thank you, Your Honor, the  
2 Applicants would call Michael Frank.

3 (Witness sworn.)

4 MR. MCMAHON: Your Honor, with your  
5 permission may I approach the witness?

6 HEARINGS OFFICER LEAPHART: Yes.

7  
8 DIRECT EXAMINATION OF MICHAEL FRANK

9 BY MR. MCMAHON:

10 Q Mr. Frank, what I'm handing you is a copy  
11 of your March 5th, 2013 direct testimony. Today do  
12 you affirm the testimony that you provided in that  
13 document?

14 A I do.

15 MR. MCMAHON: May I approach the witness,  
16 Your Honor?

17 HEARINGS OFFICER LEAPHART: Yes.

18 Q (By Mr. McMahan) I'm handing you what's  
19 been marked as Applicant's Exhibit Number 9.

20 MR. MCMAHON: Your Honor, I have a  
21 courtesy copy for you.

22 HEARINGS OFFICER LEAPHART: Thank you.

23 Q (By Mr. McMahan) Mr. Frank, do you  
24 recognize that document?

25 A I do.

1 Q Can you tell Justice Leaphart what that  
2 document is?

3 A This is a document that was entered into  
4 between Blue Cross Blue Shield of Montana, Montana's  
5 Attorney General and Health Care Service  
6 Corporation, it's a stipulation.

7 Q And Mr. Frank, the document has been made  
8 a part of the, quote, public record that's been  
9 filed with the Commissioner of Insurance Office.  
10 For purposes of today we want to make sure that it's  
11 a matter of the hearing record.

12 MR. MCMAHON: Your Honor, I would move for  
13 the admission of Exhibit 9.

14 HEARINGS OFFICER LEAPHART: Any objection?

15 MR. LASLOVICH: We don't object, Your  
16 Honor.

17 MS. HUBBARD: No objection.

18 HEARINGS OFFICER LEAPHART: It is  
19 admitted.

20 Q (By Mr. McMahan) Mr. Frank, between the  
21 time of your direct testimony and submission on  
22 March 5th and yesterday is it your understanding  
23 that the price that HCSC has agreed to pay has  
24 changed?

25 A Yes.

1 Q And what price has HCSC agreed to pay for  
2 the core insurance assets of Blue Cross Blue Shield  
3 of Montana?

4 HEARINGS OFFICER LEAPHART: Excuse me,  
5 Mr. McMahon, would you focus a little bit more  
6 on the mic there?

7 MR. MCMAHON: Sorry.

8 Q (By Mr. McMahon) Mr. Frank, during the  
9 interim you indicated that HCSC has agreed to pay  
10 more than what you testified to in your direct  
11 testimony, correct?

12 A Correct.

13 Q What is that amount?

14 A Pursuant to the stipulation it's my  
15 understanding that HCSC agrees to pay \$40.2 million.

16 Q Mr. Frank, is it your understanding that  
17 that 40.2 is the maximum amount?

18 A That's my understanding, yes.

19 MR. MCMAHON: Your Honor, we submit the  
20 witness for cross-examination.

21 HEARINGS OFFICER LEAPHART: Thank you.

22 MR. MCMAHON: Thank you, Mr. Frank.

23 HEARINGS OFFICER LEAPHART: Commissioner,  
24 please. Mr. Angoff?

25

1

2

CROSS-EXAMINATION OF MICHAEL FRANK

3

BY MR. ANGOFF:

4

Q Good morning, Mr. Frank.

5

A Good morning.

6

Q You remember about ten days ago your deposition was taken in this matter?

8

A I do.

9

Q For several hours?

10

A For several hours, yes.

11

Q And one of the things we talked about at that deposition was Company X, wasn't it?

13

A It was.

14

Q Now, Blue Cross Blue Shield of Montana ultimately decided to enter into a transaction with Health Care Service Corporation, correct?

17

A That's correct.

18

Q But there was at least one other company that Blue Cross of Montana spoke seriously with about a possible relationship, correct?

21

A Yes.

22

Q And that's the company that we refer to as Company X?

24

A Correct.

25

Q And there were some advantages, weren't

1 there, of going with Company X? For example, there  
2 would be a geographical advantage, Company X was  
3 closer, wasn't it, or isn't it, to Blue Cross Blue  
4 Shield of Montana and HCSC?

5 A Some of the states are closer, yes.

6 Q And also it would have been a different  
7 structure, right, than the structure of the  
8 transaction with HCSC?

9 A Not necessarily, no.

10 Q Wouldn't Blue Cross Blue Shield of Montana  
11 have remained an independent corporation?

12 A Not necessarily, no.

13 Q Would it have been a division of Company  
14 X?

15 A Possibly, yes.

16 Q You could, couldn't you, have continued to  
17 be domiciled in Montana, couldn't you?

18 A I'm uncertain.

19 Q Well, tell me then what didn't you like  
20 about Company X?

21 A Well, we went through a detailed analysis  
22 of Company X and HCSC and there were multiple  
23 factors that we examined in narrowing our selection  
24 and discussions with HCSC. Some of those factors  
25 included size, technology, they also included

1 membership. When I say size I should say financial  
2 membership. It included culture, it included their  
3 operations or services, it included their strategic  
4 plans and then there were multiple other factors  
5 that we looked at as well.

6 In looking at those factors it was the  
7 Blue Cross Blue Shield of Montana's board of  
8 directors' belief as well as the opinions of our  
9 executive team that was involved that there were  
10 benefits to HCSC over Company X.

11 Q And what were those benefits?

12 A Let me just start first with size. The  
13 membership size, as has been mentioned this morning  
14 of HCSC, is 13 and a half million members or larger,  
15 which is substantially larger than Company X's  
16 membership. We thought that that was very important  
17 as we get into some of the uncertainty as we move  
18 into the ACA or the full implementation of the  
19 Affordable Care Act. So needing to look at the size  
20 of the membership and spread the potential risk  
21 along with the uncertainty was one factor that  
22 distinguished HCSC over Company X.

23 There are multiple factors, one of the  
24 other factors was just the overall size of the  
25 operation and the administrative cost of Company X

1 versus HCSC. As I mentioned, HCSC is a much larger  
2 company and, in fact, has a lower administrative  
3 cost than Company X. We thought that that would be  
4 a benefit to all of Montanans and not just to our  
5 membership because the administrative costs along  
6 with the claims costs are what drive our premium and  
7 if we are able to bring down the administrative cost  
8 that will give us the possibility of lowering the  
9 increase of our premium.

10           There was also technology. Company X does  
11 not own or does not have a proprietary technology  
12 system and HCSC does. The company that Company X  
13 had worked for or, I'm sorry, was utilizing for its  
14 technology is the company that we are using for our  
15 claims processing system and our membership system.  
16 It's two different systems but the same company and  
17 we had gone through almost an eight- or ten-year  
18 process of moving our membership from our old system  
19 to our new system and we had a number of issues with  
20 that company in doing so and, in fact, have not  
21 fully converted our business.

22           Q     Is that the TriZetto system?

23           A     Yes, sir.

24           Q     And what was the problem or is the problem  
25 with the TriZetto system?

1           A     Well, we are having a, we were having and  
2     are having a number of problems with our conversion.  
3     The QNEC platform which we utilize is not able to  
4     handle all lines of business that we operate in  
5     today. For example, our federal employee program's  
6     business, it's not able to handle that business.  
7     There were certain and there are certain provider  
8     arrangements that that system is not able to handle  
9     or to perform on our behalf.

10                 We have issues with the ITS host, which is  
11     our BlueCard system in bringing in the upgrades, we  
12     also are not able on that system to support a  
13     Medicare Advantage product. So from the Blue Cross  
14     Blue Shield of Montana perspective we were having  
15     numerous issues with that system and our concern was  
16     with Company X utilizing the same vendor and having  
17     an understanding of some of the issues that Company  
18     X faced in converting all of its states onto that  
19     platform we were very concerned with the technology.

20           Q     Did you have any concerns about whether or  
21     not Company X was profitable enough?

22           A     It's my understanding that the surplus of  
23     Company X is stable.

24           Q     I'm sorry, is what?

25           A     Is stable.

1 Q Is stable?

2 A Yes.

3 Q And did you have any concerns about  
4 Company X's commitment to maintain current  
5 management?

6 A We did not have concerns about Company X's  
7 commitment to maintaining current management but we  
8 did have some concerns about recent changes in some  
9 of Company X's leadership.

10 Q Did you ever or anyone under your  
11 direction ever prepare a grid in which Company X and  
12 HCSC were compared on various criteria?

13 A We did not and we didn't do that  
14 specifically because the Blue system is a very small  
15 system even though we service the United States and  
16 there is 38 plans, it's a very small system and we  
17 were concerned about the sensitive nature of that  
18 type of information. If that information was ever  
19 to for some reason be leaked out, the impacts that  
20 that could have on either HCSC, Company X or Blue  
21 Cross Blue Shield of Montana as we went forward.

22 Q Did you ever look into the level of  
23 Company X's pricing?

24 A We did not examine the rating of  
25 Company X.

1 Q And did discussions with Company X get to  
2 the stage at which Company X offered a certain price  
3 for them?

4 A We did not have negotiations on price with  
5 Company X.

6 Q Now, HCSC and Company X were the only two  
7 companies that you actually spoke with about a  
8 possible affiliation, correct?

9 A They were the only two companies that we  
10 had formal conversations with regarding a possible  
11 relationship.

12 Q Did you have informal discussions with any  
13 other companies regarding the relationship?

14 A You know, there have been throughout the  
15 history of Blue Cross Blue Shield of Montana and the  
16 fact that we are a part of the Blue system, there  
17 have been discussions with other plans that have  
18 talked about how do we share services together, are  
19 there best practices, are there relationships that  
20 we can have with Blue Cross and potentially other  
21 plans.

22 Q Which plans have you had discussions with?

23 A Well, as far as the potential outsourcing  
24 for shared services that I mentioned, there have  
25 been discussions with Premara in the past where we

1 are received services from Premara, we are a partner  
2 with other plans, or I should say were a partner on  
3 some Medicare Advantage products. We had numerous  
4 conversations and trips with Blue Cross of Idaho on  
5 sharing best practices and if there were different  
6 functions that we could be performing together and,  
7 in fact, we did form a joint venture with Blue Cross  
8 of Idaho with one of our subsidiaries.

9           There had been conversations with Nebraska  
10 on its claims processing system that it has with  
11 North Dakota and Wyoming, so those are just a few of  
12 some of the informal conversations that we've had.

13           Q     Did you ever talk about a possible  
14 affiliation with Premara?

15           A     No, we did not.

16           Q     And Premara is a larger company than  
17 Company X, correct?

18           A     I'm not sure on the overall size or  
19 membership of Premara at that time.

20           Q     It's more profitable than Company X?

21           A     I think they've done well.

22           Q     And so why did you not approach Premara?

23           A     Well, there were -- like I mentioned, we  
24 had a good working relationship with Premara. We  
25 looked at the size of Premara and then we also were

1 under the understanding that in the past Premara had  
2 looked to moving into a for-profit entity.

3 Q And you're familiar, aren't you, with the  
4 fact that the Commissioner rejected Premara's  
5 application?

6 A That's my understanding, yes.

7 Q And do you think that once that  
8 application has been rejected Premara would still  
9 continue down that path that had been projected?

10 A I don't have an opinion on that.

11 Q But for whatever reason you did not pursue  
12 an affiliation with Premara?

13 A That's correct.

14 Q And did you pursue an affiliation with  
15 Blue Cross of Idaho?

16 A No, we did not.

17 Q And why not?

18 A Again, it was just based on size. We  
19 believe that as we move forward with some of the  
20 uncertainty in health care reform, some of the  
21 financial issues that we were having as well as the  
22 technology issues that we were having, we did not  
23 believe that Blue Cross of Idaho was large enough or  
24 would be an ideal partner for us.

25 Q Now, there are some substantially sized

1 nonprofit Blue Cross plans other than HCSC, correct?

2 A Yes.

3 Q One is Carelst in Maryland and D.C. and  
4 Delaware?

5 A Yes.

6 Q And did you speak to them about a possible  
7 affiliation?

8 A We did not.

9 Q And why not?

10 A In part it was the geographic location and  
11 some on size as well.

12 Q And are you familiar with Highmark in  
13 Pennsylvania?

14 A Yes.

15 Q And did you pursue an affiliation with  
16 them?

17 A We did not.

18 Q And why not?

19 A Because, again, of their geographic  
20 location and my understanding of they're primarily  
21 operating only in that area.

22 Q Is there an advantage to contiguousness,  
23 that is, is there an advantage to affiliating with a  
24 company whose territory borders on Montana's?

25 A I believe there is an advantage to

1 affiliating with a company that's reasonably close  
2 geographically or has some types of states that are  
3 similar to Montana in nature, for example, some of  
4 the, some of the rural issues that we deal with.

5 Q And Carelst out in Maryland and D.C.  
6 certainly is not contiguous, is not close  
7 geographically but it is large, isn't it?

8 A Yes.

9 Q And did you consider the fact that maybe  
10 its size was great enough that it would outweigh, at  
11 least cause you to consider them as a possible  
12 affiliation partner?

13 A You know, I think that the size would have  
14 been possible but, again, just with the geography  
15 issues and some of the cultural issues as well and  
16 the fact that HCSC is actually larger.

17 Q And by cultural issues do you mean the  
18 difference between east and west?

19 A Some.

20 Q Urban and rural?

21 A Some.

22 Q Anything else you care to add under the  
23 topic of cultural issues?

24 A No.

25 Q Did Blue Cross of Montana ever pursue to

1 your knowledge an affiliation with Company X in the  
2 past?

3 A It's my understanding that they have.

4 Q And when was that as far as you know?

5 A It's my understanding that was sometime in  
6 the mid 1990s. I can't be sure on those dates, but  
7 I believe that it was at the time when there were,  
8 when I wasn't at the company.

9 Q You weren't at the company at all?

10 A No.

11 Q And what, if anything, have you heard  
12 about that potential affiliation at that time?

13 A You know, the only things that I have  
14 heard is that they did look at affiliating with  
15 Company X. I don't have any of the details of that  
16 affiliation.

17 Q You don't know who would be the acquirer,  
18 for example, and who would be the acquired company?

19 A No.

20 Q Blue Cross of Montana doesn't have  
21 shareholders, does it?

22 A No.

23 Q Then who owns Blue Cross of Montana?

24 A Blue Cross Blue Shield of Montana is a  
25 mutual benefit company that is governed by a board

1 of directors with a mission to provide affordable  
2 and accessible health care to Montanans.

3 Q And who owns the company?

4 A Again, it's not owned in my opinion by any  
5 shareholders or anybody else, we're there for the  
6 benefit of Montana.

7 Q Well, do you know whether the  
8 policyholders also have a status as owners?

9 A I don't believe so.

10 Q And do you know whether the policyholders  
11 have annual meetings?

12 A No, they don't.

13 Q Then who at Blue Cross of Montana who, if  
14 anyone, is the board of directors responsible to?

15 A The board of directors is a  
16 self-perpetuating board that oversees Blue Cross  
17 Blue Shield of Montana, so it is responsible for  
18 itself.

19 Q And how would a member of the board of  
20 directors be removed?

21 A There are certain criteria that are  
22 identified for the removal of the board based on the  
23 by-laws of Blue Cross Blue Shield of Montana.

24 Q And when you say it's a self-perpetuating  
25 board does that mean that the board of directors

1 elects new directors from time to time?

2 A Yes.

3 Q So Blue Cross Blue Shield of Montana  
4 doesn't file a 10K statement with the Securities and  
5 Exchange Commission?

6 A No.

7 Q Does Blue Cross of Montana have an annual  
8 report that it makes available to the public?

9 A It does have an annual report, yes.

10 Q And is that annual report on the Blue  
11 Cross of Montana website?

12 A I'm not sure if the 2012 one is on yet but  
13 the past ones should be.

14 Q And does that annual report contain the  
15 same type of information that a public company, a  
16 stockholder owned company includes in its 10K?

17 A I'm not sure.

18 Q What type of information is included in  
19 the annual report that Blue Cross of Montana  
20 currently publishes?

21 A It would provide information on Blue Cross  
22 Blue Shield of Montana and what it's accomplished  
23 over the last year, it would also, if I recall  
24 correctly, provide information on community  
25 involvement and it could provide some financial

1 information.

2 Q Do you think there is any reason why the  
3 policyholders of Blue Cross Blue Shield of Montana  
4 should not have access to the same type of  
5 information that stockholders have access to of  
6 stock-owned companies?

7 A I believe that the policyholders and  
8 others in Montana have access to additional  
9 information through the Department of Insurance  
10 through its regulation and oversight of Blue Cross  
11 Blue Shield of Montana.

12 Q You don't know then whether Blue Cross of  
13 Montana makes available the same type of information  
14 to its customers as public companies make available  
15 to their stockholders?

16 A I've never compared the two.

17 Q Now, if this transaction is approved  
18 you'll continue to be president of Blue Cross of  
19 Montana, right?

20 A Correct.

21 Q And how do you know that?

22 A That's the conversations that I've had  
23 with individuals at HCSC.

24 Q And did they come to you and offer you  
25 that?

1           A     If I recall correctly, you know, there  
2     have been discussions about all of our employees and  
3     the fact that all of our employees would maintain  
4     employment with Blue Cross and Blue Shield of  
5     Montana and that's probably when those discussions  
6     arose.

7           Q     And do you remember who first broached the  
8     topic?

9           A     I've had conversations with the CEO of  
10    HCSC, Pat Hemingway-Hall.

11          Q     But you don't remember whether she asked  
12    you to stay on or you asked whether you could stay  
13    on?

14          A     I believe it was a mutual conversation.

15          Q     And so you'll continue to be president of  
16    Blue Cross of Montana, which would be a division  
17    though of HCSC?

18          A     Yes.

19          Q     And you'll report to the executive  
20    vice-president?

21          A     Yes.

22          Q     And that executive vice-president will  
23    report to Pat Hall, the CEO?

24          A     Yes.

25          Q     Now, what about your senior leaders or

1 senior staff members, will they all have the same  
2 positions if the acquisition is approved that they  
3 currently have?

4 A Some of their positions may change just  
5 as, you know, positions have changed over time as  
6 we've been an independent plan.

7 Q So let's take, for example, your general  
8 counsel. Will the general counsel of Blue Cross of  
9 Montana today, will she continue to be general  
10 counsel to Blue Cross of Montana, a division of  
11 Health Care Service Corporation?

12 A I'm not sure of the exact title that our  
13 general counsel would have.

14 Q Well, will there be a general counsel of  
15 Blue Cross of Montana, a division of HCSC?

16 A Again, I'm not sure of the exact title but  
17 we will have a lead attorney that will be housed in  
18 Montana at our facilities.

19 Q And what about your chief actuary, will  
20 your chief actuary continue to be chief actuary of  
21 Blue Cross of Montana?

22 A I'm not sure of the exact title but he  
23 will still oversee our actuarial functions for Blue  
24 Cross Blue Shield of Montana.

25 Q And do you know who he'll report to?

1           A     I don't.

2           Q     Is there a chief underwriter at Blue Cross  
3 of Montana?

4           A     We have a director of underwriting that  
5 reports up through our actuary.

6           Q     And do you know what will happen to your  
7 chief underwriter if the acquisition is approved,  
8 that is, do you know whether your chief underwriter  
9 will continue in the same position at Blue Cross of  
10 Montana if the acquisition is approved?

11          A     There will be changes in some of the  
12 underwriting functions with or without the proposed  
13 alliance with HCSC just based on some of the changes  
14 under the ACA.

15          Q     And will there actually be less of a need  
16 for underwriters because of the ACAs mandating a  
17 particular underwriting methodology?

18          A     There could be.

19          Q     And so have you discussed or considered  
20 what underwriters who might not be needed in the  
21 future would be doing?

22          A     I believe that there will still be a  
23 period of time in which we will need some of the  
24 underwriting functions and then, you know, again  
25 either with or without HCSC we would be dealing with

1 the issue of the functions that should be performed  
2 by our underwriters.

3 Q So the ACA sets out an underwriting  
4 methodology and that underwriting methodology will  
5 apply whether or not Blue Cross of Montana is  
6 acquired by HCSC, right?

7 A Yes, Blue Cross Blue Shield of Montana  
8 will need to comply with the ACA regardless of any  
9 alliance with HCSC.

10 Q And there will be less of a need for  
11 underwriters then regardless of whether the  
12 acquisition is approved or not?

13 A Possibly, yes.

14 Q Mr. Burzynski is your chief financial  
15 officer, right?

16 A Correct.

17 Q So if the acquisition is approved will  
18 there continue to be a chief financial officer of  
19 Blue Cross of Montana?

20 A No, there will not.

21 Q Then what will happen to Mr. Burzynski's  
22 position?

23 A Mr. Burzynski has been with the company  
24 for more than ten years and has held multiple roles  
25 in our company and he will be working with our

1 providers, as he has done in the past.

2 Q But the position of chief financial  
3 officer, will that be abolished or merged into  
4 another position or will something else happen to  
5 it?

6 A My understanding is that many of the  
7 financial functions will be performed at the  
8 enterprise supporting our local plan.

9 Q And by the enterprise you mean at the  
10 holding company level?

11 A At the HCSC level.

12 Q And would that be out of Chicago?

13 A That's my -- parts of that may be, yes.

14 Q Is there a head of claims at Blue Cross of  
15 Montana?

16 A Today we have a senior director of our  
17 operation staff.

18 Q And will he still be the head of claims if  
19 Blue Cross of Montana becomes a division of HCSC?

20 A She will still be responsible for  
21 overseeing the operations.

22 Q And does the head of claims now report  
23 directly to you?

24 A No, she does not.

25 Q Does she report to Mr. Burzynski?

1 A That's correct.

2 Q And do you know who she will report to  
3 after the merger if the acquisition is approved?

4 A I'm not sure exactly who she'll report to.

5 Q But she'll report to someone at the  
6 enterprise level?

7 A Correct.

8 Q Does that also go for the head of customer  
9 service?

10 A We have one senior director that oversees  
11 the operations area, that includes claims, customer  
12 service and membership, so it's the same individual.

13 Q It's the same individual who is the head  
14 of customer service is also the head of claims?

15 A Correct.

16 Q What about HR, you've got an HR  
17 department, right?

18 A We do.

19 Q Will that run the same way it's running  
20 today or will there be changes?

21 A It will run the same way, where the HR  
22 director will support our local plan.

23 Q And who will the HR director report to?

24 A It's my understanding that she will report  
25 up through the enterprise as well.

1 Q And I assume you've also got a head of IT?

2 A Yes, we do.

3 Q And an IT department?

4 A Yes.

5 Q And does the head of the IT department now  
6 report directly to you?

7 A Yes.

8 Q And then if the acquisition is approved  
9 then who will the IT director report to?

10 A That will report up to the enterprise  
11 director as well but we will maintain our own local  
12 IT staff and oversight at our plant.

13 Q So today how many direct reports do you  
14 have?

15 A I have six or seven.

16 Q And of those six or seven if the  
17 acquisition is approved how many will continue to  
18 report to you?

19 A I'll still have four or five.

20 Q Now, if any of the people that we just  
21 discussed voluntarily leave the company after the  
22 acquisition is consummated, assuming that it is  
23 consummated, do you know what, if any, benefits they  
24 will receive?

25 MR. MCMAHON: Your Honor, for this purpose

1 of the examination, as you understand and know,  
2 employee law requires strict confidentiality  
3 with respect to wages, benefits, who they are  
4 and what they do get and what they don't get.  
5 So I'm a little concerned that we're getting  
6 into an area that is --

7 HEARINGS OFFICER LEAPHART: Mr. Angoff, do  
8 you have some questions that do not involve  
9 confidentiality that you could explore first  
10 and then if need be we can ask the public to  
11 leave for further questions?

12 MR. ANGOFF: Certainly, Your Honor, and we  
13 have no objection to keeping confidential what  
14 they ask be kept confidential. Why don't I  
15 continue and to the extent that you think it  
16 calls for confidential information to be  
17 disclosed I'll withdraw the question.

18 MR. MCMAHON: Or we can wait until he's  
19 done and have all of that examination outside  
20 of the public hearing process, whatever is  
21 easiest for you, Your Honor.

22 HEARINGS OFFICER LEAPHART: Well, I'm not  
23 knowing what the questions are, I'm kind at  
24 your mercy. If you think that you're getting  
25 into areas that involve potential issues of

1           confidentiality maybe we can parcel those off  
2           and deal with them later.

3           MR. ANGOFF: I think that makes sense.  
4           Thank you.

5           HEARINGS OFFICER LEAPHART: Maybe you can  
6           proceed with another line at this point and  
7           maybe right after lunch would be a good time.

8           Q        (By Mr. Angoff) Mr. Frank, I'm sure  
9           you're sorry to hear that for the time being we'll  
10          be abandoning that line of questioning.

11          A        Yes.

12          Q        But we'll come back to it. In the  
13          meantime, there are several initiatives that HCSC  
14          and Blue Cross of Montana are currently working on,  
15          correct?

16          A        I'm not sure what you mean by initiatives.

17          Q        Projects, Medicare Advantage, for example.

18          A        Yes.

19          Q        What is HCSC doing in connection with  
20          Medicare Advantage with Blue Cross of Montana?

21          A        As I mentioned previously, Blue Cross Blue  
22          Shield of Montana as a stand-alone plan was not able  
23          to enter into the Medicare Advantage arena once they  
24          identified the different regions for Medicare  
25          Advantage of five or so years ago.

1           So we had entered into what's called the  
2 Northern Plains Alliance or the Regional Advantages  
3 Services with some other Blue plans. It was decided  
4 last year that that would not continue for a portion  
5 of the Medicare Advantage product, so we are  
6 currently not in the Medicare Advantage line of  
7 business for 2013.

8           Because we wanted to get back into the MA  
9 or the Medicare Advantage business, we had looked at  
10 multiple options or plans to do that in '13 and  
11 unfortunately none of those worked out. So we are  
12 currently working with HCSC to help us operate on  
13 the back office side for a Medicare Advantage  
14 offering in 2014.

15           Q     And your relationship with HCSC in  
16 connection with Medicare Advantage will continue  
17 whether or not the acquisition is approved, correct?

18           A     Correct.

19           Q     And are you also working with HCSC  
20 regarding your FEP business?

21           A     Yes, we are.

22           Q     And what is FEP business?

23           A     FEP is the Federal Employees Program  
24 business and Blue Cross Blue Shield of Montana has  
25 been in that line of business for a number of years

1 but unfortunately last year we, maybe the year  
2 before, we had to close down our Great Falls office  
3 for administrative cost purposes, move that back and  
4 we were having issues with our FEP service scores  
5 and in addition our current claims processing  
6 system, QNEC, is not able to handle or process our  
7 FEP business so we were looking to outsource that  
8 business regardless of the alliance.

9 Q So the relationship between HCSC and Blue  
10 Cross of Montana regarding the FEP business will  
11 continue regardless of whether the acquisition is  
12 approved?

13 A That's correct.

14 Q What, if anything, is Blue Cross of  
15 Montana currently doing regarding the exchanges in  
16 connection with HCSC?

17 A Specific to working with HCSC we are  
18 working on our exchange readiness platform with  
19 HCSC.

20 Q And what does that work consist of?

21 A It consists of us being able to cap into  
22 the HCSC front end or platform, which we wouldn't be  
23 able to develop on our own. That then connects or  
24 will connect with the federally funded exchange and  
25 possibly some other exchanges.

1 Q When you say the HCSC front end, is that  
2 the same thing as a user interface, is that what the  
3 consumer sees when he or she goes to the Internet?

4 A Yes.

5 Q And HCSC has already developed that?

6 A They're working on that.

7 Q And Blue Cross -- and how much, if  
8 anything, has Blue Cross of Montana done regarding a  
9 front end?

10 A We had been working on some items related  
11 to the exchange but I will tell you that our  
12 technology was not where it needed to be.

13 Q And about how many people at Blue Cross of  
14 Montana are working on the exchange-related project  
15 with HCSC?

16 A Well, I don't know the exact number that's  
17 working with them.

18 Q Approximately, ballpark?

19 A You know, I would say 10 to 15 just  
20 depending upon different areas of the company.

21 Q And do you know how many people at HCSC  
22 are working on it?

23 A I don't have the number, no.

24 Q And this relationship regarding the  
25 exchanges will continue regardless of what happens

1 with the acquisition, right?

2 A That's correct.

3 Q Did the discussions about any of these  
4 three projects, what I call projects with HCSC, the  
5 Medicare Advantage, the FEP business and the  
6 exchanges, did any of these discussions predate your  
7 discussions with HCSC about a potential alliance?

8 A Once we started to have discussions with  
9 HCSC we immediately did not know what the structure  
10 of the ultimate transaction would be but we did  
11 start discussions about a possible relationship for  
12 those three projects at that time as well.

13 Q So let's talk about the structure then of  
14 the relationship, of the affiliation. When Blue  
15 Cross initiated discussions with HCSC about a  
16 possible affiliation did it have an idea of the type  
17 of structure it wanted to see, the type of structure  
18 it wanted to see the affiliation take?

19 A We thought that it was important to have  
20 those conversations with the potential partner to  
21 come up with the final transaction.

22 Q But did you have any idea yourself of what  
23 you wanted the structure of the affiliation to look  
24 like?

25 A We didn't have an idea on the specific

1 structure but we had an idea on certain things that  
2 we wanted to accomplish through the relationship.

3 Q And as we discussed two weeks ago, Blue  
4 Cross of Montana certainly is not, it's not  
5 realistic to think that Blue Cross of Montana would  
6 acquire, would be the acquiring company and HCSC the  
7 acquired company?

8 A Not when you look at the size of our plan,  
9 no.

10 Q But besides the current structure answer,  
11 which is an asset purchase, correct?

12 A Yes.

13 Q Were there other types of structures that  
14 you looked at?

15 A You know, there were discussions on,  
16 again, what we thought would be the best way to form  
17 the relationship to provide Blue Cross Blue Shield  
18 of Montana the services, the resources and some of  
19 the risk sharing that it needed, which ultimately  
20 led to the asset purchase agreement.

21 Q And did you ever talk to an investment  
22 banker about what the structure of the affiliation  
23 should be?

24 A Not that I'm aware of.

25 Q Who, if anyone, did you rely on then for

1 advice as to what the structure of the affiliation  
2 should be?

3 A We did hire an attorney named Mark  
4 Droppert from Graham & Dunn, along with one of his  
5 partners, David Lundsgaard, who assisted us.

6 Q And other than legal advice, which I'm not  
7 asking you to discuss, did they provide any other  
8 type of advice?

9 A You know, Mr. Droppert has experience in  
10 the health care field so he was helpful in the  
11 discussion of the APA.

12 Q Was there anyone else that you relied on  
13 for advice as to what the structure of the  
14 affiliation should look like?

15 A Not externally, no.

16 Q Internally?

17 A Well, we relied on our own staff as we  
18 went through this process.

19 Q Would Mr. Burzynski be one of the people  
20 that you relied on?

21 A I'm sure we had conversations with  
22 Mr. Burzynski, again, about what our objectives were  
23 and what we needed to accomplish through it and how  
24 that led to the ultimate relationship.

25 Q And who else did you rely on?

1           A     You know, I'm sure there was input from  
2 others on our executive team.

3           Q     Do you recall who?

4           A     Not specifically, no.

5           Q     In your discussions with HCSC about what  
6 the ultimate structure of the affiliation would look  
7 like what issues had to be negotiated out besides  
8 the structure itself, what other issues did you  
9 discuss with HCSC?

10          A     Well, there was a long process to  
11 ultimately end up at the final APA, as with, you  
12 know, any transaction there are various terms that  
13 we discussed. I think what readily come to mind are  
14 what would happen with our employees, what would  
15 happen with our employee benefits, you know, what  
16 would happen to our insured members and our  
17 self-funded members for their protection. So those  
18 are some that readily come to mind.

19          Q     Were those among the issues that you  
20 considered the most important?

21          A     Not necessarily. I'm sure I ranked them  
22 but obviously the protection of our employees and  
23 our members ranked right at the top.

24          Q     What other issues, if any, did you  
25 consider important?

1           A     Well, I'm sure that there were others that  
2 were discussed as far as in any transaction, you  
3 know, which assets that would be transferred, the  
4 assets that would remain, what would happen with our  
5 subsidiaries, how we would work with providers, I'm  
6 sure there were others as well.

7           Q     Were you concerned that there could be  
8 layoffs as a result of the affiliation?

9           A     We went into, in our discussions with  
10 HCSC, about the need to protect our employees. I  
11 was more concerned about layoffs if we did not have  
12 the affiliation.

13          Q     So were you concerned at all about layoffs  
14 with the affiliation?

15          A     Not following our discussions, no.

16          Q     They assured you that all of your  
17 employees would remain with Blue Cross of Montana?

18          A     That's correct.

19          Q     Did they assure you that everyone would  
20 remain in Montana?

21          A     They assured us that no one would have to  
22 move.

23          Q     They didn't assure you that everyone would  
24 stay in their current job?

25          A     Correct, they did not.

1 HEARINGS OFFICER LEAPHART: Mr. Angoff, it  
2 is noon so if you have an appropriate place for  
3 a break. I don't want to interrupt you.

4 MR. ANGOFF: This would be an appropriate  
5 place for a break, Your Honor.

6 HEARINGS OFFICER LEAPHART: Let's take a  
7 break until 1:30.

8 MR. ANGOFF: Very good. Thank you,  
9 Mr. Frank.

10 (Lunch break taken.)

11 HEARING OFFICER LEAPHART: Let's  
12 reconvene. At this point due to concerns over  
13 confidentiality we're going to go into a closed  
14 session for a period of time anyway and so I  
15 would ask that everybody with the exception of  
16 the lawyers working on this case please step  
17 out into the hallway and we'll shut the doors.

18 (Confidential portion of  
19 transcript.)  
20  
21  
22  
23  
24  
25

1 (Confidential portion  
2 concluded.)

3 HEARING OFFICER LEAPHART: Okay, you can  
4 proceed.

5 MR. ANGOFF: Thank you, Your Honor.

6

7 CROSS-EXAMINATION OF MICHAEL FRANK (Continued)

8 BY MR. ANGOFF:

9 Q Mr. Frank, do you recall this morning you  
10 had a brief discussion with Mr. McMahon about the  
11 stipulation that Blue Cross and HCSC had entered  
12 into with the Attorney General?

13 A Yes.

14 Q And he showed you what's been marked as  
15 Applicant Exhibit 9, correct?

16 A He did.

17 Q And in Applicant Exhibit 9 it says that  
18 this stipulation or all obligations pursuant to this  
19 stipulation will expire on March 30 of this year,  
20 correct?

21 A That's my understanding.

22 Q And why is that?

23 A It's my understanding that the March 30th  
24 date is related to the necessity to, for the  
25 positions in Great Falls.

1 Q And how do you come to so understand?

2 A That has been shared with me by HCSC.

3 Q Are you familiar with Colleen Reitan's  
4 prefiled testimony saying that February is the  
5 deadline for being able to begin finalizing these  
6 customer service plans?

7 A I did not review her prefiled testimony.

8 Q And have you done independent analysis as  
9 to what you believe the deadline is for finalizing  
10 customer service plans?

11 A No.

12 Q March 30th, you understand that March 30th  
13 of this year is before the date on which the parties  
14 must submit to the Judge their proposed findings and  
15 conclusions?

16 A That's my understanding.

17 Q Now, the stipulation provided, didn't it,  
18 that the price for the assets that are being  
19 purchased would be 40.2 million?

20 A That's my understanding.

21 Q And are you familiar with Mr. Galasso's  
22 study that was done in connection with the  
23 application?

24 A I am familiar with the amount that he  
25 identified.

1 Q Okay, what was that amount?

2 A \$17.6 million.

3 Q And that amount was based on, wasn't it,  
4 Mr. Galasso's assumptions which were arrived at in  
5 conjunction with the advice of Blue Cross?

6 A I have not reviewed his study but that's  
7 my understanding.

8 Q Then how did Blue Cross arrive at the 40.2  
9 million price having earlier been advised by  
10 Mr. Galasso that the value of the company was 17.6  
11 million?

12 A Blue Cross did not arrive at the \$40.2  
13 million price.

14 Q Okay, who did?

15 A I believe those were with HCSC.

16 Q But Blue Cross has signed this  
17 stipulation, correct?

18 A That's correct.

19 Q So presumably Blue Cross agrees that the  
20 40.2 million purchase price is reasonable?

21 A Correct.

22 Q And what is that belief that it's  
23 reasonable based on?

24 A It's my understanding based on the  
25 different valuations, as Miss Hubbard talked in her

1 opening, that it was within the range of the  
2 valuations.

3 Q So Mr. Galasso had a valuation that was  
4 substantially similar. Is it fair to say one of  
5 Mr. Galasso's scenarios produced a valuation that  
6 was substantially similar to the 40.2 million?

7 A If I recall correctly there was a  
8 valuation that was close but I can't recall the  
9 details of that.

10 Q Is there any other basis for this 40.2  
11 million price that you're aware of?

12 A Not that I'm aware of.

13 Q Now when you were discussing a possible  
14 affiliation with HCSC, when, if at all, is the first  
15 time that the issue of the price to be paid for the  
16 assets to be transferred was raised?

17 A I believe it was in late June or sometime  
18 in July where we were discussing different possible  
19 structures and we had agreed that, that there would  
20 be a valuation done and HCSC would either accept or  
21 reject that valuation.

22 Q And who raised it?

23 A I can't recall who raised that.

24 Q And before that discussion did you ever  
25 talk within Blue Cross about talking about the price

1 that would ultimately be paid for the assets that  
2 are being transferred?

3 A No.

4 Q You said in your deposition that lawyers  
5 talked to you about price, right; do you remember  
6 that?

7 A That the lawyers talked to me about the  
8 price, I don't recall that in my deposition but I  
9 may have.

10 Q But you don't recall that?

11 MR. MCMAHON: Your Honor, if he has a  
12 specific page number with respect to the  
13 deposition it may help.

14 MR. ANGOFF: Yes, page 113 lines 8 to 14.

15 MR. MCMAHON: Do you have a copy for  
16 Mr. Frank to have?

17 HEARING OFFICER LEAPHART: Yes, show him a  
18 copy of the deposition.

19 MR. ANGOFF: May I approach the witness,  
20 Your Honor.

21 HEARING OFFICER LEAPHART: You may.

22 Q (By Mr. Angoff) Mr. Frank, could you  
23 please read lines 9 to 14 from your deposition?

24 A It says "Who, if you remember, who first  
25 broached the idea, who first brought up the issue of

1 price?" and "I think we first talked about price at  
2 one of the Chicago meetings and it was not a  
3 discussion about what the price would be but more of  
4 a discussion from some of the counsel talking to us  
5 about the conversion statute and how to arrive at  
6 price."

7 Q And my only question, Mr. Frank, is do you  
8 happen to recall whether those lawyers were Montana  
9 lawyers or Chicago lawyers?

10 A I don't recall.

11 Q Did HCSC ever offer to pay for a valuation  
12 of Blue Cross Blue Shield of Montana?

13 A Not that I'm aware of, no.

14 Q Did they ever suggest a joint evaluation?

15 A Not that I'm aware of, no.

16 Q Had Blue Cross Blue Shield of Montana ever  
17 valued the company before deciding to talk with HCSC  
18 about an affiliation?

19 A Not that I'm aware of.

20 Q Did you ever ask an investment banker to  
21 value the company?

22 A No.

23 Q Have you gotten a fairness opinion from an  
24 investment banker on this case as of today?

25 A Not that I'm aware of, no.

1 Q Did you ever determine how much HCSC could  
2 afford to pay?

3 A No.

4 Q Did you ever look at characteristics of  
5 HCSC that might make Blue Cross of Montana worth  
6 more to HCSC than an appraisal price?

7 A No.

8 Q Did you ever look at how much HCSC had  
9 paid for its other acquisitions?

10 A No.

11 Q Did you ever look at how much other Blue  
12 Cross plans who acquired Blue Cross plans had paid  
13 for those plans?

14 MR. MCMAHON: Your Honor, I'm sorry, but  
15 from the standard of the statutory requirements  
16 under the conversion statute we've allowed  
17 Mr. Angoff some leniency about other companies,  
18 but the statute requires fair market value of  
19 the transfer of Blue Cross Blue Shield of  
20 Montana.

21 HEARING OFFICER LEAPHART: Objection  
22 noted. Proceed.

23 Q (By Mr. Angoff) Is it too late now for  
24 another company to come in and offer more for Blue  
25 Cross?

1           A     You know, the -- it is.

2           Q     Did you ever think that you could get a  
3 higher price by having multiple prospective bidders  
4 bid against each other?

5           A     You know, we did not consider any type of  
6 bid because of the multiple factors that we took  
7 into account in determining what we believed would  
8 be the best partner and then also the fact of the  
9 ultimate conversion statute and the requirement for  
10 an independent valuation.

11          Q     Did you ever think that you should see how  
12 much other companies were willing to pay before  
13 rejecting them?

14          A     No, again, because of the requirements  
15 under the conversion statute.

16          Q     Did you ever think that you had a duty to  
17 the Montana public or to your policyholders to get  
18 the highest price possible for the company?

19          A     I believe that we have the duty in Montana  
20 to follow the conversion statute, as vague as it is,  
21 and that we've agreed to follow it to the  
22 determination of value.

23          Q     Now, you agreed to the transaction subject  
24 to a price to be determined, correct?

25          A     We were, we had established the basic

1 structure of the transaction, we were continuing to  
2 perform due diligence, just as HCSC was continuing  
3 to perform due diligence and I believe at the same  
4 time the valuation was being conducted.

5 Q Have you ever agreed to any other  
6 transaction subject to a price to be determined?

7 A I have been involved in transactions where  
8 methodologies have been established for the  
9 determination of value.

10 Q And these methodologies were established  
11 after you agreed to the, after you agreed to the  
12 transaction?

13 A Not after we've agreed to the transaction  
14 but after we've agreed to some of the structural  
15 items.

16 Q And what were those transactions?

17 A Some of those were when I was in private  
18 practice as an attorney.

19 Q But since you've been at Blue Cross of  
20 Montana have you?

21 A We have agreed to a set methodology.

22 Q And what transaction was that in  
23 connection with?

24 A When we were working through the  
25 transaction between Western States and Payne

1 Financial Group there was basic agreement on the  
2 methodology and then the information would identify  
3 a price.

4 Q And in this case though did you agree on a  
5 methodology?

6 A We did not have a methodology because it  
7 was set by the statute.

8 Q Have you discussed with HCSC at any time  
9 your competition in Montana?

10 A We have discussed with HCSC the fact that  
11 there is more competition in Montana and, in fact,  
12 more national multistate competition.

13 Q And what do you base your statement on  
14 that there is more national and multistate  
15 competition on?

16 A The fact that PacificSource is doing  
17 business in Montana and we are now seeing more of a  
18 presence from Cigna and, in fact, that United Health  
19 Care was recently awarded the TriWest contract and  
20 will have the largest stake in Montana.

21 Q Had you discussed with HCSC the taxes that  
22 the merged company would be likely to pay in  
23 Montana?

24 A I have not.

25 Q Have you discussed with HCSC the federal

1 taxes the merged company would be likely to pay?

2 A I have not.

3 Q Have you discussed with HCSC the things  
4 that HCSC's increased bargaining, the things that  
5 the increased bargaining power that the merged  
6 company would have would allow the merged company to  
7 do?

8 MR. MCMAHON: Object to foundation, Your  
9 Honor.

10 HEARING OFFICER LEAPHART: Do you want to  
11 lay some more foundation?

12 Q (By Mr. Angoff) You have discussed the --  
13 you've been negotiating the integration of Blue  
14 Cross of Montana with HCSC, correct?

15 A Yes.

16 Q And one of the benefits of the acquisition  
17 is, isn't it, that it would allow Blue Cross of  
18 Montana to take advantage of the greater scale that  
19 HCSC has, correct?

20 A We would be able to take advantage of the  
21 scale on an administrative standpoint with HCSC  
22 systems and back office work.

23 Q You would also be able to take advantage  
24 of the increased bargaining power by reason of their  
25 size that HCSC brings, wouldn't you?

1 A No.

2 Q Why not?

3 A Because HCSC does not bring membership to  
4 the state of Montana so I'm not sure how we're going  
5 to have any increased bargaining power.

6 Q So you have to buy typing paper, or I  
7 guess you can't call it typing paper anymore, or  
8 computer paper, if HCSC buys it on behalf of all 13  
9 million members they would get a lower price,  
10 wouldn't they, than if Blue Cross did it on behalf  
11 of its 270,000 members?

12 A I'm not sure how HCSC would negotiate for  
13 typing paper.

14 Q It may not be the most eloquent example,  
15 but won't the merged company have more strength  
16 because they've got more lives and, therefore, more  
17 potential volume, won't they have more bargaining  
18 power with vendors?

19 A Possibly with some.

20 Q And then you think they will not have,  
21 that the merged company would not have more  
22 bargaining power with others?

23 A It depends on the vendors, or the  
24 relationship, so...

25 Q Would the merged company have more

1 bargaining power with doctors?

2 A Not in my opinion.

3 Q And what about with hospitals?

4 A Not in my opinion.

5 Q What about with agents?

6 A Not in my opinion.

7 Q But you're familiar, aren't you, with  
8 Mr. Gallaso's study and his assumption that Blue  
9 Cross of Montana would be paying agents 1 percent  
10 less in commission in 2013 and thereafter?

11 A I'm familiar with that because you brought  
12 it up in my deposition.

13 Q But have you read Mr. Galasso's report?

14 A I have not.

15 Q But you know it's a part of the record?

16 A Yes.

17 Q Have you discussed with HCSC the products  
18 that you'll be selling through the exchange if the  
19 transaction is approved?

20 A I personally have not.

21 Q Do you know if anyone else at Blue Cross  
22 has?

23 A It's my understanding that others in our  
24 company have talked with HCSC about exchange  
25 products.

1 Q And do you know whether they've discussed  
2 pricing?

3 A They have not is my understanding.

4 Q And do you know whether they've discussed  
5 products that will be sold outside of the exchange?

6 A I believe they have.

7 Q And do you know what products would be  
8 sold outside of the exchange?

9 A I don't know the benefit design of the  
10 products that will be sold outside of the exchange.

11 Q And do you know what, if any, products  
12 that are not subject to the Affordable Care Act Blue  
13 Cross will be selling after January 21st, 2014?

14 A I do not.

15 Q Mr. Frank, as president of Blue Cross of  
16 Montana I assume you're familiar with Blue Cross  
17 Blue Shield of Montana's annual statement for 2012?

18 A I've seen parts of it, yes.

19 Q Are you familiar with the five year  
20 historical data pages?

21 A I can't recall offhand.

22 MR. ANGOFF: Well, Your Honor, may I have  
23 this marked as Commissioner's A for  
24 identification?

25 HEARING OFFICER LEAPHART: You may.

1           What's the exhibit ID on this again?

2           MR. ANGOFF:   Exhibit A.

3           Q       (By Mr. Angoff)   Mr. Frank, I've shown you  
4 what's been marked as Commissioner's Exhibit A for  
5 identification and ask whether you can identify it.

6           A       It's our, it's the Blue Cross Blue Shield  
7 of Montana's annual statement for the year ended  
8 December 31st, 2012.

9           MR. ANGOFF:   Your Honor, the parties  
10 having agreed to foundation and authenticity, I  
11 move that what's been marked as Commissioner's  
12 Exhibit A for identification be admitted into  
13 evidence as Commissioner's Exhibit A.

14           HEARING OFFICER LEAPHART:   Any objection?

15           MR. MCMAHON:   No objection, Your Honor,  
16 from Blue Cross of Montana.

17           MS. LENMARK:   No objection.

18           HEARING OFFICER LEAPHART:   Attorney  
19 General?

20           MS. HUBBARD:   No objection.

21           HEARING OFFICER LEAPHART:   It's admitted.

22           Q       (By Mr. Angoff)   Mr. Frank, could you turn  
23 to page 28 of Commissioner's Exhibit A?

24           A       I'm sorry, which page?

25           Q       Page 28, which is headed Five Year

1 Historical Data.

2 A Yes, I'm there.

3 Q And I just want to make sure I understand  
4 a few numbers on that page. If you go to line 5 do  
5 you see that it says total revenue?

6 A Yes.

7 Q Am I reading that correctly, does it show  
8 Blue Cross of Montana's total revenues going from  
9 516 million in 2008 to 601 million in 2012?

10 A Generally, yes.

11 Q And at the same time that your revenues  
12 went up your claims adjustment expenses went down,  
13 correct, they went from 36 million in 2008 to 30  
14 million and 31 million in 2012?

15 A Yes, they did.

16 Q Do you know why that is, do you know why  
17 there was such an improvement?

18 A I'm not sure specific to that line 7, no.

19 Q Do you have any idea, did your claims  
20 adjustment function change during that period?

21 A I'm not sure what's all captured in the  
22 claims adjustment expenses so I'm sorry, I can't  
23 answer that.

24 Q On the other hand, your total administered  
25 expenses went from 47 million to 52 million between

1 2008 and 2012, right?

2 A According to this, yes.

3 Q You say "according to this," do you have  
4 any doubts that this is accurate?

5 A No.

6 Q And your total administrative expenses  
7 from 2008 through 2011 remained substantially  
8 constant, while your total revenues went up from 516  
9 to 562 between 2008 and 2011. Do you see that?

10 A Yes.

11 Q And so my question is, do you know why  
12 there was this sudden jump in total administrative  
13 expenses of about 5 million in the one year between  
14 2008 and 2012?

15 A I'm not sure of all of the factors that  
16 are included in the total administrative expenses on  
17 line 8 so I can't answer that.

18 Q Would Mr. Burzynski be more familiar with  
19 this?

20 A I'm assuming so but I'm not sure.

21 Q And if Mr. Burzynski wouldn't who would?

22 A I believe somebody else from our finance  
23 department would be.

24 Q But Mr. Burzynski's in charge of the  
25 finance department, correct?

1           A     That's correct.

2           Q     And then going down to line 12, that shows  
3 you had a positive net income in all years except  
4 for 2009, correct?

5           A     That's correct.

6           Q     Why was 2009 so bad, do you know?

7           A     I don't. I don't recall.

8           Q     And you weren't CEO at the time, right?

9           A     That is correct.

10          Q     So you had a positive net income in all  
11 years expect for one in that five-year period but if  
12 you'll go down to page 23, I'm sorry, line 23, that  
13 shows that you had a negative underwriting gain for  
14 all those five years, correct?

15          A     We had a negative underwriting gain for  
16 all of those as identified in line 9 as well.

17          Q     Very good. But I assume that you  
18 targeted -- did you target a positive underwriting  
19 gain?

20          A     It was our goal to have a positive  
21 underwriting gain but unfortunately based on claims  
22 costs, technology costs, admin and other things we  
23 weren't able to achieve a positive underwriting  
24 gain.

25          Q     And your MLR on page 19 in all five years

1 was at least 83, at minimum it was 83.8, right?

2 A On page what, I'm sorry?

3 Q On line 19.

4 A Oh, line 19. At least 83 according to  
5 this, yes.

6 Q And you're familiar with the U.S.  
7 Department of Health and Human Services MLR rule?

8 A Generally, yes.

9 Q And you complied with that rule in 2011,  
10 right? Blue Cross Blue Shield of Montana did not  
11 owe a refund because it didn't comply with the MLR,  
12 did it?

13 A Blue Cross Blue Shield of Montana did not  
14 have to make a refund because it exceeded the  
15 minimum MLRs.

16 Q Blue Cross of Montana will have a seat on  
17 the HCSC board if the acquisition is approved,  
18 correct?

19 A That's correct.

20 Q And will you be -- will that seat be  
21 yours?

22 A No, it will not.

23 Q Who will be serving on the board?

24 A The process that will be followed to  
25 identify the board member, is that names have been

1 submitted to the HCSC board and then they will  
2 identify the Blue Cross Blue Shield of Montana board  
3 member that will sit on the HCSC board based on the  
4 criteria that they've identified.

5 Q So you don't know who the individual will  
6 be who will be a member of the board?

7 A No.

8 Q And there will be a Montana affiliate  
9 board, correct?

10 A Yes.

11 Q And what is that board?

12 A That board will be -- all members of our  
13 current board have been offered the opportunity to  
14 continue to serve on the board following the closing  
15 of the transaction.

16 Q And this board would be an advisory board,  
17 correct?

18 A I believe that it will have the  
19 responsibility to oversee part of the local  
20 operations, to provide input on the local operations  
21 of our Blue Cross Blue Shield of Montana plan.

22 Q But it won't be voting on HCSC company  
23 decisions?

24 A I don't believe so.

25 MR. ANGOFF: No further questions, Your

1 Honor.

2 HEARING OFFICER LEAPHART: Any questions  
3 from the Attorney General?

4 MS. HUBBARD: No further questions, Your  
5 Honor.

6 HEARING OFFICER LEAPHART: Questions from  
7 HCSC?

8 MR. KALECZYC: No further questions.

9 HEARING OFFICER LEAPHART: Redirect from  
10 Blue Cross?

11 MR. MCMAHON: Thank you, Your Honor.

12

13 DIRECT EXAMINATION OF MICHAEL FRANK (Continued)

14 BY MR. MCMAHON:

15 Q Mr. Frank, early on in Mr. Angoff's  
16 examination of you this morning he talked about what  
17 other entities Blue Cross talked to with respect to  
18 potential alliance or partnership. Do you recall  
19 that?

20 A Yes.

21 Q Did Blue Cross Blue Shield of Montana  
22 consider any other Blue plans?

23 A Blue Cross Blue Shield of Montana looked  
24 at all Blue plans and eliminated Blue plans based on  
25 some of the factors that I identified this morning.

1 For example, we eliminated the for-profit Blue plans  
2 that exist under the WellPoint Napa umbrella, and  
3 that's approximately 14 plans because we did not  
4 want to move to a for-profit plans. We then looked  
5 at the size and geographic location of many of the  
6 single-state plans and eliminated those plans. We  
7 then, as I mentioned this morning, looked at the  
8 multistate plans that we discussed and then narrowed  
9 it to the two that we ultimately had discussions.

10 Q Now, from a standpoint of the history of  
11 how Blue Cross arrived at the decision to request  
12 the Attorney General's Office and the Commissioner  
13 of Insurance to approve the alliance, in your direct  
14 testimony do you recall testifying of the process?

15 A Yes.

16 Q And how that process took a number of I  
17 would say years and months, correct?

18 A From when we first started talking about  
19 the need to do something different within our  
20 company, yes.

21 Q So it wasn't as perhaps maybe left with  
22 the impression that it was a rushed decision?

23 A No, I think it was a very deliberate  
24 decision after looking at multiple options.

25 Q And those multiple options included shared

1 services?

2 A Yes.

3 Q Outsourcing services?

4 A Yes.

5 Q For purpose of the conversion statute do  
6 you agree that Blue Cross Blue Shield consented to  
7 being treated as a public benefit corporation?

8 A For purposes of this transaction and the  
9 consent order, yes.

10 Q It's a mutual benefit, isn't it?

11 A That's correct.

12 Q Now, the annual report that the  
13 Commissioner's Office has marked and identified and  
14 introduced as Exhibit A, that's filed with the  
15 Commissioner's Office, isn't it?

16 A Yes.

17 Q It's a matter of public record?

18 A Yes.

19 Q I believe on Exhibit A, Mr. Frank, on  
20 page 5 -- do you still have it up there?

21 A I do. It will take me a minute to get  
22 there. Yes.

23 Q Line 49, can you explain to Justice  
24 Leaphart what that line 49 represents?

25 A That's what we would typically refer to as

1 our surplus or our reserves. I think in the  
2 simplest terms it's the amount that we essentially  
3 have available to utilize for payment of claims for  
4 some of our administrative expenses, technology  
5 expenses, those types of things.

6 Q Now, because there is a comparison of your  
7 current year and prior year, do you see that on page  
8 5?

9 A Yes.

10 Q There is a decrease in the surplus?

11 A Yes.

12 Q Has that decrease in the surplus from  
13 2011, 2012, is that normal?

14 A We have been seeing years where we've been  
15 seeing a decrease in our surplus, yes.

16 Q Mr. Angoff talked to you about the  
17 projects, the FEP business, the exchange readiness,  
18 the Medicare Advantage. Do you recall that line of  
19 questioning?

20 A Yes.

21 Q And you had indicated with respect to  
22 exchange readiness Blue Cross wouldn't be able to do  
23 it on your own; do you recall that?

24 A I believe we would have still participated  
25 on the exchange but we would not have been able to

1 afford the technology or the other items which I  
2 believe are necessary to put us in the best light on  
3 the exchange.

4 Q Are you able to explain to Justice  
5 Leaphart the cost of that technology?

6 A I don't know the exact cost of the  
7 technology but I know that we have looked at it and  
8 when you combine that cost with the other technology  
9 projects that we have it would severely cut into our  
10 surplus and I don't think we'd be able to complete  
11 that along with our other projects.

12 Q I do understand you correctly, Mr. Frank,  
13 that while price was not negotiated between the  
14 parties, the parties did negotiate on how the price  
15 would be determined?

16 A Yes.

17 Q And that would, and as I understand based  
18 upon your testimony, how the price would be  
19 negotiated was direct part and parcel with the  
20 conversion statute, correct?

21 A How price would be determined was part and  
22 parcel to the conversion statute, yes.

23 Q Now you indicated in your answers to  
24 Mr. Angoff that regardless if the alliance goes  
25 through or not the Medicare Advantage, the FEP

1 business, the exchange rate would still continue  
2 with HCSC, correct?

3 A Yes.

4 Q Is that going to continue through  
5 eternity?

6 A No, it was a set term.

7 Q Was size of competition in Montana a  
8 factor with respect to Blue Cross Blue Shield of  
9 Montana's consideration of alliance or a partnership  
10 with another Blue plan?

11 A It was the size of the competition, the  
12 fact that much of the competition is operating in  
13 multiple states, which we do not. So it was size  
14 plus some other things.

15 Q Now, when I say size of competition I  
16 refer to, and I apologize for not indicating  
17 earlier, size of membership of those other  
18 competitors?

19 A That's what I would consider the size as  
20 well.

21 Q Do you know whether, how many members  
22 Cigna or Aetna or United have?

23 A I believe that they can range anywhere  
24 from probably 10 or 12 million up to 40 million.  
25 I'm not certain on the size of those entities.

1 Q So in that respect was it important for  
2 Blue Cross Blue Shield of Montana to be able to  
3 compete on those member sizes?

4 A It was very important for us to compete,  
5 again, for many of the things that we've talked  
6 about as far as scale, administrative cost,  
7 spreading the risk over multiple members, and it was  
8 also important when we looked at size because we did  
9 not want to do a transaction with a plan, with a  
10 Blue plan, and then have to do it again because of  
11 size or other issues.

12 Q With respect to Company X, did it have  
13 fewer members than HCSC?

14 A Yes.

15 Q And as I understand what you just last  
16 said, you didn't want to go through multiple  
17 conversions?

18 A We didn't want to go through multiple  
19 transactions with multiple different companies.

20 Q So there was a concern that with respect  
21 to the size of membership you wanted to make sure  
22 that if this happened this was the only time it  
23 happened?

24 A Yes.

25 Q Now, in consideration of HCSC, as I

1 understand the factors that you talked about in your  
2 direct testimony and again with Mr. Angoff today, a  
3 very important factor was the nonprofit status,  
4 correct?

5 A That's correct.

6 Q And HCSC is a not-for-profit company,  
7 correct?

8 A That's my understanding, yes.

9 Q And that was determined before Blue Cross  
10 went down this path with HCSC, correct?

11 A As I mentioned to you earlier, when  
12 looking at the universe of Blue plans we eliminated  
13 the for-profit Blue plans, yes.

14 Q Mr. Frank, Mr. Angoff talked at some  
15 length about Blue Cross not having asked for prices  
16 from other companies. Do you recall that?

17 A Yes.

18 Q Can you explain to Justice Leaphart why  
19 that was not done?

20 A Well, as I explained before, there is  
21 multiple factors that went into our ultimate  
22 decision making about forming an alliance and then  
23 what we thought would be or which entity we thought  
24 would be the best partner. For example, looking at  
25 technology, looking at size, financial strength,

1 culture, protection for employees, leadership, local  
2 presence, use of name, those types of things, so  
3 that drove where we went on looking at potential  
4 partners. Once we started to discuss structure, as  
5 I mentioned, we then started to follow the  
6 conversion statute and the requirements under the  
7 conversion statute.

8 Q And as Mr. Miltenberger, you were here  
9 today when he testified, do you remember that?

10 A Yes.

11 Q This wasn't a situation where a car was  
12 running out of gas and pulled over and had a fire  
13 sale, was it?

14 A I'm very concerned about the future of our  
15 company and although we may not be out of gas today,  
16 I believe that our board of directors and myself and  
17 our executive team have the obligation to, for the  
18 citizens of Montana to have the strongest  
19 not-for-profit Blue plan that we can possibly have.  
20 And when you look at the issues that we're facing  
21 with the uncertainty of health care and the ACA, our  
22 technology needs, our inability to maintain or to  
23 reach an underwriting gain on a consistent basis, we  
24 may not be the car running out of gas but I don't  
25 want to become the car running out of gas and we

1 have to take those into account and strengthen our  
2 plan for Montana.

3 Q So Blue Cross is being proactive rather  
4 than reactive, correct?

5 A Yes.

6 MR. MCMAHON: I don't have anything  
7 further, Your Honor. Thank you.

8 HEARING OFFICER LEAPHART: Thank you. Any  
9 recross?

10 MR. ANGOFF: Yes, Your Honor.

11

12 CROSS-EXAMINATION OF MICHAEL FRANK (Continued)

13 BY MR. ANGOFF:

14 Q Mr. Frank, you told Mr. McMahon that the  
15 parties did not negotiate the price in this  
16 transaction but that they did negotiate on how the  
17 price would be determined. Do you remember that?

18 A Yes.

19 Q So when you negotiated on how the price  
20 would be determined what position did you take, how  
21 did you want the price to be determined?

22 A I think the parties came to agreement that  
23 there would be an independent valuation and HCSC  
24 would either accept or reject that price.

25 Q Well, did you have a position, before Blue

1 Cross Blue Shield Cross and HCSC came to that  
2 agreement, did Blue Cross have any other suggestion  
3 as to how price should be determined?

4 A Not that I'm aware of, no.

5 Q And do you recall HCSC ever making any  
6 other suggestion?

7 A Not that I'm aware of, no.

8 MR. ANGOFF: Nothing further, Your Honor.

9 HEARING OFFICER LEAPHART: Thank you.

10 Mr. Kaleczyc?

11 MR. KALECZYC: Thank you, Your Honor.

12

13 CROSS-EXAMINATION OF MICHAEL FRANK

14 BY MR. KALECZYC:

15 Q With respect to the question of price,  
16 Mr. Frank, would it be in your opinion in the best  
17 interest of Blue Cross to get the highest price  
18 possible for its core assets without regard to  
19 either factors such as profit versus nonprofit  
20 status or the technology available from other  
21 companies?

22 A I think as in any transaction there is  
23 multiple factors that go into play and come into  
24 play for the long-term viability, the stability of  
25 the plan, some of which you've identified like

1 technology, employee base not-for-profit status. So  
2 I think you have to look at the multitude of factors  
3 to get the best partner for the plan for the company  
4 that may be involved in the transaction.

5 Q And you say, Mr. Frank, that you want to  
6 consider those for the best interests of the plan  
7 and company. Do those also translate into the  
8 interests of the public in the state of Montana?

9 A I believe they do because I believe that  
10 it's in the best interest of the public to have the  
11 strongest not-for-profit Blue plan that we can to  
12 continue the service that we've provided over the  
13 last 72 years.

14 Q And that strength does not in your view  
15 translate directly into getting the largest purchase  
16 price in the best interests of the public in  
17 Montana; is that correct?

18 A Again, you've got to get the purchase  
19 prices allowed for under the conversion factor, but  
20 there is multiple factors that go into any  
21 transaction.

22 MR. KALECZYC: Thank you. I have no  
23 further questions, Your Honor.

24 HEARING OFFICER LEAPHART: Any other  
25 questions? You may be excused. Your next

1 witness?

2 MR. MCMAHON: Your Honor, Mr. Burzynski  
3 has been sequestered, if it's okay we'll go  
4 find him.

5 MR. LASLOVICH: Your Honor, can we take a  
6 short break?

7 HEARING OFFICER LEAPHART: Sure. Take a  
8 ten-minute break until five after.

9 (Break taken.)

10 MR. MCMAHON: Your Honor, Blue Cross Blue  
11 Shield of Montana would call Mark Burzynski.

12 (Witness sworn.)

13 MR. MCMAHON: May I approach, Your Honor?

14 HEARING OFFICER LEAPHART: Yes.

15

16 DIRECT EXAMINATION OF MARK BURZYNSKI

17 BY MR. MCMAHON:

18 Q Mr. Burzynski, what I'm handing to you is  
19 a copy of your March 5th, 2013 direct testimony.

20 A Okay.

21 Q Did you affirm the statements that you  
22 made in that direct testimony?

23 A Yes.

24 Q Since your direct testimony was filed are  
25 you aware of a change of the purchase price that you

1 testified to in your direct testimony?

2 A Would you please restate that?

3 Q Since the direct testimony was filed are  
4 you aware of a change in the purchase price that you  
5 testified to in your direct testimony?

6 A Yes, I am.

7 Q And what has that purchase price changed  
8 from and to?

9 A It changed from 17.611 million to 40.2  
10 million.

11 MR. MCMAHON: I offer the witness for  
12 cross-examination, Your Honor.

13 HEARING OFFICER LEAPHART: Mr. Angoff?  
14

15 CROSS-EXAMINATION OF MARK BURZYNSKI

16 BY MR. ANGOFF:

17 Q Good afternoon, Mr. Burzynski.

18 A Good afternoon.

19 Q Do you recall the week before last that we  
20 met when your deposition was taken?

21 A Yes, I do.

22 Q Now, you've been with Blue Cross of  
23 Montana for how long?

24 A Thirteen years.

25 Q And you've had several different jobs,

1 right?

2 A That is correct.

3 Q You were in government relations for a  
4 while?

5 A Yes.

6 Q And you've also dealt with providers?

7 A Yes.

8 Q And since 2010 you've been CFO, right?

9 A Correct.

10 Q And you're also an accountant?

11 A Yes.

12 Q And as CFO you're responsible for the  
13 finance department?

14 A Yes.

15 Q And the accounting department?

16 A Yes.

17 Q And treasury functions?

18 A Yes.

19 Q And budgeting?

20 A Yes.

21 Q And the actuarial department?

22 A Yes.

23 Q And the underwriting department?

24 A Yes.

25 Q And you're also responsible for strategic

1 planning?

2 A Yes.

3 Q And you are also involved in the  
4 negotiations between Blue Cross Blue Shield of  
5 Montana and HCSC about the terms of the acquisition,  
6 correct?

7 A No.

8 Q You weren't involved in negotiating with  
9 HCSC?

10 A Correct.

11 Q Weren't you on a team that was responsible  
12 for working out the specific terms of the  
13 affiliation with HCSC after the board decided to  
14 approach HCSC?

15 A My focus was the administrative services  
16 agreement.

17 Q That was your only focus with HCSC? You  
18 weren't involved in negotiating the terms of the  
19 transaction with HCSC, is that what you're saying?

20 A Correct.

21 Q Were you involved in negotiating the  
22 integration of Blue Cross of Montana with HCSC?

23 A Would you define -- I lost my train of  
24 thought, I'm sorry, but would you define  
25 integration, please?

1 Q After the parties agreed to affiliate  
2 issues have to be worked out, don't they, as to how  
3 the companies are going to join together?

4 A Understood.

5 Q And you have been involved in that  
6 process, haven't you?

7 A Yes.

8 Q And what's been your involvement in that  
9 process?

10 A My primary responsibility has been the, as  
11 I mentioned earlier, the administrative services  
12 agreement where we are outsourcing functions and  
13 duties to HCSC.

14 Q And you're also involved in planning for  
15 the exchanges, aren't you?

16 A I am responsible for it, yes.

17 Q And what exactly are you responsible for  
18 in connection with the exchanges?

19 A Making sure we're successful on the  
20 exchange.

21 Q And so what are the tasks, what are the  
22 functions that you're responsible for in connection  
23 with the exchanges?

24 A Could you maybe restate that, please?

25 Q I think the question is clear. What are

1 the functions that you're responsible for in  
2 connection with the exchanges?

3 A I am responsible for making sure that we  
4 are successful on the exchange and as a result we  
5 have, to that end I should say, we have a team of  
6 individuals that are working in conjunction with the  
7 teams at HCSC to make sure that we are functional on  
8 exchange.

9 Q And you're responsible for that team?

10 A Yes.

11 Q And are you also responsible for preparing  
12 the annual statement that's filed with the  
13 Department of Insurance each year?

14 A The annual statement is completed by the  
15 finance department, which I oversee.

16 Q Now, when we spoke two weeks ago you said  
17 that Blue Cross of Montana targeted a one half of 1  
18 percent underwriting gain; do you remember that?

19 A I remember the conversation. I think  
20 the -- I'm not sure I heard you correctly but it was  
21 a .5 percent underwriting gain.

22 Q Right, .5 percent. And .5 percent is  
23 equal, isn't it, to one half of 1 percent?

24 A Correct.

25 Q And in the last several years Blue Cross

1 of Montana has not made that target .5 percent, has  
2 it?

3 A Correct.

4 Q It's had an underwriting loss?

5 A Correct.

6 Q But except for one year it still made a  
7 net profit right out of the last five years?

8 A Would you repeat that?

9 Q Yes. Over the most recent five-year  
10 period from 2008 to 2012, Blue Cross still had a net  
11 profit in all but one year, correct?

12 A To the best of my recollection, yes.

13 Q And that's because it had other income  
14 that was greater than the amount that the company  
15 lost on underwriting, correct?

16 A Correct.

17 Q And most of that income was investment  
18 income; is that right?

19 A Yes.

20 Q And are there other sources of income  
21 besides investment income that are other income?

22 A I'm assuming when you say investment  
23 income that, are you excluding or including income  
24 from our subsidiaries?

25 Q I'm excluding income from subsidiaries.

1 So income from subsidiaries is another type of  
2 income?

3 A Yes, and we have generated income from our  
4 subs.

5 Q And so for four of the last five years  
6 your income from subsidiaries and investment income  
7 has been more than your loss on underwriting,  
8 correct?

9 A To the best of my recollection, yes.

10 Q Now, one of the goals of the acquisition  
11 is, isn't it, to enable Blue Cross of Montana to  
12 post underwriting gains rather than underwriting  
13 losses?

14 A Preferred, yes.

15 Q And do you know whether if the acquisition  
16 is approved whether HCSC will continue to target the  
17 one half of 1 percent underwriting gain that Blue  
18 Cross of Montana now targets?

19 A I do not know that.

20 Q Have you had any discussions about that?

21 A No, I have not.

22 Q Now, the higher the underwriting gain the  
23 higher the premium is going to be all other things  
24 equal, correct?

25 A Please state it again.

1 Q Sure. Everything else equal, all other  
2 things remaining the same, the higher the  
3 underwriting gain the higher the premium is going to  
4 be; isn't that right?

5 A I can't say I can answer that.

6 Q Why not?

7 A I don't know that I can agree with you.  
8 I'm trying to think it through.

9 Q Okay, tell me why, tell me why that is not  
10 a true statement.

11 A That premiums would necessarily be higher  
12 if the underwriting gain is higher?

13 Q All other things equal, yes.

14 A Not to quibble, and I apologize, but when  
15 you say "all other things equal," could you define  
16 that or at least describe that for me, please?

17 Q All other things equal, the higher the  
18 underwriting gain the higher the premium is going to  
19 be. I would like you to tell me whether you agree  
20 with that and if you don't to tell me why you don't  
21 agree with that.

22 A The underwriting gain is dependent on a  
23 variety of factors, including your utilization and  
24 administrative expenses, so to the extent that those  
25 are lower or higher that will affect your

1 underwriting gain or loss.

2 Q Sure. But I'm saying all things, all  
3 other things equal, that's the premise of my  
4 question, I'm simply asking, holding everything else  
5 equal isn't it true that the higher the underwriting  
6 gain the higher the premium is going to be?

7 A I'll say yes.

8 Q Did you ever participate in any discussion  
9 with Blue Cross of Montana, at Blue Cross of Montana  
10 rather, in which changing the underwriting profit  
11 target of one half of 1 percent was discussed?

12 A You're asking if I participated in  
13 discussions changing that?

14 Q Yes, was that issue ever discussed at Blue  
15 Cross of Montana to the extent you can recall?

16 A I will say that there was discussion of  
17 establishing a .5 so I don't know if that's  
18 technically changing it but establishing the .5.

19 Q Was there ever any discussion of making  
20 that .5 higher, of having a higher target  
21 underwriting profit?

22 A No.

23 Q Was there ever a discussion of having a  
24 lower underwriting profit target than .5 percent?

25 A No.

1           MR. ANGOFF: Your Honor, we may want to  
2           for just the next few minutes make these  
3           questions confidential. Why don't I ask one  
4           question and give counsel an opportunity to  
5           make that request.

6           HEARING OFFICER LEAPHART: Ask the  
7           question and you hold off on the answer.

8           Q        (By Mr. Angoff) Mr. Burzynski, if the  
9           acquisition is approved do you know whether you will  
10          still be the CFO of Blue Cross of Montana?

11          HEARING OFFICER LEAPHART: Counsel, are  
12          you okay?

13          MR. MCMAHON: I think it's okay if he  
14          answers the question.

15          HEARING OFFICER LEAPHART: Okay.

16          A        I have been told I will not be.

17          Q        (By Mr. Angoff) So do you expect to be  
18          the CFO of Blue Cross of Montana if the acquisition  
19          is approved?

20          A        No.

21          Q        Why not?

22          A        Because at the local level my position  
23          would not exist and I've been told that.

24          Q        So there would no longer be a CFO of Blue  
25          Cross of Montana, correct?

1           A     Correct.

2           Q     Then what position within the HCSC  
3     enterprise would perform the functions that you now  
4     do as CFO of Blue Cross of Montana?

5           A     The financial function, many of the  
6     functions that you mentioned earlier would be  
7     handled at the enterprise level.

8           Q     Well then if there is not going to be any  
9     CFO of Blue Cross of Montana if the acquisition is  
10    approved and you're now the CFO of Blue Cross of  
11    Montana, would you want to, do you want to stay with  
12    the company if the acquisition is approved?

13          A     Yes, I do.

14          Q     And have you had discussions as to what  
15    your role would be?

16          A     No.

17          Q     If you decide to leave voluntarily do you  
18    know what, if any, benefits you will receive?

19                MR. MCMAHON: Your Honor, this is probably  
20    an issue with respect to the confidentiality of  
21    Mr. Burzynski's employment, so...

22                MR. ANGOFF: No objection. With a caveat  
23    that we're happy to proceed for purposes of  
24    this hearing today on a confidential basis,  
25    that doesn't mean that the Department

1 necessarily agrees that as a matter of law this  
2 area should be kept confidential.

3 HEARING OFFICER LEAPHART: Do you want to  
4 go into confidentiality right now or do you  
5 want to hold it off to the end of your  
6 questioning?

7 MR. ANGOFF: I guess I prefer to go into  
8 it now.

9 HEARING OFFICER LEAPHART: Okay. Once  
10 again, we have to ask everybody other than the  
11 attorneys directly involved in this case to  
12 please exit out into the lobby area and have  
13 the doors shut.

14 (Confidential portion of  
15 transcript.)  
16  
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1 (Confidential portion  
2 concluded.)

3

4 HEARING OFFICER LEAPHART: Let the record  
5 reflect that the public has been allowed back  
6 into the room and Mr. Angoff can continue with  
7 his examination of Mr. Burzynski.

8

9 CROSS-EXAMINATION OF MARK BURZYNSKI (Continued)

10 BY MR. ANGOFF:

11 Q Mr. Burzynski, forgive me, I'm going to  
12 repeat largely several questions that were asked  
13 when the public was out of the room which should not  
14 have been made confidential so I'm going to repeat  
15 them. I hope you'll bear with me.

16 When your deposition was taken the week  
17 before last you said that the amount of surplus Blue  
18 Cross targets doesn't depend on a formula, right;  
19 isn't that right?

20 A Yes.

21 Q And instead you said it depends on  
22 modeling, correct?

23 A Yes.

24 Q And you talked about modeling five risks  
25 and you at that time could recall three big ones,

1 correct?

2 A I don't know that I could recall the  
3 three.

4 Q And one of them was trend rates, right?

5 A I don't recall that.

6 MR. ANGOFF: May I approach the witness,  
7 Your Honor?

8 HEARING OFFICER LEAPHART: You may.

9 Q (By Mr. Angoff) Mr. Burzynski, could you  
10 turn to page 113, please, of that deposition and  
11 could you read lines 6 and 7?

12 A Underwriting performance, technology  
13 needs, trend rates, those are probably the three big  
14 ones.

15 Q Okay. And so does that refresh your  
16 recollection as to what you testified in your  
17 deposition?

18 HEARING OFFICER LEAPHART: Does that  
19 refresh your recollection?

20 THE WITNESS: Excuse me, I was reading.

21 HEARING OFFICER LEAPHART: Sorry. Go  
22 ahead and read.

23 A Please ask the question again.

24 Q (By Mr. Angoff) Yes, does that refresh  
25 your recollection as to what you testified in your

1 deposition?

2 A I remember the conversation.

3 Q So in recent years your actual trend has  
4 turned out to be higher than the trend you assume,  
5 right?

6 A Yes.

7 Q Has it turned out to be about a point and  
8 a half higher?

9 A I don't recall.

10 Q More than that, more than a point and a  
11 half?

12 A All I can say is it was significant.

13 Q And significant would certainly be greater  
14 than a point then, right?

15 A Yes.

16 Q Now, in the course of your discussions  
17 with HCSC when, if at all, did you first hear the  
18 issue of the price that HCSC would pay for Blue  
19 Cross of Montana broached?

20 A I would say it was in September.

21 Q And who broached it?

22 A The price came out of the work that was  
23 done by Dr. Galasso, the independent fair market  
24 value.

25 Q There was a time, wasn't there, when there

1 was some discussion as to the price that HCSC would  
2 pay for the assets it's acquiring from Blue Cross of  
3 Montana, correct?

4 A Yes.

5 Q And so I'm aware of Dr. Galasso's study,  
6 but what I'm trying to find out is when did the  
7 first discussion about that price take place between  
8 HCSC and Blue Cross of Montana?

9 A It only took place in the context of the  
10 fair market valuation. It wasn't discussed other  
11 than that.

12 Q Well, how did Dr. Galasso come then to do  
13 his fair market valuation?

14 A According to statute we had to have a fair  
15 market valuation done and so Dr. Galasso was  
16 contacted to do that valuation.

17 Q Did you instruct him to do that valuation?

18 A Yes.

19 Q And did somebody instruct you to instruct  
20 Dr. Galasso to do that valuation?

21 A Yes.

22 Q And who was that?

23 A Jerry Lusk, the chairperson of Blue Cross  
24 Blue Shield's board.

25 Q And approximately when did Mr. Lusk give

1 you those instructions?

2 A I would say the end of July, the beginning  
3 of August.

4 Q And was Mr. Lusk involved in discussing  
5 the affiliation with HCSC?

6 A No.

7 Q Do you remember the meeting that HCSC went  
8 to in Three Forks, Montana on June 11th, do you  
9 remember that meeting?

10 A Yes, I do.

11 Q Was Mr. Lusk there?

12 A Yes, he was.

13 Q And was the chair of the board of HCSC  
14 there?

15 A I don't believe he was there.

16 Q Now, as the CFO of Blue Cross of Montana  
17 you've seen various, you've overseen various  
18 acquisitions that Blue Cross of Montana has made,  
19 correct?

20 MR. MCMAHON: Objection, no foundation.

21 Q (By Mr. Angoff) Has Blue Cross of Montana  
22 made acquisitions while you've been CFO of Blue  
23 Cross of Montana?

24 A No.

25 Q It's made no acquisitions?

1           A     None that -- you might have an example but  
2 none come to mind.

3           Q     Since you've been at Blue Cross of Montana  
4 in any capacity has Blue Cross of Montana made any  
5 acquisitions?

6           A     No.

7           Q     And you've been at Blue Cross of Montana  
8 since when?

9           A     Thirteen years, 2000.

10          Q     And to your knowledge within that 13 years  
11 Blue Cross of Montana has made no acquisitions?

12          A     Not to my knowledge.

13          Q     As CFO of Blue Cross of Montana have you  
14 ever estimated the value of Blue Cross of Montana?

15          A     While I was CFO?

16          Q     Yes.

17          A     Other than related to this transaction?

18          Q     Yes.

19          A     No.

20          Q     Have you ever estimated the value of Blue  
21 Cross of Montana before you were CFO?

22          A     No.

23          Q     In connection with this transaction what  
24 valuation of Blue Cross of Montana have you done?

25          A     I haven't personally done any.

1 Q Have you ever convened a committee to  
2 estimate the value of Blue Cross of Montana?

3 A No.

4 Q Have you ever instructed any individual or  
5 a team of individuals to estimate the value of Blue  
6 Cross of Montana?

7 A No.

8 Q Now as Blue Cross CFO you're familiar with  
9 the Blue Cross name and mark, right?

10 A Yes.

11 Q Have you ever seen a report as to what the  
12 value of the Blue Cross name and mark is?

13 A No.

14 Q You've never seen a report done by the  
15 Blue Cross association about the value of Blue Cross  
16 name and mark?

17 A No.

18 Q Have you ever tried to place a value on  
19 the Blue Cross name and mark yourself?

20 A No.

21 Q Have you ever instructed any committee or  
22 team of individuals to value the Blue Cross name and  
23 mark?

24 A No.

25 Q Now, as CFO of Blue Cross of Montana do

1 you make it your business to know about other  
2 acquisitions that occur in the health insurance  
3 business?

4 A Occasionally I read about them in  
5 periodicals.

6 Q Are you familiar with the proposed Aetna,  
7 Coventry acquisition?

8 A No.

9 Q Do you know whether there is an Aetna,  
10 Coventry acquisition?

11 A No.

12 Q Now, as CFO of Blue Cross of Montana is it  
13 fair to say that you're familiar with other proposed  
14 acquisitions of other Blue Cross companies that have  
15 occurred?

16 A Yes.

17 Q Which ones are you familiar with?

18 A The ones that have occurred within  
19 regions, HMI.

20 Q I'm sorry, HMI?

21 A Which is the, I think it's Pittsburgh  
22 based, Western Pennsylvania plan, Carelst and then  
23 the various acquisitions that Anthem did for their  
24 for-profit group.

25 Q Now, with respect to any of these

1 acquisitions did you ever look into how much the  
2 acquiring company paid for the acquired company?

3 A No.

4 Q Did you ever seek to see how much per  
5 member, per covered life the acquired company paid?

6 A No.

7 Q The acquiring company paid?

8 A No.

9 Q Now what about the acquisitions that HCSC  
10 has made in the past, have you looked into them to  
11 see how much HCSC paid for the companies that it's  
12 already acquired?

13 A No.

14 Q And then I guess you haven't valued how  
15 much HCSC paid per covered life in connection with  
16 any of those acquisitions?

17 A No.

18 Q And what about the Blue Cross plans that  
19 have converted to for-profit status, are you  
20 familiar with the amount that they've raised through  
21 an initial public offer?

22 A No.

23 Q And did you ever review the price that was  
24 offered for Blue Cross companies where the  
25 acquisition was disapproved by the insurance

1 commission?

2 A Would you please repeat that?

3 Q Yeah. Did you ever review the price that  
4 was offered for Blue Cross companies by a potential,  
5 by a would-be acquirer where the acquisition was  
6 disapproved by the insurance department?

7 A No.

8 Q And then I assume you never reviewed the  
9 Commission's opinion in any of those matters?

10 A Correct.

11 Q Did you ever review the estimated IPL  
12 price of Blue Cross companies whose applications to  
13 convert to for-profit status were denied by the  
14 insurance department?

15 A No.

16 Q Did you ever think you should get the  
17 highest price you possibly could for Blue Cross of  
18 Montana?

19 A The only price that I was focused on was  
20 the one that would be delivered by the independent  
21 evaluator trying to determine a fair market value.

22 Q Did you ever discuss with anyone at Blue  
23 Cross of Montana the question of whether you should  
24 get the highest price you possibly could for the  
25 company?

1 A No, we followed the statute.

2 Q Did you ever review the process, if any,  
3 that other Blue Cross companies which were acquired  
4 went through to determine the purchase price of the  
5 company?

6 A No.

7 Q Now, your insureds are the owners of the  
8 company, right?

9 MR. MCMAHON: Objection, no foundation.

10 Q (By Mr. Angoff) Do you know who owns --  
11 Blue Cross of Montana doesn't have stockholders,  
12 right?

13 THE WITNESS: I'm a little confused right  
14 now.

15 HEARING OFFICER LEAPHART: He's asked you  
16 if you know does Blue Cross of Montana have  
17 stockholders.

18 A We do now.

19 Q (By Mr. Angoff) So Blue Cross of Montana  
20 is not owned by stockholders, correct?

21 A Correct.

22 Q Well, do you know who does own Blue Cross  
23 of Montana.

24 A I consider it a state entity.

25 Q I'm sorry?

1 A We serve the interests of the state.

2 Q Meaning the people of Montana?

3 A Correct.

4 Q Do you know what assets of Blue Cross of  
5 Montana HCSC has agreed to acquire?

6 A Yes.

7 Q What are those assets?

8 A HCSC is acquiring our lines of business  
9 and our operating assets.

10 Q Are there any assets of Blue Cross of  
11 Montana that HCSC is not acquiring?

12 A Yes.

13 Q And what are those assets?

14 A Those are our investments, which are part  
15 surplus, and buildings would be the primary ones.

16 Q And what will happen to those assets?

17 A They will end up in the foundation that's  
18 created should the alliance be approved.

19 Q Have you ever done any investigation of  
20 the effectiveness of foundations that have resulted  
21 from conversions in other states?

22 A No.

23 Q Did you study the integration process that  
24 occurred between Blue Cross of New Mexico and HCSC  
25 when Blue Cross of New Mexico was purchased by HCSC?

1 A No.

2 Q Did you study the integration process that  
3 Blue Cross of Oklahoma went through when Blue Cross  
4 of Oklahoma was purchased by HCSC?

5 A Could I ask, what do you mean by study?

6 Q Do you know what the process was that Blue  
7 Cross of Oklahoma went through when they agreed to  
8 an affiliation with HCSC?

9 A No.

10 MR. ANGOFF: No further questions, Your  
11 Honor.

12 HEARING OFFICER LEAPHART: Attorney  
13 General?

14 MS. HUBBARD: We have none, Your Honor.

15 HEARING OFFICER LEAPHART: Mr. Kaleczyc?  
16

17 CROSS-EXAMINATION OF MARK BURZYNSKI

18 BY MR. KALECZYC:

19 Q Mr. Burzynski, I just wanted to talk to  
20 you for a moment about the assets that are going to  
21 be acquired and not acquired by HCSC. I believe  
22 your testimony in response to questions from  
23 Mr. Angoff was that the lines of business and  
24 operating assets would be acquired but investments  
25 in buildings would not be acquired; is that correct?

1           A     Yes.

2           Q     In addition to that are there other lines  
3 of business that Blue Cross Blue Shield of Montana  
4 has now that would not be acquired by HCSC such as  
5 WSI?

6           A     WSI or the entities in Combined Benefit  
7 Management, Inc., CBMI, are subsidiaries as opposed  
8 to lines of business. The CBMI would be left in the  
9 foundation.

10          Q     Thank you. I have no other questions.

11                   HEARING OFFICER LEAPHART: For my benefit  
12 WSI is Western States Insurance?

13                   MR. KALECZYC: I'm sorry, Western States  
14 Insurance.

15                   HEARING OFFICER LEAPHART: Okay.

16  
17                   REDIRECT EXAMINATION OF MARK BURZYNSKI

18 BY MR. MCMAHON:

19          Q     Mr. Burzynski, do you recall Mr. Angoff's  
20 questioning about your study or analysis of other  
21 transactions of other Blue plans?

22          A     I do recall the conversation.

23          Q     Do you know if those other acquisitions,  
24 integrations, whether it's a alliance or whatever,  
25 were they governed under the Montana conversion

1 statute?

2 A They were not.

3 Q So when he talks about whether you did any  
4 research with respect to those other transactions or  
5 proposed transactions or whether a commissioner of  
6 insurance said yes or no, would you agree with me  
7 that they weren't under the conversion statute?

8 A Yes, I would.

9 Q We are under the conversion statute,  
10 correct?

11 A Yes.

12 Q And Blue Cross is committed to comply with  
13 the conversion statute, correct?

14 A Yes.

15 Q You talked about assets that HCSC was  
16 acquiring in this transaction, correct?

17 A Yes.

18 Q Is HCSC taking any surplus from Blue  
19 Cross?

20 A No.

21 Q And that surplus, one of the things that  
22 it's used for and can be used for is to cover fully  
23 insured lives?

24 A Yes.

25 Q Have you ever looked at from a standpoint

1 of an estimate of what that surplus/reserves to  
2 cover may be worth?

3 A Yes.

4 Q Can you tell Justice Leaphart what that  
5 is?

6 A I would estimate that at 200 percent RBC  
7 that number might be approximately \$50 million and  
8 at 375 percent RBC that number might be closer to  
9 \$90 million.

10 Q And that surplus stays here in Montana,  
11 doesn't it?

12 A Yes, it does.

13 Q Now, Mr. Angoff asked you about whether  
14 you've ever seen any studies about the value of the  
15 Blue Cross name and mark, do you recall that line of  
16 questioning?

17 A Yes.

18 Q Do you recall any studies of the Blue  
19 Cross name and mark under the Montana conversion  
20 statute?

21 A No.

22 Q In your direct testimony you talked about  
23 various capital expenditures that Blue Cross will  
24 save if this transaction goes through, correct?

25 A Yes.

1 Q Now, from those capital expenditures if  
2 the alliance doesn't go through will Blue Cross have  
3 to make those investments?

4 A Yes.

5 Q And could you refresh my recollection how  
6 much that is?

7 A The estimate is just over \$100 million.

8 Q You had some discussion with Mr. Angoff  
9 regarding .5 underwriting gain targeting, correct?

10 A Yes.

11 Q And do you remember the line of  
12 questioning we said all things considered equal if  
13 the underwriting gain is .5 percent, the higher the  
14 underwriting gain all things being equal the higher  
15 the premium may be?

16 A Yes.

17 Q If a company has a .5 percent underwriting  
18 profit target but has 11 to 12 percent  
19 administrative costs and one company has a 2 percent  
20 underwriting target with 7 percent administrative  
21 expenses, what company may have higher premiums?

22 A The first one.

23 Q Why?

24 A Because with the .5 and the higher  
25 administrative retention premiums would be higher.

1 Q So really you have to compare apples to  
2 apples in that type of discussion, don't you?

3 A Yes.

4 Q When we're talking whether the premiums  
5 are going to increase or decrease?

6 A Correct.

7 Q Now, Mr. Burzynski, when Mr. Angoff was  
8 talking about from a standpoint there is going to be  
9 no CFO at Blue Cross Blue Shield of Montana if this  
10 transaction goes through, correct?

11 A Correct.

12 Q And I believe your testimony was that you  
13 would like to be employed by HCSC, correct?

14 A Yes.

15 Q Why is this transaction so important to  
16 you?

17 A Because it will fundamentally change Blue  
18 Cross and Blue Shield of Montana's ability to serve  
19 the residents of the state in terms of technology,  
20 assumption of risk, access to subject matter  
21 experts, the creation of economies of scale, ability  
22 to compete with the new marketplace where our  
23 competitors have 13, 18 and 35 million members. We  
24 just couldn't possibly compete with 245,000 members  
25 against that kind of competition. Because of that

1 we would have the ability to get out, we'll have the  
2 ability to get on the exchange.

3           Currently HCSC has over 1,500 people  
4 working on health care reform, that's fire power  
5 that Blue Cross Blue Shield of Montana just would  
6 never ever have with approximately 530 employees.  
7 Health care reform is very complex, very  
8 technologically demanding and the only way we are  
9 going to be able to compete and serve the residents  
10 of the state of Montana effectively is through the  
11 resources afforded us by HCSC. This is the most  
12 important thing I will do in my care career.

13           Q     Do you believe that in attempting to seek  
14 the Attorney General's approval and the Commission  
15 of Insurance approval in this transaction that Blue  
16 Cross is being proactive or reactive to the change  
17 in the health care industry?

18           A     Very much proactive.

19           Q     Thank you, Mr. Burzynski.

20           HEARING OFFICER LEAPHART: Any further  
21 questions, Mr. Angoff?

22           MR. ANGOFF: No questions, Your Honor.

23           HEARING OFFICER LEAPHART: You may step  
24 down, Mr. Burzynski. Thank you.

25           MR. KALECZYC: If we could take a quick

1 break so we could change.

2 HEARING OFFICER LEAPHART: Sure.

3 (Off the record briefly.)

4 MR. KALECZYC: Your Honor, I'd like to  
5 call Mr. James Kadela.

6 (Witness sworn.)

7

8 DIRECT EXAMINATION OF JAMES KADELA

9 BY MR. KALECZYC:

10 Q Would you state your name for the record,  
11 please?

12 A James Kadela.

13 MR. KALECZYC: May I approach the witness,  
14 please?

15 HEARING OFFICER LEAPHART: Yes.

16 Q (By Mr. Kaleczyc) Mr. Kadela, I've handed  
17 you your prefiled testimony dated February 8th,  
18 2013. Is that, in fact, your prefiled testimony?

19 A Yes, it is.

20 Q For purposes of the hearing today do you  
21 adopt the statements contained in that prefiled  
22 testimony?

23 A Yes, I do.

24 MR. KALECZYC: Your Honor, we submit the  
25 witness for any cross-examination.

1 HEARING OFFICER LEAPHART: Mr. Angoff?

2 CROSS-EXAMINATION OF JAMES KADELA

3 BY MR. ANGOFF:

4 Q Good afternoon, Mr. Kadela.

5 A Good afternoon.

6 Q You'll be pleased to know I have very few  
7 questions. First, in your direct testimony you note  
8 that after acquisitions in other states the Blue  
9 Cross company there saw a very substantial increase  
10 in membership, Oklahoma, for example, saw a 47  
11 percent increase, correct?

12 A Yes.

13 Q And Texas a 148 percent increase, that was  
14 over several years?

15 A Yes.

16 Q And then since 2001 you say New Mexico has  
17 seen a 30 percent increase in membership?

18 A Right.

19 Q Have you done any analysis of the amount  
20 of increase that you project Blue Cross of Montana  
21 would receive if the acquisition is --

22 A No, we haven't done any analysis.

23 Q I'm sorry?

24 A We have not done any analysis.

25 Q Would you expect it to be within the range

1 of the other three states?

2 A It's hard to know. There is so many  
3 different factors that go into growth that it would  
4 be hard for me to estimate.

5 Q Do you know whether there are any factors  
6 unique to the Montana market which would indicate  
7 either a higher or lower membership growth than you  
8 had in your other states?

9 A None that I'm aware of.

10 Q Have you done any analysis of the Montana  
11 market?

12 A No.

13 Q Is this your first time in Helena?

14 A Yes.

15 Q Have you done a market share analysis of  
16 the Montana market?

17 A No.

18 Q You also say in your prefiled testimony  
19 that FEP business if the acquisition goes through  
20 will be handled out of your Abilene service center?

21 A That's correct.

22 Q And that includes for the Montana FEP  
23 business?

24 A That is correct.

25 Q Have you had any discussions with the

1 people at Blue Cross of Montana who are working on  
2 the FEP business today?

3 A Yes, we have.

4 Q Okay, and could you tell me the thrust of  
5 those discussions?

6 A We've talked about the reason that we have  
7 consolidated into one center was based on the  
8 federal government asking so we can get better  
9 economies of scale by putting that business in a  
10 common place and we talked about the fact that we  
11 would like to move their business in there and  
12 they've agreed with that premise.

13 Q And do you know what would happen to the  
14 people at Blue Cross of Montana who today are  
15 working on the FEP business?

16 A At this point we talked about we would  
17 need them in the interim for other conversion work  
18 but then we would look to replace their work if the  
19 transaction is approved with other work either  
20 through growth of the Montana business or through  
21 movement of work that support our other four HCSC  
22 states.

23 Q And by replace their work you don't mean  
24 replace them, you mean --

25 A Not them, correct.

1 Q -- you would give them different --

2 A Different work, yes.

3 Q But you would continue to retain those  
4 individuals --

5 A Yes.

6 Q -- in some position or another?

7 A Yes.

8 Q And then you also talk about the next  
9 generation or NGEN team, correct?

10 A Correct.

11 Q What is that?

12 A That is the team within HCSC that's  
13 preparing for the exchanges. So as Mark mentioned,  
14 there is about 1,500 employees and contractors  
15 working on everything from designing our marketing  
16 strategies to building up system capabilities and  
17 then preparing our workforce to be able to handle  
18 the additional membership growth that we expect.

19 Q And what has your involvement with the  
20 NGEN team been?

21 A I have oversight of all of our projects  
22 within HCSC, so just making sure we get the right  
23 resources to work on it.

24 Q So you oversee all 1,500 people who are  
25 working on the transition to exchanges?

1           A     No, I ensure that HCSC provides the right  
2 resources to work on projects, so I do not oversee  
3 them all.

4           Q     Do you know what the NGEN team has done  
5 with respect to marketing for the exchanges?

6           A     High level I'm aware of the analysis  
7 they've begun to do on the types of constituents  
8 that are uninsured in our states and preparing  
9 marketing plans to reach those members.

10          Q     And what is that analysis?

11          A     It's just looking at an analysis of the  
12 uninsured, what population groups make those up and  
13 then how to best reach those, whether that's through  
14 direct advertising or through community based  
15 groups.

16          Q     And do you know what products HCSC -- let  
17 me strike that. Do you know what benefit packages  
18 HCSC will be selling through the exchanges?

19          A     We're still working and finalizing those.

20          Q     And do you know whether HCSC will be  
21 selling the same benefit packages in all four and if  
22 the acquisition closes five of its states?

23          A     They are substantially the same, there  
24 could be market differences that come into play  
25 based on state mandates and requirements.

1 Q And do you know whether HCSC would be  
2 selling one standard benefit package at each of the  
3 metal levels or multiple benefit packages?

4 A At least one at each level.

5 Q Do you know whether there is a maximum  
6 number of plans that HCSC would be selling at each  
7 level?

8 A No, I don't know.

9 Q And do you know what, if any, analysis of  
10 pricing the NGEN team has done through the  
11 exchanges?

12 A I'm not aware of the pricing. I know  
13 they're working on it.

14 Q And is the NGEN team also working on  
15 HCSC's selling outside of the exchanges after 2014?

16 A That team is focused on primarily the  
17 exchanges. Some things they'll do will carry over  
18 to outside the exchange but that's not their main  
19 focus.

20 Q Is HCSC going to sell a catastrophic plan  
21 through the exchange?

22 A I believe so.

23 Q And what is a catastrophic plan?

24 A It's a high level kind of high deductible  
25 plan that's available to certain subsets of the

1 market.

2 Q And have you been involved in any issues  
3 resulting from the transition from HCSC's present  
4 underwriting and rating methodology to the  
5 underwriting and rating methodology that will be  
6 required by the Affordable Care Act?

7 A No, I'm not.

8 MR. ANGOFF: No further questions, Your  
9 Honor.

10 HEARING OFFICER LEAPHART: Thank you.  
11 Miss Hubbard?

12 MS. HUBBARD: We have none, Your Honor.

13 HEARING OFFICER LEAPHART: Mr. McMahon?

14 MR. MCMAHON: None, Your Honor.

15 HEARING OFFICER LEAPHART: Mr. Kaleczyc?

16

17 REDIRECT EXAMINATION OF JAMES KADELA

18 BY MR. KALECZYC:

19 Q Mr. Kadela, when Mr. Angoff asked you  
20 about the growth that has been experienced by HCSC  
21 with Blues plans in New Mexico, Oklahoma and Texas I  
22 think you responded and said that there are several  
23 factors that figure into whether there is growth  
24 after HCSC has engaged in consolidations. Could you  
25 explain to Justice Leaphart what those factors are?

1           A     I can give you a few factors that would be  
2     the relative competitive offering that we would have  
3     versus the other carriers in the state, whether  
4     that's from capabilities or from pricing. It would  
5     also involve just the magnitude of available  
6     business that is open to bid in that market, so some  
7     groups come up for bid every several years, a lot of  
8     that would factor into even the potential for  
9     growth.

10          Q     When you say "capabilities," what did you  
11     mean by capabilities?

12          A     Some of that's the technology that we have  
13     to offer, so whether that's technology to allow for  
14     better self-service by members, and HCSC has a lot  
15     of that with web and mobile capabilities that other  
16     carriers don't. It could be capabilities around  
17     helping to manage medical costs, such as our  
18     integrated health management tools, and then it  
19     could also be wellness-type offerings to help ensure  
20     a healthier population.

21          Q     If the alliance is approved in the state  
22     of Montana do you anticipate that your web and  
23     mobile capabilities will be brought to the Blue  
24     Cross Montana plan?

25          A     Yes, they would be brought upon conversion

1 to our systems.

2 Q How about your wellness plans?

3 A I would assume some of those would also be  
4 brought forward, yes.

5 Q And integration of technology?

6 A Yes.

7 Q You were involved directly in the state of  
8 Oklahoma with its consolidation; is that correct?

9 A Correct.

10 Q And what was the nature of your  
11 involvement in Oklahoma?

12 A I was the business lead on the operational  
13 integration of the two plans.

14 Q And you're bringing that experience and  
15 expertise now to this transaction?

16 A Yes.

17 Q Mr. Angoff asked you and he quoted from  
18 your direct testimony about the growth in Texas, New  
19 Mexico and Oklahoma. During the transition and the  
20 consolidation process was any business lost by those  
21 plans?

22 A Not that I recall.

23 Q In determining capabilities and  
24 satisfaction of consumers and potential consumers  
25 does claims handling fit into that analysis of

1 whether there is a potential for growth?

2 A Definitely that would be, timely and  
3 accurate claim payment would factor in.

4 Q Refresh my memory, how many claims does  
5 HCSC through its four Blues plans currently handle?

6 A Over 750,000 claims a day.

7 Q And what does that translate into for a  
8 year?

9 A Almost 200 million claims a year.

10 Q Are a lot of those claims handled by  
11 telephone?

12 A Telephone or electronically, yes.

13 Q How many telephone calls do you get?

14 A How many telephone calls? From members  
15 it's about 30,000 per day, so 15, 20 million a year.

16 Q Does that include calls from providers?

17 A Another similar number for providers.

18 Q And if this alliance is approved for the  
19 state of Montana do you know whether HCSC plans on  
20 putting a call center in Montana?

21 A Yes, our goal would be local people  
22 performing those functions using our enterprise  
23 technology.

24 Q And what kinds of calls would be fielded  
25 through this new Great Falls office?

1           A     The Great Falls office would be provider  
2     calls for eligibility and benefit information for  
3     our other four HCSC states.

4           Q     So they would handle calls for the other  
5     four states as well as potentially from Montana?

6           A     Potentially, but most of the Montana calls  
7     we would assume would be here in Helena.

8           Q     And Mr. Angoff asked you about the work on  
9     the exchange that you're currently doing. How many  
10    people are involved in that?

11          A     It's upwards around 1,500.

12          Q     And do you have an estimate of how many  
13    hours has been spent so far by these people in  
14    preparing for the exchange?

15          A     To date it's about 300,000 hours.

16          Q     And would those capabilities then be  
17    brought to the state of Montana if this is approved?

18          A     Yes.

19                MR. KALECZYC: Your Honor, I have no other  
20    questions. Thank you, Mr. Kadela.

21                HEARING OFFICER LEAPHART: Any further  
22    questions, Mr. Angoff?

23                MR. ANGOFF: Nothing further, Your Honor.

24                HEARING OFFICER LEAPHART: Any further  
25    questions? You may step down.

1 MR. KALECZYC: We'd call Maurice Smith.

2 (Witness sworn.)

3

4 DIRECT EXAMINATION OF MAURICE SMITH

5 BY MR. KALECZYC:

6 Q Good afternoon, Mr. Smith.

7 A Good afternoon.

8 Q And would you state your name for the  
9 record?

10 A My name is Maurice Smith, M-a-u-r-i-c-e,  
11 Smith.

12 MR. KALECZYC: May I approach the witness  
13 please?

14 HEARING OFFICER LEAPHART: Yes.

15 Q (By Mr. Kaleczyc) Mr. Smith, I've just  
16 handed you what was your direct testimony previously  
17 submitted on February 18, 2013. Is that, in fact,  
18 your direct testimony?

19 A It is.

20 Q And do you adopt that for purpose of the  
21 hearing today?

22 A Yes, with the acknowledgment that there  
23 was a stipulation around the price of 40.2 million.

24 Q And so in your direct testimony you refer  
25 to a price of 17.6 million?

1           A     I did.

2           Q     And you are aware that it's 40.2 million  
3 that has been stipulated by the Attorney General,  
4 HCSC and Blue Cross Blue Shield of Montana as the  
5 acquisition price?

6           A     I'm aware.

7                   MR. KALECZYC: With that, Your Honor, I  
8 submit the witness for cross-examination.

9                   HEARING OFFICER LEAPHART: Mr. Laslovich?

10                  MR. LASLOVICH: Thank you, Your Honor.

11

12                           CROSS-EXAMINATION OF MAURICE SMITH

13 BY MR. LASLOVICH:

14           Q     Good afternoon, Mr. Smith.

15           A     Good afternoon.

16           Q     It's good to see you again and I hope you  
17 feel as good as I do about a Green Bay Packer asking  
18 a Dallas Cowboy questions.

19                   HEARING OFFICER LEAPHART: If I can say in  
20 jest, Your Honor, we should take his testimony  
21 with a grain of salt in light of his NFL team.

22           A     We will rise again.

23           Q     (By Mr. Laslovich) Fair enough, fair  
24 enough.

25                   Mr. Smith, in your direct testimony you

1 talked a little bit about the status of HCSC being a  
2 not for, having a not-for-profit philosophy,  
3 correct?

4 A Correct.

5 Q Do you know what the legal status is of  
6 HCSC in Illinois?

7 A A mutually reserved company.

8 Q So can you explain to me the  
9 not-for-profit portion is based on what HCSC has in  
10 their by-laws and articles of incorporation; is that  
11 right?

12 A That's my understanding.

13 Q And do you know if HCSC wants to become a  
14 for-profit company how they'll be able to do that?

15 A I do not know that.

16 Q Did I also understand your direct  
17 testimony that you for purposes of -- let me get  
18 this correct. Let me back up a little bit. You're  
19 responsible, Mr. Smith, for overseeing HCSC's  
20 corporate mergers and acquisition strategy, correct?

21 A That is correct.

22 Q So is it fair to say that you were  
23 responsible for, one of the people responsible for  
24 the decision to partner with Blue Cross Blue Shield  
25 of Montana?

1           A       That is fair, I was part of the team.

2           Q       You also discuss in your testimony how  
3 HCSC reinvests its earnings for the benefits of its  
4 members, correct?

5           A       That is correct.

6           Q       Can you give me some examples of some of  
7 those reinvestments that specifically directly  
8 benefit HCSC members?

9           A       Well, first surplus, you know, it's for  
10 the protection of the HCSC's policyholders. So as  
11 HCSC offers new products, new capabilities, to the  
12 extent that those products and capabilities need to  
13 be developed, surplus is one way to do that but we  
14 make continual investments in our technology. You  
15 heard Jim Kadela talk about mobile platforms. We  
16 make continued investments into our claim system, we  
17 make continued investments into our people and  
18 resources.

19                   One of the assets that Montana is looking  
20 to acquire from us is HCSC's expertise, so we invest  
21 in our people as well and just being good, I'll call  
22 it good community and civic partners and where HCSC  
23 continues to advise. But in the overall investment,  
24 it comes in a multitude of ways and it's more  
25 important now with the exchanges in front of us,

1 we're certainly going to make large investments,  
2 which you heard that a team of about 1,500 people  
3 are working and getting ready for that effort as  
4 well.

5 Q I appreciate that. So related to the  
6 surplus portion of your testimony you reference  
7 risk-based capital. Will you explain to Justice  
8 Leaphart in laymen's terms what that is?

9 A Risk-based capital in the most simplest  
10 way, it's a formula that was designed by actuaries  
11 under the Commission of the National Association of  
12 Insurance Commissioners and what it's designed to do  
13 is determine the riskiness of a particular entity.  
14 To oversimplify it, the math is you look at the  
15 surplus that the entity has over its relative risks.  
16 The risks are calculated and computed through a  
17 scientific algorithm developed by those actuaries.

18 So the components of that risk are like  
19 underwriting risk, which looks at the health of your  
20 business, loss trends, assets risks, the things that  
21 you've been investing in, subsidiary risk and one  
22 other, administrative risk, how efficient you are  
23 with your administrative expenses, and it takes kind  
24 of a composite score of all those things and comes  
25 up with a hypothetical amount of surplus, a middle

1 amount that you need. So you take your surplus,  
2 divide it by this hypothetical risk number and that  
3 result is your RBC, your risk-based capital for an  
4 entity.

5 Q I appreciate that. So the RBC for HCSC as  
6 of September 30th, 2012, I believe, you correct me  
7 if I'm wrong, as of September 30th, 2012 -- maybe  
8 I'm -- I'll say 2012, was 1,227 percent?

9 A I think that's a December 31, 2011 number.

10 Q Thank you. So do you know what the RBC  
11 number was as of December 31st, 2012?

12 A 1,241, I believe.

13 Q 1,241 you said?

14 A Yes.

15 Q And do you know, Mr. Smith, historically  
16 what HCSC's RBC has done?

17 A Yeah, I mean, you can see in the five-year  
18 history that it's been improving over the last five  
19 years.

20 Q So do you recall what it was five years  
21 ago, what the RBC was?

22 A I don't.

23 Q But it's fair to say that the RBC ratio as  
24 of December 31st, 2012 is higher than it was five  
25 years ago?

1           A     That is fair.

2           Q     Has it gone down at all to your  
3 recollection in the last five years?

4           A     Not in the last five years.

5           Q     And then also is there a statutory minimum  
6 requirement for RBC in Montana?

7           A     In Montana, I'm not aware of it in  
8 Montana. But assuming that the Montana falls under  
9 the NAIC, which is the National Association of  
10 Insurance Commissioners, there would be a 200  
11 percent minimum but no company is really operating  
12 at that level, it has to be something more than that  
13 because they would not be able to weather any  
14 adverse business conditions for a period of time.  
15 So that's a pretty thin margin so you see companies  
16 operate at levels much greater than that.

17          Q     So what practically happens then, if you  
18 can explain for the Judge if a company does not meet  
19 that minimum 200 percent threshold?

20          A     Every state is different, but if it gets  
21 too low it can actually go into receivership, you  
22 know. But I think like most commissioners, like  
23 yourself, you probably not only look at the RBC  
24 today but where it's trending to determine whether  
25 you are satisfied with the business plan and the

1 action that the company has taken to shore it up.

2 Q And similarly, are you aware of whether  
3 the Blue Cross Blue Shield association has a minimum  
4 requirement --

5 A I am.

6 Q -- regarding RBC?

7 A I'm aware.

8 Q And what is that?

9 A 375, but I think that's really more of our  
10 early monitoring system. It's not -- most companies  
11 are going to operate at a higher RBC than that  
12 because small changes in your underwriting or asset  
13 risk can actually produce significant changes in  
14 your RBC.

15 Q Okay, so explain to me this early, if you  
16 can expand on this early monitoring process.

17 A 375 is, you know, in my view, I don't know  
18 how NAIC would articulate it, but it would be that  
19 the company would want to protect the Blue system,  
20 so they want to make sure they understand whether a  
21 company is having trouble or not ahead of it  
22 becoming a problem for the commission.

23 Q So then I understand then, if the company  
24 is below the 375 percent threshold, RBC threshold,  
25 then for purposes of the Blue Cross Blue Shield

1 association they consider the company could  
2 potentially be in trouble?

3 A Trouble is my word but I think they would  
4 actually have more discussions with the company and  
5 understand its business plans.

6 Q And then do you know if the Blue Cross  
7 Blue Shield association has an RBC threshold for  
8 purposes of considering whether the Blue plan is a  
9 strong plan?

10 A I'm not aware of that.

11 Q And do you know, Mr. Smith, if any other  
12 states have caps on the RBC amount?

13 A I'm not aware of that.

14 Q And do you have an opinion as to whether  
15 an insurer's RBC can be too high?

16 A I don't have an opinion on that.

17 Q You do not have an opinion?

18 A (Shakes head.)

19 Q You also discussed -- well, before we  
20 leave that I should back track a little bit. Are  
21 you familiar with Blue Cross Blue Shield of  
22 Montana's RBC?

23 A Somewhat, yes. I saw the filing.

24 Q I'm sorry?

25 A I saw the filing.

1 Q By the filing what are you referring to?

2 A The filing history page that you can  
3 compute the RBC.

4 Q But prior to seeing that today you weren't  
5 familiar with Blue Cross Blue Shield's RBC?

6 A No, but I did see that before today.

7 Q Thank you. You also talked in your  
8 testimony about not having access to the, that  
9 HCSC -- let me try to be more articulate here. You  
10 talked in your prefiled testimony about HCSC not  
11 having access to the capital markets like a, for  
12 example, for-profit company; do you recall that?

13 A Yes.

14 Q And you also reference too that HCSC's  
15 access is not as broad as other, as a for-profit  
16 company; do you remember that?

17 A Kind of. Tell me what I said again. I  
18 apologize and maybe you can refer me to a page.

19 Q I will. Do you have it in front of you?

20 A I do. I do recall that conversation in my  
21 prefiled testimony. HCSC did not have access to  
22 capital markets, I just wasn't sure.

23 Q Yeah, that's where I'm going to look. So  
24 it's page 5, Mr. Smith, at the top of page 5 on  
25 lines 1 and 2 you discuss not having access, the

1 same access to capital markets that a public company  
2 has and then if you see -- did you follow that?

3 A Yes.

4 Q And then if you look down to line 22 you  
5 say in the middle of that sentence the options and  
6 terms of access and capital markets are not as broad  
7 as they are for public companies turning to that  
8 page. Do you remember that?

9 A I do.

10 Q Can you tell me what you mean by not as  
11 broad?

12 A So a public company, if it wants to invest  
13 or take any strategic initiatives, if it doesn't  
14 have that money in reserves it actually can tap the  
15 capital marks by issuing additional stock and that's  
16 a very effective and efficient way to raise lots of  
17 money. The point here is that, you know, for a  
18 noninvestor owned company we actually can have  
19 limited access to the market and it can issue debt  
20 but it's a very difficult thing to issue debt in a  
21 market. So HCSC has private placement debt but it  
22 does not have broad access to the capital markets.

23 Q Okay, I appreciate that. So because of  
24 that, because of the not having as broad of access  
25 to the capital markets essentially HCSC is relying

1 on its --

2 A Surplus.

3 Q -- its surplus?

4 A Right.

5 Q And to get that surplus obviously you have  
6 underwriting gain, you have investment income?

7 A That's correct.

8 Q What other kinds of income?

9 A Those are the two -- I mean, those are two  
10 primary sources of income.

11 Q Mr. Smith, the financial review of the  
12 transaction you said in your testimony that you  
13 were, that was one of your responsibilities; is that  
14 correct?

15 A Yes, part of the team.

16 Q Did you negotiate a purchase price with  
17 Blue Cross Blue Shield?

18 A I did not.

19 Q And do you know why?

20 A Everyone was following the statute, the  
21 statute called for a fair market valuation and  
22 that's what we accepted.

23 Q Is it your understanding of the fair  
24 market statute that it requires, that the purchase  
25 price needs to be the fair market value?

1           A     That was my understanding.

2           Q     All right.  And is that based on your  
3 reading the statute?

4           A     I did read the statute after I did it  
5 early on.  I can't tell you I remember all the  
6 details of it.

7           Q     You also talked about how you were also  
8 responsible to advise the HCSC board of directors,  
9 is that right, regarding the financial piece of the  
10 transaction with Blue Cross Blue Shield of Montana?

11          A     That's correct.

12          Q     And if you can elaborate on what the  
13 extent of that work involved.

14          A     So just as in any transaction, any  
15 material transaction to the company, we would advise  
16 the board of the entity that we're looking to, or  
17 business we're looking to acquire, we would advise  
18 them of just the general facts of the business, we  
19 would provide them with various financial data and  
20 any other data that would help them in arriving at  
21 the conclusion that we arrived at ultimately.

22          Q     Are you familiar with any of the other  
23 HCSC acquisitions in Texas and New Mexico and  
24 Oklahoma?

25          A     Familiar with them but I wasn't a part of

1 those teams, no. I was around at the company but I  
2 wasn't part of those teams that put those place.

3 Q Okay, so to what extent is your  
4 familiarity with those?

5 A I understand, in Texas and in Oklahoma I  
6 understand those were mergers and New Mexico was  
7 more of an asset purchase.

8 Q Any other understandings?

9 A No, not really.

10 Q You also talked in your prefiled  
11 testimony, Mr. Smith, about it being significant  
12 that Blue Cross Blue Shield of Montana has had  
13 positive net income in recent years while having  
14 underwriting losses. Do you remember that?

15 A Somewhat, yes.

16 Q Pardon me?

17 A Somewhat, yes.

18 Q Well, I'll refer you to page 9 starting at  
19 line 9 and you can perhaps refresh your memory.

20 A Okay.

21 Q So based on your testimony there am I to  
22 understand it that you have concerns about Blue  
23 Cross Blue Shield of Montana's underwriting  
24 practices?

25 A Not about the underwriting practices but

1 the underwriting result. The result is that if this  
2 is your core business and you're actually seeing  
3 losses in your core business then you have to take  
4 upon various strategies or engage in various  
5 strategies to shore that up. So it's not really the  
6 practice itself but it's really the result.

7 Q And so as part of the, if I understood  
8 too, as part of the decision of HCSC entering into  
9 this transaction you were part of the due diligence  
10 team, is that right, on the financial piece?

11 A I don't think you would call it  
12 traditional due diligence per se but yes.

13 Q So when you were conducting that work,  
14 whether it's due diligence or not, did you have  
15 concerns about their underwriting practices?

16 A Not concerns about the practices but I had  
17 concerns really about the issue of or the fact that  
18 they have not achieved underwriting gains for a  
19 period of years.

20 Q And did you discuss those with Blue Cross  
21 Blue Shield of Montana?

22 A No, I mean, it was obvious they filed  
23 statements so there was no discussion really  
24 necessary.

25 Q You also in your prefiled testimony talked

1 about HCSC's demonstrated commitment and strong  
2 commitment to remaining a nonprofit company. Do you  
3 remember that?

4 A I do.

5 Q And what do you mean by demonstrated and  
6 strong commitment?

7 A I've been at the company 20 years and the  
8 company has touted it as a not-for profit mission,  
9 everything it does it takes the long-term  
10 perspective in terms of what's good for the members.  
11 I see instances where, as I changed jobs I think  
12 there were places where the company could have cut  
13 and run when things weren't going so well and they  
14 stuck it out. I think that's a demonstration to its  
15 nonprofit mission. I've seen civil and community  
16 engagement at every level, that's huge. I see  
17 customers' service scores and the provider  
18 relationship and it's very positive. I think from  
19 the president, from the board down you really hear  
20 it's a not-for-profit mission. So I think it's very  
21 important to the company and we all subscribe to it.

22 Q Do you have any concerns that that will  
23 change in the immediate future?

24 A I don't.

25 Q How about long term?

1           A     I don't see a change in long term but  
2 obviously, you know, you can't foresee it or  
3 foretell what that may look like, but if something  
4 happened so catastrophic that caused you to rethink  
5 your business model you have to be prudent and do  
6 that, but there are current plans and I don't think  
7 there are any current desires to do something like  
8 that.

9           Q     So no one has expressed a desire, whether  
10 it be an officer or a board member, that HCSC should  
11 become a for-profit company; is that correct?

12          A     Oh, no. That is correct.

13          Q     Did you verify the capital expenditure  
14 requirements that Blue Cross Blue Shield of Montana  
15 felt they needed to --

16          A     I did not.

17          Q     You also discussed administrative  
18 synergies that this transaction would bring to both  
19 HCSC, Blue Cross, along with your four our states;  
20 do you recall that?

21          A     Yes.

22          Q     In your opinion what does Blue Cross Blue  
23 Shield of Montana bring to the transaction as part  
24 of those administrative synergies?

25          A     What does Montana bring?

1 Q Correct.

2 A Well, I would -- they would bring  
3 expertise, so they bring employees and expertise,  
4 they bring members, membership to us. So, I mean,  
5 simple math is that you spread the costs across a  
6 greater base. So if we have 13 million and we take  
7 13.2 and 13.3 and the unit cost is going down for  
8 the entire enterprise, not only across Montana but  
9 the entire enterprise would actually benefit from  
10 that, so that is huge too. So any time that you can  
11 make scale adjustments or scale increases it  
12 actually benefits the entire enterprise and that's  
13 huge for both companies. But then you have the  
14 intangibles like employee capabilities and solid  
15 leadership, those are all things that would help the  
16 company become more efficient than it is today.

17 Q As part of those administrative synergies  
18 would you agree that the relationships that the Blue  
19 Cross team, Blue Cross Blue Shield of Montana team  
20 has with providers would be a benefit to HCSC?

21 A That the local team has with providers?

22 Q Yes, sir.

23 A Well, sure.

24 Q So by providers I mean hospitals and  
25 doctors?

1           A     Yes.

2           Q     I want to talk a little bit about the  
3 purchase price, Mr. Smith, you referenced that in  
4 your direct. Your understanding was prior to  
5 yesterday that HCSC was willing to pay \$17.6 million  
6 for Blue Cross Blue Shield of Montana's core  
7 business; is that correct?

8           A     That is correct.

9           Q     And pursuant to that stipulation the  
10 purchase price is now 40.2 million, correct?

11          A     That is correct.

12          Q     Were you a part of the discussions about  
13 that stipulation?

14          A     About the stipulation?

15          Q     Yes.

16          A     I was part of the discussion about 40.2,  
17 yes.

18          Q     And let me back up a little bit,  
19 Mr. Smith. How did we arrive at the \$17.6 million?

20          A     Through the work of Jim Gallaso.

21          Q     And Jim Gallaso was the actuary who valued  
22 the core business on behalf of Blue Cross Blue  
23 Shield of Montana; is that right?

24          A     Yes.

25          Q     And he was not doing that on behalf of

1 HCSC, correct?

2 A Correct.

3 Q So Gallaso came up with the \$17.6 million.  
4 Do you know how the \$40.2 million was arrived at?

5 A Well, I wouldn't characterize it as a  
6 result of negotiation, if you will. I mean, so you  
7 have two experts, you have MDS --

8 MR. KALECZYC: Excuse me, Your Honor, at  
9 this point I don't know if Mr. Laslovich is  
10 starting to move toward asking the client,  
11 asking Mr. Smith either about attorney-client  
12 privileged discussions that were had or if he  
13 is going to move into the area of settlement  
14 discussions that were conducted under Rule 408.  
15 Under either of them I believe those kinds of  
16 questions aren't appropriate to be asked of  
17 this or any witness. I would like some  
18 clarification of where Mr. Laslovich is going  
19 at this point because he may be treading into  
20 Rule 408 territory.

21 HEARING OFFICER LEAPHART: Can you  
22 generalize as to where you're going?

23 MR. LASLOVICH: Generalizing, yes, Your  
24 Honor. We certainly know how we arrived at the  
25 \$17.6 million and now I'm exploring how we

1 arrived at the \$40.2 million and whether there  
2 was reliance upon the valuations that were  
3 conducted as part of the transaction.

4 HEARING OFFICER LEAPHART: Do you have  
5 objection to that?

6 MR. KALECZYC: If the question is whether  
7 they relied upon or reflect the various  
8 valuations I do not have an objection to that  
9 particular question.

10 MR. LASLOVICH: I don't know where we left  
11 off, Your Honor. I know Mr. Smith was talking  
12 about --

13 HEARING OFFICER LEAPHART: I think you had  
14 inquired as to what went into the \$40.2 million  
15 figure, what was relied on.

16 Q (By Mr. Laslovich) So go ahead,  
17 Mr. Smith. I'm sorry.

18 A Well, the \$40.2 million -- I probably  
19 should step back and tell you that when I'm looking  
20 at this transaction I'm not looking at just \$40.2  
21 million, I'm looking at a transaction that's much  
22 greater than that, it's the \$40.2 million plus the  
23 reserve requirements that we need to cover it to  
24 take on the business, plus the investments that we  
25 need to make into Blue Cross of Montana and make it

1 a viable going concern, which is the outline. So we  
2 were actually talking about a number that's way  
3 greater than that.

4 But when you take the \$40.2 million, I  
5 should say add the \$40.2 million and you assume at a  
6 balance sheet of about \$166 million in surplus in  
7 the Moss Adams report, it puts us into the range of  
8 the MDS valuation, which it's really a net range.

9 Q So is it fair to say that the valuations,  
10 that the MDS Consulting valuation was utilized as  
11 part of the \$40.2 million?

12 A Utilized, considered perhaps.

13 Q How about the Moss Adams valuation, was  
14 that considered?

15 A Yes.

16 Q And then how about Dr. Gallaso, would that  
17 be considered since it's part of the Moss Adams  
18 valuation?

19 A Yes.

20 MR. LASLOVICH: Your Honor, I believe  
21 those are my questions. Thank you.

22 HEARING OFFICER LEAPHART: Thank you.

23 Miss Hubbard, do you have any questions?

24 MS. HUBBARD: No, Your Honor.

25 HEARING OFFICER LEAPHART: Mr. McMahon?

1 MR. MCMAHON: No, Your Honor.

2 REDIRECT EXAMINATION OF MAURICE SMITH

3 BY MR. KALECZYC:

4 Q It's getting late in the afternoon and I  
5 appreciate you hanging in with us, Mr. Smith.

6 A Thank you.

7 Q I'd like to begin where Mr. Laslovich  
8 basically left off, and I believe in response to one  
9 of his questions about what was considered you said  
10 that it's more than just the \$40.2 million asset  
11 purchase price, that there are other factors and one  
12 of them you said was what is the impact on taking on  
13 this new business and how does that affect reserve  
14 requirements. Do you remember your testimony on  
15 that?

16 A I probably spoke too quickly. You  
17 probably should disconnect them because they're both  
18 relevant and I should be clear and slow down a  
19 little bit. So you have the purchase price  
20 certainly and then nationally we talked about RBC,  
21 we've had to cover the reserve requirements. Since  
22 we're not taking any of the surplus with us we'd had  
23 to cover those reserve requirements. As you heard  
24 through all of the testimony today, even if you took  
25 them at the absolute minimum you would actually talk

1 about a number of 50 million, but certainly that's  
2 not a natural operating level. You know, assume a  
3 natural operating level is closer to an 400 RBC or  
4 100 million for these purposes.

5 Q So the \$50 million figure, this is a  
6 number that you heard from Mr. Burzynski's  
7 testimony, is that what you remember?

8 A Yes, but it's a calculable number.

9 Q It's a what number?

10 A It's a number that can be computed. If  
11 you look at the five year history page, which was  
12 Exhibit A earlier, you see in a risk-based capital  
13 formula where we talk about real surplus over  
14 hypothetical surplus, a need, that number is roughly  
15 24 million, so doubling the 24 is 48, so call it 50  
16 million in round numbers so it's actually a number  
17 that can be computed.

18 That is the bare minimum, state minimum  
19 that you can have, that no company would operate at  
20 that level successfully. So if you think about any  
21 real operating level you would talk about a number  
22 around 400 percent or more, much more than that.  
23 That would be the most standard to operate a company  
24 probably.

25 You talk about -- so that would translate

1 into something like \$100 million reserve  
2 requirements that HCSC would have to cover at a  
3 minimum, at a minimum, not even in the 500-some  
4 percent that you take today. So you take the  
5 average plus whatever you need to invest in the  
6 business, what you heard Mr. Kadela talk about, to  
7 make it a viable business going forward. So you  
8 take all of those things taken together puts you, in  
9 my view, in a range above a range that's within the  
10 MDS report, MDS is Mr. Blackmer's report.

11 Q And that 50 to \$1 million that would be  
12 needed for surplus to cover the liabilities and  
13 claims associated with taking on the Montana  
14 membership, that would have to come out of the  
15 current surplus that HCSC has?

16 A HCSC would have to earmark that much of a  
17 surplus for those items because we would take both  
18 the risk and not the surplus.

19 Q Now, are you familiar with the  
20 administrative costs that the Montana plan currently  
21 has in order to operate?

22 A Not really, not really.

23 Q Do you know how those compare to HCSC's  
24 administrative costs?

25 A Generally I do, I know that they're

1 higher. But I don't know any particulars because  
2 you have to go through and figure out where and why.

3 Q In looking at this transaction do you  
4 anticipate that if the alliance is approved that the  
5 Montana administrative costs will come down more in  
6 line with where HCSC's administrative costs are?

7 A That would be my assumption, but I'm going  
8 to caution that not only do you have to when you  
9 compare administrative costs you have to compare the  
10 capabilities that HCSC picks up. So to the extent  
11 they pick up more capabilities, you know, you have  
12 to factor for that in as well, so it has to be an  
13 apples-to-apples comparison.

14 Q And is it fair to say, Mr. Smith, that  
15 administrative costs are a factor in determining  
16 whether there is an underwriting loss or gain in a  
17 particular year for a company?

18 A It's fair.

19 Q And so if administrative costs are higher  
20 that could adversely affect underwriting gain and  
21 might produce an underwriting loss?

22 A That's correct.

23 Q Do you recall the questions that  
24 Mr. McMahon asked Mr. Burzynski concerning the two  
25 hypotheticals, one of a company that has an

1 underwriting target of 0.5 percent but 12 percent  
2 administrative costs and another company that might  
3 have a 2 percent underwriting gain target but 7  
4 percent administrative costs; do you recall those  
5 questions?

6 A I do.

7 Q And do you recall Mr. Burzynski's answer  
8 that he thought that possibly the rates charged to  
9 consumers might be lower for the company that has  
10 the 2 percent gain but lower administrative costs?

11 A Yeah.

12 Q Would you agree with his statement that  
13 that could be the case?

14 A That's very difficult to answer. I think  
15 you're really looking at a very narrow focus. The  
16 basic premise says that if you have lower  
17 administrative costs then obviously you have a  
18 better chance of producing an underwriting gain and  
19 if you have lower administrative costs then  
20 obviously you charge less in premiums to cover that.  
21 So it's probably artificial to box it into this  
22 binary answer to say that either this happens or  
23 that happens because you're lowering it by the other  
24 things that would change along the line.

25 An example of that is do you change your

1 revenue, your commissions are likely to change so  
2 it's really not the best way to look at that. I  
3 think there is an unfair premise for a cost share.

4 Q So would it be fair to say, Mr. Smith,  
5 that in the real world considering all of the  
6 factors that you just testified to there never  
7 really is a situation where all things are equal?

8 A I think that's right.

9 MR. KALECZYC: I have no other questions  
10 of this witness.

11 HEARING OFFICER LEAPHART: Thank you. Any  
12 further cross, Mr. Laslovich?

13 MR. LASLOVICH: No, sir. Thank you.

14 HEARING OFFICER LEAPHART: You may step  
15 down. And I'm going to declare us in recess  
16 until tomorrow morning.

17 MR. ANGOFF: Thank you, Your Honor.

18 (The proceedings were concluded  
19 for the day at 5:00 p.m.)

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C E R T I F I C A T E

I, LISA R. LESOFSKI, Registered Professional Reporter do hereby certify:

That the proceedings were taken before me at the time and place herein named, that the proceedings were reported by me and that the foregoing -281- pages contain a true record of the proceedings to the best of my ability.

Dated this 28th day of March, 2013.

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Lisa R. Lesofski