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BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE
MONTANA STATE AUDITOR

)	Case No. INS-2012-238
IN THE MATTER OF THE CONVERSION)	
OF BLUE CROSS AND BLUE SHIELD OF)	
MONTANA, INC., AND ALLIANCE WITH)	PROPOSED FINDINGS OF FACT AND
HEALTH CARE SERVICE CORPORATION)	CONCLUSIONS OF LAW
)	
Applicants.)	
)	

On November 15, 2012, Blue Cross and Blue Shield of Montana, Inc. (BCBSMT) and Health Care Service Corporation, a Mutual Legal Reserve Company (HCSC) (collectively, Applicants), filed an Application for Approval of Alliance (Application) with the Office of the Commissioner of Securities and Insurance, Montana State Auditor (CSI). The Applicants filed the Application pursuant to the provisions of Mont. Code Ann. Title 50, Part 4, Chapter 7 (Conversion Statute). In the Application, the Applicants petitioned for approval of a conversion transaction (Transaction) between the two entities.

On December 3, 2013, in accordance with Mont. Code Ann. § 50-4-709, the CSI issued a Notice of Application for Conversion and Public Hearing (Notice). In the Notice, the CSI

advised the public that a public hearing would be held in the above-mentioned matter on February 12, 2013, in the Lewis and Clark County Courthouse, Helena, Montana.

On February 12, 2013, a public hearing was held in the matter. Hearing Examiner W. William Leaphart presided. The hearing was conducted pursuant to the contested case procedures set forth under Mont. Code Ann. § 50-4-711(1). Members of the public provided oral comment, but none of the members subjected themselves to cross-examination. No further testimony was provided and no exhibits were admitted into evidence at the hearing.

On March 12, 2013, an additional public hearing was held. Hearing Examiner W. William Leaphart presided. The hearing was conducted pursuant to the contested case procedures set forth under Mont. Code Ann. § 50-4-711(1). Members of the public provided oral comment, some of whom subjected themselves to cross-examination. Testimony was received from witnesses for the CSI, Montana Attorney General, BCBSMT, and HCSC. Exhibits were admitted into evidence. The hearing concluded on March 14, 2013. The record in the matter was closed on March 18, 2013.

Based upon the public comment made subject to cross-examination, the testimony received, and the exhibits admitted into evidence, and the Stipulation entered into between the CSI and Applicants dated April 19, 2013, the undersigned makes the following proposed:

FINDINGS OF FACT

THE APPLICANTS

1. BCBSMT provides health insurance and third-party insurance administration services in the state of Montana. It has operated in various capacities as a Montana health insurer since 1940. (Direct Testimony of Michael E. Frank 4:5-12, March 5, 2013.)

2. BCBSMT is organized in the state of Montana as a health service corporation. (Hearing Transcript 514:21-24 (Mar. 14, 2013).)

3. BCBSMT is an independent licensee of the Blue Cross and Blue Shield Association (BCBSA). (Dir. Test. Frank 5:4-5.) As a licensee, BCBSMT has exclusive rights to use the Blue Cross and Blue Shield trademarks and names within Montana. (*Id.* at 7:2-5.)

4. As of December 31, 2012, the membership of BCBSMT totaled 271,152. (*Id.* at 4: 15.) The insurer has an extensive provider network within the state of Montana. (*Id.* at 4:15-18.)

5. The BCBSMT Bylaws provide that the Board of Directors (Board) shall “exercise all corporate powers” for BCBSMT, and they grant the Board supervision and control over corporate affairs. (Hearing CSI Exhibit M: Bylaws, Art. III, Sec. 3.1(May 10, 2012).) The Bylaws do not restrict the ability of the Board to enter into a conversion transaction, or to make decisions relating to or facilitating such a transaction. (*Id.*)

6. The Board is self-perpetuating, meaning the Board elects new directors. (Hrg. Tr. 117:24-118:2 (Mar. 12, 2013).)

7. The BCBSMT Articles of Incorporation do not restrict the ability of BCBSMT to engage in a conversion transaction. (Hearing CSI Exhibit L: BCBSMT Articles of Incorporation (May 5, 1995).)

8. HCSC is a health care service plan incorporated in the state of Illinois. (Application for Approval of Alliance, 5 (November 15, 2012).) HCSC is a non-investor owned corporation, meaning it has no third-party investors. (Direct Testimony of Colleen F. Reitan 4:5-7 (March 5, 2013).)

9. HCSC offers both fully-insured products and administrative services for self-insured plans. (*Id.* at 4:9-10.) Its diverse product lines cover virtually every aspect of the health insurance market. (*Id.* at 4:11-14.)

10. HCSC operates Blue Cross and Blue Shield (Blue) plans in Illinois, New Mexico, Oklahoma, and Texas. (*Id.* at 5:3-4.) In total, HCSC has over 13 million members cumulative of the four Blue plans. (*Id.* at 5:6-7.) Like BCBSMT, HCSC is a licensee of the BCBSA. (*Id.* at 5:4-5.)

THE APPLICATION
Mont. Code Ann. § 50-4-707

11. On November 15, 2012, the Applicants submitted to the CSI an Application. In the Application, the Applicants requested that the Commissioner of Securities and Insurance, Montana State Auditor (Commissioner), approve the Transaction between the Applicants pursuant to the requirements of the Conversion Statute. (App., 31.)

12. The Application identified BCBSMT as the transferor and HCSC as the transferee of the assets in the Transaction. Included in the Application and its exhibits were the following:

- A. A Schedule of Assets and Liabilities to be transferred to HCSC and to be retained by BCBSMT if the Transaction is approved (Application Exhibit 1);
- B. A Consideration of Exchanges for the Transaction, as of June 30, 2012 (Application Exhibit 2);
- C. An Asset Purchase Agreement (Agreement) executed by the Applicants (November 14, 2012) (Application Exhibit 3);
- D. A Financial and Community Impact Report prepared by NERA Economic Consulting (NERA) (November 10, 2012) (Application Exhibit 4);

- E. A Report Prepared By Actuarial Services & Modeling, Inc. as Requested by Blue Cross and Blue Shield of Montana Regarding Actuarial Appraisal of Certain Health Care Contracts With Appraisal Dates of January 1, 2013, and June 30, 2012 (Application Exhibit 5);
- F. An Antitrust Report prepared by NERA (Application Exhibit 6);
- G. A Valuation Analysis prepared by Moss Adams LLP (Moss Adams) providing an independent valuation of the fair market value of BCBSMT as of June 30, 2012 (Application Exhibit 7); and
- H. An internal BCBSMT document entitled Project Sapphire: Transaction Summary and Analysis (Application Exhibit 8);

13. The Applicants have stipulated that the Conversion Statute applies to the Transaction. (App., 3.)

14. The Applicants have stipulated that the Conversion Statute applies as though BCBSMT is a Montana public benefit corporation. (App., 24.)

15. The Applicants have stipulated that certain assets of BCBSMT constitute public assets for purposes of the Transaction. (App., 24-5.)

The Asset Purchase Agreement

16. The Applicants structured the Transaction as an asset purchase through which HCSC would acquire the insurance and Administrative Services Only (ASO) operations and related assets and specified associated liabilities of BCBSMT . (App., 2, 7.)

17. The terms of the Transaction are memorialized in the Agreement. (App. Ex. 3).
The Agreement includes the following terms:

- A. HCSC will acquire from BCBSMT its insurance and ASO contracts; (App.,7)

- B. HCSC will acquire from BCBSMT its provider contracts; (App., 7)
 - C. HCSC will acquire from BCBSMT the license to use the Blue Cross and Blue Shield marks within Montana; (App., 7)
 - D. HCSC will acquire from BCBSMT certain other assets; (App. Ex. 1)
 - E. HCSC will assume specified liabilities, including liabilities associated with the acquired assets and specified pension liabilities; (App., 7-8)
 - F. HCSC will pay to the remaining corporation formerly known as BCBSMT (OldCo) \$17.6 million in consideration; (App., 8)
 - G. OldCo will retain certain assets, including surplus, investments, and BCBSMT plan buildings; (App. Ex. 3.) and
 - H. OldCo will retain certain liabilities, including litigation liabilities. (App., 8)
18. The assets BCBSMT seeks to sell to HCSC represent more than 10 percent in fair market value of BCBSMT's assets. (App. Ex. 2).

BCBSMT EXPERT ASSISTANCE
Mont. Code Ann. § 50-4-717(2)(b)

Graham and Dunn

19. BCBSMT retained the law firm of Graham & Dunn PC (Graham and Dunn) to assist BCBSMT in negotiating the Transaction. Graham and Dunn specializes in corporate transactional law, including mergers and acquisitions. (Dir. Test. Frank 39:9-20.) BCBSMT worked specifically with attorneys Mark Droppert and David Lundsgaard of Graham and Dunn. (Hrg. Tr. 133:25-134:5 (Mar. 12, 2013).) Droppert is experienced in the field of health care. (Hrg. Tr. 134:9-11 (Mar. 12, 2013).)

20. Graham and Dunn represented BCBSMT in negotiating the terms of the Agreement with HCSC. It also advised BCBSMT and senior management on the due diligence

process, antitrust matters, the structure of the Transaction, and other related issues. (Dir. Test. Frank 39:9-20.)

Actuarial Modeling

21. BCBSMT retained Actuarial and Financial Modeling, Inc. (AFM) to independently value BCBSMT's core business. (Dir. Test. Frank 26:6-8; App. Ex. 5.) As President of AFM, James Galasso authored the AFM report and presented expert testimony at the hearing. (App. Ex. 5; Hrg. Tr. 100 (Mar. 13, 2013).)

22. Galasso has performed actuarial consulting for more than ten Blue plans, as well as for the BCBSA. (Hrg. Tr. 104:7-105:16 (Mar. 13, 2013).)

23. Galasso noted that he did not develop his appraisal tailored to or in anticipation of an HCSC acquisition. (App. Ex. 5 at 3.) He was not aware when he drafted the report that HCSC was a potential acquirer. (Hrg. Tr. 106:2-9 (Mar. 13, 2013).)

24. In his report, Galasso noted that it is not customary to prepare an appraisal identifying a single purchase price. However, BCBSMT asked him to do so in this case. (App. Ex. 5 at 3.)

NERA Economic Consulting

25. The Applicants retained NERA to provide expert opinions on various topics, including, but not limited to, the impact of the Transaction upon the community and antitrust implications of the Transaction. As a member of NERA's project team, Dr. Thomas McCarthy co-authored the NERA reports and presented expert testimony at the hearing. (App. Ex. 4; Hrg. Tr. 6:17-22 (March 13, 2013).)

26. McCarthy relied heavily on the representations of the Applicants, and failed to independently verify those representations. For example:

- A. He concluded that HCSC had a strong track record of improvement and maintenance of customer-facing websites, but never accessed any of those websites himself to verify HCSC's representations on this point. (Hrg. Tr. 31:19-32:23 (March 13, 2013).)
- B. He concluded that HCSC had successfully integrated the New Mexico and Oklahoma plans it previously acquired, but talked to no one from the plans of either state about the effects of the integration process there. (*Id.* at 37:11-25.)

27. McCarthy concluded that the Transaction would not raise premiums. However, he did not review the premium rates that BCBSMT or any other insurer charges in Montana. (*Id.* at 18:7-17.) He also did not review the premium rates charged in Oklahoma and New Mexico, either before or after the Blue plans in those states were acquired by HCSC. (*Id.* at 18:18-19:13.)

28. McCarthy has consulted in dozens of mergers, but has never been retained by any governmental entity to analyze a proposed merger. (*Id.* at 41:5-13.)

29. During his testimony, McCarthy discussed several matters involving health insurance companies in which he was retained. Except in divestiture actions, he never concluded that any of these cases would substantially lessen competition in any way. (*Id.* at 39:17-22.)

30. McCarthy has never been retained by any governmental entity to analyze a proposed merger. (*Id.* at 41:5-13.)

Moss Adams

31. BCBSMT retained Moss Adams to provide an expert opinion as to the fair market value of the BCBSMT surplus, certain other BCBSMT assets and liabilities, and its subsidiary, Health-E-Web. (App. Ex. 7 at 1.) As a member of Moss Adams' project team, Calvin Swartley

co-authored the Moss Adams report and presented expert testimony at the hearing. (App. Ex. 7; Hrg. Tr. 468:20-21 (March 14, 2013).)

32. Swartley has valued two large insurance companies besides BCBSMT in the past three years. These insurers offered specialty worker's compensation and automobile-related products. (*Id.* at 494: 10-22.)

33. Swartley had never valued a health insurance company prior to being retained by BCBSMT. (*Id.* at 494:23-25.)

34. In his report, Swartley relied upon financial projections and forecasts provided by BCBSMT rather than generating his own independent projections and forecasts. (*Id.* at 472:12-473:5.)

35. Swartley relied significantly upon Galasso's appraisal calculation in his own determination of BCBSMT's fair market value. (*Id.* at 487:22-25.)

36. Although Swartley stated in his pre-filed testimony that he had reviewed the assumptions and methodology Galasso used to calculate the purchase price, (Direct Testimony of Calvin E. Swartley 7:15 (February 8, 2013)), he admitted at the hearing that he did not verify Galasso's work, and simply relied upon Galasso's calculations for purposes of his analysis. (*Id.* at 489:23-490:5.)

37. Despite Swartley's assertion that he had reviewed the assumptions Galasso used in his report (*Id.* at 7:15), he later conceded that he was unfamiliar with a number of Galasso's assumptions. In fact, he was not even familiar with the following underlying concepts, all of which constituted significant Galasso assumptions:

- A. Risk-based capital (*Id.* at 491:4-17);
- B. Medical trend (*Id.* at 491:18-24);

C. Medical loss ratio (while Swartley stated that he knew what a medical loss ratio was at the hearing, he did not know the definition of the term or understand its underlying concept when he drafted his report) (*Id.* at 492:10-493:4); and

D. Lapse rate (*Id.* at 493:5-7).

38. Swartley did not know what factor had the greatest impact on the figure Galasso generated. (*Id.* at 493:22-494:2.)

39. Swartley did not consider BCBSMT historical underwriting results separately in his fair market valuation analysis. (*Id.* at 495:19-496:1.)

CSI EXPERT ASSISTANCE
Mont. Code Ann. § 50-4-712

Advanced Analytical Consulting Group

40. The CSI retained Advanced Analytical Consulting Group (AACG) to provide expert opinions on various topics, including but not limited to, the impact of the Transaction upon the community and antitrust implications of the Transaction. As a member of AACG's project team, Dr. Timothy Tardiff co-authored the AACG report and presented expert testimony at the hearing. (Direct Testimony of Timothy J. Tardiff, Ph. D. 5:9-10 (February 7, 2013).)

MONTANA ATTORNEY GENERAL EXPERT ASSISTANCE
Mont. Code Ann. § 50-4-712

41. The Montana Attorney General retained MDS Consulting, LLC (MDS) to provide an expert opinion on the fair market value of BCBSMT in conjunction with the Transaction. (Direct Testimony Timothy J. Blackmer 2 (Mar. 5, 2013).) Timothy Blackmer authored the MDS report and presented expert testimony at the hearing. (*Id.*)

BCBSMT DECISION TO ENGAGE IN THE CONVERSION TRANSACTION
Mont. Code Ann. § 50-4-717(2)(a)

Due Diligence Process

42. As early as August of 2010, BCBSMT Chief Executive Officer Michael Frank expressed concerns to the BCBSMT Board regarding BCBSMT's ability to continue functioning as an independent entity. (Dir. Test. Frank 8:9-12.) Frank began discussing this issue further with the Board chairman in early 2012. (*Id.* at 8:12-13.)

43. In March of 2012, following further analysis of BCBSMT's condition and future viability, a team of BCBSMT personnel was tasked with preparing a document identifying possible alternative business arrangements, including partnering with another Blue plan. The document was presented to the Executive Committee of the Board in May of 2012. (*Id.* at 8:13-19.)

44. The Board examined at length various possible business arrangements, including shared services and outsourcing arrangements. (*Id.* at 10:9-15.) In light of BCBSMT's recent financial challenges, the Board seriously considered some form of partnership with another Blue plan. (*Id.* at 8:17-19.)

45. The Board considered the following factors in determining whether to partner with another Blue plan:

A. BCBSMT's recent underwriting losses and declining risk-based capital ratio

(*Id.* at 9:1-4);

B. Increased market competition and shifting membership (*Id.* at 9:11-17);

C. Required technology improvements and associated cost (*Id.* at 9:10-11); and

D. Marketplace challenges associated with implementation of the Patient

Protection and Affordable Care Act (*Id.* at 9:17-20).

Financial Factors Influencing Decision

46. BCBSMT targets an underwriting profit of one-half of one percent of premiums earned, but has not met that target in the last several years. (Hrg. Tr. 203:17-25 (Mar. 12, 2013).)

47. BCBSMT has experienced significant underwriting losses in four of the last five years, including losses of \$5.4 million in 2011 and over \$10 million in 2012. Hearing CSI Exhibit A: 2012 BCBSMT Annual Statement, 28 (December 31, 2012).) BCBSMT has had a combined \$63 million in underwriting losses over the past 15 years. (Direct Testimony of Mark A. Burzynski 10:9-12 (March 5, 2013).)

48. Surplus is the excess of an insurer's assets over its liabilities. (Direct Testimony of Maurice S. Smith 4:9-19 (February 8, 2013).) The NAIC has developed a formula for determining the minimum surplus an insurer must hold to do business. (Hrg. Tr. 258:9-13, 260:8-14 (Mar. 12, 2013).) This formula calculates an entity's risk-based capital (RBC) level. (*Id.* at 259:1-4.) As a practical matter an insurer must hold surplus of at least a 200 percent RBC level, or else face heightened supervision or even receivership. (Hrg. Tr. 567:7-16 (Mar. 14, 2013); Hrg. Tr. 260:20-22 (Mar. 12, 2013).) In addition, the BCBSA enforces a minimum 375 percent RBC standard for BCBSA plans. (Hrg. Tr. 261:2-10 (Mar. 12, 2013).)

49. RBC levels are calculated based on data provided in an insurer's annual statement. An annual RBC rate is determined using the Five-Year Historical Data page by dividing line 14 (Total adjusted capital) by line 15 (Authorized control level risk-based capital). *See generally* (Hrg. Tr. 258:7-259:4 (Mar. 12, 2013); Hrg. CSI Ex. A, 28);

50. BCBSMT has maintained a relatively consistent surplus amount over the past 5 years. As of December 31, 2008, BCBSMT held \$118 million in surplus; at the end of 2012, its surplus was \$127 million. (Hrg. CSI Ex. A, 28)

51. BCBSMT's RBC ratio declined from 645 percent at year-end 2008 to 577 percent at year-end 2011. It dropped further in 2012, to 532 percent. (*Id.*)

52. BCBSMT has had a net profit nearly every year between 2007 and 2011. (App. Ex. 5 at Ex. 1.) However, these gains generally have been realized through non-core assets including subsidiaries and investment income. (*Id.*)

53. From 2007 to 2011, BCBSMT lowered its adjusted administrative expense ratio from 16.3 percent to 12.8 percent. (App. Ex. 8 at 23.) Nevertheless, its adjusted administrative expense ratio has been consistently and significantly higher than that of HCSC. (*Id.*)

54. BCBSMT must invest an estimated \$100 million to satisfy identified capital requirements and incremental operating expenses. For example, BCBSMT must expend \$41 million to implement an ACA-mandated ICD-10 compliant claims system and data warehouse. (App., 7.) These expenditures are necessary to successfully compete in the marketplace, gain efficiencies, and comply with new ACA regulatory mandates. (*Id.* at 6.)

55. Due to its limited size and not-for-profit status, BCBSMT has insufficient access to capital needed to satisfy the expenditure requirements it faces in the next several years while remaining in good financial health. (Dir. Test. Burzynski 15:10-12.)

Other Factors Influencing Decision

56. BCBSMT must implement ACA market reform provisions in the coming years, some of which increase the risks facing small insurers such as BCBSMT. (*Id.* at 12:11-13.) In

its current state, BCBSMT is ill-suited to weather the additional financial uncertainty associated with ACA implementation. (*Id.* at 13:9-12, 15:1-4.)

57. Generally speaking, large insurers are better positioned to succeed in the post-ACA marketplace due to ability to access capital and leverage economies of scale. (Dir. Test. Frank 9:11-20.)

58. The ACA provides for creation of a federal health insurance exchange in Montana (Exchange). The Exchange is an online marketplace through which individuals may purchase health insurance. (Dir. Test. Burzynski 15:10-12.) This Exchange could result in greater competition within Montana, particularly in terms of pricing. This increased competition would further strain BCBSMT resources as it is forced to compete with larger, more efficient for-profit insurers. (*Id.* at 16:9-13.)

59. The new ACA medical loss ratio thresholds potentially limit the aggregate margin an insurer may realize because the insurer must refund premium in years when it fails to meet the thresholds, resulting in a direct decline in margin. (*Id.* at 14:4-13.)

60. The ACA eliminates annual and lifetime policy benefit limits. (*Id.* at 14:21-15:1.) As a result, insurers like BCBSMT will carry greater risk due to required coverage of catastrophic claims. (*Id.* at 14:21-15:4.)

61. BCBSMT assumes proportionally greater risk as a result of eliminating annual and lifetime policy limits compared to larger insurers. This is due to BCBSMT's smaller membership base over which to spread catastrophic claim risks. (*Id.* at 15:1-8.)

62. As a direct result of comparative scale, small Blue plans generally carry significantly higher administrative expense ratios than their larger counterparts. (*Id.* at 19:3-10.)

63. BCBSMT's lack of scale causes it to pay a proportionally greater "per-unit" cost for infrastructure and other items that are required regardless of an insurer's size. Examples of such items include technology upgrades and employment of subject matter experts. (*Id.* at 18:13-19.)

[REDACTED]

[REDACTED]

[REDACTED]

Decision to Enter Into Conversion Transaction

65. The Board determined that associating with another plan would serve the best interest of BCBSMT, its policyholders, providers, and employees. (Dir. Test. Frank 10:5-9.)

BCBSMT SELECTION OF HCSC AS TRANSFEREE
Mont. Code Ann. § 50-4-717(2)(a)

Process of Selecting a Transferee

66. The Board considered a number of factors in selecting a partnering plan. These included, but were not limited to, the following:

- A. The partner must be a non-investor owned entity (Dir. Test. Frank 10:18-19);
- B. The partner must maintain use of the BCBSMT name and marks (*Id.*);
- C. The partner must possess sufficient scale to address the efficiencies, capital access, and expense concerns BCBSMT currently faced (*Id.* at 11:3-8);
- D. The partner must possess information technology competencies (*Id.* at 13:8-10); and
- E. The companies must enjoy organizational and cultural compatibility (*Id.* at 13:16-19).

67. BCBSMT utilized its past experience with and knowledge of other Blue plans to narrow the field of prospective partners. (*Id.* at 15:3-8.) This included the experience of Frank,

who regularly attends high-level BCBSA and BCBSA-related meetings and conferences. (*Id.* at 15:1-3.)

68. The Board first eliminated all for-profit Blue plans from partnership consideration. (*Id.* at 15:9-10.) It then eliminated plans it deemed too small to provide sufficient scale, and any geographically remote plans. (*Id.* at 15:10-12.) This process left two multistate Blue plans: HCSC and another entity. (*Id.* at 15:13.)

69. The Board chair and Frank reached out to both multistate Blue plan presidents in Spring of 2012. Each president expressed interest in aligning with BCBSMT. (*Id.* at 15:13-19.)

70. The Board chair and two BCBSMT officers conducted an informational on-site visit to HCSC in May of 2012. (*Id.* at 15:19-21.)

71. In early June of 2012, BCBSMT Board members and staff met separately with each plan. (*Id.* at 16:7-11.) Each potential partner discussed its past and present operations, as well as future strategic direction. (*Id.* at 16:11-14.) BCBSMT personnel presented similar information. The parties then discussed potential partnership opportunities. (*Id.* at 16:14-16.)

72. After additional conversations with each plan, the Board concluded HCSC best suited BCBSMT as a potential partner. The Board then focused its attentions to the further vetting of HCSC. (*Id.* at 16:22-17:3.)

HCSC Attributes Influencing Selection

73. HCSC has earned underwriting gains in each of the past five years, including over \$1 billion in 2012. (Hearing CSI Exhibit C (Conf.): HCSC Annual Report, 28 (December 31, 2012).)

74. HCSC has consistently maintained a high level of surplus over the same five year period:

12/31/2008: \$6.1 billion

12/31/2009: \$6.7 billion
12/31/2010: \$7.8 billion
12/31/2011: \$8.9 billion
12/31/2012: \$9.6 billion

(Id.)

75. Likewise, HCSC's RBC ratio is significantly higher than that of BCBSMT, and is growing. Its five year RBC history is as follows:

12/31/2008: 1034 percent
12/31/2009: 1004 percent
12/31/2010: 1084 percent
12/31/2011: 1227 percent
12/31/2012: 1241 percent

(Id.)

76. HCSC has consistently maintained a lower adjusted administrative expense ratio than BCBSMT. Additionally, it has lowered this ratio in four of the last five years::

2008: 10.5 percent
2009: 10.0 percent
2010: 10.2 percent
2011: 9.0 percent
2012: 8.6 percent

(App. Ex. 8 at 23.)

77. HCSC currently has over 13 million members, and its membership has increased by 12 percent over the past five years. (Direct Testimony of James L. Kadela 4:7-12 (February 8, 2012).)

78. HCSC processes approximately 749,000 claims daily, with a financial accuracy rate of approximately 99 percent. (*Id.* at 4:15-21.)

79. HCSC employs a single-system technology scheme emphasizing efficiency and cost containment. (*Id.* at 9:1-3.) BCBSMT would benefit from the increased scale and efficiency which results from operating on this common technology platform. (*Id.* at 9:1-3.)

80. HCSC utilizes several proprietary information technology systems. (*Id.* at 5:3-4.) These include Blue Chip, an online, real time claims adjudication system (*Id.* at 5:10-14.); BlueSTAR, an efficiency-oriented online membership system, (*Id.* at 5:21-6:2.); and Blue Gateway, which analyzes various financial data and generates operational reports (*Id.* at 6:4-8.).

81. In addition to these systems, HCSC also offers a variety of other web and mobile based services to its members and providers. (*Id.* at 6:11-12.) HCSC also possesses state-of-the-art data centers that securely store insured-related data and ensure uninterrupted service to policyholders. (*Id.* at 7:13-15, 7:22-8:3.)

82. HCSC spends over \$200 million annually on information technology-related expenses. (*Id.* at 9:4-7.)

BCBSMT Due Diligence Review of HCSC

83. BCBSMT assembled two teams to conduct further due diligence: a transactional due diligence team, and an operational due diligence team. (Dir. Test. Frank 17:16-19.) The teams conducted their respective duties over several months, concluding in October 2012. (*Id.* at 17:20-22.) As part of their research, the teams conducted multiple in-person visits with HCSC and spoke frequently via teleconference. (*Id.* at 18:1-2.)

84. The transactional due diligence team reviewed HCSC's financial state, size and scale, and technology. Additionally, it assessed HCSC's non-investor owned focus and corporate culture. (*Id.* at 18:12-17.)

85. The transactional due diligence team concluded that HCSC satisfied BCBSMT's desired attributes with respect to the items it reviewed. (*Id.* at 18:18-19:16.)

86. The operational due diligence team reviewed HCSC's operational and service areas. (*Id.* at 19:19-21.) It examined, among other things, HCSC's customer-focused programs

and technology. (*Id.* at 20:7-21:18.) These include HCSC's proprietary Blue Chip claims processing system, its Concierge Service Analytics customer service initiative, its enterprise data warehouse, and its Seasons of Life bereavement assistance program. (*Id.* at 20:7-21:7.) Additionally, BCBSMT considered HCSC's legal, financial, and internal audit resources. (*Id.* at 21:21-22:3.)

87. The operational due diligence team concluded that partnering with HCSC would greatly benefit BCBSMT policyholders, providers, and others, (*Id.* at 21:16-18) and would free up resources to focus on Montana-specific issues (*Id.* at 22:3-6).

88. BCBSMT officers also visited HCSC's Oklahoma plan site as part of the due diligence process. (*Id.* at 18:5-9.) They observed that the plan seemed to maintain a local focus while experiencing the benefits of the scale HCSC enjoys. (*Id.* at 22:11-19.)

89. The findings of the due diligence teams were presented to the Board in written form in October of 2012. (*Id.* at 23:21-24:1.)

Decision to Select HCSC and Enter Into Transaction

90. On November 7, 2012, the BCBSMT Board approved the Transaction with HCSC and directed BCBSMT officers to take steps for its execution. (*Id.* at 24:4-8.)

BCBSMT NEGOTIATION OF CONVERSION TRANSACTION TERMS AND CONDITIONS

Mont. Code Ann. § 50-4-717(2)(a)

91. The Applicants began negotiating the terms of the Agreement on or around August of 2012. (*Id.* at 25:12-16.)

92. Although BCBSMT negotiated most of the Agreement terms, BCBSMT did not negotiate the purchase price of its core insurance business. (*Id.* at 26:1-4.) Instead, BCBSMT retained AFM to independently value that business. (*Id.* at 26:4-8.)

93. Galasso appraised BCBSMT's core business at \$17.6 million with a valuation date of June 30, 2012. (App. Ex.5 at 3.) The Applicants then agreed that amount would represent the purchase price of BCBSMT's core business under the Transaction. (Dir. Test. Frank, 26:4-8.) Moss Adams also incorporated that figure into its fair market valuation. (*Id.* at 26:8-10.)

94. Blackmer testified at hearing that \$40.2 million is a reasonable fair market value of the assets that HCSC proposes to purchase from BCBSMT in the Transaction. (Hrg. Tr. 509:14-16 (Mar. 14, 2013).)

95. HCSC employee Maurice Smith testified that a core business purchase price of \$40.2 million was consistent with the aggregate fair market value of BCBSMT generated by MDS. (Hrg. Tr. 275:4-8 (Mar. 12, 2013).)

96. HCSC Chief Operating Officer Colleen Reitan testified that HCSC believes \$40.2 million is a fair market valuation of BCBSMT's core business. (Hr.g Tr. 83:13-14 (Mar. 13, 2013).)

97. BCBSMT did not retain an investment banker to perform a valuation of BCBSMT or provide a fairness opinion of BCBSMT. (*Id.* at 171:21-172:14.)

98. BCBSMT did not review the purchase prices involved in HCSC's prior plan acquisitions. (*Id.* at 172:9-11.)

99. BCBSMT did not consider factors that would lead HCSC to pay a higher purchase price due to the synergies resulting from the Transaction. (*Id.* at 172:5-8.)

100. BCBSMT entertained no bids from other prospective purchasers. (*Id.* at 173:3-11.)

Investment Value of BCBSMT to HCSC

101. “Investment value” is the value an acquisition represents to a strategic buyer. Investment value considers factors such as synergies, economies of scale, and other benefits unique to the buyer. In light of such factors, strategic buyers tend to pay a purchase price exceeding the fair market value of an entity. (App. Ex. 7 at 30.)

102. One factor relevant to investment value is the opportunity of a strategic buyer to enter a marketplace in which they are not currently operating. (Hrg. Tr. 484:8-11 (Mar. 14, 2013).)

103. HCSC cannot currently do business in Montana using the Blue Cross and Blue Shield marks, but would obtain the right to do so through acquiring BCBSMT. (Dir. Test. Frank 7:2-5; App., 7.)

104. In acquiring BCBSMT, HCSC would benefit from administrative synergies by gaining experienced BCBSMT employees and increasing membership. These synergies would increase HCSC’s scalability and enterprise efficiency. (Hrg. Tr. at 270:22-271:16 (Mar. 12, 2013).) HCSC would additionally benefit from assuming the existing BCBSMT provider relationships. (*Id.* at 271:17-23.)

105. Acquisition of BCBSMT would also allow HCSC to expand into a new geographic market. Geographic expansion could lead to a higher HCSC credit rating and lower borrowing costs. (Dir. Test. Smith 10:16-19.)

106. Acquiring BCBSMT would provide HCSC an immediate 66 percent share of the Montana group market and 90 percent share of the individual market. (App. Ex. 6 at 7.)

107. Moss Adams did not consider BCBSMT’s investment value to HCSC as a strategic buyer. (Hrg. Tr. 483:8-12 (Mar. 14, 2013).)

108. Galasso did not consider BCBSMT's investment value to HCSC as a strategic buyer. He acknowledged that he was not in a position to judge the synergies that could result from the Transaction. (Hrg. Tr. 170:16-171:2 (Mar. 13, 2013).)

[REDACTED]

The Galasso Report

119. Galasso valued the company at \$17.6 million as of June 30, 2012, but acknowledged that that value could change substantially if his modeling assumptions changed (App. Ex. 5 at 3; *See e.g.* Hrg. Tr. 151:20-152:2, 155:11-25, 157:1-6, 159:19-160:3, 164:9-13, 166:14-167:5, 168:8-10 (Mar. 13, 2013).)

120. Galasso acknowledged that increasing the lapse replacement ratio from the seventy-five percent assumed in his model would increase the value of BCBSMT's core business. (Hrg. Tr. 151:20-152:2 (Mar. 13, 2013).)

121. Galasso assumed in his model that the acquirer would pay 2.75 percent annually in premium taxes. Galasso acknowledged that if the acquirer were not required to pay premium taxes, the value of the core business would increase. (*Id.* at 155:11-25.)

122. Galasso estimated that a one percent decrease in the annual premium tax requirement would increase the value of BCBSMT's core business by \$24 million. (*Id.* at 157:1-6.)

123. Galasso acknowledged that an increase in the medical trend assumption would increase the value of the core business. (*Id.* at 168:8-10.)

124. During the first five years of the appraisal period, Galasso assumed largely static administrative expense ratios for individual and small group business segments and an increased administrative expense ratio for large groups. (App. Ex. 5 at Ex. 9(a).) Included in his calculation is a two percent annual administrative expense inflation factor. (App. Ex. 5 at 34.)

125. Assuming an annual administrative expense factor increase of one percent rather than two percent would increase the appraisal value by \$24 million. (Hrg. Tr. 166:14-167:5 (Mar. 13, 2013).) Such an assumption is reasonable because:

- A. Galasso does not account for technological advances that directly decrease administrative expenses; (*See generally* App. Ex. 5.)
- B. Selling insurance through the Exchange will reduce insurer administrative expenses by changing methods of distribution, including increasing direct sales; (Hrg. Tr. 652:12-15, 20-23 (Mar. 14, 2013).) and
- C. BCBSMT successfully lowered its administrative expense ratio by 3.5 percent from 2007 to 2011. (App. Ex. 8 at 23)

126. Galasso acknowledged that a change of one percent in his assumed medical loss ratio would change the value of the company by \$24 million. (Hrg. Tr. 164:9-13 (March 13, 2013).)

127. Galasso acknowledged that a decrease of one percent in his assumed discount rates of eight percent for old business and 13 percent for new business would increase the value of the company by over \$17 million. (*Id.* at 159:19-160:3.)

128. Assuming a one percent discount rate downward adjustment for both old and new business is reasonable because Galasso himself uses these lower discount rates in one of his modeling scenarios. (App. Ex. 5 at Ex. 3(b).)

CONFLICT OF INTEREST DISCLOSURE
Mont. Code Ann. § 50-4-717(2)(c)

129. BCBSMT represents that it has disclosed all conflicts of interest relating to the Transaction, including conflicts of the Board, BCBSMT executives, and experts retained by the Applicants. (App., 27.)

130. Frank testified that he was not aware of any conflicts of interest that any Board member, BCBSMT executive, or expert may have in relation to the Transaction. (Dir. Test. Frank 41:17-42.)

[REDACTED]

139. Galasso was compensated according to hourly rates; his total compensation amount was independent of his final findings and opinions. (Direct Testimony of James P. Galasso 9:1-2 (February 8, 2013).)

140. Swartley was compensated according to hourly rates; his total compensation amount was independent of his final findings and opinions. (Dir. Test. Swartley 11:14-15.)

COMMUNITY IMPACT: AVAILABILITY AND ACCESSIBILITY OF HEALTH CARE SERVICES AND HEALTH INSURANCE COVERAGE
Mont. Code Ann. § 50-4-717(2)(d)

141. McCarthy analyzed the Transaction to determine its impact upon the availability and accessibility of health care services and health insurance coverage in Montana. (Direct Testimony of Thomas R. McCarthy 4:1-4 (February 8, 2013).) He concluded that the Transaction would not adversely impact Montanans' ability to obtain or access either health care services or health insurance coverage. (*Id.* at 4:3-4.)

142. HCSC's higher RBC ratio would reduce an HCSC-owned Montana Blue plan's risk exposure and increase its financial stability. (*Id.* at 8:24-5.) This greater stability translates to greater protection and security for members of the Montana plan. (*Id.* at 8:25.)

143. The Transaction would permit an HCSC-owned Montana Blue plan to spread its administrative expenses among HCSC's larger membership base, and the plan could access HCSC's technology. (*Id.* at 9:13-15.) These factors would result in a lower administrative expense ratio which could, in turn, lead to more reasonable premiums. (*Id.* at 9:13-17.)

144. By accessing the technology available to HCSC, a Montana-owned Blue plan would improve member services generally. (*Id.* at 10:10-12.)

145. Tardiff also analyzed the impact of the Transaction upon the availability and accessibility of health services and insurance coverage. He concluded that the Transaction would not adversely affect either of these factors. (Dir. Test. Tardiff 19:18-20:2.)

146. In his analysis, Tardiff considered: (1) the continued presence of care providers, insurance brokers, and enrollees; (2) marketplace competition; and (3) the presence and financial stability of BCBSMT. (*Id.* at 17:15-18:2.)

147. A reduction in the number of Montana providers would result in more limited health care services for Montanans. Factors potentially limiting provider presence include reductions in provider contracts or reimbursement rates. Because the Transaction is unlikely to restrict either of these factors, a reduction in provider presence is unlikely. (*Id.* at 18:5-10.)

148. Providers would benefit from the Transaction through faster claim processing and improved provider reimbursement methodologies. (Dir. Test. Reitan 17:20-21.)

149. If the Transaction is approved, HCSC will assume all current BCBSMT broker agreements. (Dir. Test. Tardiff 18:13-16.)

150. If the Transaction is approved, HCSC will assume all current enrollee contracts. Additionally, enrollment levels have not dropped following HCSC acquisitions of Blue plans in its other states, suggesting that Montana would not experience decreased enrollment. (*Id.* at 19:1-5.)

151. Because HCSC performs better than BCBSMT in terms of efficiency, financial stability, and risk, the Transaction would likely ensure the continued presence of a strong Blue plan in Montana. (*Id.* at 19:12-17.)

152. The Exchange will increase insurer competition by enabling individuals to easily access alternative insurance products. (Hrg. Tr. 29:1-6 (Mar. 13, 2013).)

153. Testimony from the public also showed that availability and accessibility of health care services and health care coverage would continue or, alternatively, improve. (*See generally* Hrg. Tr, 61:16-85:4 (Mar. 12, 2013).) For example, the Great Falls Development Authority testified that BCBSMT as a division of HCSC would be able to handle the costs associated with technological advances due to the size of HCSC. (Hrg. Tr. 67:11-13 (Mar. 12, 2013).)

**COMMUNITY IMPACT: SAFEGUARDS ENSURING ACCESS TO AFFORDABLE
HEALTH CARE
Mont. Code Ann. § 50-4-717(2)(e)**

154. McCarthy analyzed the Transaction to determine whether it included sufficient safeguards to ensure that Montanans will have continued access to affordable health care. He concluded that sufficient competitive safeguards would exist to ensure continued access to affordable health care. (Dir. Test. McCarthy 10:14-24.)

155. BCBSMT currently faces several significant competitors in the health insurance market, including Cigna, UnitedHealth, and PacificSource, all of which have a growing Montana presence. (*Id.* at 11:6-10.)

156. If the Transaction were approved, a Montana-owned Blue plan could lose significant membership to its competitors if it raised its premiums. (*Id.* at 11:20-23.)

157. Tardiff also analyzed whether the Transaction included sufficient safeguards to ensure continued access to affordable health care. He concluded that the Transaction would not adversely impact health care affordability. (Dir. Test. Tardiff 24:10-13.)

158. Tardiff examined three factors in relation to affordable health care access. These included (1) the potential for increased premium rates, (2) the potential for modified benefit plans, and (3) the presence of regulatory safeguards. (*Id.* at 20:6-8.)

159. Analysis of pre- and post-acquisition rating trends in those states where HCSC has acquired Blue plans indicates that such HCSC acquisitions traditionally do not result in significant rate increases. (*Id.* at 20:18-21:2.)

160. HCSC has represented that it has no current plans to modify or terminate existing BCBSMT benefit plans. (*Id.* at 22:5-7.)

161. The ACA provides for governmental review of certain premium rate increases that exceed 10 percent. The rating insurer must publicly disclose such rate increases and provide justification. This review procedure does not prevent insurers from using those rates, even if the rates are deemed unreasonable. (*Id.* at 23:6-10.)

162. Health insurers are not currently required to file rating plans with the CSI or any other Montana state agency. (*Id.* at 23:13-14; Hrg. Tr. 543:12-16 (Mar. 14, 2013); *see generally* Mont. Code Ann. Title 33.)

163. If the Transaction is approved, the BCBSMT division of HCSC will continue its current process for handling escalated CSI consumer inquiries and complaints. This process will continue to be handled at the BCBSMT division in Montana with direct access to the BCBSMT Plan President. There is no expiration date on this commitment. (CSI Stipulation with Applicants (April 19, 2013).)

164. Testimony from the public also showed that aspects of the Transaction would include safeguards to ensure access to affordable health care. (*See generally* Hrg. Tr. 61:16-85:4 (Mar. 12, 2013).) For example, Richard Miltenberger, a partner with Mountain West Benefits, which primarily advises associations and aggregations of smaller employers, testified that the financial strength of HCSC would protect Montana consumers. (*Id.* at 79:11-80:9, 81:20-21.)

CONVERSION TRANSACTION MANAGEMENT CONTRACTS
Mont. Code Ann. § 50-4-717(2)(f)

165. Frank testified that no management contracts will be transferred to HCSC by BCBSMT if the Transaction is approved. (Dir. Test. Frank 42:12-14.)

166. BCBSMT Chief Financial Officer Mark Burzynski testified that no management contracts were entered into in relation to the Transaction. (Dir. Test. Burzynski 31:5-7.)

167. HCSC represents that any management contract under the Transaction is for reasonable value. (App., 25.)

168. No evidence was introduced that any management contracts have been entered into in relation to the Transaction.

EQUITIES OF THE CONVERSION TRANSACTION
Mont. Code Ann. § 50-4-717(2)(g)(i)

169. McCarthy analyzed whether the Transaction was equitable to the public interest, and to BCBSMT's enrollees, insureds, shareholders, and certificate holders. He concluded that the Transaction was equitable to all of these parties. (Dir. Test. McCarthy 12:3-11.)

170. Tardiff also analyzed whether the Transaction was equitable to the public interest, and to BCBSMT's enrollees, insureds, shareholders, and certificate holders. He concluded that the Transaction was equitable to all of these parties. (Dir. Test. Tardiff 26:14-18.)

171. BCBSMT has no shareholders due to its not-for-profit status. (*Id.* at 25:1-2.)

172. Available data suggests that if the Transaction is approved, HCSC will charge reasonable premiums while not significantly modifying benefit plans. (*Id.* at 25:4-6.) The Transaction would result in a more efficient Montana Blue plan able to price its products more aggressively. (Dir. Test. Frank, 34:10-13.)

173. Testimony elicited at the public hearing urged support for the Transaction, particularly regarding the equitability to the public interest. (*See generally* Hrg. Tr. 61:16-85:4 (Mar. 12, 2013).) For example, the president of the Kalispell Chamber of Commerce testified that HCSC's scale would be beneficial to reducing administrative costs. (*Id.* at 65:2-13.)

174. Similarly, the Great Falls Development Authority testified that BCBSMT could not be cost effective due to its small size and the necessity and increasing technological demands. (*Id.* at 67:11.)

175. Additionally, if the Transaction is approved, HCSC will charge insured Montana commercial market business for individuals and employers who enroll on average 500 members or less, administrative fees including margin, that are a lower percentage of their total premium basis than those charged by BCBSMT at the close of the Transaction. Certain items would be excluded from the calculation of administrative fees. This commitment would be effective for the three calendar years following the Transaction. (CSI Stip.)

176. Under the terms of the Agreement, HCSC will hire all BCBSMT employees at least at current compensation levels. (Dir. Test. Tardiff 25:9-12.)

[REDACTED]

[REDACTED]

[REDACTED]

178. If the Transaction is approved, HCSC will employ at least 100 individuals at a Montana-based HCSC facility. This shall occur no later than December 31, 2016. (CSI Stip.)

179. If the Transaction is approved, it will result in the creation of a foundation funded by the assets remaining in OldCo following its wind-down. These assets are estimated to exceed

\$120 million. The foundation will be governed by a board of independent and disinterested members. (App., 2-3.)

180. HCSC has demonstrated that it is committed to charitable giving and community participation in the states in which it operates. (Dir. Test. Frank, 32:15-33:3.)

181. If the Transaction is approved, HCSC shall continue at its expense BCBSMT's past charitable and community contributions in the amount of at least \$200,000 per year. This commitment would be effective for the calendar years 2014 through 2016. (CSI Stip.)

182. If the Transaction is approved, HCSC will operate a mobile immunization van in Montana to provide immunizations to Montanans at no expense. All Montanans would be eligible for this service, and HCSC would focus its immunization services on underserved areas. At least 2,000 immunizations will be made available to Montanans during the commitment period. The commitment would be effective on an ongoing basis until December 31, 2016. (*Id.*)

183. If the Transaction is approved, HCSC will donate an aggregate of \$3 million to the Foundation for Healthy Montanans, or to the Caring Foundation, or both. (*Id.*)

184. BCBSMT has benefited from an estimated \$87,125,733 in premium tax exemption during the last 10 years. (Hrg. Tr. 519:14-19 (Mar. 14, 2013).) BCBSMT has been exempted from paying premium tax in Montana for at least the past 27 years. (*Id.* at 542:10-22.)

185. If the Transaction is approved, the BCBSMT division of HCSC will pay the insurer premium tax as set forth in Mont. Code Ann. § 33-2-705 so long as, as determined by the CSI, such tax remains applicable to health insurers in Montana not otherwise exempt from the payment of such tax under current Montana law, or unless Mont. Code Ann. § 33-2-705 is preempted by federal law expressly by Congress or as determined by a court of competent jurisdiction, or unless, as determined by the CSI, there is a substantial change in either applicable

facts or law which result in the inapplicability of the premium tax to the BCBSMT division of HCSC. This commitment would be effective indefinitely. (CSI Stip.)

186. If the Transaction is approved, on or before March 31 of each year thereafter, the BCBSMT division of HCSC shall submit to the CSI a letter containing the same information as specified in the Supplemental Compensation Exhibit currently filed by BCBSMT with the CSI, regarding the annual compensation for the president of the BCBSMT division of HCSC and the four most highly paid other executive officers of such division for the previous calendar year. This information is considered a public record, pursuant only to Montana law, that is accessible by the public. (*Id.*)

COMPLIANCE WITH TITLE 33, CHAPTERS 30-31
Mont. Code Ann. § 50-4-717(2)(g)(ii)

187. BCBSMT represents that the Transaction complies with Mont. Code Ann. Title 33 chapters 30 and 31. (App., 27.)

188. No evidence was introduced that the Transaction violates Mont. Code Ann. Title 33 chapters 30 or 31.

SUFFICIENCY OF HCSC SURPLUS
Mont. Code Ann. § 50-4-717(2)(g)(iii)

[REDACTED]

[REDACTED]

IMPACT UPON ECONOMIES OF SCALE
Mont. Code Ann. § 50-4-717(3)

190. Economies of scale consist of the relationship between cost and an entity's size and output. Specifically, a stronger economy of scale exists when cost falls as an organization grows and increases its production. (Dir. Test. McCarthy 13:14-15.)

191. McCarthy analyzed the effects of the Transaction upon scale. He concluded that the Transaction would result in greater economies of scale. (*Id.* at 13:21-22.)

192. BCBSMT will realize stronger scale economies by joining administrative processes with HCSC, allowing the two entities to spread administrative costs over a larger membership base. (*Id.* at 13:21-25.) Many administrative costs, such as technology costs, are fixed regardless of entity size; therefore, HCSC's technology expenses would not vary significantly due to the Transaction. (*Id.* at 14:11-12.)

193. HCSC has previously reduced the administrative expense ratios of the Texas, New Mexico, and Oklahoma Blue plans. (*Id.* at 14:21-24.)

194. Tardiff also evaluated the Transaction's impact on economies of scale. He concluded that the Transaction would result in increased economies of scale. (Dir. Test. Tardiff 17:3-6.)

195. In reaching his conclusion, Tardiff evaluated the Applicants' respective sizes, cost structures, and natures of business. (*Id.* at 16:1-2.) His assessment of these factors supported the conclusion that the Transaction would result in increased economies of scale. (*Id.* at 17:5-6).

COMPLIANCE WITH ANTITRUST LAWS
Mont. Code Ann. § 50-4-717(3)(b)

196. McCarthy analyzed the Transaction to determine whether it implicated antitrust issues, i.e., whether it would lead to a lessening of competition in Montana. Dir. Test. McCarthy 15:2-7. His analysis included competitive effects on various lines of health insurance, dental insurance, and provider services. He concluded that the Transaction would not lessen competition in any of these areas. (*Id.* at 15:5-10.)

197. HCSC does not actively compete for members within Montana, and currently has very few insureds within the state. (*Id.* at 15:12-14.)

198. Those HCSC insureds in Montana are national account members tied to out-of-state employers. Because those employers are located outside of Montana, BCBSMT does not compete with HCSC for their business. (*Id.* at 15:14-19.)

199. Since HCSC and BCBSMT do not directly compete, no competition is lost if the two entities combine. (*Id.* at 15:19-21.)

200. McCarthy performed a NAIC Form E analysis in relation to the Transaction. (*Id.* at 16:2-3.) Many state departments of insurance use a Form E analysis to evaluate potential antitrust issues. (*Id.* at 16:8-10.) This Form E analysis identified no anticompetitive concerns. (*Id.* at 16:21-22.)

201. Tardiff also analyzed the Transaction from an antitrust perspective. Like McCarthy, he concluded that the Transaction would have no significant anticompetitive effects. (Dir. Test. Tardiff 15:7-9.)

202. Tardiff adopted the Horizontal Merger Guidelines (Guidelines) approach to evaluate the Transaction's effects upon competition. This approach has been set forth by the

United States Department of Justice (DOJ) and the Federal Trade Commission (FTC). (*Id.* at 9:4-6.)

203. The Guidelines identify several factors significant in a competitive analysis. Among these are: the product and geographic area that are the subject of competition, the competitors that are present in the market, and market concentration. (*Id.* at 10:13-16.)

204. A Guidelines analysis demonstrated that the Transaction implicates no antitrust concerns. (*Id.* at 15:9-12.)

205. The Applicants filed a Hart-Scott-Rodino filing with the DOJ and FTC. These agencies issued a letter to BCBSMT on February 5, 2013, indicating neither entity had identified antitrust concerns associated with the Transaction. (Dir. Test. Frank 40:1-7.)

LIQUIDATED DAMAGES PROVISION
Mont. Code Ann. § 50-4-717(4)

206. Section 10.01 of the Agreement identifies permissible reasons for each party to terminate the Agreement prior to closing of the Transaction. (App. Ex. 3.)

207. Section 5.08 of the Agreement requires that BCBSMT pay HCSC a Termination Fee equal to 3 percent of the Agreement purchase price (i.e. \$528,330.00) if the Agreement is terminated for certain specified reasons relating to BCBSMT entering into a business agreement similar to the Transaction with another entity. (App. Ex. 3, Sec. 5.08, 10.01(a), (c).)

208. The Agreement does not require HCSC to pay a Termination Fee under any circumstances.

Based on the foregoing, the undersigned propose the following:

CONCLUSIONS OF LAW

INTRODUCTION

1. The Commissioner of Securities and Insurance, Montana State Auditor (Commissioner), has jurisdiction over this matter pursuant to Mont. Code Ann. §§ 2-15-1903, 3-1-311, and 50-4-702.

2. The CSI is under the control and supervision of the Commissioner pursuant to Mont. Code Ann. §§ 2-15-1902 and 33-1-301.

3. The Commissioner shall enforce the applicable provisions of the laws of the state of Montana. Mont. Code Ann. § 33-1-311(1).

4. The Commissioner has a duty to ensure that the interests of consumers are protected. Mont. Code Ann. § 33-1-311(3).

5. The Commissioner has the powers and authority expressly conferred upon the Commissioner or reasonably implied from the laws of the state of Montana. Mont. Code Ann. § 33-1-311(2).

6. A person may not engage in a conversion transaction involving a nonprofit health entity unless the Commissioner and Montana Attorney General issue separate orders approving the transaction under the Conversion Statute. Mont. Code Ann. §§ 50-4-702, -713(2).

7. The Commissioner may not approve a conversion transaction absent an affirmative finding that the transaction is in the public interest. Mont. Code Ann. § 50-4-717.

8. Mont. Code Ann. § 50-4-717(2) sets forth the criteria the Commissioner must consider in determining whether a conversion transaction is in the public interest. The subsection sets forth a factor-based test. The Commissioner need not conclude that all factors are satisfied to determine a transaction is in the public interest.

9. The Applicants carry the burden of demonstrating that the Transaction is in the public interest. Mont. Code Ann. § 50-4-717.

10. In reviewing a conversion transaction, the Commissioner may contract with experts to provide assistance in reviewing the transaction, including but not limited to, determining whether to approve the transaction generally. Mont. Code Ann. § 50-4-712(1).

DEFINITIONS

11. “Nonprofit health entity” includes a nonprofit health service corporation. Mont. Code Ann. § 50-4-701(7)(a)(ii).

12. BCBSMT is a nonprofit health entity for purposes of the Conversion Statute. (Hrg. Tr. 514:21-24 (Mar. 14, 2013).) Mont. Code Ann. § 50-4-701(7)(a)(ii).

13. “Conversion transaction” includes a sale by a nonprofit health entity resulting in the transfer of control or governance to another entity of more than 10 percent in fair market value of the assets or operations of a nonprofit health entity. Mont. Code Ann. § 50-4-701(3)(a).

14. The Transaction constitutes a conversion transaction because it contemplates the sale to HCSC of more than 10 percent of BCBSMT’s assets. (App. Ex. 2.) Mont. Code Ann. § 50-4-701(3)(a).

15. “Public assets” include assets held for the benefit of the public or the community. Mont. Code Ann. § 50-4-701(9)(a).

16. The assets of BCBSMT are public assets for purposes of the Transaction. (App., 24-5).

THE APPLICATION **Mont. Code Ann. § 50-4-707**

17. Persons seeking to engage in a conversion transaction must submit an application to the Commissioner in the form prescribed under Mont. Code Ann. § 50-4-707.

18. The Application submitted on November 15, 2013, contains all the elements required under Mont. Code Ann. § 50-4-707. (App.)

DUE DILIGENCE ANALYTICAL FRAMEWORK

19. “The business judgment rule immunizes management from liability in a corporate transaction undertaken within both [1] the power of the corporation and [2] the authority of management where [3] there is a reasonable basis to indicate that the transaction was made in good faith.” *Warren v. Campbell Farming Corp.*, 2011 MT 324, ¶ 22, 363 Mont. 190, 271 P.3d 36 (internal quotation marks omitted) (quoting *Ski Roundtop, Inc. v. Hall* (1983), 202 Mont. 260, 273, 658 P.2d 1071, 1078.

20. The business judgment rule addresses director liability in civil litigation. *Warren*, ¶ 22. Because the instant matter does not involve a determination of civil liability, the business judgment rule is not binding upon the Commissioner as to whether BCBSMT has satisfied the factors under the Conversion Statute.

21. Nevertheless, the business judgment rule provides a reasonable analytical methodology for assessing BCBSMT’s conduct in relation to the Transaction, and shall be used in evaluating whether BCBSMT exercised due diligence in deciding to engage in the Transaction and selecting HCSC as the transferee. Mont. Code Ann. § 50-4-717(2)(a).

22. A public benefit corporation that is a nonprofit health entity may enter into a merger with another entity through compliance with Mont. Code Ann. § 35-2-617 and the Conversion Statute. Mont. Code Ann. § 35-2-609.

23. Unless its articles of incorporation provide otherwise, a corporation has the same powers as an individual to do all things necessary or convenient to carry out its affairs. Mont. Code Ann. § 35-2-118.

24. It is within the power of BCBSMT as a corporation to engage in the Transaction subject to the terms of Mont. Code Ann. § 35-2-617 and the Conversion Statute because BCBSMT is a public benefit corporation for purposes of the Conversion Statute. (App., at 24.) *Warren*, ¶ 22.

25. It is within the power of BCBSMT as a corporation to take or approve the taking of those actions necessary to carry out the Transaction. (Hrg. Ex. L.) Mont. Code Ann. § 35-2-118.

BCBSMT DECISION TO ENGAGE IN THE CONVERSION TRANSACTION
Mont. Code Ann. § 50-4-717(2)(a)

26. The Commissioner must consider whether the transferor exercised due diligence in deciding to engage in a conversion transaction. Mont. Code Ann. § 50-4-717(2)(a).

27. The decision to engage in the Transaction is within the authority granted to the Board in the BCBSMT Bylaws. (Hrg. CSI Ex. M, Art. III, Sec. 3.1.) *Warren*, ¶ 22.

28. In light of BCBSMT's recent financial performance, marketplace pressures, and looming capital expenditures, the Board members acted in good faith when they decided that BCBSMT should engage in the Transaction. (Dir. Test Frank 9:1-7.) *Warren*, ¶ 22.

29. BCBSMT exercised due diligence in deciding to engage in the Transaction. (Dir. Test. Frank 10:5-9.) Mont. Code Ann. § 50-4-717(2)(a).

BCBSMT SELECTION OF HCSC AS TRANSFEREE
Mont. Code Ann. § 50-4-717(2)(a)

30. The Commissioner must consider whether the transferor exercised due diligence in selecting the transferee in a conversion transaction. Mont. Code Ann. § 50-4-717(2)(a).

31. The selection of HCSC as transferee in the Transaction is within the authority granted to the Board in the BCBSMT Bylaws. (Bylaws Art. III, Sec. 3.1. Ex. M.); *Warren*, ¶ 22.

32. The Board members acted in good faith when they selected HCSC as transferee after determining that it satisfied their detailed criteria for a prospective acquirer. (Dir. Test. Frank 23:21-24:1, 24:4-8.) *Warren*, ¶ 22.

33. BCBSMT exercised due diligence in selecting HCSC as the entity with which to enter into the Transaction. (Dir. Test. Frank 23:21-24:1, 24:4-8.) Mont. Code Ann. § 50-4-717(2)(a).

**BCBSMT NEGOTIATION OF CONVERSION TRANSACTION TERMS AND
CONDITIONS**

Mont. Code Ann. § 50-4-717(2)(a)

34. The Commissioner must consider whether the transferor exercised due diligence in negotiating the terms and conditions of a conversion transaction. Mont. Code Ann. § 50-4-717(2)(a).

35. Nowhere in Title 50, Chapter 4, Part 7 does it state that the purchase price for a transaction involving a nonprofit health entity must be a price determined by an independent fair market valuation analysis. Rather, fair market value means the fair market value as of the date of the transaction or proposed transaction as determined by an independent appraisal of the assets or operations performed and communicated by a qualified appraiser according to applicable professional appraisal standards. Mont. Code Ann. § 50-4-701(4).

36. The purchase price of BCBSMT's core business constitutes a term of the Transaction under Mont. Code Ann. § 50-4-717(2)(a). (Dir. Test. Frank 26:3-4.)

37. Because the purchase price of the core business constitutes a term of the Agreement, BCBSMT must exercise due diligence in negotiating the purchase price. (Dir. Test. Frank 26:3-4.) Mont. Code Ann. § 50-4-717(2)(a).

38. It is undisputed that, for purposes of the Conversion Statute, BCBSMT is a public benefit corporation. (App., 24.) *See* Mont. Code Ann. § 35-2-114(28). As a public benefit corporation, BCBSMT has a fiduciary duty to the Montana public. (Hrg. Tr. 234:1-3 (Mar. 12, 2013).)

39. Under the *Revlon* doctrine, once the board of directors of a public company decides to sell the company, it has a fiduciary duty to its shareholders to obtain the highest possible value for the company. *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

40. The *Revlon* doctrine should apply equally to directors of a not-for-profit corporation, as they too have a fiduciary duty in relation to the corporation. *See* Mont. Code Ann. § 35-2-416. Such a standard is especially appropriate in the case of a self-perpetuating not-for-profit board of directors not subject to shareholder oversight.

41. The *Revlon* doctrine provides a reasonable analytical methodology for purposes of the Transaction, and shall be used in evaluating whether BCBSMT exercised due diligence in negotiating the purchase price of BCBSMT's core business. (Dir. Test. Frank 26:4-8.) Mont. Code Ann. § 50-4-717(2)(a).

42. The *Revlon* doctrine applies to the Transaction because BCBSMT is a public benefit corporation with a self-perpetuating board of directors. (App., 24; Hrg. Tr. 117:24-118:2 (Mar. 12, 2013).)

43. BCBSMT did not exercise due diligence in negotiating the terms of the Transaction because, by relying upon the Galasso appraisal instead of negotiating the core business purchase price, the Board failed its fiduciary duty to the public to obtain the highest possible value for BCBSMT's core business. (Dir. Test. Frank 26:4-8.) *Revlon*, 506 A.2d 173.

44. Even if the *Revlon* doctrine does not apply to the Transaction, BCBSMT nonetheless failed to exercise due diligence in its negotiations when it did not negotiate a key term of the Transaction, namely, the purchase price of BCBSMT's core business. (Dir. Test. Frank 26:4-8.) Mont. Code Ann. § 50-4-717(2)(a).

**BCBSMT DECISIONMAKING PROCEDURE
AND EXPERT ASSISTANCE
Mont. Code Ann. § 50-4-717(2)(b)**

45. The Commissioner must consider the procedures that the transferor used in deciding to enter into a conversion transaction. Such consideration includes whether the transferor utilized appropriate expert assistance. Mont. Code Ann. § 50-4-717(2)(b).

46. The procedures BCBSMT utilized in determining whether to enter into the Transaction with HCSC were adequate because BCBSMT properly evaluated its current circumstances justifying the Transaction and engaged in a systematic process to identify an acquirer meeting the criteria it clearly delineated. (Dir. Test. Frank 10:5-9, 23:21-24:1, 24:4-8.) Mont. Code Ann. § 50-4-717(2)(b).

47. While McCarthy and Swartley demonstrated deficient expertise in their respective areas of analysis (*see e.g.* Hrg. Tr. 31:19-32:23 (Mar. 13, 2013); Hrg. Tr. 489:23-490:5 (Mar. 14, 2013).), on balance BCBSMT utilized appropriate expert assistance in deciding to enter into the Transaction. Mont. Code Ann. § 50-4-717(2)(b).

**CONFLICT OF INTEREST DISCLOSURE
Mont. Code Ann. § 50-4-717(2)(c)**

48. In reviewing a conversion transaction, the Commissioner must consider whether the transferor and/or transferee disclosed any conflicts of interest. These include conflicts involving board members, executives, and experts retained by a party to the transaction. Mont. Code Ann. § 50-4-717(2)(c).

49. With respect to directors, a conflict of interest transaction is a transaction with the corporation in which the director of the corporation has a direct or indirect interest. Mont. Code Ann. § 35-2-418.

50. [REDACTED]

51. [REDACTED]

52. [REDACTED]

53. [REDACTED]

54. [REDACTED]

55. BCBSMT and HCSC have not failed to disclose any conflicts of interest with regard to the experts the Applicants retained in this matter. Mont. Code Ann. § 50-4-717(2)(c).

COMMUNITY IMPACT: AVAILABILITY AND ACCESSIBILITY OF HEALTH CARE SERVICES AND HEALTH INSURANCE COVERAGE
Mont. Code Ann. § 50-4-717(2)(d)

56. The Commissioner must consider whether the conversion transaction is likely to create a significant adverse impact on the availability or accessibility of health care services or health insurance coverage in the affected community. Mont. Code Ann. § 50-4-717(2)(d).

57. The Transaction is unlikely to create a significant adverse impact on the availability or accessibility of health care services because it would not restrict or reduce the presence of care providers or insurance brokers. (Dir. Test. Tardiff 18:5-10, 13-16.) Mont. Code Ann. § 50-4-717(2)(d).

58. The Transaction is unlikely to create a significant adverse impact on the availability or accessibility of health insurance coverage in Montana because the Transaction would enable the continued presence of a strong Blue plan in Montana. (Dir. Test. Tardiff 19:12-17.) Mont. Code Ann. § 50-4-717(2)(d).

59. The Transaction is unlikely to create a significant adverse impact on the availability or accessibility of health insurance coverage in Montana because HCSC's superior size and financial condition would enable a Montana-owned Blue plan to control costs and charge more reasonable premiums. (Dir. Test. McCarthy 9:13-17.) Mont. Code Ann. § 50-4-717(2)(d).

60. The Transaction is unlikely to create a significant adverse impact on the availability of health insurance coverage because it would not result in decreased insurer competition in Montana. (Dir. Test. Tardiff 15:9-12.) Mont. Code Ann. § 50-4-717(2)(d).

61. The Transaction is unlikely to create a significant adverse impact on the availability of health insurance coverage in Montana because the Exchange will increase

competition by providing insureds greater access to alternative insurance products. (Hrg. Tr. 29:1-6 (Mar. 13, 2013).) Mont. Code Ann. § 50-4-717(2)(d).

**COMMUNITY IMPACT: SAFEGUARDS ENSURING ACCESS TO AFFORDABLE
HEALTH CARE**

Mont. Code Ann. § 50-4-717(2)(e)

62. The Commissioner must consider whether the conversion transaction includes sufficient safeguards to ensure that the affected community will have continued access to affordable health care. Mont. Code Ann. § 50-4-717(2)(e).

63. No state regulatory safeguards exist to ensure continued access to affordable health care because health insurers are not currently subject to rate review in Montana. (Hrg. Tr. 543:12-16 (Mar. 14, 2013).) *See generally* Mont. Code Ann. Title 33; Mont. Code Ann. § 50-4-717(2)(e).

64. Limited federal regulatory safeguards exist to ensure continued access to affordable health care because although certain health insurance rates are reviewed for reasonableness, insurers are not prevented from using such rates even if deemed unreasonable. (Dir. Test. Tardiff 23:6-10.) Mont. Code Ann. § 50-4-717(2)(e).

65. The limited scope of state and federal regulatory rate oversight is a marginal consideration in relation to the Transaction because the lack of regulation is not specific to the Applicants, but instead applies to Montana health insurers generally.

66. Present and anticipated future competition in the Montana health insurance market, combined with what limited federal rating oversight exists, sufficiently safeguard Montanans' continued access to affordable health care. (Dir. Test. McCarthy 11:6-10, 20-23.) Mont. Code Ann. § 50-4-717(2)(e).

CONVERSION TRANSACTION MANAGEMENT CONTRACTS
Mont. Code Ann. § 50-4-717(2)(f)

67. The Commissioner must consider whether any management contract under the conversion transaction is for reasonable value. Mont. Code Ann. § 50-4-717(2)(f).

68. HCSC and BCBSMT have established no management contracts relating to the Transaction. (Dir. Test. Burzynski 31:5-7.) Therefore, the Applicants have established no management contract for unreasonable value. Mont. Code Ann. § 50-4-717(2)(f).

EQUITIES OF THE CONVERSION TRANSACTION
Mont. Code Ann. § 50-4-717(2)(g)(i)

69. The Commissioner must consider whether the conversion transaction is equitable to the public interest, enrollees, insureds, shareholders, and certificate holders, if any, of the transferor. Mont. Code Ann. § 50-4-717(2)(g)(i).

70. The Transaction is equitable to BCBSMT's enrollees, insureds, and certificate holders because it will likely result in lower increases to premiums than the increases to premiums that would be charged by an independent BCBSMT. (Dir. Test. Tardiff 25:4-6; Dir. Test. Frank 34:10-13.) Mont. Code Ann. § 50-4-717(2)(g)(i).

71. The Transaction is equitable to the public interest because it provides for the continued employment of current BCBSMT employees and the future hiring of 100 other Montanans. (Dir. Test. Tardiff 25:9-12; Hrg. Tr. 220:10-15 (Mar. 12, 2013); CSI Stip.) Mont. Code Ann. § 50-4-717(2)(g)(i).

72. The Transaction is equitable to the public interest because it would result in the creation and funding of the foundation contemplated in the Conversion Statute. (App., 2-3.) Mont. Code Ann. §§ 50-4-717(2)(g)(i), -720.

IMPACT UPON ECONOMIES OF SCALE
Mont. Code Ann. § 50-4-717(3)

81. A nonprofit health entity seeking to enter into a conversion transaction must consider whether the transaction would result in inefficient economies of scale. Mont. Code Ann. § 50-4-717(3)(a).

82. BCBSMT sufficiently considered whether the Transaction would result in inefficient economies of scale when it evaluated HCSC's operations throughout the due diligence process and retained NERA to evaluate the impact of the Transaction upon economies of scale. (Dir. Test. Frank 18:18-19:16; Dir. Test. McCarthy 13:21-22.) Mont. Code Ann. § 50-4-717(3)(a).

COMPLIANCE WITH ANTITRUST LAWS
Mont. Code Ann. § 50-4-717(3)(b)

83. A nonprofit health entity seeking to enter into a conversion transaction must consider whether the transaction would violate federal or state antitrust laws. Mont. Code Ann. § 50-4-717(3)(b).

84. BCBSMT sufficiently considered whether the conversion transaction would violate federal antitrust laws by submitting a Hart-Scott-Rodino filing for DOJ and FTC review. (Dir. Test. Frank 40:1-7.) Mont. Code Ann. § 50-4-717(3)(a).

85. BCBSMT sufficiently considered whether the conversion transaction would violate state antitrust laws by retaining Graham and Dunn and NERA to evaluate antitrust

implications of the Transaction. (Dir. Test. Frank 39:9-20; App. Ex. 6.) Mont. Code Ann. § 50-4-717(3)(a).

LIQUIDATED DAMAGES PROVISION
Mont. Code Ann. § 50-4-717(4)

86. If an agreement for the conversion of a nonprofit health entity requires payment of money in the event the nonprofit health entity breaches the agreement, the Commissioner shall determine whether and to what extent the payment by the nonprofit health entity is in the public interest. Mont. Code Ann. § 50-4-717(4).

87. A liquidated damages provision provides for payment of a presumed amount of damages sustained due to breach of contract. Mont. Code Ann. § 28-2-721(2).

88. A contract may include a liquidated damages provision only if, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damages. Mont. Code Ann. § 28-2-721(2).

89. Agreement Section 5.08 constitutes a liquidated damages provision under Montana law. (App. Ex. 3.) Mont. Code Ann. § 28-2-721(2).

90. A liquidated damages provision is presumed enforceable. A party seeking avoidance must show it is unconscionable as a matter of law. *Arrowhead Sch. Dist. No. 75 v. Klyap*, 2003 MT 294, ¶ 54, 318 Mont. 103, 79 P.3d 250.

91. A liquidated damages provision is unconscionable if (1) the provision is a contract of adhesion “such that the weaker bargaining party had no meaningful choice regarding acceptance of the provisions,” and (2) the terms of the contract unreasonably favor its drafter. *Arrowhead*, ¶ 48.

92. Agreement Section 5.08 is not unconscionable because no evidence indicates that it is a contract of adhesion, or that its terms unreasonably favor one Applicant at the expense of the other. (App. Ex. 3.) Mont. Code Ann. § 50-4-717(4); *Arrowhead*, ¶¶ 48, 54.

93. Agreement Section 5.08 is in the public interest because it requires BCBSMT to pay a relatively small fee only under the limited circumstances set forth in Agreement Sections 5.08 and 10.01(a), (c), and the occurrence of such circumstances is within BCBSMT's control. (App. Ex. 3) Mont. Code Ann. § 50-4-717(4).

* * * * *

IN CONSIDERATION OF THE FOREGOING, and upon balancing the factors in Title 50, Chapter 4, Part 7 with the evidence in the Record and the Stipulation signed by the CSI and the Applicants on April 19, 2013, the undersigned respectfully recommend to the Hearing Examiner that the Transaction be approved.

Dated this 19 day of April, 2013.

/s/Jesse Laslovich

JESSE LASLOVICH
Chief Legal Counsel

/s/Nick Mazanec

NICK MAZANEC
Attorney

CERTIFICATE OF SERVICE

This is to certify that a true and accurate copy of the foregoing document was hand delivered, picked up by courier, emailed, or sent by U.S. Mail, postage paid, this 19 day of April, 2013, to the following:

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