BEFORE THE INSURANCE COMMISSIONER
FOR THE STATE OF DELAWARE

In Re: The proposed affiliation of	**)**	
BCBSD, INC., doing business as	**)**	**Docket No. 1509-10**
Blue Cross Blue Shield of Delaware,	**)**	
with Highmark Inc.	**)**	

RECOMMENDED FINDINGS OF FACT, CONCLUSIONS OF LAW AND DECISION PURSUANT TO 29 *DEL. C.* § 10126

Highmark Inc., a Pennsylvania nonprofit corporation, and BCBSD, Inc., a Delaware nonstock corporation, wish to affiliate and they seek the blessing of the Delaware Insurance Commissioner on the union.

Essentially, the affiliation (the "Affiliation") is an arrangement whereby Highmark Inc. ("Highmark") will provide a number of benefits to BCBSD, Inc. ("BCBSD"), including financial security, merger onto Highmark's information technology platform, administrative services, and opportunity to expand products and services to its customers. Highmark will also guarantee all of BCBSD's contractual and financial obligations. In turn, BCBSD, although it will continue to be based in Delaware and to provide many operations and services in the State, will be governed by Highmark and Highmark will appoint the Board of BCBSD and oversee its operations.

This arrangement is set out in an affiliation agreement and related documents, including additional agreements in the form of conditions which have been agreed to by BCBSD, Highmark and the Department of Insurance ("DOI"). The Delaware Insurance Commissioner ("Commissioner") must determine if the Affiliation, whereby local control of a venerable and respected Delaware institution is ended, and prospective benefits which a larger insurer can offer are gained, meets the requirements of Delaware law as set out in Title18, Delaware Code, Chapters 50 and 63. In particular, the Commissioner must address whether or not the Affiliation is in the interest of BCBSD's policyholders and the public, and whether the financial reserves of BCBSD, to which Delaware policyholders and taxpayers have contributed, are sufficiently protected.

The Commissioner appointed me to serve as hearing officer ("Hearing Officer") in the matter. As Hearing Officer I, along with my counsel GianClaudio Finizio, have reviewed the extensive record, heard the testimony of witnesses and the comments of the public, and now offer to the Commissioner Recommended Findings of Fact, Conclusions of Law and Decision pursuant to 29 *Del. C.* Section 10126 (the "Findings"). I have found that, with the inclusion of the conditions agreed to by the Department, BCBSD and Highmark, and the additional conditions which I am proposing, the proposed Affiliation complies with the provisions of Delaware law. I have declined to recommend that the Commissioner adopt the condition proposed by the Attorney General. I, therefore, recommend that the Commissioner approve the Affiliation subject to the conditions set out in the attached Exhibit A (the "Conditions").

INTRODUCTION

Highmark is incorporated in the Commonwealth of Pennsylvania and operates as a hospital plan and professional health services plan under the laws of that State. It has over 4.8 million subscribers and is among the ten largest health insurers in the United States in terms of membership. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Hanlon testimony, p. 191).[1] It is the largest non-profit Blue Cross Blue Shield plan in the country. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Hanlon testimony, p. 191). (*Id.*).

BCBSD, which does business as Blue Cross Blue Shield of Delaware, is the State's largest health insurer, serving 394,000 Delawareans. (*Id.*, Constantine testimony, p. 54). Both Highmark and BCBSD are currently engaged in the business of providing health insurance and

[1] References to "D.I." are to the docket index tab as identified on the docket index attached as Exhibit B hereto.

other types of health related services and products and both entities hold licenses from the national Blue Cross Blue Shield Association ("BCBSA") to use the Blue Cross and Blue Shield names and insignias, or "marks", in their respective service areas. (*Id.*, Constantine testimony, p. 55; Hanlon testimony, p. 303). The record indicates that Highmark and BCBSD are highly successful businesses and they, and their subsidiaries, are in good standing in their respective jurisdictions.

On August 19, 2010, the chief executive officers of Highmark and BCBSD, following the approval of their respective Boards of Directors, signed a Business Affiliation Agreement (the "Agreement"). (D.I. 1; Ex. 1, pp.1-43). Insurance being a highly regulated business in the State of Delaware, the proposed Affiliation is subject to the Commissioner's review pursuant to the Delaware Code and the consent of Highmark and BCBSD.

The matter comes before the Commissioner at a time of profound changes in the health insurance market. Recent years have seen rapid consolidation of health insurance providers. At the public hearing, Timothy Constantine, President of BCBSD, testified that in 1993, 80% of the U.S. health insurance market share was held by 47 insurers, whereas today just 9 insurers hold this 80% market share. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Constantine testimony, p. 63). The era has also been marked by steady increases in health insurance premiums and in health care costs generally. Federal mandates portend significant changes in regulatory requirements and in the delivery of health insurance. (*Id.*; p. 64). It is also a time of increased scrutiny of large corporations and executive compensation. In recent years, Delawareans have seen respected local businesses taken over by out-of-state entities or go out of business entirely. In short, it is a difficult time to judge what will best address long-term challenges in health insurance.

Faced with these complexities, the Board of BCBSD has, since at least the early 1990s, been convinced that the long term viability of the company can best be assured by associating with a larger, "Blue" organization. (*Id.*, p. 58). The factors the Board asserts as justification for such an affiliation include BCBSD's need for significant upgrades to its technology systems, the cost-saving benefits of economies of scale that association with a larger company can provide, the challenges of a new federal regulatory environment, an expansion of product offerings, and a desire to position itself against competition in Delaware from large, nation-wide for-profit insurers. (*Id.*, pp. 63-64). In the Board's view, a small, stand-alone insurer such as BCBSD, whose operations are limited to a single State, lacks the capital and human resources to make necessary investments to meet marketplace needs and to respond to healthcare reform measures. (*Id.*, p. 58).

After an extensive process described by Mr. Constantine and summarized *infra* at Finding No. 1, pp. 13-16, the Board determined that affiliation was the preferred course for BCBSD and selected Highmark as its preferred suitor. Following lengthy negotiations, the two entered into the Agreement. (*Id.*, pp. 59-63).

THE AFFILIATION DOCUMENTS

The Affiliation is created and is to be governed by a series of documents: the Agreement; an Administrative Services Agreement ("ASA"); a Line of Credit Agreement ("LOC"); BCBSD's amended certificate of incorporation ("COI" or "Charter"); by-laws ("Bylaws"); and a Confidentiality Agreement (collectively, the "Transaction Documents"). (D.I. 1, Exhibits 1, 2, 3, 4, 5; Ex. 1, sec. 6.7). Also pertinent to the Affiliation are the guidelines of BCBSA. (JX 13, filed as confidential).[2] At this point, only the Agreement and the Confidentiality Agreement

[2] References to "JX" are to joint exhibits submitted for purposes of the public hearing.

have been signed; the others are to be signed at the Closing, when all transactions pertinent to the Affiliation are to be consummated.

Pursuant to the Agreement – and the guidelines of BCBSA – Highmark will acquire control of BCBSD and BCBSD will become a "controlled affiliate" of Highmark. This means that Highmark will be entitled to select BCBSD's Board members, control the governance of BCBSD, and generally oversee its policies and operations. (D.I. 1, Ex. 1, Agreement, Art. II, Sec. 2.1; *see also* Ex. 2, COI, Art. Fifth, Eighth, Ninth; Ex. 3, Bylaws, Art. IV, Sec. 4.1, Art. 5). It will also offer administrative, technical, and strategic support to BCBSD. (*Id.*, Ex. 1, Agreement, Sec. 2.1).

Although the guarantee is not specifically set out in the Agreement itself, as a condition to obtaining and maintaining the primary Blue Cross and Blue Shield licenses for Delaware, Highmark agrees to guarantee all of BCBSD's contractual and financial obligations to BCBSD's customers. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Hanlon testimony, p. 219).

BCBSD will continue to exist as a separate, not-for-profit Delaware health service corporation, with its office in Delaware and, as such, will be subject to the Commissioner's authority. (18 *Del. C.* Chs. 3, 63 and 50; *see also* D.I. 130, JX 113A, condition 31). It must, for instance, continue to submit proposed rate increases to the Department of Insurance ("DOI" or the "Department"), file an annual report, and open its books and records to an examiner appointed by the Commissioner, all as required under 18 *Del. C.* Ch. 63. The Agreement calls for BCBSD to maintain a "significant Delaware presence" and to continue to provide products and services to Delaware residents. (D.I. 1, Ex. 1, Agreement , Art. VII, Sec.7.4). The BCBSD Charter and Bylaws will be amended to reflect these governance changes; however, its corporate purpose, as set out in the Charter, remains unchanged. (*Id.*, Ex. 2, COI, Art. Third).

The Agreement calls for the parties to maintain employment levels within Delaware that are proportionate to the employment levels that Highmark maintains in other geographic areas which it serves, subject to certain factors. (*Id.*, Ex. 1, Agreement, Sec. 7.4). Highmark also agrees to identify and create new employment opportunities in Delaware as business needs and conditions permit. (*Id.*). The Agreement also specifies how employee benefits will be maintained following the Affiliation. (*Id.*, Sec. 7.5).

Under BCBSA guidelines, Highmark will be BCBSA's sole licensee in Delaware. (D.I. 1, Ex. 3, Bylaws, Sec. 4.1). However, it will exercise those rights solely through BCBSD. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Constantine testimony, p. 72).

The related ASA provides for Highmark to provide such administrative and corporate services to BCBSD as the parties may from time to time determine are necessary and appropriate. The ASA includes a non-exclusive list of 23 such services, many which pertain to the integration of information technology ("IT") systems and operations between the two affiliates and the services Highmark will provide to BCBSD as part of that integration. (D.I. 1, Ex. 4, ASA, Art. I). BCBSD is to compensate Highmark in an "amount equal to BCBSD's fair and reasonable allocable share of the total actual cost, without provision for profit to Highmark of providing the Services." (*Id.*, Art. II). Such costs include employee salaries and benefits related to the services and "other direct and indirect administrative costs, including reasonable charges for corporate overhead." (*Id.*). BCBSD's share of these expenses will be determined in accordance with Highmark's established cost accounting practices. (*Id.*).

The LOC governs the terms of a line of credit to be made available to BCBSD by Highmark and used "solely for the payment of costs associated with the systems conversion and integration contemplated by the ASA". (*Id.*, Ex. 5, LOC, Sec. 6).

Significant provisions of the Agreement and the Bylaws also address the right of BCBSD to disaffiliate from Highmark. Under the terms of the Agreement, if one of several triggering events occurs, the Class A members of the BCBSD Board, the so-called "independent directors", can call on Highmark to withdraw from the Affiliation and consent to BCBSD re-acquiring its BCBSA license. (D.I. 1, Ex. 1, Agreement, Sec. 7.8; Ex. 3, Bylaws, Art. XIII). The Agreement also specifies BCBSD's obligations in the event of disaffiliation. (*Id.*, Ex. 1, Agreement, Sec. 7.8).

THE CONDITIONS

The conditions considered by the Hearing Officer in connection with the Affiliation fall into five categories: statutory, negotiated, DOJ proposed, community support and Hearing Officer recommended.

A. Statutory Conditions

Since the filing of the Agreement, the Delaware General Assembly has enacted new provisions which pertain to control-related transactions between two non-profit entities and requires the Commissioner to impose certain conditions on such transactions. 18 *Del. C.* §§ 6310 and 6311. These statutory conditions ("Statutory Conditions") are included in the Conditions attached as Exhibit A to these Findings as Conditions 1 through 6, and Condition 38.

B. Negotiated Conditions

In addition to the undertakings specifically set out in the Affiliation documents and the Statutory Conditions, there are a number of conditions to the Affiliation which have been negotiated by Highmark, BCBSD and the DOI (the "Negotiated Conditions"). The Negotiated Conditions grew out of the recommendations of the DOI, which spent approximately a year reviewing the Affiliation. In that task, the DOI was aided by well-qualified consultants.

BCBSD's experience with the CareFirst affiliation also informed the process. Finally, Highmark and BCBSD and their experienced officers and counsel have engaged in extensive negotiations over the Negotiated Conditions. If approved by the Commissioner, the Negotiated Conditions and the Statutory Conditions will in effect modify the terms of the Transaction Documents and will be binding on the parties. The Negotiated Conditions are included as Conditions 7 through 37 in the Conditions attached as Exhibit A to these Findings.

C. DOJ Proposed Condition

The Attorney General and the Department of Justice ("DOJ") have proposed a condition to the Affiliation: that Highmark and BCBSD establish a mechanism to guarantee that the public's investment in BCBSD remains in Delaware to be held and protected for the benefit of Delawareans, specifically to serve the State's unmet health needs. (D.I. 93). One suggested mechanism is a foundation set up under Delaware law. The Attorney General and the DOJ suggest that a sum of no less than $45 million from BCBSD's reserves be used to establish the foundation. (*Id.*). This proposal has not been agreed to by BCBSD, Highmark or the DOI, who question the legal authority of the Commissioner to condition the Affiliation upon the establishment of such a mechanism, and who wish to preserve the reserve for the use of BCBSD. The Attorney General takes no position on the Negotiated Conditions. However, he opposes the Affiliation unless his proposed condition is accepted by the Commissioner.

D. Community Support Conditions

In response to the concerns and questions expressed with regard to the continuity of BCBSD's community support programs, BCBSD has now offered community support conditions (the "Community Support Conditions") as part of the Affiliation. These conditions have been agreed to by Highmark and the DOI and are included as Conditions 39 through 43 in the Conditions attached as Exhibit A to these Findings. In brief, the Community Support Conditions memorialize the voluntary commitments about which Mr. Constantine testified (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 83-85). They also include additional provisions which were not included in his testimony, such as additional members to be added to the Delaware Community Foundation, Blue Prints for the Community ("Blue Prints") Advisory Council, and add specificity about time periods when the contributions will be made, as well as the amounts to be paid in each such period.

The full text of the Community Support Conditions is included in Exhibit A attached to these Findings.

E. Hearing Officer's Recommended Conditions

The Hearing Officer recommends additional conditions which are included as Conditions 44 through 47 in the Conditions attached as Exhibit A to these Findings. In summary, the Hearing Officer's conditions support the Negotiated Conditions by reinforcing the party's commitments and enforcement rights thereunder, ameliorate the risk to BCBSD in the event of a disaffiliation, and ensure that no incentive has been offered to any BCBSD executives or directors in connection with the Affiliation.

The Hearing Officer's conditions, together with the Statutory Conditions, the Negotiated Conditions and the Community Support Conditions make up the "Conditions" as set forth in Exhibit A hereto.

LEGAL AUTHORITIES

As a nonprofit health service corporation in the State of Delaware, BCBSD is governed by the provisions of 18 *Del. C.* Sections 6301 *et seq*. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Constantine testimony; p. 55).

The newly enacted Section 6311 of Chapter 63, Del. Code, requires that a change of control of a health service corporation must also be considered under the provisions of Chapter 50 of the Insurance Code, 18 Del. Code, Ch. 50 (18 *Del. C.* § 6311(a)). In addition, the Commissioner's October 2010 Order directs the Hearing Officer to apply the specific criteria for approving or disapproving a change of control of a Delaware domestic insurer found in Chapter 50 (18 *Del. C.* § 5003 (d)(1)) and, as her Order notes, the parties have consented to these criteria being employed in this matter. (D.I. 2).

In addition to making the provisions of Section 5003(d)(1) applicable to a change of control of a health services corporation, as previously noted in connection with the Statutory Conditions, Sections 6310 and 6311 of Title 18 also contain conditions which apply to such a transaction. These are specifically concerned with the preservation of the amount that constitutes the surplus, or reserves, of the corporation, and ensuring that the Affiliation will result in BCBSD offering an insurance plan with the same benefits and eligibility criteria as a Delaware Healthy Children Program under 16 *Del. C.* Section 9909(j). The four conditions specified in Section 6311 are "without limitation".

PROCEDURAL BACKGROUND

The Affiliation statement was filed with the Department on October 7, 2010 and sought the approval of the Commissioner to the proposed transaction. (D.I. 1). The Commissioner's Pre-Hearing Order of October 20, 2010 (D.I. 2) directed an inquiry into the matter pursuant to her authority under Title 18, Delaware Code, Chapter 3, and specified that the criteria contained in 18 *Del. C.* Section 5003(d)(1) should apply. Her Order identified as parties in the matter Highmark, BCBSD, the DOI and the Delaware Attorney General (and his staff at the DOJ) representing the State in his capacity as *parens patriae*. (*Id.* par. 3). A later order appointed the Hearing Officer. (D.I. 3).

The Pre-Hearing Order invited other interested individuals and entities to apply to be parties to the proceeding. (D.I. 2, par. 5). One individual, Jo Ann Fields, M.D., made such a request, which was denied because she did not meet the criteria for becoming a party to the proceedings. (D.I. 21; D.I. 17, from Jan. 18, 2011 Public hearing).

During the year following the filing of the Affiliation statement, an inquiry was conducted by the DOI with the assistance of its legal advisor and two consultants, KPMG LLP ("KPMG") and Blackstone Advisory Partners ("Blackstone"). Extensive discovery was conducted by the parties and a sizeable record was developed. This record, consisting of the documents, transcripts, studies and reports, as well as communications from the public, all of which make up the public docket as set out in the attached Exhibit B, has been available to the public on the DOI's website and in its offices (with portions redacted to preserve confidentiality). The DOI also sponsored a series of public information sessions throughout the State and transcriptions of the sessions were also posted on the Department's web site. (*See* D.I. 40, 41, and 42).

A public hearing, as required by Delaware law (18 *Del. C.* § 5003(d)(1)) was held on October 5, 6 and 7, 2011. The Honorable Joseph R. Biden III, Attorney General of Delaware, was present and made a statement at the opening of the hearing, which was placed on the record and is available on the Department's website. (*See* D.I. 109, Hr'g Tr. Oct., 5, 2011, pp. 12-24).

Six witnesses testified on behalf of BCBSD and Highmark: Timothy J. Constantine (President and Chief Executive Officer, BCBSD); Scott Fad (Senior Vice President of Operations, BCBSD); James Hynek (Vice President, Chief Financial Officer, and Treasurer, BCBSD); Karen L. Hanlon (Senior Vice President for Financial Planning and Analysis, Highmark); Kenneth B. Gebhard (Vice President, Cost Management and Analysis, Highmark); and J. Fred Earley, III (President, Highmark West Virginia). David S. Swayze and Michael W. Teichman of Parkowski, Guerke and Swayze, P.A. appeared as counsel for BCBSD. Frederick K. Campbell and S. Doak Foster of Mitchell, Williams, Selig, Gates and Woodyard, P.L.L.C. (admitted *pro hac vice*) and Mona A. Parikh of Buchanan, Ingersol & Rooney PC appeared as counsel for Highmark.

Michael Houghton, Leslie A. Polizoti and Brenda Mayrack of Morris, Nichols, Arsht & Tunnell LLP appeared as special counsel to the Department. The Department presented the testimony of three witnesses: Martin Alderson Smith (Senior Managing Director, Blackstone); Kenneth Jackson (Senior Director, KPMG); and Linda Sizemore (Director of Company Regulation, DOI).

Ian McConnell and Meredith Stewart Tweedie, Deputy Attorneys General and Cynthia R. Shoss of Dewey & LeBoeuf LLP (admitted *pro hac vice*) appeared on behalf of the DOJ. The DOJ did not offer direct testimony at the hearing but did conduct cross-examination of witnesses.

The Hearing Officer expresses appreciation to all counsel of record and counsel's teams of associates for their thorough preparation and submissions including the well prepared pre-hearing and post-hearing submissions, and the efficient organization of the testimony and cross examination at the public hearing.

On the final day of the hearing, five members of the public offered comments on the Affiliation. They were James Lafferty (Executive Director, Mental Health Association in Delaware); Joanne Hasse (former Board member, Delaware Health Information Network, who follows healthcare issues for the League of Women Voters); Mitch Crane (a former employee of the DOI); Vincent White; and Jo Ann Fields, M.D. Because of the extensive record, the Hearing Officer kept the record open until October 14, 2011 for any additional exhibits from the parties, as well as written statements from the public.

Having thoughtfully considered the Attorney General's presentation, the testimony of the witnesses, the statements of and communications from members of the public, and having reviewed the extensive record and the memoranda of the parties, I hereby respectfully submit the following Findings to the Commissioner.

Finding Number 1: *THE BOARD OF DIRECTORS OF BCBSD ENGAGED IN AN EXTENSIVE STRATEGIC PLANNING PROCESS WHICH RESULTED IN THE DECISION TO AFFILIATE WITH HIGHMARK*

Since at least the early 1990s the Board of Directors of BCBSD has been of the view that the long term success of BCBSD requires that it affiliate with a larger insurer. (D.I. 109, Hr'g Tr. Oct., 5, 2011, Constantine testimony, p. 58). An attempted transaction with Blue Cross Blue Shield of New Jersey was not successful, but in 2000 BCBSD became affiliated with CareFirst, another "Blue" insurer operating in Maryland, the District of Columbia and Virginia, an arrangement which lasted 6 years. (*Id.*, p. 57; *see also* D.I. 81, JX 22, March 20, 2000 Affiliation Order). According to Timothy Constantine, Chief Executive Officer of BCBSD, BCBSD found this affiliation, though short lived, to be "largely successful, resulting in reduced per member per month administrative expenses and increases in both membership, reserves and employees." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 59). Significantly, nothing in the Department's inquiry or public hearing on the current proposed Affiliation indicated that Delaware policyholders and the Delaware public at large were ill served under this affiliation.

When the CareFirst affiliation failed, the Board of Directors engaged in a strategic planning process. (*Id.*, p. 59). A number of the joint exhibits in the record of this proceeding detail the process in which the Board engaged between 2006, when the CareFirst affiliation ended, and 2010 when the current Agreement was signed. (*See* D.I. 80, JX 4.1, 5.1; D.I. 81, JX 25, 26, 27, 28.1, 30.1, 31.1, 32.1, 33, 34.1, 35.1, 36). The process included a strategic retreat of the Board, senior managers and outside experts; the retention of Louis Pavia of Care Companion and Robert C. Cole, Jr., BCBSD's former President and Chief Executive Officer, to provide advice and counsel; and a year long series of strategy sessions. In addition, BCBSD was guided by advice from Deloitte LLP ("Deloitte"), an international consulting firm. Deloitte had conducted an assessment of BCBSD's business capabilities in 2004. The assessment was updated in 2008 and again in 2010. (D.I. 83, JX 47.1, 48). This assessment analyzed the capabilities of BCBSD and discussed the strengths and risks of various options open to the company.

The Board concluded, once again, that given the competitive environment in which BCBSD must operate and the need for systems and capabilities upgrades, affiliation with a stronger partner was the preferred option. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 60; *see also* D.I. 81, JX 25, BCBSD Board Minutes, Dec. 1, 2006; JX 26, BCBSD Board Minutes Feb. 7, 2007 at 4). The Board then identified and considered more than thirty potential partners, with six being determined to be best suited to meet the requirements of BCBSD. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 60-61; *see also* D.I. 81, JX 27, CareCompanion, Mar. 7, 2007, BCBSD Strategy Session II). Further due diligence and investigation was conducted, and eventually the Board narrowed the field to three companies but was unable to come to an agreement with any of them.

The Board reconsidered the remaining organizations of the six originally identified as potential partners and issued an updated Partnership Memorandum to two of them, one of which was Highmark. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 62). After further discussion and consideration, by the end of 2009 the Board determined to engage in exclusive negotiations with Highmark (*Id*., p. 63; *see also* D.I. 81, JX 34 BCBSD Board Minutes, Dec. 3, 2009 at 2; JX 35, CareCompanion Dec. 3, 2009 Presentation – Strategic Partnership Considerations) and since early 2010 BCBSD has worked with Highmark to establish a partnership. As described by Scott Fad, Senior Vice President for Operations of BCBSD, this work has included due diligence by both parties, meetings with each other's leadership, site visits, and contract negotiations. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, pp. 127-132, *see also* D.I. 81, JX 36, BCBSD Board Minutes, July 21 2010 at 9).

Mr. Constantine testified that there were several reasons for the selection of Highmark. According to Mr. Constantine, "Highmark offers the most practical, efficient, and cost-effective means of ensuring that BCBSD can meet the near-future and long-term needs of its Delaware stakeholders while remaining a viable and robust local presence in the Delaware employers' marketplace." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 67-68). He also testified that Highmark has a "state of the art and highly capable information technology platform that has proven itself in service and support arrangements with several other Blue Cross Blue Shield plans." (*Id.*) An affiliation with Highmark would also be less expensive than other options available to BCBSD. (*Id*., p. 68).

Mr. Constantine put a premium on the fact that under the Affiliation BCBSD will remain a not-for-profit Delaware company, while enjoying Highmark's broad and innovative mix of health care products and services. (*Id.*; *see also* D.I. 40, May 16, 2011 Public Information Session Tr. at 34:24-41:2).

The DOI's consultant, Blackstone, reviewed BCBSD's search for a strategic partner following the CareFirst disaffiliation. Mr. Alderson Smith of Blackstone testified that BCBSD's review of its strategic alternatives, as well as the process followed in searching for a partner, were reasonable. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 399).

I am satisfied that the process followed by the Board of BCBSD, which culminated in the selection of Highmark Inc. as its partner, was a thorough and thoughtful process and should be respected by the Commissioner in reviewing the Affiliation.

Finding Number 2: *BCBSD'S DECISION TO SEEK AFFILIATION WITH A LARGER INSURER, RATHER THAN REMAINING A STANDALONE COMPANY, WAS A REASONABLE BUSINESS JUDGMENT AND IS SUPPORTED BY THE RECORD*

Martin Alderson Smith of Blackstone testified that, while BCBSD's customers are generally satisfied with BCBSD's current performance, the company faces many challenges. These include limited technology resources, a limited ability to adapt to regulatory change, and difficulty innovating in the areas of product development and pricing. (*Id.*, p. 389).

The DOI retained as a consultant KPMG LLP to assess BCBSD's information technology needs and potential options to address those needs. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Kenneth Jackson testimony, pp. 479-480). Kenneth Jackson, Senior Director at KPMG LLP, who focuses on technology, or "IT", issues testified that "[i]nformation technology goes to the heart of what Blue Cross does. Almost all of the services provided by [BCBSD] run off of [BCBSD's] IT platform. [BCBSD's] IT capabilities can, therefore, affect the company's ability to perform current processes more efficiently and to address new services required to compete with other providers in its market." (*Id.* p. 476).

BCBSD currently delivers its business on a core operating system installed in the 1980s. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 65). As part of the strategic planning process, Deloitte advised BCBSD about its IT capabilities, identified "capabilities gaps", and recommended solutions. Mr. Jackson explained these "gaps" are areas where BCBSD needs to upgrade in order to remain competitive in the marketplace and compliant with government mandates. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, p. 482). Deloitte's 2008 assessment and 2010 updated analysis appear in the record as JX 47.1 and JX 48 located at D.I. 83.

Mr. Jackson expressed KPMG's general agreement with the capability gaps identified by Deloitte. (*Id.* p. 483). He also described how KPMG recommended additional technological improvements for BCBSD beyond those identified in the Deloitte reports, such as the development of private exchanges and retail initiatives. (*Id.* p 484).

One technology challenge for BCBSD, which both Deloitte and KPMG identified, is the necessity of meeting federal health care mandates. Such federal mandates include the 2014 market reform provisions of the Patient Protection and Affordable Care Act ("PPACA") which involve integration with the new health insurance exchanges, elimination of medical underwriting, new product design mandates, Accountable Care Organization payment reform administrative capabilities, and medical loss ratio pool management and rebate administration capabilities. More immediate challenges are the new coding system required under the International Classification of Disease standard ("ICD-10") and the new electronic exchange standards under standard 5010 of the Health Insurance Portability and Accountability Act ("HIPAA"). (*Id.* pp. 477-479). Mr. Jackson testified that both Highmark and BCBSD are already compliant with the HIPAA standards and while Highmark has made substantial progress toward meeting the ICD-10 standards, BCBSD has not yet begun any substantial ICD-10 remediation work. (*Id., pp.* 485, 501). He stated that "it may be very difficult for Blue Cross to perform full ICD-10 remediation within the remaining time to meet published deadlines." (*Id.,* p. 485). Mr. Jackson testified that "timely ICD-10 compliance is very important for [BCBSD] to ensure smooth business operations". (*Id.,* p. 479). Mr. Constantine of BCBSD testified that the federal compliance deadline for ICD-10 is October 2013 and that "BCBSD would need to have systems, products, and services ready to go to market in early 2013 in order to meet the January 1, 2014 effective date of these PPACA plans and regulations." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 69).

In addition to improving its IT capabilities and complying with federal regulations, BCBSD states it would like to expand its product offerings and to provide additional products and services to its customers, employers, and brokers in the State. (*Id.,* pp. 8, 19, 20). It believes such offerings are key to remaining competitive in the marketplace. But its small size makes it difficult to compete with health insurers which are national in scope and have technological capabilities, as well as product offerings, that exceed BCBSD's current resources.

In assessing how best to address these needs, BCBSD considered several strategic options, including an affiliation. According to Mr. Constantine (*Id.,* p. 70) there are two plausible alternatives to affiliation: (i) remaining a "standalone" company, as BCBSD has been since the affiliation with CareFirst ended, and making the capital investment necessary to upgrade its technology and services; or (ii) outsourcing its IT needs to a third party vendor. The Board, however, ultimately rejected both of these options because it believed they "would result in less desirable outcomes for BCBSD and its Delaware stakeholders." (*Id.*)

a. <u>The standalone option</u>: At the hearing, witnesses testified and were cross examined about the pros and cons of the standalone option, whereby BCBSD would remain under local control and upgrade its IT capabilities. Members of the public also questioned why BCBSD does not upgrade its IT capacity or outsource its IT needs, in lieu of being controlled by an out of state entity. (D.I. 42, Comments of Mark Sharnoff and Stuart Snyder, Public Information Session Tr., Wilmington DE, May 19, 2011, pp. 47, 50).

According to Mr. Constantine of BCBSD, it would require "enormous capital expenditures" for BCBSD to make the recommended enhancements to its IT capabilities on its own. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 11). James Hynek, the Chief Financial Officer and Treasurer of BCBSD, described the methodology used in developing financial statements prepared for BCBSD. (*Id.*, Hynek testimony, p. 153). These contain two projections, one of which reflects an affiliation with Highmark while the other assumes BCBSD will remain an independent entity. (*Id.*). Mr. Hynek testified that "[o]verall projections indicate that it is more favorable for BCBSD to affiliate with Highmark than to remain a standalone company. (*Id.*, p. 157). According to Mr. Hynek, the Affiliation will cost BCBSD $35 million in one time IT upgrades, whereas the cost for BCBSD to upgrade as a standalone entity would range between $88 million and $140 million. (*Id.*).

The DOI's witness, Mr. Jackson, testified that KPMG agreed with the estimated one-time costs of $35 million for the Affiliation option. However, KPMG reached an estimate that the standalone option would cost $93 million to $150 million. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, p. 487). This is based on KPMG's analysis of additional upgrades which it felt are necessary for BCBSD to remain competitive. (*Id.*). Scott Fad of BCBSD testified that the migration cost of $37.4 million for BCBSD to migrate onto Highmark's IT platform is "a considerable savings from the estimated $100 million to $140 million that BCBSD would otherwise need to spend to obtain such capabilities as an independent company." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, p. 142).

Blackstone, another consultant to the DOI, determined from the BCBSD financial *pro formas* that BCBSD's reserves as a standalone company would be $53 million lower by 2015 than the projected surplus under the Affiliation scenario. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 386). Deloitte determined that the amount necessary to upgrade BCBSD's core operating system would amount to between 49 percent and 77 percent of BCBSD's current reserves. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 65). Mr. Alderson Smith of Blackstone testified that the standalone alternative, in which BCBSD would bear the full cost of upgrades on its own, "will necessitate raising premium prices in order to help recoup a portion of the cost of the upgrades and that Blue Cross's membership will suffer due to these price increases". (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 385). In contrast, under the Affiliation scenario, "[BCBSD] assumes that it will be able to keep its premium rates lower than possible in the standalone scenario and that membership will increase as a result of the company's projected operational benefits of affiliating with Highmark and the ability to introduce new products to the market." (*Id.*).

With respect to meeting the federal mandates, including ICD-10, Mr. Jackson of KPMG testified that, although BCBSD could remain independent and meet these mandates, "it still would not fully address the other areas of weakness identified in Deloitte's assessments, including IT strategy and planning, program and process management, and resource management." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, p. 489).

Mr. Jackson testified that the potential benefit of a standalone option is that BCBSD would "remain self-reliant". (*Id.,* p. 488). However, Mr. Jackson cautioned that "in addition to what may be substantial cost of the standalone option, this type of IT upgrade can be highly complex and it's inherently risky." (*Id.,* p. 487). The risks include the possibility of increased costs of the transformation, as well as delay in implementation. (*Id.,* pp. 488, 489). He also noted that "the current [BCBSD] organization has not had experience in delivering such a complex, multi-year transformation project." (*Id.*)

Another benefit of an affiliation with Highmark was noted by Mr. Jackson: Highmark was ranked third in the nation's top 500 innovators of IT and has invested approximately $400 million dollars in IT capabilities in the past three years. Therefore, "Highmark's commitment to IT allows it to offer state of the art technology and systems to meet the evolving needs of its customers, including [BCBSD's] customer base." (*Id.,* p. 401).

Testimony indicated that offering increased services and products would also be difficult for BCBSD as a standalone company. Mr. Constantine testified that "(f)rom a very practical view, a small, independent plan such as BCBSD, is not likely to have the human or technological resources to effectively evolve to meet these increased demands on its own." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 8, 9). The DOI's witness, Mr. Alderson Smith of Blackstone, echoed this concern, testifying that "[BCBSD's] small size and lean business model limit the resources [BCBSD] is able to devote to development of new products, improving its data management and addressing other capability enhancements necessary for BCBSD to continue its successful performance and service." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 394).

b. Outsourcing option: In addition to continuing as a standalone entity, BCBSD also considered the possibility of "outsourcing" its IT needs. Mr. Jackson explained that "IT outsourcing involves contracting with a third party to provide day to day operations support, such as IT application program management (for example, development, maintenance and support) and IT computer services (for example data center operations, telecom, server and storage hosting and management support)." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, p. 491). Under the outsourcing option, outside vendors could provide BCBSD with expertise, access to new technology and business practices, and could potentially be able to provide services more quickly and cheaper than under the standalone option. (*Id.*, p. 492). KPMG concluded – based on a preliminary analysis – that a long-term contractual arrangement for outsourcing IT functions could cost between $30 and $45 million up front, with estimated annual costs of between $30 and $60 million dollars. (*Id.*, p. 490). The projected set-up cost is roughly comparable to the anticipated cost of migrating onto Highmark's IT systems.

However, KPMG cautioned about risks inherent in the outsourcing option. Mr. Jackson noted two: first, that BCBSD would have difficulty in finding an appropriate outsourcing provider, due to the demand for outsourcing providers in order to meet upcoming government deadlines (*Id.*, pp. 492-493); and second, that BCBSD "currently lack(s) the experience and expertise in managing such a long term contractual relationship", particularly if the option involves dealing with a number of outsourcing companies. (*Id.*) BCBSD may also incur "throw-away" costs of three to five million dollars if it needs to take other steps to become compliant with ICD-10 requirements. (*Id.*) KPMG also cautioned that many of the business processes identified in the Deloitte studies "are not necessarily good candidates for outsourcing". It found that of the 70 of the Affiliation integration processes currently being considered by Highmark and BCBSD, over half may not best be delivered through outsourcing. (*Id.*, p. 494). Mr. Constantine testified that there would be a negative impact on BCBSD's employment if the company's back-office operations were outsourced. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 71).

Karen Hanlon of Highmark testified to the merits of an affiliation over remaining an independent company. She stated that "[c]ontrary to causing the removal of assets out of BCBSD, the Affiliation. . .will enable BCBSD to preserve tens of millions of dollars that it would otherwise expend making IT capital improvements and other capability enhancements." (*Id.*, Hanlon testimony, p. 224). Ms. Hanlon testified that the Affiliation will result in BCBSD's surplus being $226 million by the end of 2015, rather than $89 million if BCBSD remains a standalone company. (*Id.*, p. 224). Mr. Hynek of BCBSD noted that BCBSD enrollment is expected to increase during the Affiliation, but is expected to decrease if BCBSD remains a standalone entity. (*Id.*, Hynek testimony, p. 155). Finally, Martin Alderson Smith of Blackstone testified that "[i]t is unlikely that the financial condition of [BCBSD] will be materially worse in the foreseeable future as a result of an affiliation with Highmark than it would otherwise be if [BCBSD] were to…remain a standalone entity, and [the financial condition] may well improve as a consequence of the Affiliation." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 388). He also stated that "the Affiliation scenario implies a significantly greater amount of claims-paying resources than the stand-alone scenario." (*Id.*, pp. 386-387). Mr. Alderson Smith also testified that "[t]he Affiliation is anticipated to address many of these capability gaps, particularly given the breadth of experience Highmark has with various affiliations and administrative services agreements." (*Id.*, p. 390).

In sum, while it is appears that BCBSD, with its large capital reserves, has sufficient resources to invest in upgrading its technological resources or to outsource them while continuing to operate on its own, there are significant drawbacks to each of these options. The Board, guided by its planning process and its advisors, determined that an affiliation would best serve the needs of the company. This decision was borne out by the testimony at the hearing, and I find it to be reasonable.

Finding Number 3: *BCBSD OFFICERS WERE NOT OFFERED INCENTIVES TO FAVOR THE AFFILIATION WITH HIGHMARK OVER OTHER AVAILABLE OPTIONS*

There is nothing in the record to indicate that BCBSD directors and officers were offered personal or financial incentives to persuade them to favor the Affiliation. Timothy Constantine testified that "[n]o BCBSD executive will be paid any bonus or incentive compensation as a result of negotiating or closing the [Affiliation]." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 78). He testified that the current compensation and incentive packages for BCBSD executives are "far below the average for non-publicly traded Blue Cross Blue Shield plan officers, as well as the health insurance and managed care industry sector averages." (*Id.,* p. 79). Mr. Constantine also explained the limited reasons for which a BCBSD executive may be entitled to severance payments after the closing of the Affiliation, which include a substantial reduction of the executive's duties or a substantial reduction in compensation. (*Id.,* pp. 80-81). He testified, however, that "BCBSD and Highmark have no plans to terminate any of the BCBSD executives following the Affiliation." (*Id.,* p. 82). This was affirmed by Ms. Hanlon of Highmark. (*Id.,* Hanlon testimony, pp. 214-215).

Mr. Constantine testified about a "worst-case scenario" which is that in the "highly unlikely event that all seven [BCBSD] executives were terminated immediately after closing [of the Affiliation]," there would be a total lump-sum severance payment of approximately $5,960,000 to the seven BCBSD executives. (*Id.,* Constantine testimony, pp 82-83). This amounts to an average severance package of approximately $850,000 for each executive. While this is a generous amount in these economic times, no testimony was offered about whether such severance pay is excessive in the health insurance business. And, as Linda Sizemore of the Department of Insurance testified, those rights to severance pay were in place before the Affiliation was negotiated and will not be automatically triggered by the Affiliation." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 544). Ms. Sizemore also testified that the DOI "determined that the [BCBSD] executives will not receive any financial compensation as a result of the consummation of the Affiliation." (*Id*). Mr. Alderson Smith confirmed this description of the executive compensation packages, testifying that "Blackstone has not discovered and is not aware of any [side] agreement" between Highmark and BCBSD executives which would give those executives a personal financial incentive to enter into the Affiliation, and that "[i]t is unlikely that [BCBSD] management will gain direct financial benefit from the Affiliation at the expense of the company's policyholders." (*Id.,* Alderson Smith testimony, pp. 367-369).

Nevertheless, the DOI has proposed a condition, which has been agreed to by Highmark and BCBSD, that precludes "any separate arrangements or understandings with BCBSD executives that would give BCBSD executives any personal, financial incentives to favor the Affiliation." (*Id.,* Sizemore testimony, pp. 544-545; D.I. 130, Appendix A, JX 113A, Condition No. 36).

As further assurance that no incentive was offered, I recommend that an additional related condition be imposed to provide that for a period of two years following the closing of the Affiliation, any severance pay, bonuses, or pay raises of any current BCBSD executive, or any transfer of a BCBSD executive to the Highmark payroll, as well as any increase in compensation paid to a director of BCBSD, be reported to the DOI in a confidential filing. In addition, prior to the closing of the Affiliation, Highmark and BCBSD shall provide written representations to the DOI that no incentives were offered to any BCBSD director in connection with the Affiliation.

Finding Number 4: *WHILE THE AFFILIATION WILL RESULT IN THE LOSS OF LOCAL CONTROL OVER BCBSD, PROVISIONS OF THE AGREEMENT AND CONDITIONS WILL PROTECT BCBSD'S DELAWARE PRESENCE*

Perhaps the primary concern about the proposed Affiliation is the loss of local control over a venerable and respected Delaware institution and what that loss means for Delaware stakeholders. BCBSD has operated in Delaware since 1935 and is currently the largest health insurer in Delaware, according to Mr. Constantine. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 54.55). Linda Sizemore of the DOI testified that the Department "is concerned that the degree to which Highmark will exercise control over [BCBSD] could cause [BCBSD] to, for example, lose its local control and not make decisions effectively considering the interest of Delaware policyholders." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 530).

As part of its analysis of the Affiliation performed for the DOI, Blackstone participated in the public information sessions and also conducted private meetings in order to identify public and private concerns about the Affiliation. According to Mr. Alderson Smith of Blackstone, the "greatest concern" expressed at those meetings was BCBSD's "ability to retain a strong local presence and local decision-making authority." (*Id.,* Alderson Smith testimony, p. 398). Mr. Alderson Smith went on to testify that "(e)ven with these concerns, however, nearly all of the interested parties contacted voiced their support, on balance, for the proposed Affiliation due to [BCBSD's] perceived current lack of cutting edge products and capabilities when compared to larger competitors." (*Id.*). The impact on local control is most obvious in the proposed operational changes and in the restructuring of the governance of BCBSD. A description of these changes follows.

Operational changes: Karen Hanlon of Highmark testified that, immediately following the closing of the Affiliation, there will be virtually no change to BCBSD's operations. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, pp. 206-208). According to Ms. Hanlon, providers, subscribers, group customers, and the insurance-buying public in Delaware will continue to receive services from BCBSD as they do today.

However, in areas other than so-called market-facing functions, gradually over time the leaders of BCBSD functions will report to supervisors at Highmark. Some changes will occur immediately upon the closing of the Affiliation, when a limited number of BCBSD executives will begin to report organizationally to an executive at Highmark. (*Id.*). For instance, Timothy Constantine, President of BCBSD, will report to Highmark's Executive Vice President of Health Services and James Hynek, the Chief Financial Officer of BCBSD, will report to Karen Hanlon. (*Id.*). However, Ms. Hanlon testified that the market-facing functions which involve the most interaction with Delaware consumers and policyholders will continue to report to the President of BCBSD. (*Id.*).

Scott Fad, Vice President of BCBSD, who is charged with coordinating the business integration effort on behalf of BCBSD testified that full and final business integration between BCBSD and Highmark is expected to be completed in 18 to 24 months after approval of the Affiliation. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, pp. 128, 141). At that point, there will be three levels of organizational structure for BCBSD: a locally-managed level, a shared-services level with Highmark, and a centralized support services level at Highmark. (*Id.*, p. 135).

Mr. Fad explained in detail the types of services at each level. (*Id.*, pp. 135-138). He emphasized that the locally-managed level includes important market-facing functions which will be locally managed in Delaware, thereby "preserving BCBSD's ability to be responsive to the Delaware marketplace and [BCBSD's] local stakeholders." (*Id.*, pp. 135-136). These functions include sales and account management, provider contracting, government affairs and community affairs. (*Id.*, p. 136). The functions in the shared services level will be predominantly delivered in Delaware by local BCBSD employees, but will be moved onto Highmark's technology platforms. These functions include claims processing, billing and enrollment, and product development. (*Id.*, pp. 136, 137). Functions which are part of the centralized support level will be directly managed by Highmark personnel and will be predominantly delivered by staff at central locations that support the entire Highmark enterprise. These include computer operations. (*Id.*, pp. 137, 138).

Martin Alderson Smith of Blackstone testified that, while corporate budgets will be determined at Highmark, the BCBSD President and certain BCBSD personnel will have input into Highmark's budget-planning process. This is important so that BCBSD personnel can help "to address any extraordinary cost issues impacting [BCBSD], or to introduce strategic changes in such areas as pricing and product development." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 374). With respect to pricing and product introduction, Mr. Alderson Smith noted these functions "will be subject to both input from the [BCBSD] board and approval by Highmark through the annual budgeting progression." (*Id.*, p. 373). He also testified that, in his view, the BCBSD President will "retain relative autonomy when making decisions relating to interactions with customers and the public." (*Id.*, pp. 373, 374).

The potential risk that Delaware's interest will simply be lost in a business with the scale of Highmark is recognized by all parties in this proceeding. Many of the conditions imposed by newly enacted Delaware law and others negotiated by Highmark and BCBSD with the Delaware Department of Insurance are designed to ameliorate this risk. These include most notably Condition 8, which requires BCBSD, for four years after the effective date of the Affiliation, to take "such actions as necessary to ensure that there is not a material decrease in the quality of BCBSD's provision of account and broker management, customer service and provider service to Delaware customers by Delaware-based staff under the immediate supervision of Delaware-based staff, it being understood, however, that additional support may be provided by Highmark or other Highmark affiliates during periods of additional need as determined to be necessary or appropriate to drive optimum client satisfaction." (D.I. 130, Appendix A, Joint Ex. 113A, Condition 8). Condition 7 seeks to maintain the local presence of BCBSD, both as a Delaware-based company and as an employer of Delawareans, by assuring that employment for Delawareans, including current BCBSD employees, remains a priority for BCBSD. (*Id.*, Condition 7). Condition 9 is designed to ensure Highmark does not improperly drain BCBSD of its assets or reserves. (*Id.*, Condition 9).

Other Conditions are contained in the newly enacted 18 *Del. C.* Section 6311(b). These provide for Department oversight of expenditures and transfers of funds by BCBSD in excess of $500,000 to Highmark or one of its affiliates, authorize court action to prevent Highmark from improperly using the assets of BCBSD for the benefit of Highmark rather than the benefit of BDBSD and its subscribers, require Department approval of any change in BCBSD's COI, and mandate simultaneous notice to the DOJ of requests required to be approved by the Department. (*Id.*, Conditions 1-6).

Governance changes: Under the Agreement, selection of BCBSD's Board of Directors, and thereby control of the governance of the company, will pass to Highmark which will be the sole "member" of BCBSD. The proposed revisions to BCBSD's Charter and Bylaws are set out in D.I. 1, Exhibits 2 and 3. They provide that post-Affiliation the BCBSD Board will consist of nine members, who are divided into three "classes": four Class A members, four Class B members, and a ninth member who is the Chief Executive Officer of BCBSD. Class A directors are the so-called "independent directors", as none of them may be officers or directors of Highmark or BCBSD. (*Id.*, Exhibit 3, Art. V, Sec. 5.2(b)). Members will be selected by BCBSD and they will nominate their successors. However, it is Highmark that is charged with ultimately electing all members of the Board, including the Class A members. (*Id.*, Exhibit 3, Art. V, Sec. 5.2 (a)).

Class B members will initially consist of Highmark's Chief Executive Officer, who is currently Dr. Kenneth Melani, and two other executive officers of the corporation, Nanette DeTurk and Deborah Rice. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, pp. 224-225; *see also* D.I. 83, JX 40-42). Highmark has not yet selected the fourth Class B member.

The ninth Board member is the "President Director" - the President of BCBSD. The President Director who, under the Affiliation will report to an Executive Vice President of Highmark, will serve as long as he or she is President of BCBSD. (D.I. 1, Exhibit 3, Art. V, Sec. 5.2 (a) and (d)). The President's election and term is subject to the approval of Highmark, with Highmark having the ability to terminate the President of BCBSD with or without cause. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 112-113).

Several of the Conditions deal with the selection and composition of the BCBSD Board and are designed to perpetuate local influence on the post-Affiliation Board. For instance, as required by 18 *Del. C.* Section 6311(b)(iii), a majority of the BCBSD Board members must be Delaware residents who have lived in the State for five years prior to appointment and who are not employed by BCBSD. (18 *Del. C.*, § 6311(b)(3); D.I. 130, Appendix A, JX 113A, Condition No. 3). Section 6311 also requires that the DOI must give prior approval of any change in the COI of BCBSD. (18 *Del. C.*, § 6311(b)(i)).

Condition 20 provides that a quorum of the BCBSD Board must consist of at least one Class A Director and one Class B Director, unless two consecutively properly- called meetings have lacked a Class A director or a Class B director. (D.I. 130, Appendix A, JX 113A, Condition 20). This promotes local control and input by requiring that at least one Class A (independent) Director of BCBSD must be present before the Board can conduct business. Condition No. 21 extends the terms of the initial Class A directors beyond what is proposed in the Agreement, so that the initial Class A directors will have staggered terms, serving until the third, fourth, fifth, and sixth annual meeting, respectively. (*Id.*, Condition No. 21). According to Condition 22, Highmark may not unreasonably withhold its election of a nominated Class A Director and must give BCBSD in writing its reason for withholding any such election. (D.I. 130, Appendix A, JX 113A, Condition No. 22).

In assessing the impact of the Affiliation on local control, it is instructive to review the experience of Highmark West Virginia. Scott Fad of BCBSD testified that the proposed BCBSD/Highmark Affiliation is generally based on the affiliation that led to the creation of Highmark West Virginia. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, p. 130). He testified that BCBSD's diligence efforts support a conclusion that the West Virginia affiliation involved not only integration with Highmark's technology platforms but "West Virginia was able to preserve its local presence as a robust and growing West Virginia employer under local leadership and offering local services." (*Id.,* p. 131). According to Mr. Fad, "This approach assures the West Virginia plan remains dedicated to serving West Virginia customers, accounts, health care providers and other local stakeholders, while also providing improved services and products as part of the Highmark platform." (*Id.*). Fred Earley, President of Highmark West Virginia, testified that under the West Virginia affiliation he retains overall responsibility for all West Virginia market functions, including sales and marketing, provider reimbursement and relations, government relations, public relations, and regulatory affairs. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Earley testimony, p. 311). He also testified about job and economic benefits to the local economy which followed the affiliation and stated his belief that the affiliation "has been beneficial to [Highmark West Virginia] customers and providers and has provided an overall benefit to the state of West Virginia as well as its citizens." (*Id.,* p. 315). Mr. Alderson Smith of Blackstone reported that "no significant complaints related to loss of local autonomy have been received by the West Virginia Department of Insurance from market participants or customers since the completion of the full integration between Highmark and Highmark West Virginia." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 391).

To lose a substantial amount of local control over a respected Delaware enterprise is difficult. However, the record supports a finding that the provisions of the Agreement itself, conditions imposed by statue, and other Conditions including those which the parties have negotiated will provide protection to Delaware policyholders and maintain BCBSD's presence in the State.

Finding Number 5: *THE AFFILIATION AND THE COMMUNITY SUPPORT CONDITIONS PRESERVE BCBSD'S NOT FOR PROFIT STATUS AND ITS CHARITABLE ACTIVITIES*

The Affiliation involves two not-for-profit entities, both of which are "Blue" organizations. There was nothing in the record indicating a plan to convert to a for-profit business or to end the association with BCBSA. Karen Hanlon of Highmark indicated, in response to a question from the Hearing Officer, that she was not aware of any plans that Highmark has to convert to for-profit status. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 251).

The Agreement provides that Highmark's conversion to a for-profit entity is a "triggering event" under which BCBSD could withdraw from the Affiliation. (D.I. 1, Ex. 1, Sec. 7.8; and Ex. 3, Art. XIII, Sec. 13.1). Mr. Constantine of BCBSD testified to the positive image BCBSD enjoys as a result of its not-for-profit status. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 93).

Related to BCBSD's non-profit status, and a very important aspect of the Affiliation inquiry, is the impact the Affiliation will have on BCBSD's support of charitable initiatives in Delaware. Much of the public comment on the Affiliation centered on BCBSD's assistance to community health organizations and the hope that it will continue if the Affiliation is approved by the Commissioner. Vicenta G. Marquez, M.D., described BCBSD's commitment to good health for all Delawareans via its charitable grants to The Hope Medical Clinic, Inc. (D.I. 108, JX 118). The Dover Interfaith Mission for Housing expressed similar sentiments, writing that "[w]ith [BCBSD's] help, we were able to shelter, feed, and help over 150 homeless men with their health care and employments needs." (D.I. 116, JX 122). Jeanine Kleimo of the Mission reiterated this concern at the public information session in Dover. (D.I. 41, Public Information Session Tr., Dover, DE., May 17, 2011, pp. 49, 50). La Red Health Center also wrote about

BCBSD's support for the Center's outreach efforts in Sussex County. (D.I. 123, JX 131). The Nemours Fund for Children's Health expressed its appreciation for BCBSD's charitable contributions to the Nemours/Alfred I.duPont Hospital for Children, including a $250,000 grant in 2008 supporting dental care for children with mental and physical disabilities, as well as a $500,000 grant to support the expansion of the hospital. (D.I. 122, JX 128). Catholic Charities Inc. of the Diocese of Wilmington, which has received more than $200,000 to support its counseling services for those underinsured or uninsured who need treatment of mental health disorders, wrote that it "depends on a vibrant Blue Cross Blue Shield organization in Delaware to support our mission of providing caring services to those in need." (D.I. 122, JX 129). James Lafferty, Executive Director, Mental Health Association in Delaware, spoke at the public hearing about BCBSD's support of the Association's fundraising efforts and treatment programs for individuals with mental health disorders, particularly with regard to programs in southern Delaware. (D.I. 111, Hr'g Tr. Oct. 7, 2011, Lafferty statement, p. 618-621).

A letter from the Delaware Health Information Network ("DHIN") requests that the Affiliation be conditioned on "BCBSD reach[ing] agreement with the DHIN regarding BCBSD's ongoing financial support of the DHIN via per member per month fees that will enable to continued financial sustainability of the DHIN." (D.I. 125, JX 134 at 3).

The Delaware Attorney General, the Hon. Joseph R. Biden III, and his staff at the Department of Justice have been particularly vigilant to protect the public investment in the assets of BCBSD and in assuring that they are used to promote the public good. (D.I. 109, Hr'g Tr. Oct. 5, 2011, statement of Attorney General Biden, pp. 11-24). The Attorney General's efforts are discussed more fully at pages 61-66 *infra*. For reasons set out in that Section, I decline to endorse his proposal that a foundation be established. However, his insistence that the

Affiliation both protect the substantial contributions Delaware taxpayers have made to BCBSD through the years and be mindful of unmet health needs in the State has greatly benefited the process.

At the hearing, BCBSD proffered testimony by Timothy Constantine that BCBSD is committed to maintaining its charitable role in the Delaware community following the Affiliation. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 83-85). He testified that BCBSD intends to continue with contributions to the Delaware Community Foundation (which began in 2008) in lieu of paying certain state taxes, as well as to continue with making additional community contributions of $750,000 each year at least through 2015. (*Id.*, pp. 96-98). With respect to the Delaware Community Foundation, Mr. Constantine explained that BCBSD established Blue Prints, a donor-advised fund at the Foundation, a nonprofit organization that manages and administers charitable funds throughout Delaware. Blue Prints was created to help address issues faced by Delaware's uninsured and underserved populations, as well as healthcare disparities throughout the state. (*Id.*, pp. 83-84). As for BCBSD's other community-support/corporate citizenship initiatives, Mr. Constantine testified that BCBSD also contributes $750,000 to community causes through a program called Working Well Together. (*Id.*, pp. 84-85).

Mr. Constantine characterized these commitments as "voluntary". And, at the time he testified, there were no Community Support Conditions or other document memorializing them. (*Id.*, pp. 97, 99). Further, as he admitted on cross-examination, under the Affiliation BCBSD's commitments would be subject to Highmark's approval. (*Id.*, p. 99).

Karen Hanlon of Highmark testified that "[t]he [A]ffiliation will not interfere with BCBSD's ongoing community support and charitable activity commitments [and that] Highmark will work with BCBSD to develop programs that leverage the lessons learned by both parties in community and charitable initiatives." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 222). She testified that the BCBSD Board of Directors would approve charitable contributions subsequent to the Affiliation closing. (*Id.,* pp. 230, 233). It should be noted, however, that the BCBSD board of directors will be controlled by Highmark. (JX 13 (filed confidential), BCBSA Guidelines at 7; D.I. 1, Exhibit 3, BCBSD Amended Bylaws, Art. V; D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 112-113). Ms. Hanlon also testified that she would expect to discuss the possibility of whether and how the Highmark Foundation might establish a charitable presence in Delaware after the closing of the Affiliation, as it has done in West Virginia. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 240).

The Community Support Conditions, which have been proposed by BCBSD, memorialize BCBSD's ongoing commitment to community and make it part of the Affiliation. Importantly, it has been agreed to by Highmark. These conditions address concerns raised by the public during the course of these proceedings. It amounts to a total commitment of $45 million dollars, although spread out over a period of years. The amount approximates the amount the Attorney General has requested as the minimal amount to be applied to a foundation and would appear to provide a "mechanism", as requested by the Attorney General, for meeting healthcare needs in Delaware. However, the Attorney General has not agreed to the Community Support Conditions which he considered inadequate. (D.I. 146, Ltr. from M. Tweedie, October 28, 2011).

I find that the Community Support Conditions will serve to continue BCBSD's important involvement with the community, conform with its benevolent and charitable purpose as a not-for-profit entity, and respect the contributions made to the financial well-being of BCBSD by Delaware taxpayers and BCBSD subscribers.

Finding Number 6. *NONE OF THE CRITERIA CONTAINED IN 18 DEL. CODE, SECTION 5003(d)(1)WHICH WOULD REQUIRE THE COMMISSIONER TO DISAPPROVE THE AFFILIATION HAVE BEEN ESTABLISHED*

The Commissioner specified (Order, October 20, 2010), and the parties agreed, that the Affiliation be assessed according to the criteria contained in 18 *Del. C.* Section 5003(d)(1). (*See also* 18 *Del. C.* § 6311(a)).

Section 5003(d)(1) of Title 18 reads as follows:

> The Commissioner shall approve any merger or other acquisition of control referred to in subsection (a) of this section unless, after a public hearing thereon, the Commissioners finds that [one of the criteria for disapproval is shown].

Thus, unless one of the six bases for disapproval is found to exist, the Commissioner must approve the proposed Affiliation.

The facts set out in Findings 1-5, above, are incorporated in the following discussion of the six statutory factors.

a. *After the change of control, the domestic insurer. . . would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed. (18 Del. C. § 5003(d)(1)a.)*

According to Timothy Constantine of BCBSD, BCBSD is regulated as a health service corporation under Chapter 63 of the Delaware Insurance Code and, because BCBSD was in existence prior to the adoption of Chapter 63, BCBSD is not required to hold a license or a certificate of authority. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 55; *See 18 Del. C.* § 6304(a)).

Martin Alderson Smith of Blackstone testified that after the Affiliation BCBSD will continue to operate as a non-profit, non-stock health services corporation and will continue to be able to write the same lines of insurance as it writes now, without having to acquire a certificate of authority from the DOI. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 345). Linda Sizemore of the Department testified that the proposed Affiliation "does not involve a change to [BCBSD's] corporate identity, its status as a health service corporation under Chapter 63 of the Delaware Insurance Code, or its ability to satisfy all applicable licensing standards." (*Id.,* Sizemore testimony, pp. 521-522).

At the public information sessions held in May 2011, one individual inquired whether current BCBSD policyholders will be required to reapply for insurance after the Affiliation takes place. (D.I. 42, Stuart Snyder, Public Information Session Tr., Wilmington DE, May 19, 2011, pp. 50-52). A physician also asked if mental health coverage will be "carved out" of standard BCBSD policies and have to be purchased separately. (*Id.,* Dr. Traci Bolander, pp. 58, 59). In a letter dated June 27, 2011, Highmark and BCBSD replied, first, that there are "no plans to institute coverage changes to any current customers that could result in the need to re-apply for other plans[,]" and, second, that Highmark and BCBSD "do not contemplate that the [A]ffiliation will have any impact on mental health benefits." (D.I. 43).

Mr. Alderson Smith also testified that, post-Affiliation, Highmark's three subsidiaries which are now licensed in Delaware will continue to meet the capital balance requirements for the satisfaction of their licensing requirements. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 346).

There was no evidence presented which contradicted the testimony of Mr. Constantine, Ms. Sizemore and Mr. Alderson Smith. Accordingly, it appears that there is no basis for disapproval under the licensing criterion of Section 5003(d)(1)a.

b. *The effect of the merger or other acquisition of control would be substantially to lessen competition in insurance in this State or tend to create a monopoly therein (18 Del. C. § 5003(d)(1)b.)*

Title 18, *Del. C.* Section. 5003A(d)(2) sets out specific quantitative standards for measuring whether, under an acquisition of control, competition within Delaware in the writing of any line of insurance would be substantially lessened, or a monopoly created thereby. The standards constitute *prima facie* indications of reduced competition and may be rebutted by substantial evidence which suggests the change of control will not have an anti-competitive effect. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 348; 18 *Del. C.* § 5003A(d)(2)d.).

Martin Alderson Smith testified that Blackstone applied these standards in analyzing the effect of the Affiliation on competition. (*Id.*, p. 347). He advised that an examination of data from the National Association of Insurance Commissioners ("NAIC") shows that there are two insurance categories in which BCBSD and Highmark currently compete in the Delaware health insurance market: Dental and Stop-Loss. (*Id.*, p. 348). With respect to dental insurance, Mr. Alderson Smith testified that the Delaware market is highly concentrated, with the 4 largest insurers having 98% of the market. (*Id.*, p. 351). Under the applicable standard, there is a *prima facie* violation if one of the insurers in the affiliation holds 10% or more of the market while the other holds 2% or more. (*Id.*, p. 352). BCBSD currently enjoys approximately 11% of this market and Highmark, through its subsidiary Concordia Dental, has about 6%. (*Id.*). The high market concentration of the four largest dental insurers, when considered along with the specific market shares of BCBSD and Highmark, results in a *prima facie* violation of the competitive standard. (*Id.*).

However, to evaluate the potential anti-competitive effect, Blackstone also considered additional factors which, it concluded, effectively negate the *prima facie* showing. First, the dental market in Delaware is currently dominated by Delta Dental, which has a market share of more than 73%. (*Id.*, p. 354). By comparison, the combined share of BCBSD and Highmark is approximately 17%. (*Id.*, p. 352). Given the dominant position of Delta Dental, Blackstone concluded that competition in the dental insurance business will not be substantially lessened; indeed, the Affiliation may actually make the market more competitive by introducing a strengthened competitor into the market. (*Id.*, p. 354). In addition, a significant percentage (81%) of Concordia's dental business in Delaware comes from customers who live in Delaware but obtain their dental insurance from employers in other states. Taking this into account resulted in an estimated adjusted market share for United Concordia that is below the statutory 2 percent threshold. (*Id.*, p. 353). Therefore, BCBSD's pricing actions in Delaware have little, if any, impact on Concordia's pricing. (*Id.*, p. 352). In Blacksone's view, these factors effectively rebut the presumption. There was no evidence in the record which conflicts with this analysis or conclusion.

With respect to Stop-Loss insurance, Blackstone found it impossible to measure the percentage of a health insurer's market share that comes from such premiums because insurers report stop-loss premiums using different and inconsistent categories. (*Id.*, pp. 348, 349). According to the DOI, in 2010 Highmark reported its health insurance premiums written in Delaware in two NAIC categories: "Comprehensive Health" and "Life, Accident and Health", with no separate category for Stop-Loss, whereas BCBSD reports all its premiums in the "Comprehensive Health" category. (*Id.*, pp. 349, 350). Because these categories do not correspond, Blackstone used a secondary measurement. This measurement showed that if

Highmark's total insurance premiums in both categories are compared to the total premiums reported in the Comprehensive Health category, Highmark would have a 0.8% market share in the NAIC category most closely aligned with the overall market for insurance in Delaware. (*Id.*) Since the *prima facie* standards require a market share of 1 percent or more, Highmark's market share does not indicate a violation of the competitive standard.

In assessing the competitiveness standard it is important to note that a Condition of the Affiliation which has been agreed to by BCBSD, Highmark and the DOI is that there will be no "bundling" of health offerings. (D.I. 130, Appendix A, JX 113A, Condition 30). Thus, no potential customer would be required to purchase, for instance, Highmark dental insurance in order to purchase BCBSD health coverage. Mr. Alderson Smith testified that such practices could negatively impact consumers and recommended prohibiting the practice. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, pp. 355-356). Ms. Sizemore also expressed the DOI's concern about the potential negative impacts of bundling and supported the Condition dealing with the practice. (*Id.,* p. 524). Condition 30 prohibits conditioning the sale of a list of products and services on the purchase of an ancillary product. Each such product will continue to be offered as a stand alone product. (D.I. 130, Appendix A, JX 113A, Condition No. 30).

Blackstone's method and conclusions were not challenged. Thus, it appears that the evidence has not established a violation of the anti-competitive standard.

Although BCBSD's currently enjoys the largest market share among health insurers in the State (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 88-89), there was no testimony about whether BCBSD's affiliation with a much larger insurer will "tend to create a monopoly" in health insurance in the State, one of the criteria contained in Sec. 5003(d)(1)b.

BCBSD is already the largest insurer in the State, with approximately 30% of the market, and serves almost 400,000 Delawareans. (*Id.,* pp. 54, 89). Highmark operates on a scale which far exceeds BCBSD. (*Id.* p. 68). Karen Hanlon, Highmark's Senior Vice President for Financial Planning and Analysis, described the scope of Highmark's operations. (*Id.*, Hanlon testimony, pp. 189-197).

Given BCBSD's strength in Delaware, its affiliation with a far larger, financially secure insurer, portends that it will be poised to enjoy an even stronger position in the Delaware market. However, there was no testimony which showed that the statutory standard is met as regards BCBSD and its competitors. According to Mr. Constantine, BCBSD's primary competitors in Delaware are Aetna, Coventry and United Healthcare. He stated that "[t]hese competitors dwarf BCBSD in size, and each has a national presence with very strong business and technology capabilities." (*Id.,* p. 64). Further, "[t]hese large insurers have the capital to invest in the leading-edge technologies that consumers and providers demand, and they have the size and leverage to secure economies of scale and favorable national medical costs agreements…."

(*Id.*). BCBSD clearly feels that the Affiliation will enable it to compete more effectively against these companies in the future. (*Id.,* p. 67).

None of BCBSD's competitors sought to participate in these proceedings and challenge the Affiliation. One of the competitors, Coventry, sent a letter commenting on the Affiliation and suggesting restrictions. Some of these suggestions are sufficiently contained in the Agreement or the Conditions. (D.I. 90, JX 112, groups (iii), (iv) and suggestions 1, 2 and 3 of paragraph (v)). The remaining proposals, however, fall outside of the scope of this proceeding.

Based on the Department's analysis, and in light of the anti-bundling Condition 30, it does not appear that the Affiliation will have an anti-competitive effect in the State or create a monopoly. Thus, I find the provisions of Section 5003(d)(1)b. are not applicable.

c. *The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders (18 Del. C. § 5003(d)(1)c.)*

Under the Affiliation, Highmark is obligated to guarantee claims against BCBSD, to offer administrative and corporate services to BCBSD, and to make available to BCBSD the line of credit pursuant to the LOC. (D.I. 1, Exhibits 1, 3 and 4). Thus, it is important to BCBSD and its policyholders that Highmark has the financial ability to meet these obligations.

Martin Alderson Smith testified that Blackstone's review of Highmark's financial condition focused on three issues: (1) the likelihood that Highmark will have sufficient financial strength to remain a dependable source of services for BCBSD; (2) the likelihood that BCBSD will need to rely on Highmark for support in paying BCBSD's claims; and (3) the potential impact of Highmark's proposed affiliation with West Penn Allegheny Health System on Highmark's overall financial stability. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, pp. 357-358).

Mr. Alderson Smith testified that, based on calculations by Blackstone, Highmark's risk based capital ratio ("RBC") of approximately 692% is higher than the median ratio of 487% found in a sample of large publicly traded health insurers. (*Id.*, p. 359). The RBC is a frequently-used metric in the insurance industry to indicate the financial strength of an insurer. (*Id.*, p. 358). Mr. Alderson Smith testified that Highmark's RBC "indicates the above-average strength of Highmark's financial condition, as it relates to the ability to satisfy liabilities even in the face of a market downturn or other adverse development." (*Id.*, pp. 359, 360).

Karen Hanlon of Highmark testified that Highmark has an A rating from both A.M. Best and Standard & Poor's. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 212). Highmark's quarterly financial statement, dated June 30, 2011, reflects that Highmark had over $4 billion in surplus and that its net income was over $138.5 million. (*Id.*). It is the largest in terms of total revenue of those Blue Cross Blue Shield plans in the nation which remain not-for-profit. (*Id.*, pp. 191, 192).

Mr. Alderson Smith testified that, in addition to considering Highmark's financial stability, it was also important to consider BCBSD's reserves which it will carry into the Affiliation. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, pp. 357, 358, 361, 362). The current reserves of BCBSD are approximately $180 million. (*Id.*, p. 445; D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 95). According to Mr. Alderson Smith, the reserves are important because they "comparatively strengthen [BCBSD's] relative ability to maintain local operational decision-making as a result of decreased potential dependence on Highmark for financial stability." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 362). He concluded that BCBSD's current reserve levels are such that "it is unlikely that [BCBSD] would need to rely on Highmark to honor [BCBSD's] claims in the near future." (*Id.*, p. 365).

The record in the proceeding amply demonstrates that Highmark - the "acquiring party" in this transaction - enjoys a strong financial position and appears to be capable of satisfying its contractual obligations to BCBSD, even in the event of an economic downturn, and to offer financial support to BCBSD if required to do so.

However, there is a concern that Highmark's pending affiliation with West Penn, which is a non-profit provider operating five hospitals in the Pittsburgh region, has the potential of adversely affecting Highmark's financial status. One member of the public who spoke at the public hearing feared that Highmark will use BCBSD's reserve to "recover billions of dollars in investments from West Penn Allegheny. . . ." (D.I. 111, Hr'g Tr. Oct. 7, 2011, comments of Vincent White, p. 645).

The affiliation with West Penn has not been consummated, so it is difficult to assess what Highmark's total financial contribution may be. From information furnished by Highmark, Mr. Alderson Smith testified that it preliminarily appears that Highmark has made a commitment to West Penn in the form of loans and grants in the amount of $475 million over four years. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 363). However, according to Mr. Alderson Smith, even if Highmark were to lose its entire potential financial commitment to West Penn, Highmark estimates its RBC ratio would fall only approximately 60 to 115 percentage points. (*Id.,* p. 364). This would still leave its RBC ratio above the 375% monitoring threshold of BCBSA and above the 478% median ratio among a sample of large publicly traded health insurers. (*Id.*).

With respect to the West Penn affiliation, the Department has proposed, and BCBSD and Highmark, have agreed to, a Condition which offers further protection to BCBSD in the event the West Penn transaction goes awry. Condition 35 provides that in the event Highmark affiliates with West Penn, Highmark will not, directly or indirectly, pass any up-front or ongoing costs associated with the Affiliation on to BCBSD. (D.I. 130, Appendix A, JX 113A, Condition 35). Other conditions imposed under 18 *Del. C.* Sections 6311(b)(ii) and (iv) require DOI review and monitoring of certain financial transactions between the two affiliates and authorize the Department to seek relief in court if Highmark improperly uses assets of BCBSD for the benefit of Highmark, rather than the benefit of BCBSD. These Statutory Conditions offer further protection and are memorialized in Conditions 1 and 2. (*Id.,* Appendix A, JX 113A, Conditions 1, 2; *see also* Condition 9).

The facts show that Highmark enjoys a strong financial position which does not jeopardize the financial stability of BCBSD or prejudice the interest of its policyholders. This satisfies the requirements of 18 *Del. C.* Section 5003(d)(1)c. and I so find.

d. The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management are unfair and unreasonable to policyholders of the insurer and not in the public interest. (18 Del. C. § 5003(d)(1)d.)

Karen Hanlon, Senior Vice President of Highmark, testified that Highmark does not have any plans or proposals to sell or liquidate BCBSD or merge it with another entity. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 213). She also testified that "Highmark has no current plans to replace the current officers of BCBSD as a result of the [A]ffiliation." (*Id.,* pp. 214-215). She also stated that "Highmark has no plans or intentions to gain access to BCBSD's assets or to transfer any of BCBSD's assets to Highmark or any subsidiary or affiliate of Highmark." (*Id.,* p. 222; *see also* D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 529). Highmark has agreed to a Condition incorporating these assurances, specifically that "Highmark has no plans or proposal to liquidate [BCBSD] or sell [BCBSD's] assets or consolidate or merge it with any person or entity." (D.I. 130, Appendix A, JX 113A, Condition No. 37).

This testimony from Highmark notwithstanding, Linda Sizemore of the Department testified that "[m]any of the [Department's] concerns about the Affiliation are implicated by Standard d." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 528). Similarly, Martin Alderson Smith of Blackstone stated that "Standard 'd' is "one of the most critical standards by which to evaluate this [A]ffiliation." (*Id.*, Alderson Smith testimony, p. 365).

Specifically, the concern is whether changes to the business, corporate structure, or management of BCBSD which will follow the Affiliation are unfair or unreasonable to BCBSD policyholders and not in the public interest. The structural changes in BCBSD governance and business operations have been discussed at length in connection with Finding Number 4 above, and should be considered in analyzing standard "d". Other notable changes the Affiliation may bring about to the business, corporate structure and management of BCBSD and which may impact policyholders are discussed below:

1. Effect of Affiliation on benefits to policyholders: With respect to BCBSD policyholders, the record shows that the Affiliation has the potential of being beneficial to them in many respects. Karen Hanlon testified at length about the benefits which the Affiliation will bring to Delaware policyholders, employers, providers and producers. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, pp. 219-220). Highmark will guarantee all claims against BCBSD and offer other financial security to BCBSD. (*Id.*, p. 219). The planned merger of BCBSD into Highmark's advanced technology platform promises faster processing of claims and benefits and other services. (*Id.*, pp. 208-209). According to the testimony of Ms. Hanlon, Delaware stakeholders "will continue to have the same benefits and coverage that they have today, but their business will be administered on a more automated advanced technology platform." (*Id.* p. 208). Ms. Hanlon also pointed to the likelihood that BCBSD will be able to offer new products because of its affiliation with Highmark. (*Id.*). One health provider commented on how well claims transactions which are already being handled through Highmark are now being serviced. (D.I. 42, Dr. Traci Boland, Public Information Session Tr., Wilmington DE, May 19, 2011, p. 59).

BCBSD also projects that under the Affiliation a number of additional services and programs can be provided to Delawareans, both individual subscribers and Delaware employers who offer BCBSD insurance. These services include retail stores, wellness programs, and on-line tools for customers. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, p. 484). BCBSD claims that because of its small size, it has not been able to provide such expansive offerings in the past and that it would be far more economical to participate in programs offered through Highmark than to start such programs on its own. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 67).

2. Effect on rate increases: There was limited testimony about how the Affiliation may impact rates paid for health insurance by individual policyholders or employers. Given the sizeable reserves of the two entities and repeated testimony about "economies of scale" which will follow Affiliation, it was surprising that the impact of these projected savings on insurance rates was so little discussed. One individual, an insurance broker who spoke at a public information session, stressed the need for stability in rates. (D.I. 40, Clay Monroe, Public Information Session Tr., May 16, 2011, Georgetown DE, p. 45).

"Current projections anticipate that premiums will increase in the Delaware health insurance marketplace regardless of the financial status -- or of the affiliation status of BCBSD." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 221). Karen Hanlon further testified that BCBSD and Highmark project that future rate increases will be about 3% lower under the Affiliation than if BCBSD remained on a stand-alone basis. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 221). And, in assessing the overall financial impact of affiliation versus BCBSD remaining a standalone company, Mr. Alderson Smith of Blackstone testified that "[T]he standalone projections assume that [BCBS] will bear the full cost of the IT upgrades on its own which will necessitate raising premium prices in order to help recoup a portion of the cost of the upgrades, and that [BCBSD's] membership will suffer due to these price increases." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 385). In support of its commitment to control future rate increases, BCBSD has included as part of its Community Support Conditions a commitment to "establish a rate stabilization reserve or other appropriate mechanism, in the amount of $10 million, which shall be applied to reduce the rate premium growth for individual and small group subscribers." (D.I. 147, Ltr. from D. Swayze and M. Teichman re: Community Support Conditions, Nov. 2, 2011).

In light of all the current uncertainties in the health care system, it is difficult to project whether a slowing of rate increases and greater stability in rates will actually occur as a result of the Affiliation. However, should the lower rate of premium increase materialize, as projected, it would undoubtedly be a welcome development to the insurance buying public.

3. Effect of the Affiliation on BCBSD business operations and corporate structure: The significant changes in BCBSD's governance system and business operations have been explicated at length in Finding No. 4 above and are equally pertinent to this discussion. Concerns expressed by the DOI and the public about the loss of local control has resulted in a number of Conditions designed to maximize BCBSD's local presence after the Affiliation. The DOI believes these Conditions "are necessary to ensure that the corporate governance structure appropriately protects the interests of policyholders and the Delaware public." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, pp. 530-31; D.I. 130, JX 113A, Conditions 20, 21 & 22).

4. Effect of Affiliation on Delaware employment: Another potential impact on the "public interest" is the likelihood of reduced employment in the State which could follow the Affiliation.

Scott Fad of BCBSD noted that "[i]n order to achieve the administrative efficiencies, economies of scale and synergies that are so important to the Affiliation, the BCBSD end-state employment levels appear to place BCBSD at approximately 435 full-time equivalents [FTEs]", which is "a significant reduction from the current employment level of 617 FTEs." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, pp. 142-143). Martin Alderson Smith of Blackstone testified that BCBSD employment levels "could decline as a result of the Affiliation" and that "ultimately [there is] a tension between Highmark's goal of enhancing [BCBSD's] competitiveness by promoting greater efficiency with [BCBSD] and efforts to preserve [Delaware] employment levels." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 387).

The impact of the Affiliation on employment in Delaware has been a matter of concern during the negotiation of the Agreement and the review by the DOI. It has led to several provisions designed to protect employment in the State. Mr. Fad testified that in negotiating the Agreement and in planning for the Affiliation BCBSD "stressed the importance of preserving robust employment in Delaware" and discussed a number of employment-related commitments that appear in the Affiliation documents. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, p. 143). The Agreement provides that BCBSD and Highmark agree "to use commercially reasonable efforts to maintain employment levels in Delaware that are proportionate to the employment levels that Highmark maintains in other geographic areas to directly service its health insurance servers." (D.I. 1, Ex. 1, Sec. 7.4). In addition, Highmark must act in good faith to "identify and create new employment opportunities in the State of Delaware as business needs and conditions permit." (*Id.*).

Mr. Fad also testified about three additional voluntary commitments that BCBSD and Highmark have made with respect to employment: (i) "the total number of employees in Delaware [617] will remain the same after implementation of the [A]ffiliation is complete, approximately 18 months, as it was at the start of the [A]ffiliation integration activities"; (ii) "any BCBSD employees whose positions are eliminated due to the implementation will be given first opportunity to fill any new BCBSD or Highmark positions that are created in Delaware"; and (iii) "Highmark will make good faith efforts to locate additional positions in Delaware as Highmark's business opportunities arise." (*Id.,* pp. 144, 145). At the suggestion of the DOI, these commitments are incorporated into Condition 7. (D.I. 130, Appendix A, JX 113A, Condition 7).

Finally, Mr. Fad noted that "in [BCBSD's] due diligence process we placed considerable importance on the results of the Highmark West Virginia experience. There, although the plan experienced the same significant integration between Highmark and West Virginia that Highmark and BCBSD anticipate, employment has actually grown meaningfully in West Virginia since the affiliation . . .BCBSD experienced similar growth in employment following the CareFirst affiliation and we expect to see it with Highmark as well." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Fad testimony, pp. 145, 146).

Karen Hanlon of Highmark affirmed Mr. Fad's testimony. (*Id.*, Hanlon testimony, pp. 217, 218). Specifically, Ms. Hanlon testified that "Highmark and BCBSD have committed to maintaining a significant Delaware presence and to maintain the BCBSD corporate headquarters in Delaware." (*Id.*, p. 216). This commitment appears in Section 7.4 of the Agreement. (*See* D.I. 1, Ex. 1, Affiliation Agreement, Sec. 7.4). Ms. Hanlon also testified about the other voluntary commitments BCBSD and Highmark have made to maintain employment levels in

Delaware, as described in Mr. Fad's testimony discussed above. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, pp. 216, 217).

Highmark also agreed to a DOI-proposed condition that seeks to preserve the quality and focus of BCBSD's service to its customers and stakeholders in Delaware, in part and in effect through employment of Delaware based staff. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 218; *see also* D.I. 130, Appendix A, JX 113A, Condition No. 8).

5. <u>The effect of the Affiliation on BCBSD's financial condition:</u> As discussed in connection with Finding Number 2, which deals with the decision of the BCBSD Board to enter into an affiliation rather than remain independent, the projected cost for BCBSD to migrate onto Highmark's IT platform is $35 to $37 million. This is considerably less than the estimated $100 million to $140 million that BCBSD would expend to upgrade its IT capabilities on its own. Given the necessity of IT upgrades, an affiliation represents a substantial savings to BCBSD over the standalone option. Ms. Hanlon of Highmark testified that the Affiliation "will enable BCBSD to preserve tens of millions of dollars that it would otherwise expend making IT capital improvements and other capability enhancements." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 224). She also testified that the Affiliation will result in BCBSD's surplus being $226 million by the end of 2015, rather than $89 million if BCBSD remains a standalone company. (*Id.,* p. 224). These projections indicate the Affiliation will be financially beneficial to BCBSD.

However, there are concerns about the transfer of funds from BCBSD to Highmark and how these might deplete BCBSD's financial resources. Mr. Alderson Smith testified that the Agreement contemplates three types of economic transfers from BCBSD to Highmark: (1) payments for upgrades to BCBSD's IT systems; (2) payments for Highmark's ongoing administrative and technology services; and (3) interest payments to Highmark on any funds BCBSD opts to borrow under the LOC designed to provide funding to BCBSD for integration costs if needed. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 378). He testified that "[t]he Affiliation does not otherwise provide for any mechanism for [BCBSD] to transfer funds to Highmark." (*Id.*). The DOI has proposed, and both Highmark and BCBSD have agreed to, a condition providing that the three types of economic transfers identified by Mr. Alderson Smith will be the only economic transfers that can be made by BCBSD to Highmark without DOI approval. (D.I. 130, Appendix A, JX 113A, Condition No. 9). An additional provision in this Condition provides that "Highmark shall not improperly use the assets of BCBSD for the benefit of Highmark, rather than the benefit of BCBSD and its subscribers." (*Id.*).

Despite these assurances, it is possible, as Timothy Constantine admitted on cross-examination by the DOJ, that assets could be diverted from BCBSD to Highmark through the overcharging for administrative services, or the provision of inadequate services at full cost. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 104-105). Each of the three economic transfers is discussed below.

<u>(i) Payments for upgrades to BCBSD's IT systems</u>: Mr. Hynek of BCBSD testified that the cost of BCBSD's IT upgrades will cost approximately $35 million if it affiliates with Highmark. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hynek testimony, p. 147). In order to assure that this expense does not exceed the projected cost, the DOI has proposed, and both Highmark and BCBSD have agreed to, a Condition placing a cap of $42 million on the integration costs. Any integration costs in excess of this amount must be paid or absorbed by Highmark. (D.I. 130, Appendix A, JX 113A, Condition No. 17).

(ii) Payments for Highmark's ongoing administrative and technology services:

At the hearing, much testimony was elicited about the cost-allocation methodology ("CAM") of Highmark, which determines how costs will be apportioned to BCBSD under the ASA. The ASA provides that BCBSD's payment to Highmark for services it provides will be "in an amount equal to BCBSD's fair and reasonable allocable share of the total actual costs without provision for profit…." (D.I. 1, Exhibit 4, Art. II, par. A). It further provides that BCBSD has the "right at any time and from time to time to review and inspect the appropriate records of Highmark" relating to costs. (*Id.* at par. C). As noted above, the concerns about this provision are that it could serve as a conduit whereby Highmark could access funds from BCBSD through overcharging for its services or providing inadequate services at full price.

Karen Hanlon of Highmark testified that the ASA "does not include any profit margin to be paid to Highmark" and that "BCBSD will receive the services and access to Highmark business. . .and simply must pay Highmark for the allocated cost of those services." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, p. 204). According to Ms. Hanlon, the costs to BCBSD for services Highmark provides under the ASA will include those for "executive oversight, strategic planning, procurement, and other corporate services which are sometimes referred to as corporate overhead" and which include some portion of the salaries of Highmark executives. (*Id.,* p. 203). She explained that "BCBSD's allocable share of the costs will be based on Highmark's established cost accounting practices which will be used consistently across all the business lines for which Highmark is providing services." (*Id.*). These business lines include all of Highmark's numerous subsidiaries and affiliates and Highmark West Virginia. (*Id.,* p. 204).

Ken Gebhard, Highmark's Vice President for Cost Management and Analysis, is the person responsible for administering its budgeting, cost accounting and cost forecasting business.

(D.I. 109, Hr'g Tr. Oct. 5, 2011, Gebhard testimony, p. 254). He testified at length and in detail about the mechanics of Highmark's established cost-allocation methodology ("CAM"), including the ways in which Highmark determines which costs to apportion to which of its affiliates and subsidiaries. (*Id.*, pp. 258-262, 273-275). Mr. Gebhard testified that the CAM itself is reflected in a detailed Highmark internal document approximately three hundred pages in length. (*Id.*, p. 267). He explained that the intent of the CAM is to reflect Highmark's "single set of cost accounting practices" across all of its affiliates and subsidiaries, and that "the important thing about the cost accounting is the consistency, and that's what [Highmark is] basically maintaining through the discipline of the cost accounting methodologies that [Highmark has] in place." (*Id.*, pp. 264-265). Mr. Gebhard noted that Highmark had recently hired a consulting firm regarding cost allocation and the consultant concluded that Highmark's cost accounting practices conformed with industry best practices. (*Id.*, p. 285). He also confirmed that several government entities audit the cost-accounting practices for several segments of Highmark's businesses, and that he cannot think of an example in which Highmark was found to be non-compliant or that there was an audit issue requiring Highmark to institute a change. (*Id.*, pp. 267-269, 283-285). Ms. Sizemore of the DOI testified that she was "impressed by how rigorous and complex [Highmark's] cost allocation methodology is," including the numerous allocation factors used, although she professed she could not understand it all as yet. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 556).

Despite these assurances, several problems with the CAM were brought out by the DOJ on cross-examination of the witnesses. The first pertains to whether BCBSD will have any input into either the development of the CAM or its application. Mr. Constantine admitted on cross-examination by the DOJ that it is Highmark that determines the CAM, in respect to both the creation of the CAM and any changes to it. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, pp. 108-111). When asked by the DOJ who at BCBSD would raise CAM disputes with Highmark, Mr. Constantine replied that he or a more junior employee would do so. (*Id.,* p.112). But he confirmed that Highmark would be able to remove him from his position at any time without cause. (*Id.,* pp. 112-113). Mr. Gebhard, however, testified that he does not see Highmark as having full discretion regarding its CAM, in light of contractual obligations in administrative services agreements that require the CAM to be fair and reasonable, although he admitted it would be Highmark that would ultimately determine whether an allocation is fair and reasonable. (*Id.,* Gebhard testimony, p. 286).

A second difficulty with the CAM is its flexibility and the fact that it can be revised due to changes in the business. Mr. Gebhard testified that this flexibility is desirable and that "[t]o lay [the CAM] out specifically as though they were going to be in place for the entire duration of the agreement that hopefully has a long life, it would be impossible because they would be constantly changing to keep up with the changes in the business." (*Id.,* p. 264).

Commenting on this flexibility, James Hynek of BCBSD testified on cross-examination that, from BCBSD's perspective, it is expected that the cost-allocation process will change over time "to meet new business requirements [and] new types of costs" and that it is not as if the CAM is "frozen in time and written down for posterity." (*Id.,* Hynek testimony, p. 169).

A third issue is that, at the time of the hearing, neither BCBSD nor the DOI had conducted a comprehensive review of Highmark's cost-allocation methodology. James Hynek anticipated that this will be done in the first quarter following the closing of the Affiliation when BCBSD will develop testing and monitoring protocols. (*Id.,* pp. 163, 168). One product of that review process will be an internal BCBSD document that will be used to confirm BCBSD's analytical testing (for example, change over time) and substantive testing (for example, verifying the accuracy of apportioned costs) of the proposed CAM accounting from Highmark. (*Id.,* pp. 178-179). Mr. Hynek testified that BCBSD believes the postclosing period is adequate to develop testing and monitoring protocols. (*Id.,* p. 163). This was echoed by Ms. Sizemore of the DOI who testified that she did not think the DOI needed to see the CAM before determining whether or not to approve the Affiliation. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 586). She believe that under the Affiliation BCBSD would gradually integrate into Highmark and, as it did so, BCBSD "would move onto more and more of this cost allocation methodology" and DOI's understanding of the CAM would increase as it worked with it. (*Id.*).

At the instigation of the DOI, several conditions were proposed dealing with cost-allocations, and these have been agreed to by both Highmark and BCBSD and are included in the Conditions. Ms. Hanlon of Highmark described these particular Conditions. Specifically, prior to closing, BCBSD and Highmark will file with the DOI Highmark's CAM and CAM formula, and thereafter BCBSD will each year file with the DOI a copy of the proposed budget for the following year, including the planned CAM charges. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hanlon testimony, pp. 246-247; D.I. 130, Appendix A, JX 113A, Condition No. 10). The DOI will annually review and approve the proposed CAM charges which appear in the proposed budget to determine if they are fair and reasonable. (*Id.,* p. 247; D.I. 130, Appendix A, JX 113A, Condition No. 11). In addition, BCBSD must obtain the DOI's approval before making any payment for CAM charges that exceed the DOI-approved budget by more than $500,000. (*Id.,* pp. 247-248; D.I., 130, Appendix A, JX 113A, Condition No. 12). These conditions do not apply to reimbursement BCBSD makes to Highmark for third-party costs Highmark incurs for the sole benefit of BCBSD, so long as Highmark submits to the DOI evidence supporting the amount and purpose of any such charges that exceed $100,000. (*Id.,* p. 248; D.I. 130, Appendix A, JX 113A, Condition 13).

Two other Conditions also relate to CAM charges. BCBSD and Highmark must maintain their books and records so that the precise nature and details of transactions are clear and that there is support for the reasonableness of charges and fees. (D.I. 130. Appendix A, JX 113A, Condition 14). Also, pursuant to Delaware law, BCBSD and Highmark must receive the prior review and approval of the DOI, on the basis of "commercial reasonableness", of any expenditure, transfer of funds, or coordinated series of expenditures from BCBSD to Highmark that exceed $500,000. (18 Del D. 6311(b)(ii); D.I. 130, Appendix A, JX 113A, Condition 1). The same statute requires that whenever approval must be obtained from the DOI simultaneous notice must be provided to the DOJ. (18 *Del. C.* § 6311(c)).

Testimony indicated that Highmark's CAM method is not unreasonable, given monitoring by the DOI and other requirements of the Conditions. As Mr. Alderson Smith testified, "Highmark's methodology for allocating ongoing operational and administrative charges to [BCBSD] is not unreasonable, subject to appropriate monitoring, authorization and dispute controls being implemented as planned [in the relevant Conditions]." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 383). Mr. Jackson of KPMG also stated his belief that the ongoing CAM charges are reasonable. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, pp. 496-497). He explained the specific types of IT services that would generate ongoing CAM charges, and that Highmark's proposed provision of services to BCBSD "at cost" is a system common in the industry. (*Id.,* pp. 497-498.). On cross-examination, the DOJ questioned whether Highmark has the ability to enrich itself to the detriment of BCBSD and while Mr. Jackson did not answer the question directly, he expressed his belief that the required transparency would be able to rectify any misallocation, stating that "the cost allocation methodology is set up in a way that allows for transparency in terms of how costs are captured and how they are allocated based on various allocations bases" and that, given this transparency, "there will be plenty of opportunity for there to be an audit of these specific allocation costs on an annual basis or on an as-needed basis, and that can ensure that the allocation of costs is fair and equitable" and "will be implemented appropriately and fairly." (*Id.*, pp. 511-513).

Mr. Alderson Smith explained how the CAM process would work and also testified that in his view the conditions proposed by the DOI have struck the right balance between allowing BDBSD to continue to run effectively while also ensuring that BCBSD's reserves and interests are protected in Delaware. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, pp. 417-421). Accordingly, he felt it was not necessary for all questions regarding the CAM to be referred to the DOI. (*Id.*, p 418). Ms. Sizemore felt confident that once the DOI examines the variances, "we should be able to pick up on things that we want to question and examine." (*Id.* Sizemore testimony, p. 588). She noted that if, pursuant to the Conditions, the DOI "find[s] out later this cost methodology is not what it's cracked up to be, I believe we have relief in the Court of Chancery...I feel protected – I feel fine as we are now." (*Id.*, pp. 586-587).

The DOJ questioned several witnesses about the possibility of placing a hard cap on increases in cost allocations. Under cross-examination by the DOJ, Mr. Earley, President of Highmark West Virginia, testified that Highmark had committed to an annual hard cap of no greater than two percentage points more than the Consumer Prince Index ("CPI+2") on increases in cost allocations to Highmark West Virginia, stating "that was something that was discussed as part of our understanding with the West Virginia Insurance Commissioner." (D.I. 109, Hr'g Tr. Oct. 5, 2011, Earley testimony, pp. 319-320). Mr. Alderson Smith testified that rather than impose a hard cap such as CPI+2 on annual charge increases, the DOI preferred to use a more flexible combination of the conditions and the DOI's regulatory powers to monitor and approve ongoing CAM charges to BCBSD. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, pp. 421-423, 442-444). On cross examination of Mr. Alderson Smith, the DOJ questioned whether using a hard and soft cap are mutually exclusive and Mr. Alderson Smith responded, without answering the question directly, that in his view a hard cap "wouldn't really have done much" in light of the Conditions reached by BCBSD and Highmark. (*Id.,* p. 423). Ms. Sizemore also testified in response to cross-examination by the DOJ that the DOI had discussed with its advisors the possibility of a hard cap on annual CAM charges, such as the CPI+2 cap in West Virginia, but that the DOI felt more comfortable with a flexible set of constraints that could result in lower cost increases than with a hard cap as in West Virginia. (*Id.,* Sizemore testimony, pp. 594-595). The DOJ elicited testimony from Ms. Sizemore that the DOI never conducted a study on whether a hard cap was an appropriate option as well as testimony that indicated the option of imposing both a hard and soft cap was not seriously considered. (*Id.,* p. 595). Ms. Sizemore stated that was because the DOI felt comfortable with what had been developed. (*Id.*).

(iii) Payments Under the Line of Credit: Under the Agreement, Highmark has promised to make available to BCBSD a line of credit to help with BCBSD's migration onto Highmark's IT system. (D.I. 1, Ex. 1, Art. VII, Sec. 7.2; *see also* Ex. 5, LOC). The Agreement provides that funds advanced to BCBSD under the LOC shall not exceed Forty-Five Million Dollars ($45,000,000). (*Id.*). The LOC also includes methods for computing interest on the principal amount of the line of credit. (*Id.,* Exhibit 5). Timothy Constantine testified that BCBSD has no current plans to draw on the line of credit. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 76).

Martin Alderson Smith expressed Blackstone's belief that "[t]he terms and interest rate of [the LOC] with Highmark considered as a whole are not unreasonable." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 384). Highmark and BCBSD have accepted a condition that would provide BCBSD three years after any termination of the LOC to repay funds it has borrowed under the line of credit, unless BCBSD affiliates with a for-profit company, in which case an immediate repayment is required. (D.I. 130, Appendix A, JX 113A, Condition No. 27).

Two other Conditions relate to the LOC: first, a condition that any default by BCBSD will entitle Highmark to terminate the LOC only if the default is material and goes uncured for sixty days; and second, a condition that amends the LOC to allow BCBSD to take on certain debts, to issue certain security interests, or to encumber its assets so long as Highmark has given prior written consent or any such activity or encumbrance by BCBSD is subordinate to any security interest held by Highmark. (*Id.,* Conditions 28 and 29).

6. Effect of Affiliation on BCBSD reserves: BCBSD currently enjoys a reserve of approximately $180 million. In this proceeding, the term "reserve" has been used interchangeably with the term "surplus". (D.I. 109, Hr'g Tr. Oct. 5, 2011, Hynek testimony, pp. 176-177; *See also* 28 *Del. C.* § 6311(b)). The primary purpose of a reserve is to ensure that a non-profit insurer has sufficient funds to pay insurance claims. However, it may also be used for other purposes, including meeting unforeseen contingencies, making capital expenditures, setting insurance rates, and making charitable contributions. James Hynek of BCBSD testified that the primary purpose of BCBSD's reserve is to fund capital enhancements and to protect against catastrophic events or market downturns, given that BCBSD is a not-for-profit and cannot raise capital via the capital markets. (*Id.*) It is anticipated that the BCBSD reserve will continue to

grow; Karen Hanlon of Highmark testified that by 2015 the BCBSD reserve should be $226 million. (*Id.,* Hanlon testimony, p. 224).

In his Statement at the public hearing, the Attorney General pointed out that because BCBSD is a not-for-profit enterprise, it has enjoyed a favorable tax treatment by the State. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Attorney General Biden statement, p. 12). It has also benefited from the "goodwill and positive public perception generated by its not-for-profit status." (*Id.*). According to the Attorney General, these factors have contributed to BCBSD's strong financial position, including the build up of substantial capital and surplus. (*Id.*). The Attorney General is concerned that the Affiliation threatens this reserve because it will put control of the reserves in the hands of an out-of-state corporation. This corporation could potentially deplete the reserve for its own purposes, rather than using it to benefit Delawareans.

Initially, the Attorney General determined that the Affiliation constituted a not-for-profit healthcare conversion transaction under the Not-for-Profit Healthcare Conversion Act of 2004, 29 *Del. C.* § 2531(1)(c) (the "Conversion Act."). (*See* D.I. 80, JX 14, Conversion Letter at 1). Subsequent to the Attorney General's determination, the General Assembly enacted, and the Governor signed into law, Senate Bill 146 ("S.B. 146") which revised the Conversion Act. The Act now provides that a transaction in which a not-for-profit entity becomes controlled by another not-for-profit entity, such as the Affiliation, is not a "conversion" and is, therefore, not covered by the Act. (*See* 78 Del. Laws. c. 109, § 1 (2011)).

The Attorney General then advised the other parties that the DOJ opposes the Affiliation and recommended disapproval of the Affiliation unless, at a minimum, BCBSD and Highmark "establish a mechanism to guarantee that the public's investment in BCBSD remains in Delaware to be held and protected for the benefit of Delawareans, specifically to serve the

State's unmet health needs". (D.I. 109, Hr'g Tr. Oct. 5, 2011, Attorney General Biden statement, p. 20; *see also* D.I. 93, DOJ Letter, Oct. 4, 2011). This request is incorporated in a proposed condition to the Affiliation submitted by the DOJ. The condition states that "the asset that shall be held and protected should in no event be less than $45 million." The Attorney General believes the amount of $45 million would have an insignificant impact on the financial ability of BCBSD to pay its policyholders' claims, based on the healthy RBC ratio of BCBSD as compared to the national average of RBCs among Blue plans and the RBC requirements of the BCBSA and of the NAIC. (*Id.*, Attorney General Biden statement, pp. 21-22).

The proposed condition also calls for a valuation "prior to the closing of the transaction, taking into account the effect of the [A]ffiliation, by a valuation expert approved by the [DOJ]." The DOJ proposed to introduce into the proceeding a report prepared by the DOJ's consultant, Grace Global Capital, and to call as a witness the Managing Director of Grace Global Capital. According to the DOJ, the purpose of the report is to "estimate the amount of public investment in BCBSD." BCBSD objected to the introduction of the report, an objection which was sustained by the Hearing Officer after hearing from the parties.

The ruling permitted the Attorney General, at the public hearing, to present the facts which supported his proposed condition. However, the Grace Consulting report was concerned not with the rationale for the condition but with the methodology for capturing the public investment in BCBSD should the condition be accepted. For this reason, the report was deemed inappropriate to be introduced and considered at the public hearing. The ruling specified that should the Hearing Officer recommend that the condition be adopted, or the Commissioner accepts the condition on her own review of the record, it would be appropriate to schedule a further hearing to address the proper methodology for establishing the proposed foundation or other mechanism.

At the hearing, the Attorney General's statement and cross-examination of witnesses by the DOJ reiterated the concern that the Affiliation "presents the *potential* for movement of assets by various means which may serve to deplete the asset. . . ." (*Id.*, pp. 13, 18, emphasis supplied) There is nothing in the record, however, that establishes a credible risk that the reserve will be misused to the detriment of Delawareans. The Attorney General can only point to the new governance structure which makes it possible that BCBSD funds could be dissipated by Highmark. Similarly, the flexibility in the CAM and BCBSD's limited opportunity to challenge allocations made pursuant to it, presents an opportunity for potential misuse. But, despite a year of extensive discovery, review, and analysis, the Attorney General has not demonstrated any substantial basis to conclude that the assets of BCBSD are in danger of dissipation, waste, or conversion as a result of the Affiliation. Karen Hanlon listed Highmark's numerous affiliates and subsidiaries, some of which are not-for-profit entities and some of which, such as Highmark West Virginia, operate in a state other than Pennsylvania. (D.I. 109, Hr'g Tr. Oct.. 5, 2011, Hanlon testimony, pp. 190-196.). There is no indication that the reserves of these affiliates have been misused by Highmark. Further, there was no reference from the considerable record pertaining to BCBSD's disaffiliation from CareFirst to indicate that BCBSD's reserve was improperly appropriated in that affiliation.

In addition, there is nothing in the record of this proceeding to show that Delaware law, including regulations of the DOI, imposes any kind of limitation, or cap, on the amount of funds a not-for-profit insurer may hold in its reserve. In contrast, as Karen Hanlon testified, the Pennsylvania Insurance Department does place limits on insurers' RBCs. (D.I. 109, Hr'g Tr.

Oct. 5, 2011, Hanlon testimony p. 228). Ms. Sizemore of the DOI testified, on cross-examination, about her understanding of the process followed by Pennsylvania in dealing with excess reserves. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, pp. 578-582). In her remarks, she commented "it is not something we have considered." (*Id.* p. 578). Nor was there any testimony during the hearing that Delaware law, including the regulations of the DOI, requires an insurer to apply excess reserves in a particular way, save in situations where a non-profit converts to a for-profit enterprise. In such event, the Conversion Act directs that the reserve be placed in a foundation to serve the State's unmet health needs. (29 *Del C.* § 2533).

If such caps on reserves do exist, determining whether the amount currently held by BCBSD is excessive, and its proper disposition, involves an inquiry that goes beyond the scope of this proceeding. It would necessarily involve a review of many factors which do not necessarily correspond with the criteria contained in 18 *Del. C.* Section 5003(d)(1) which are the focus of these proceedings. If a cap does not already exist, having such a limitation may or may not be a good idea; however, that is a matter of policy for the legislature and the DOI to determine. It should not be piggy-backed onto an affiliation proceeding.

The Attorney General's position that a foundation should be established is clearly influenced by a provision of the Conversion Act which is administered by him and which requires that, when a not-for-profit health insurer converts to a for profit entity, its reserves must be placed in a foundation to serve the unmet health needs of the State. (29 *Del. C.* Ch. 25, Subchapter III). The establishment of a foundation is a reasonable requirement in such a case, because it would be unfair for the reserve to benefit the shareholders of a for-profit business who played no part in the establishment of the reserve. Further, in such a case it would be difficult, if not impossible, to trace all current and past policyholders who contributed to the reserve in order to distribute the reserve to them and to determine how much each should receive. In such a situation, placing the funds in a charitable foundation is the best recourse.

The Delaware legislature has recently addressed the situation in which a not-for-profit health service corporation comes under the control of another not-for-profit entity. (*See* 78 Del. Laws, c. 109, § 1 (2011)). First, it excluded such a transaction from the provisions of the Conversion Act, with its requirement for the establishment of a foundation. And, in a related amendment to the Health Services Corporations Act, 18 *Del. C.* Ch. 63, the legislature specifically addressed the protection of the reserve of a health service corporation involved in a change of control. The amended act directs the Commissioner to place conditions on the approval of a change of control, in order to "preserve that amount, determined in accordance with Delaware law, that constitutes the surplus or reserves of the health service corporation." Four specific conditions are set out in the law and are said to be "without limitation". All of these Statutory Conditions have been acknowledged by BCBSD and Highmark and are included on the list of Conditions which pertain to the Affiliation. (D.I. 130, Appendix A, JX 113A, Conditions 1-5). This statutory scheme evidences a clear preference for protecting a reserve by placing conditions on the transfer, by ongoing supervision and oversight by the Commissioner, and by, if necessary, a court proceeding to protect from any misapplication of the reserves. The course chosen by the DOI, with its emphasis on statutory and negotiated conditions, is the appropriate one.

I have, therefore, concluded that the Attorney General's requested condition should be denied.

If, however, the Commissioner concludes from her review of these Findings and the record in the matter that the Attorney General's request should be granted, I recommend that a further hearing be scheduled to address the proper mechanism for valuing the reserves of BCBSD and the proper disposition of any excess reserves.

7. Effect of Agreement on possible disaffiliation: Another potential risk to BCBSD policyholders posed by the Affiliation is the possibility that the Affiliation will not work and BCBSD must extricate itself from the arrangement. In light of BCBSD's earlier failed affiliation with CareFirst, this is a matter of great concern to BCBSD's policyholders, to the insurance buying public, and to the DOI. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 574).

The Affiliation Agreement, the Bylaws, and the Conditions address in detail how a disaffiliation would work. Under the terms of the Bylaws, Class A Directors (the independent directors) have the option to end the Affiliation under specific circumstances: (1) Highmark converting to a for-profit Pennsylvania corporation; (2) Highmark admitting in writing its inability to pay its debts as they become due; (3) Highmark becoming insolvent or seeking protection from creditors; (4) Highmark losing its status as the primary BSBSA licensee in Pennsylvania or Delaware; and (5) a change in Pennsylvania law that deprives Highmark from being able to select its own members or that results in a third party having decision making authority over the management, operations, or assets of Highmark. (D.I. 1, Exhibit 3, Bylaws, Art. XIII, Sec. 13.1). If any of these "triggering events" occur, the Class A directors of BCBSD can, in their sole discretion, require Highmark to disaffiliate, withdrawing from its position as sole member of BCBSD and consenting to BCBSD re-acquiring the license to the Blue marks. (*Id.*, Ex. 1, Affiliation Agreement, Sec. 7.8(a)).

Other provisions in the Agreement address BCBSD's obligations in the event of a disaffiliation, which include paying funds owed to Highmark, releasing Highmark from liabilities incurred on behalf of BCBSD, requesting the Department's approval to the withdrawal, and obtaining BCBSA's assent to reacquiring the Blue "marks" in Delaware. (*Id.*).

The Department has proposed, and Highmark and BCBSD have agreed to, additional Conditions which also pertain to disaffiliation. These include four additional "triggering events": (1) Highmark not curing any material failure to perform its obligations under any of the Affiliation-related agreements; (ii) Highmark becoming the subject of a delinquency proceeding pursuant to Pennsylvania law; (iii) Highmark's RBC ratio falling below 425 percent; or (iv) any regulator approving a "Form A" or similar regulatory filing by Highmark that involves a conversion or change-of-control. (D.I. 130, Appendix A, JX 113A, Condition No. 23). Notice of an intent to disaffiliate must be provided to the DOI when the notice is provided to Highmark. (*Id.,* Condition 24). Another condition extends from the 60 days authorized in the Bylaws, to 180 days, the period in which Class A directors must determine to disaffiliate. During that time, BCBSD may have reasonable access to, and the cooperation of, Highmark resources, including access to material information of BCBSD costs and operations as well as to certain Highmark employees for purposes of conducting due diligence meetings and interviews. (*Id.*, Condition 25). Highmark must also continue to provide administrative services to BCBSD for three years after a disaffiliation, but must also use reasonable best efforts to assist with BCBSD's transition away from Highmark. (*Id.,* Condition No. 18). Highmark also agrees to use its best efforts to facilitate the return of the Blue marks to BCBSD following any disaffiliation. (*Id.* Condition 26).

Condition 24 is particularly pertinent to the protection of BCBSD policyholders in the event of disaffiliation. It requires that notice of the Class A Directors' intent to disaffiliate must be provided to the Department of Insurance at the same time such notice is provided to Highmark. In addition, prior to implementing any disaffiliation, the entity seeking disaffiliation must submit to the Department for approval a plan discussing the impact of the disaffiliation on Delaware policyholders and the manner in which current levels of coverage for such policyholders will be maintained. (*Id.*, Condition 24).

Kenneth Jackson of KPMG estimates that the "disaffiliation effort will mirror the affiliation effort, and that disaffiliation could require two to three years." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, p. 574). Estimates on disaffiliation costs for BCBSD range from $20 million to $55 million. (*Id.*, pp. 437, 574). The Department readily acknowledges that "planning for a potential disaffiliation is essential to ensuring that policyholders are protected." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 517). Furthermore, Martin Alderson Smith of Blackstone acknowledges that the greatest likelihood for disaffiliation and consequently the greatest risk to the reserves of BCBSD would be in time of economic downturn. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony on cross examination, pp. 435-440). Based on these risks and concerns the Hearing Officer believes an additional condition is necessary to protect the reserves of BCBSD in the event of a triggering event during the initial years following the Affiliation when BCBSD is most vulnerable, having only recently made a significant financial commitment to affiliate. The Hearing Officer appreciates Highmark's effort at proposing a condition to contribute to BCBSD a maximum of 50% of the costs of disaffiliation, up to a cap of $35 million. The Hearing Officer finds this amount to be a reasonable allocation of the estimated disaffiliation costs and has added an additional requirement that Highmark contribute its maximum amount of $17.5 million pursuant to a letter of credit in favor of BCBSD as more fully set forth in the Conditions identified in Exhibit A attached to these Findings and Recommendations.

8. Effect of the Affiliation on the "public interest." In assessing the "public interest" under standard 5003(c)(1) d., it is informative to consider the comments on the Affiliation which were offered by members of the public at the public information sessions sponsored by BCBSD, Highmark, and the DOI in the three counties of the State in May 2011; at the public hearing on the Affiliation held in October 2011: and by letter and electronic mail to the Hearing Officer, the DOI, or to counsel for the various parties.

Comments from organizations which receive grants from BCBSD are discussed in Finding No. 5, *supra*. Additional comments were received from The Medical Society of Delaware, which is supportive of the Affiliation. (D.I. 84, JX 51). The Delaware State Chamber of Commerce and the New Castle County Chamber of Commerce both wrote in support, expressing the hope that Highmark's resources would allow BCBSD to provide innovative and quality products to customers and be beneficial to small business employers in the State. (D.I. 106, JX 116; D.I. 116, JX 123). A large employer, W.L. Gore & Associates, Inc., also supported the Affiliation. (D.I. 122, JX 130).

Four insurance brokers supported the partnership, which they hoped would speed claims processing and add benefits for BCBSD policyholders. (D.I. 104, the Hon. John Still, JX 114; D.I. 123, George Weiner & Associates, L.L.P, JX 132; D.I. 42, Public Information Session Tr., Wilmington, DE, May 19, 2011, Nick Moriello, p. 54; D.I. 40, Public Information Session Tr., Georgetown, DE, May 17, 2011, Clay Monroe, p. 45). Joanne Hasse, who spoke at the public hearing to express (1) her hope that the public understands BCBSD needs to, not simply wants to, upgrade its IT systems; (2) her view that the Conversion Act has no bearing on the Affiliation because both of the Applicants are not-for-profit; (3) her belief that the DOI's concerns have to include the Delaware community; and (4) that although Highmark should not be required to contribute to a fund as suggested by the Delaware Attorney General, the Affiliation should address BCBSD continuing its commitment to the Delaware Community Foundation. (D.I. 111, Hr'g Tr. Oct. 7, 2011, pp. 622-628).

Jo Ann Fields, M.D., who has been a knowledgeable and interested observer of these Affiliation proceedings, stressed the need for the Affiliation to require a continued charitable commitment on the part of BCBSD and supported the Attorney General's proposal to have a foundation set aside and funded with at least $45 million. (*Id.*, pp. 650-652). Earlier, Dr. Fields had spoken at the public information session in Dover raise six concerns she would like the Department of Insurance to address. She request the DOI to monitor BCBSD's reserves, adopt a more transparent rate review process, encourage BCBSD to make a competitive bid to participate in Medicaid in Delaware, and support features of the newly enacted federal Patient Protection and Portability Act. (D.I. 41, Public Information Session Tr., Dover, DE, May 17, 2011, pp. 44-47).

Several other physicians participated in the information sessions. Dr. Bill Wood, a salaried physician with Bayhealth, inquired about how the Affiliation would affect what he believes is a high rate of uninsured in Delaware. (D.I. 40, Public Information Session Tr., Georgetown, DE, May 17, 2011, p. 47). V. Raman Sukumar, M.D. of Doctors Pathology Services, contacted the DOI to express his concern about that "bundling" of ancillary services may crowd out "honest ancillary service who improve quality with lower cost." (D.I. 116, electronic mail letter to Linda Sizemore, October 6, 2011, JX 125). An office manager for a physician objected to having to process claims through Highmark because it will necessitate upgrading the practice's computer software, causing financial hardship. (Ed Salevan, e-mail to DOI, March 8, 2011).

As discussed under Finding No. 2, above, two individuals who spoke at the public sessions inquired as to why BCBSD could not simply either upgrade its technology resources or outsource them and remain under local control. (D.I. 42, Stuart Snyder, Public Information Session Tr., Wilmington DE., May 19, 2011, p. 50; *Id.,* Mark Sarnoff, pp. 48-50). Mr. Sarnoff pointed out that the cost for BCBSD to fund necessary upgrades to its IT systems would cost approximately $250 per year per policy holder which, over a 10 year period, would amount to $25 per policy holder per year. (*Id.,* p. 50). He felt this was a reasonable alternative to affiliation and would protect local control. He also asked what mechanisms were in place to "hold the Company to the promises made tonight." (*Id.*). The DOI responded to this question by letter, also on the DOI's website.

One writer supported the Attorney General's position that a foundation should be established (D.I. 116, Lee Mullet, JX 124); another opposed that proposal, feeling strongly that BCBSD's reserve should be directed to the benefit of policyholders. (D.I. 107, Jim Trost, JX 117).

Finally, two individuals spoke against the Affiliation. Mitchell Crane, a former employee of the DOI, questioned the need for the Affiliation. In his view, given BCBSD's strong position in the State, the Affiliation will actually result in less competition in the health insurance industry, rather than more. He also believes that it will not reduce costs. He claimed the substantial reserve of BCBSD came about due to unwarranted and frequent rate increases, noting that the reserves are off the balance sheet and not considered by the Department when premium hikes are requested. (D.I. 111, Hr'g Tr. Oct. 7, 2011, pp. 650-652).

Vincent White echoed the claim that the Affiliation will actually lessen competition in the State and will not result in premiums being reduced. In his view, the reason BCBSD is maintaining such a large reserve is in order to make itself attractive to a prospective partner. He believes Highmark was enticed into the Affiliation because of the large BCBSD reserve, which would help finance the acquisition of West Penn. (D.I. 111, Hr'g Tr. Oct. 7, 2011, pp. 639-650).

As the foregoing discussion has shown, the Affiliation is likely to bring a significant upgrade in the capabilities and services BCBSD is able to offer its customers and policyholders. This is due in large part to the advanced technology platforms Highmark has developed, as well as the broader product offers BCBSD will be able to offer. At the same time, many concerns about the Affiliation have been identified. The Affiliation will change the composition of the BCBSD board and its business structure. And while the Affiliation is projected to provide significant cost savings for BCBSD, it also provides for mechanisms by which BCBSD will transfer funds to Highmark.

These concerns have led to the development of a number of Conditions designed to mitigate the effect of the changes and smooth the integration of the two businesses.

In light of the numerous Conditions which address the most serious concerns posed by the Affiliation, I find no reason to conclude that Highmark's plans for BCBSD are unfair and unreasonable to BCBSD policyholders and not in the public interest.

e. *The competence, experience, and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control (18 Del. C. § 5003(d)(1)e.)*

Neither the biographical information furnished by Highmark nor the investigation conducted by the DOI demonstrates a reason to question the competence, experience and integrity of the Board members and top executive officers of Highmark. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, pp. 547-548). The three Highmark executives who will be named to the BCBSD Board have many years of experience and there is no indication they have committed fraud, misrepresentation, malfeasance or gross negligence. (*Id.*). As noted, one additional appointment must be made and the DOI is charged with making sure that individual is likewise qualified. (*Id.*).

No reason has been shown to question the competence, experience and integrity of those individuals named to serve on the BCBSD Board. Subject to the DOI's satisfaction with the qualifications of the last Class B director and the Commissioner's review of that determination, I conclude that the Affiliation satisfies the criteria of 18 Del. C. Section 5003(d)(1)e.

(f) The acquisition is likely to be hazardous or prejudicial to the insurance buying public. (18 Del. C. § 5003(d)(1)f.)

As discussed above, many of the features of the Affiliation suggest that it will be beneficial, rather than hazardous or prejudicial to the insurance buying public. They include Highmark's guarantee of the contractual obligations of BCBSD, including the payment of claims; increased technological capabilities in such areas as processing claims and applications; the availability of additional products and services offered to Delaware policyholders; upgraded online services to Delaware stakeholders; and a projected lower rate of increase in insurance premiums.

Karen Hanlon of Highmark testified about the benefits the Affiliation should offer to the insurance buying public. (D.I. 109, Hr'g Tr. Oct. 5, 2011, pp. 218-227). Similarly, Timothy Constantine testified that the Affiliation will allow BCBSD to maintain its not-for-profit status, to continue to provide a high level of local service, and to expand its product offerings and enhanced capabilities and resources for BCBSD customers, providers, and brokers. (*Id.*, Constantine testimony, pp. 85-86). Mr. Constantine also testified to his view that the Affiliation will enable BCBSD to "continue as a significant local employer, a good corporate citizen, and a strong contributor to Delaware's economy." (*Id.*, p. 86).

Martin Alderson Smith of Blackstone testified that given BCBSD's unique market position as Delaware's largest locally based not-for-profit insurer, the proposed Affiliation could have a significant impact on the insurance-buying public. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Alderson Smith testimony, p. 393). He testified that "Blackstone believes that conditions designed to preserve [BCBSD's] local presence and autonomy, and to ensure local decision-making and local customer service and account management would be appropriate to bring the Affiliation into compliance with the statutory criteria" and that "[w]ith such conditions in place, the Affiliation is not likely to be hazardous of prejudicial to the insurance-buying public of Delaware." (*Id.*, pp. 399-400).

Linda Sizemore testified that the DOI agrees with Blackstone's conclusion, particularly given "the prospects and challenges for [BCBSD] and the risks to its local identity that it faces as a standalone entity in the coming years." (D.I. 110, Hr'g Tr. Oct. 6, 2011, Sizemore testimony, p. 550).

I am satisfied that, with the Conditions in place, the Affiliation should not prove hazardous or prejudicial to BCBSD policyholders, customers and providers, and I so find.

Finding Number 7. *THE AFFILIATION SHOULD BE APPROVED BY DECEMBER 31, 2011*

Several witnesses testified to the need to have the Affiliation approved no later than December 31, 2011. Timothy Constantine of BCBSD testified the federal compliance deadline for ICD-10 is October 2013 and that "BCBSD would need to have systems, products and services ready to go to market in early 2013 in order to meet the January 1, 2014 effective date" for the PPACA. (D.I. 109, Hr'g Tr. Oct. 5, 2011, Constantine testimony, p. 69). Karen Hanlon of Highmark testified that "Highmark and BCBSD believe that the closing of the Affiliation needs to occur by year end 2011 so that BCBSD is able to fully comply with the ICD-10 [requirements]. . .by the October 2013 deadline." (*Id.,* Hanlon testimony, p. 211). Ms. Hanlon testified that if the Affiliation does not close by year end 2011, BCBSD will be forced to incur $2 million to $2.5 million in compliance costs for work that ultimately will be discarded once BCBSD does migrate onto Highmark's IT systems. (*Id.,* p. 212). Mr. Jackson testified that KPMG estimated these "throw-away costs" to be $3 million to $5 million, which BCBSD would have to incur if the Affiliation is not approved by year end 2011. (D.I. 110, Hr'g Tr. Oct. 6, 2011, Jackson testimony, pp. 504-505).

No one disputed these claims, and, accordingly I find that the Affiliation should be approved no later than December 31, 2011.

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CONCLUSION OF LAW

Based on a review of the record in this case, which has been summarized in the Findings of Fact set out herein, I conclude that the Affiliation between BCBSD and Highmark satisfies the requirements of 18 Del. C. Sections 5003, 6310 and 6311 and other applicable legal requirements.

Therefore, subject to the adoption of the Conditions, I recommend that no later than December 31, 2011 the Commissioner approve the proposed Affiliation.

While I do not recommend that the Commissioner approve the condition proposed by the Attorney General and the DOJ, if the Commissioner decides to adopt the DOJ's condition, I recommend she schedule a further hearing to address the methodology for determining the proper amount to fund the foundation.

Respectfully submitted,

Battle R. Robinson

Battle R. Robinson

Hearing Officer

EXHIBIT A

CONDITIONS TO AFFILIATION

The Conditions to Affiliation

Approval of the Affiliation is subject to the following Conditions which will control in the event of conflict with the underlying Affiliation documents:

No.	Condition	Condition Category
1	Review and approval by the Delaware Department of Insurance ("DOI") of any individual expenditure or transfer of funds or coordinated series of expenditures or transfers of funds by the post-Affiliation BCBSD, Inc. entity ("BCBSD") in excess of $500,000 to Highmark Inc. or any Highmark affiliate (collectively, "Highmark"), which review and approval shall assess the commercial reasonableness of the proposed expenditure or transfer or coordinated series of expenditures or transfers.	Statutory
2	Recognition of, and consent to, the ability of the Delaware Insurance Commissioner ("Commissioner") to seek appropriate relief from the Delaware Court of Chancery or other court of appropriate jurisdiction to prevent Highmark from improperly using the assets of BCBSD for the benefit of Highmark rather than the benefit of BCBSD and its subscribers, or otherwise violating the terms of 18 *Del. C.* § 6311, 18 *Del. C.* c. 50, or any agreement between BCBSD and Highmark.	Statutory
3	A majority of the board of directors of BCBSD shall consist of persons not employed by BCBSD or any of its affiliates who are residents of Delaware and have been so for at least 5 years prior to appointment.	Statutory
4	Review and approval by the DOI of any change in the certificate of incorporation of BCBSD.	Statutory
5	Whenever approval must be obtained from the Commissioner for any activity described in 18 *Del. C.* § 6311, simultaneous notice of the activity shall be provided to the Delaware Department of Justice.	Statutory
6	If BCBSD is dissolved, BCBSD shall, after the discharge of all obligations, distribute all remaining assets to the foundation created under 29 *Del. C.* § 2533.	Statutory
7	BCBSD and Highmark shall make a commitment to employment in the Delaware community, including: **(i)** BCBSD's corporate headquarters shall remain in Delaware; **(ii)** Highmark will assure the total full time equivalent ("FTE") positions in Delaware, including either BCBSD positions or Highmark positions located in Delaware, will be the same after the integration is complete as it was at the start of the integration, except to the extent total FTE positions in Delaware are reduced due to a significant decrease in BCBSD's enrollment or market share during the integration period (*e.g.*, from the loss of a large customer); **(iii)** Highmark and BCBSD will give to any BCBSD employees whose positions are eliminated due to the Affiliation the first opportunity to fill any new positions that are created by either party in Delaware; and **(iv)** Highmark and BCBSD will use commercially reasonable efforts to maintain employment levels in Delaware that are proportionate to the employment levels that Highmark maintains in other geographic areas to directly service its health insurance holders.	Negotiated

No.	Condition	Condition Category
8	For four years after the effective date of the Affiliation, BCBSD will take such actions as necessary to ensure that there is not a material decrease in the quality of BCBSD's provision of account and broker management, customer service, and provider service to Delaware customers, which shall be conducted by Delaware-based staff under the immediate supervision of Delaware-based staff, it being understood, however, that additional support may be provided by Highmark during periods of additional need as deemed to be necessary or appropriate to drive optimum client satisfaction.	Negotiated
9	Highmark shall not improperly use the assets of BCBSD for the benefit of Highmark, rather than the benefit of BCBSD and its subscribers. Without DOI approval, and without limitations on any statutory requirements or other conditions on this Affiliation, the only economic transfers that BCBSD is permitted to make to Highmark are: **(i)** payments for BCBSD's integration to Highmark's information technology ("IT") systems; **(ii)** ongoing payments for the administrative services Highmark will provide to BCBSD under the Administrative Services Agreement ("ASA") (or other replacement agreement approved by the DOI); and **(iii)** payments pursuant to the Line of Credit Agreement.	Negotiated
10	Prior to closing, BCBSD and Highmark shall file with the DOI the cost allocation methodology and formula that governs the ongoing payments BCBSD will make to Highmark under the ASA (or other replacement agreement approved by the DOI) for the administrative services Highmark will provide under the ASA. BCBSD will annually file a copy of the budget approved by its Board of Directors for the subsequent year. Such filing will identify the planned Highmark charges (*i.e.* the estimated payments by BCBSD to Highmark under the ASA (or other replacement agreement approved by the DOI) for the administrative services Highmark will provide under the ASA) as included in the budget along with a description explaining the planned Highmark charges.	Negotiated
11	The DOI will annually review and approve the planned Highmark charges (as defined in Condition No. 10) which shall be fair and reasonable in accordance with the provisions of 18 *Del. C.* § 5005.	Negotiated
12	If, subsequent to the approval of the budget required by Condition No. 10, BCBSD's allocable share of the Highmark's total actual cost exceeds the approved budget by more than $500,000, it is the responsibility of BCBSD to request approval from the DOI before any payments are made to Highmark for amounts in excess of that $500,000.	Negotiated
13	BCBSD's reimbursement to Highmark for direct third-party expenses incurred by Highmark for the sole benefit of BCBSD is not subject to these conditions, provided that BCBSD or Highmark will provide the DOI with third-party invoices or other evidence supporting the amount and purpose of such direct third-party expenses costs for items that exceed $100,000.	Negotiated
14	The books, accounts and records of BCBSD and Highmark shall be so maintained as to clearly and accurately disclose the precise nature and details of the transactions between BCBSD and Highmark, including such accounting information as is necessary to support the reasonableness of the charges or fees.	Negotiated
15	The ASA may only be terminated or amended: (i) upon notice by either party, with approval by the DOI or (ii) pursuant to Article III.B of the ASA. If the ASA is terminated, the terminating party shall give 180 days prior written notice of termination, which period may be shortened by agreement of Highmark and BCBSD.	Negotiated

No.	Condition	Condition Category
16	BCBSD and Highmark shall agree on a service level agreement (including appropriate service level metrics), that shall take effect upon completion of BCBSD moving its core health administration systems onto Highmark's production platforms (e.g., integration, which is expected to take approximately 18 months). For the first eighteen (18) months after the service level agreement takes effect, BCBSD shall provide quarterly reporting to the DOI concerning whether the metrics and other standards in such agreement are met.	Negotiated
17	There shall be a cap on integration costs (which are those listed on page 35 of the September 2011 "Project Delaware" Report prepared by KPMG for the DOI), and any integration costs in excess of $42 million are to be paid or absorbed by Highmark.	Negotiated
18	After a disaffiliation, Highmark must continue the ASA for 3 years, and will charge BCBSD a maximum of cost plus 2% for year 1; a maximum of cost plus 4% for year 2; and a maximum of cost plus 6% during year 3. (See ASA Art. III C.) Highmark also agrees to use reasonable best efforts, acting with diligence and in good faith, to assist with BCBSD's transition away from Highmark in the event of a disaffiliation. In addition, Highmark must continue to abide by these obligations in the event of any termination of the ASA (not just the termination events currently specified in Art. III C. of the ASA).	Negotiated
19	Amend Article VII.A of the ASA (relating to dispute resolution of any "Controversy" related to or arising out of the ASA) by deleting paragraph 3 and replacing with the following: 3. If the Controversy is not resolved within thirty (30) calendar days following the submission thereof to the BCBSD Board of Directors as referred to in Paragraph A(2) above, then such Controversy shall be referred, upon request of the Class A or Class B Directors (as defined in the BCBSD Bylaws), to the Delaware Department of Insurance, which shall have the final decision with respect to settling or resolving the Controversy by determining what charges are "fair and reasonable" to be allocated to BCBSD.	Negotiated
20	Quorum of the BCBSD Board requires a majority of the directors then in office and qualified to act, which majority must include at least one Class A director and at least one Class B director; provided however, in the event a quorum cannot be reached with regard to two consecutive, properly-called meetings of the Board due to no member of the Class A directors being present at either meeting or no member of the Class B directors being present at either meeting, this quorum requirement will not apply to the next properly called meeting thereafter.	Negotiated
21	The initial Class A Directors will serve until the third, fourth, fifth and sixth annual meeting, respectively. (*See* Bylaws § 5.2(b).)	Negotiated
22	Highmark cannot unreasonably withhold its election of a nominated Class A Director, and Highmark shall give BCBSD in writing Highmark's reason for withholding any such election.	Negotiated

No.	Condition	Condition Category
23	Triggering Events giving rise to the Class A Directors' ability to withdraw BCBSD from the Affiliation (withdrawal being permitted, not required, upon a Triggering Event) include those Triggering Events listed in § 13.1 of the Bylaws, and the following: (a) Highmark materially fails to perform its obligations under the Business Affiliation Agreement, the Administrative Services Agreement, or the Line of Credit Agreement; provided, however, that Highmark shall have a reasonable period to cure any such material failure; (b) Highmark becomes the subject of a delinquency proceeding pursuant to Pennsylvania law (including, but not limited to, a proceeding involving the rehabilitation or liquidation of Highmark); (c) Highmark's risk-based capital ratio falls below 425%; or (d) A 'Form A' or similar regulatory filing by Highmark of a conversion or change-of-control is approved by the regulator with which it is filed.	Negotiated
24	Notice of the Class A Directors' intent to disaffiliate shall be provided to the DOI when such notice is provided to Highmark. In addition, prior to implementing any disaffiliation, the party seeking disaffiliation must submit to the DOI for approval a plan discussing the impact of the disaffiliation on Delaware policyholders and the manner in which current levels of coverage for such policyholders will be maintained.	Negotiated
25	Upon receiving notice of a Triggering Event, the current 60-day period in which the Class A Directors must choose whether to authorize a disaffiliation under Article XIII of the Bylaws shall be extended to a total of 180 days. During this time, BCBSD shall have reasonable access to, and the cooperation of, Highmark's resources including, but not limited to: - Highmark's provision of material information (subject to an appropriate confidentiality agreement) on BCBSD costs and operations that may be available only at Highmark or through Highmark employees; and - BCBSD's access to certain Highmark employees for purposes of conducting due diligence meetings and interviews.	Negotiated
26	Highmark shall use all reasonable best efforts, acting with diligence and in good faith, to facilitate the return of the marks to BCBSD following a disaffiliation, including, but not limited to, jointly requesting with BCBSD that the Blue Cross Blue Shield Association ("BCBSA") grant BCBSD the right to use the marks in Delaware without BCBSA issuing a request for proposals or undertaking a similar process.	Negotiated
27	BCBSD shall have three (3) years following termination of the Line of Credit Agreement (including because of a disaffiliation) in which to repay the funds BCBSD has borrowed under the Line of Credit Agreement; provided, however, that if BCBSD subsequently affiliates with a for-profit company, this Condition shall not apply.	Negotiated
28	Highmark may only terminate the Line of Credit Agreement upon an Event of Default if the default is material and is uncured for sixty (60) days.	Negotiated

No.	Condition	Condition Category
29	Section 5(b) of the Line of Credit Agreement shall be modified to state: "...grant to any person any mortgage, lien, security interest or other encumbrance on any assets of BCBSD unless (i) Highmark has given prior written consent or (ii) such mortgage, lien, etc. is subordinate to any security interest held by Highmark."	Negotiated
30	During the term of the Affiliation, neither BCBSD nor Highmark shall: **(i)** Condition the sale of a Pharmacy Product or Core Health Product (defined as a Preferred Provider Organization, Exclusive Provider Organization, Traditional Indemnity, Comprehensive Major Medical, Point of Service, Health Maintenance Organization, Managed Care Organization, Medigap, or Medicare Carve-out product offered for sale by BCBSD or Highmark in Delaware on stand-alone basis) on the purchase of any Ancillary Product (meaning a Dental, Vision, Group Disability, or Group Life product offered for sale by BCBSD or Highmark in Delaware on a stand-alone basis); provided, however that this condition shall not apply to any bundling of products or services pursuant to state or federal law, or **(ii)** Discount the price of any Core Health Product on the condition of the purchase of any Ancillary Product in the Delaware market.	Negotiated
31	BCBSD agrees that it is governed by and shall comply with 18 *Del. C.* c. 50 (Insurance Holding Company System Registration) and 18 *Del. C.* c. 63 (Health Service Corporations) and is subject to the general supervisory authority of the DOI, including the "target exam" or "market conduct exam" authority of 18 *Del. C.* § 318 *et seq.*	Negotiated
32	Highmark agrees that it is governed by and shall comply with 18 *Del. C.* c. 50, not as a registered insurer, but insofar as those provisions apply to an affiliate of, and controlling person as to, a registered insurer (*i.e.*, BCBSD). Further, Highmark, though not a registered insurer governed by 18 *Del. C.* c. 3, agrees that it will provide, upon the DOI's request and consistent with the provisions of 18 *Del. C.* §§ 318, 320 and 322, all such books, records, or other information in its possession and make available such individuals, for interviews, as the DOI deems necessary for the DOI to assure compliance with and enforcing conditions imposed on or commitments made by Highmark in this application.	Negotiated
33	BCBSD and Highmark shall continue to be subject to the jurisdiction of the DOI for the purpose of implementing and enforcing the terms of these conditions, and BCBSD and Highmark continue to be jointly and severally liable for reasonable expenses incurred by the DOI for consultants in connection therewith.	Negotiated
34	The additional reporting obligations required in these conditions, which are in addition to those required by the Delaware Code, including those contained in 18 *Del. C.* c. 50, will remain in effect for four (4) years after the consummation of the Affiliation, unless it is determined by the DOI that an extension of reporting is appropriate.	Negotiated
35	In the event that Highmark affiliates with West Penn Allegheny Health System, or in the event any Highmark funds are expended in a failed attempt to so affiliate, Highmark will not, directly or indirectly, pass any up-front or ongoing costs associated with that affiliation (including any costs associated with the provider division that is contemplated to be formed) or attempted affiliation onto BCBSD.	Negotiated

<table>
<tr><th>No.</th><th>Condition</th><th>Condition Category</th></tr>
<tr><td>36</td><td>Highmark does not have, and will not have, any separate arrangements or understandings with BCBSD executives that would give BCBSD executives any personal incentives (financial or otherwise) to favor the Affiliation with Highmark.</td><td>Negotiated</td></tr>
<tr><td>37</td><td>Highmark has no plans or proposals to liquidate BCBSD or sell BCBSD's assets or consolidate or merge it with any person or entity.</td><td>Negotiated</td></tr>
<tr><td>38</td><td>BCBSD shall, as part of the approval of the proposed Affiliation, obtain the Commissioner's approval of the premiums to be initially charged under 18 Del. C. § 6310(a)(2) for the CHIP Plan addressed by § 6310. That premium approval process must provide for public input and comment. In addition, BCBSD shall have the referenced CHIP Plan in place and effective within 180 days after consummation of the Affiliation and the CHIP Plan shall meet all applicable statutory criteria, including, without limitation, those of 18 Del. C. § 6310(a)(1), (a)(2) and (a)(3), which section requires that the CHIP Plan will offer the same network of providers to its subscribers that is offered to subscribers of BCBSD's standard health insurance plan.</td><td>Statutory</td></tr>
<tr><td>39</td><td>
For the five year period beginning in 2012 and ending in 2016, BCBSD will make annual contributions of $3 million to its donor advised fund administered by the Delaware Community Foundation, Blue Prints for the Community ("BP4TC"), which annual contributions shall subsume BCBSD's commitment to the Health Service Corporation Task Force in 2007 to make payments to this fund equivalent to the amount it would pay in corporate income taxes, were it subject to such taxes. In years 2017 through 2021, BCBSD shall reduce these annual contributions to $1 million or that amount it would pay in corporate income taxes, were it subject to such taxes, whichever is higher.
BCBSD will expand the BP4TC Advisory Council to eleven members, and shall assure that at all times, three members are appointees of the Governor, Speaker of the House, and President pro tempore of the Senate respectively.
BCSBD will amend the BP4TC Advisory Council charter to require that its members are Delaware residents.
BCBSD may reduce or suspend payments under this condition if its risk based capital drops below the bottom of the range recommended by BCBSD's independent actuary.
BCBSD may reduce or suspend payments under this condition to the extent that taxes or assessments of any kind, not currently applicable to BCBSD, are levied on BCBSD.
The DOI may cause BCBSD to suspend or reduce payments under this condition if, in the DOI's discretion, the financial condition of BCBSD warrants such suspension or reduction.
</td><td>Community Support</td></tr>
</table>

No.	Condition	Condition Category

40	• BCBSD shall contribute a total of $500,000 annually for the ten-year period 2012 - 2021 to invest in health care workforce development initiatives, which in BCBSD's discretion may include, but shall not be limited to:
	  ○ Grants to colleges and universities for retraining displaced workers;
	  ○ Expanding nursing and other clinical programs; or
	  ○ Funding various health professional workforce development programs operated or administered by the Delaware Health Care Commission
	• BCBSD may reduce or suspend payments under this condition if its risk based capital drops below the bottom of the range recommended by BCBSD's independent actuary.
	• The DOI may cause BCBSD to suspend or reduce payments under this condition if, in the DOI's discretion, the financial condition of BCBSD warrants such suspension or reduction.
		Community Support

41	• BCBSD shall contribute a total of $500,000 annually for the ten-year period 2012 - 2021 to such charitable and community organizations and programs as it determines, in its discretion, will best serve the needs of the Delaware community. • BCBSD may reduce or suspend payments under this condition if its risk based capital drops below the bottom of the range recommended by BCBSD's independent actuary. • The DOI may cause BCBSD to suspend or reduce payments under this condition if, in the DOI's discretion, the financial condition of BCBSD warrants such suspension or reduction.	Community Support
42	• BCBSD will, on behalf of BCBSD's fully-insured members, commit funding to the Delaware Health Information Network ("DHIN") of $1 million annually over the five-year period 2012 through 2016. • The DOI may cause BCBSD to suspend or reduce payments under this condition if, in the DOI's discretion, the financial condition of BCBSD warrants such suspension or reduction.	Community Support

<table>
<tr><th>No.</th><th>Condition</th><th>Condition Category</th></tr>
<tr><td>43</td><td>BCBSD will establish a rate stabilization reserve or other appropriate mechanism, in the amount of $10 million, which shall be applied to reduce the rate of premium growth for individual and small group subscribers.
It is intended that these funds will be applied over the four year period 2012 through 2015. Further, in order to prevent excessive impact on premiums once the funds are exhausted, BCBSD shall make commercially reasonable efforts to apply the funds approximately as follows:
$4 million in 2012;
$3 Million in 2013;
$2 million in 2014; and
$1 million in 2015.
Provided that $10 million is expended, or designated for expenditure, between 2012 and 2015 on subscriber relief, the actual mechanism for achieving this result, and the precise amount to be expended in each year, shall be at the discretion of BCBSD.
The DOI may cause BCBSD to suspend or reduce expenditures under this condition if, in the DOI's discretion, the financial condition of BCBSD warrants such suspension or reduction.</td><td>Community Support</td></tr>
<tr><td>44</td><td>The DOI, BCBSD and Highmark shall enter into a separate agreement satisfactory to the DOI pursuant to which each party to the agreement expressly agrees to (i) perform and affirm, as applicable, the covenants and representations set forth in Conditions 1 through 38, and (ii) acknowledges each party's right to seek enforcement of the representations and covenants.</td><td>Hearing Officer</td></tr>
<tr><td>45</td><td>For a period of two years following the Closing of the Affiliation, any severance pay, bonuses, or pay raises of any current BCBSD executive, or any transfer of a BCBSD executive to the Highmark payroll, as well as any increase in compensation paid to a director of BCBSD, be reported to the DOI in a confidential filing.</td><td>Hearing Officer</td></tr>
<tr><td>46</td><td>Prior to the Closing of the Affiliation, Highmark and BCBSD shall provide written representations to the DOI that no incentives were offered to any BCBSD director in connection with the Affiliation.</td><td>Hearing Officer</td></tr>
<tr><td>47</td><td>Prior to Closing, Highmark shall obtain an Irrevocable Letter of Credit ("Credit") from a financial institution (the "Issuing Bank") in favor of BCBSD for the aggregate total sum of $17,500,000.00. This Credit shall be made available by the Issuing Bank to BCBSD if disaffiliation occurs as a result of a triggering event within the first three years after the Closing of the Affiliation. The terms of the Credit and the identity of the Issuing Bank must be agreeable to BCBSD and the DOI.</td><td>Hearing Officer</td></tr>
</table>

EXHIBIT B

DOCKET INDEX

BEFORE THE INSURANCE COMMISSIONER
FOR THE STATE OF DELAWARE

In Re: The Proposed Affiliation of BCBSD, Inc., doing business as Blue Cross Blue Shield of Delaware, with Highmark Inc.	))))	**Docket No. 1509-10**

DOCKET INDEX

Tab	Description	Date
1.	Statement Regarding the Affiliation of BCBSD, Inc. d/b/a Blue Cross Blue Shield of Delaware, a Delaware nonstock corporation, with Highmark Inc., a Pennsylvania nonprofit corporation ("Statement of Affiliation")	10/6/10
2.	Pre-Hearing Order	10/20/10
3.	Order Appointing Hon. Battle R. Robinson as Hearing Officer	11/4/10
4.	Letter from M. Houghton re Proposed Public Notice	11/24/10
5.	Public Notice of Public Hearing and Application Deadline for Identification of Parties in Interest	12/3/10
6.	Scheduling Order	1/5/11
7.	Letter from T. Mullaney re Position of Department of Justice on Application for Party Status	1/6/11
8.	Letter from M. Parikh re Motions for Admission Pro Hac Vice of Campbell and Foster	1/10/11
9.	Response of BCBSD, Inc. re BCBSD's Position on Application for Party Status	1/14/11
10.	Letter from M. Houghton re Department of Insurance Position on Application for Party Status	1/14/11

Tab	Description	Date
11.	Response of Highmark Inc. re Highmark's Position on Application for Party Status	1/14/11
12.	Letter from M. Parikh and Highmark's Motion for Confidential Treatment of Ex. 8 (biographical affidavits) and Ex. 9 (Proforma Financial Information) to the Statement of Affiliation	1/14/11
13.	Letter from D. Foster re Highmark's Supplemental Filing No. 1 to Statement of Affiliation	1/14/11
14.	Exhibit 8 to Statement of Affiliation contained in Highmark's Supplemental Filing No. 1	1/14/11
15.	Exhibit 9 to Statement of Affiliation contained in Highmark's Supplemental Filing No. 1	1/14/11
16.	Response of Dr. J. Fields re Application for Party Status	1/17/11
17.	Transcript and Exhibits from January 18, 2011 Public Hearing	1/18/11
18.	Letter from L. Polizoti re Admission Pro Hac Vice of Campbell and Foster	1/21/11
19.	Department of Insurance's First Set of Document Requests to BCBSD, Inc.	1/21/11
20.	Department of Insurance's First Set of Document Requests to Highmark Inc.	1/21/11
21.	Order on Application of Jo Ann Fields, M.D. for Party Status	1/25/11
22.	Letter from M. Houghton re Department of Insurance Position on Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/4/11
23.	Letter from M. Teichman re BCBSD, Inc. Position on Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/4/11
24.	Letter from D. Foster re Highmark Inc.'s Response to 2/4/11 M. Houghton Letter re Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/4/11

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25.	Letter from M. Houghton re Department of Insurance Position on Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/11/11
26.	Letter from T. Mullaney re Department of Justice Position on Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/11/11
27.	Letter from D. Foster re Highmark Inc.'s Response to 2/11/11 M. Houghton Letter re Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/11/11
28.	Letter from M. Teichman re BCBSD, Inc. Position on Highmark's Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/11/11
29.	Letter from M. Parikh and Highmark's Amended Motion re Confidential Treatment of Exhibits 8 (biographical affidavits) and 9 (proforma financial information) to the Statement of Affiliation	2/18/11
30.	Letter and Order of Hearing Officer Approving Highmark's Amended Motion for Confidential Treatment of Exhibits 8 and 9 to the Statement of Affiliation	2/23/11
31.	Exhibit 8 to Statement of Affiliation contained in Highmark's Supplemental Filing No. 2 (public/redacted version)	3/11/11
32.	Letter from D. Foster re Highmark's Supplemental Filing No. 2 to Statement of Affiliation	3/11/11
33.	Exhibit 9 (revised) to Statement of Affiliation contained in Highmark's Supplemental Filing No. 3 (public/redacted version)	3/14/11
34.	Letter from D. Foster re Highmark's Supplemental Filing No. 3 to Statement of Affiliation	3/14/11
35.	Scheduling Order	3/14/11
36.	Letter from D. Foster re Highmark's Supplemental Filing No. 4 to Statement of Affiliation	3/24/11

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37.	Exhibit 11 (updated with addition of 2010 year-end statutory financial statement) to Statement of Affiliation contained in Highmark's Supplemental Filing No. 4	3/24/11
38.	Public Notice of Public Information Sessions	4/19/11
39.	Letter from B. Mayrack re Department of Insurance Request for 30-Day Extension for Additional Requests for Productions of Documents	5/3/11
40.	Transcript of Public Information Sessions – Georgetown	5/16/11
41.	Transcript of Public Information Sessions – Dover	5/17/11
42.	Transcript of Public Information Sessions – Wilmington	5/19/11
43.	Joint Response of BCBSD, Inc. and Highmark Inc. to Public Information Session Questions	6/27/11
44.	Department of Insurance Response to Questions Presented at Public Information Sessions held May 16, 17 and 19, 2011	6/24/11
45.	Letter from D. Foster re Highmark's Supplemental Filing No. 5 to Statement of Affiliation	7/19/11
46.	Exhibit 8 (updated) to Statement of Affiliation contained in Highmark's Supplemental Filing No. 5 (public/redacted version)	7/19/11
47.	Scheduling Order	8/5/11
48.	Letter from L. Polizoti re Parties' Agreement Concerning Various Pre-Hearing Deadlines	8/24/11
49.	Letter from D. Foster re Highmark's Supplemental Filing No. 6 to Statement of Affiliation	8/29/11

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50.	Exhibit 9 (revised) to Statement of Affiliation contained in Highmark's Supplemental Filing No. 6	8/29/11
51.	Exhibit 11 (supplemented to include June 30, 2011 statutory quarterly financial statement) to Statement of Affiliation contained in Highmark's Supplemental Filing No. 6	8/29/11
52.	Letter from L. Polizoti re Parties' Agreement Concerning Extension of Various Pre-Hearing Deadlines	9/1/11
53.	Public Notice of Public Hearing on Merits of Affiliation Proposal	9/9/11
54.	Letter from D. Foster re Highmark's Supplemental Filing No. 7 to Statement of Affiliation	9/9/11
55.	Exhibit 9 (revised) to Statement of Affiliation contained in Highmark's Supplemental Filing No. 7(public/redacted version)	9/9/11
56.	Letter from D. Swayze re BCBSD Objection to Admission of Department of Justice Report	9/16/11
57.	Report of Department of Insurance Financial Advisor [Blackstone] (public/redacted version)	9/19/11
58.	Report of Department of Insurance Technology Advisor [KPMG] (public/redacted version)	9/19/11
59.	Letter from Attorney General Biden re Department of Justice Condition	9/21/11
60.	Letter from R. Stottmann re Prehearing Memorandum and Exhibits of Department of Insurance	9/21/11
61.	Prehearing Memorandum of the Department of Insurance (public/redacted version)	9/21/11
62.	Exhibits 1-10 to the Prehearing Memorandum of the Department of Insurance(public/redacted version)	9/21/11
63.	Exhibits 11-18 to the Prehearing Memorandum of the Department of Insurance (public/redacted version)	9/21/11
64.	Exhibits 19-25 to the Prehearing Memorandum of the Department of Insurance (public/redacted version)	9/21/11

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65.	Exhibits 26-32 to the Prehearing Memorandum of the Department of Insurance (public/redacted version)	9/21/11
66.	Exhibits 33-42 to the Prehearing Memorandum of the Department of Insurance (public/redacted version)	9/21/11
67.	Letter from M. Teichman re Joint Prehearing Memorandum and Exhibits of Applicants	9/22/11
68.	Joint Prehearing Memorandum of Applicants	9/22/11
69.	Exhibit A to Joint Prehearing Memorandum of Applicants	9/22/11
70..	Exhibit B to Joint Prehearing Memorandum of Applicants	9/22/11
71.	Exhibit C to Joint Prehearing Memorandum of Applicants (public/redacted version)	9/22/11
72.	Letter from I. McConnel re Department of Justice Proposed Witness and Exhibit	9/23/11
73.	Letter from D. Foster re Highmark's Supplemental Filing No. 8 to Statement of Affiliation	9/23/11
74.	Schedule 1 to Appendix F of Exhibit 1 to Statement regarding the Affiliation (BCBSD Business Integration Initiative)	9/23/11
75.	Letter from I. McConnel re Department of Justice Position on Proposed Exhibit	9/26/11
76.	Exhibit 39 (revised) to the Prehearing Memorandum of the Department of Insurance (public version)	9/27/11
77.	Letter from B. Mayrack re Department of Insurance Exhibit 39 to the Prehearing Memorandum	9/27/11
78.	Letter from D. Swayze re BCBSD Question on Department of Justice Position	9/27/11
79.	Letter from D. Swayze re BCBSD Opposition to Department of Justice Report and Proposed Testimony	9/28/11
80.	Hearing Exhibits Part I	10/4/11

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81.	Hearing Exhibits Part II	10/4/11
82.	Hearing Exhibits Part III	10/4/11
83.	Hearing Exhibits Part IV	10/4/11
84.	Hearing Exhibits Part V	10/4/11
85.	Hearing Exhibits Part VI	10/4/11
86.	Hearing Exhibits Part VII	10/4/11
87.	Hearing Exhibits Part VIII	10/4/11
88.	Hearing Exhibits Part IX	10/4/11
89.	Hearing Exhibits Part X	10/4/11
90.	Hearing Exhibit No. 112	10/4/11
91.	Hearing Exhibit No. 113	10/4/11
92.	Delaware Department of Justice Letter, Revised Prehearing Memorandum, and Exhibits	9/30/11
93.	Letter from I. McConnel re: Department of Justice Proposed Condition	10/3/11
94.	Hearing Exhibit List (public/redacted version)	10/4/11
95.	Hearing Exhibit No. 1	10/5/11
96.	Hearing Exhibit No. 2	10/5/11
97.	Hearing Exhibit No. 3	10/5/11
98.	Hearing Exhibit No. 9	10/5/11
99.	Hearing Exhibit No. 10	10/5/11
100.	Hearing Exhibit No. 11	10/5/11
101.	Hearing Exhibit No. 55	10/5/11
102.	Hearing Exhibit No. 56	10/5/11

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103.	Hearing Exhibit No. 57	10/5/11
104.	Hearing Exhibit No. 114	10/5/11
105.	Hearing Exhibit No. 115 (public/redacted version)	10/5/11
106.	Hearing Exhibit No. 116	10/5/11
107.	Hearing Exhibit No. 117	10/6/11
108.	Hearing Exhibit No. 118	10/6/11
109.	Public Hearing Transcript	10/5/11
110.	Public Hearing Transcript	10/6/11
111.	Public Hearing Transcript	10/7/11
112.	Hearing Exhibit No. 119	10/7/11
113.	Hearing Exhibit No. 120 (public/redacted version)	10/7/11
114.	Hearing Exhibit No. 121 (public/redacted version)	10/7/11
115.	Letter from B. Mayrack re: Department of Insurance Additional Exhibits	10/10/11
116.	Hearing Exhibits Nos. 122 – 126	10/10/11
117.	Hearing Exhibit No. 127	10/10/11
118.	Letter from M. Houghton re: Department of Insurance Additional Condition	10/14/11
119.	Additional Proposed Condition	10/14/11
120.	Letter from I. McConnel re: Department of Justice Proposed Condition	10/14/11
121.	Letter from B. Mayrack re: Department of Insurance Additional Exhibits, Errata Sheet	10/14/11
122.	Hearing Exhibits 128 – 130	10/14/11
123.	Hearing Exhibits 131 – 132	10/14/11

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124.	Hearing Exhibit 133	10/14/11
125.	Hearing Exhibit 134	10/14/11
126.	Updated Exhibit List	10/14/11
127.	Errata Sheet for Transcripts of Oct. 5-7 Public Hearings	10/14/11
128.	Letter from B. Mayrack re: Draft Proposed Findings of the Department of Insurance, BCBSD, Inc., and Highmark Inc.	10/24/11
129.	Draft Proposed Findings of the Department of Insurance, BCBSD, Inc., and Highmark Inc.	10/24/11
130.	Appendix A to Draft Proposed Findings	10/24/11
131.	Appendix B to Draft Proposed Findings	10/24/11
132.	Appendix C to Draft Proposed Findings	10/24/11
133.	Letter from M. Tweedie re: Department of Justice Response to Proposed Findings	10/24/11
134.	Department of Justice Response to Proposed Findings	10/24/11
135.	Changes in Department of Justice Response to Proposed Findings	10/24/11
136.	Appendix B to Department of Justice Response to Proposed Findings	10/24/11
137.	Letter from R. Campbell re: Highmark's Proposed Disaffiliation Cost Sharing Condition	10/25/11
138.	Letter from B. Mayrack re: Updated Draft Proposed Findings and Combined Comments of Parties	10/28/11
139.	Updated Draft Proposed Findings of the Department of Insurance, BCBSD, Inc., and Highmark Inc.	10/28/11
140.	Changes to Updated Draft Proposed Findings of the Department of Insurance, BCBSD, Inc., and Highmark Inc.	10/28/11
141.	Appendices A, B, C, E, and F to Updated Draft Proposed Findings	10/28/11
142.	Combined Comments to DOJ's Proposed Findings	10/28/11

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143.	Department of Insurance, BCBSD, and Highmark Section II of Combined Comments to DOJ's Proposed Findings	10/28/11
144.	Department of Justice Section II of Combined Comments to DOJ's Proposed Findings	10/28/11
145.	Appendices A-F to Combined Comments to DOJ's Proposed Findings	10/28/11
146.	Letter from M. Tweedie re: Department of Justice Response to Proposed Condition	10/28/11
147.	Letter from D. Swayze re: BCBSD's Proposed Community Support Condition	11/2/11