Department of Insurance – BCBSD/Highmark Affiliation
KPMG Direct Examination

Q: **Mr. Jackson, could you please introduce yourself?**

A: My name is Kenneth Jackson. I am a Senior Director at KPMG LLP in the Transactions and Restructuring Advisory practice, and a member of the Strategic Services Group, where I focus on information technology, due diligence, merger integration and divestitures as part of the Mergers and Acquisition (M&A) information technology team. I will refer to information technology as "IT".

Q: Please give us a brief overview of your educational and professional background.

A: I have a bachelor's degree in Electrical Engineering from Cornell University, and a Masters in Business Administration from Columbia University. Previously, I have held IT management consulting and professional services positions at leading consultancies, hardware and software companies, and outsourcing firms, such as Oracle Corporation, Hewlett Packard Company and Cognizant Technology Solutions.

Q: Please describe the circumstances leading to KPMG's retention in this matter.

A: KPMG was approached by the Delaware Department of Insurance earlier this year to assist in the Department's review of the proposed affiliation between BCBSD, which I will refer to as Blue Cross, and Highmark.

Q: When was KPMG retained?

A: June 2011.

Q: Has KPMG done any prior work for Blue Cross?

A: No. The conflict check KPMG ran in June before the engagement was accepted did not identify KPMG as having provided any prior work for Blue Cross.

Q: Has KPMG done any prior work for Highmark?

A: Yes. We have performed several state and local tax engagements plus one or more Pharmaceutical Benefits Manager, or PBM audits. This work does not substantively relate to any of the issues in the present matter.

Q: Has KPMG done any prior work for the Delaware Department of Insurance?

A: Yes. KPMG serves as the external auditor for the State of Delaware, and the Department of Insurance does fall within the audit.

Q: Is your analysis in connection with the Department's review of the proposed Affiliation un-biased and independent?

A: Yes.

Q: What was the scope of your work?

A: As part of the rationale for the proposed Affiliation between Blue Cross and Highmark, Blue Cross stated that there are certain aspects of its information technology capabilities that must be addressed if Blue Cross is to meet government mandates and remain competitive in the Delaware market. We were retained to do four things. First, to assess Blue Cross' information technology needs by reading and commenting on a report prepared by Deloitte for Blue Cross concerning Blue Cross' information technology needs, which report is Joint Exhibit 47, and the 2010 supplement to which is Joint Exhibit 48. Second, to consider Blue Cross' potential options in addressing those needs. Third, to consider and comment on costs or other issues that may arise in the event that Highmark and Blue Cross were to affiliate and then later disaffiliate. Finally, KPMG also considered and commented on Blue Cross' assertions that the affiliation needed to be approved by December 2011, or else Blue Cross would have difficulty meeting the government mandates that I referenced a moment ago.

Q: You mentioned "information technology capabilities." Can you explain what that means?

A: Information technology goes to the heart of what Blue Cross does. Almost all of the services provided by Blue Cross run off of Blue Cross' IT platform. Blue Cross' 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.

In addition, IT upgrades may substantively improve the quality of service Blue Cross is able to provide. For example, by implementing a CRM (Customer Relationship Management) system, Blue Cross may be able to better understand its customer segments and their specific needs. This may help Blue Cross create higher value products that are more attractive to various types of customers, thereby supporting an increase in, or retention of, its policyholders. Another example where Blue Cross might be able to add value to its policyholders is by implementing a provider profiling system with pay-for-performance capabilities. This system could allow customers to identify and compare the high-performing and cost-effective providers in the marketplace, and thus allow for potentially reduced medical costs for both Blue Cross and its customers.

Q: You also mentioned that there are certain government mandates that Blue Cross must address. What are those?

A: I'll speak to two in particular on which we focused as part of our engagement.

The first is known as "ICD-10." "ICD" stands for International Classification of Diseases. The ICD system is a coding system developed by the World Health Organization, and is a system to classify diseases that is used in more than 100 countries. The standardized codes are used by, among others, healthcare providers and payers in connection with insurance claim reimbursements. For example, a health insurance provider would use ICD codes to standardize the way it bills for its services, and to help ensure the accuracy of payments made by the insurance companies. The United States is presently the only developed country that operates under ICD-9, the coding scheme that predates ICD-10. The U.S. government has required a move to ICD-10, which must be completed by October 1, 2013. For a health insurance company, a switch from ICD-9 to ICD-10 can be both costly and time consuming. The goal is to improve healthcare and to help the U.S. healthcare system gather and share data more accurately in diagnosing and treating diseases.

The second government mandate is known as "HIPAA 5010." HIPAA is the Health Insurance Portability and Accountability Act, which regulates the

electronic exchange of health data. The intent of HIPAA is to protect health insurance clients, reduce fraud and set standards regarding the transmittal of private information. The current HIPAA standard is HIPAA 4010. The U.S. Government has required a move to HIPAA 5010, with a compliance deadline of January 1, 2012.

All health insurance companies must comply with both the ICD-10 and HIPAA 5010 mandates. Many companies have been preparing for quite some time, in some cases for years, to implement this transition.

Q: What happens if Blue Cross does not become ICD-10 compliant by the deadline?

A: Codes from ICD-9 will no longer be accepted for claims reimbursement as of October 1, 2013. So, any company that is not ICD-10 compliant by then will likely lose the ability to, for example, bill for their services or submit claims. The conversion to ICD-10 codes affects most of Blue Cross' existing IT applications, including those for adjudicating claims, managing medical cases, contracting with providers, billing customers and paying providers. Thus, timely ICD-10 compliance is very important for Blue Cross to ensure smooth business operations.

Q: Can you please give a brief summary of the work you performed in this matter?

A: In short, we considered Blue Cross' information technology needs and potential options for Blue Cross to address those needs.

First, we considered the "standalone option" whereby Blue Cross would address its IT needs as a separate, non-affiliated entity through investment in its IT infrastructure. In this analysis, we considered the feasibility of a report that was created by Deloitte at the request of Blue Cross to estimate the needs and costs of a standalone upgrade. We also provided options to consider in addition to Deloitte's recommendations regarding Blue Cross' standalone operations.

Second, we considered an option involving Blue Cross' entrance into a long-term outsourcing arrangement, whereby Blue Cross may be able to address its IT needs on a contractual basis through outsourcing with a third party.

Third, we considered the proposed Affiliation with Highmark.

Finally, in addition to our general analysis of the proposed Affiliation from an IT perspective, we also considered the potential impact if the affiliation is not approved by December 31, 2011, as well as the potential costs if Blue Cross disaffiliates from Highmark in the future.

Q: Before we go through the specific scenarios, can you describe the approach you took in considering these scenarios?

A: We took a hands-on approach within the scope of our engagement as an IT advisor. We interviewed key Blue Cross executives and managers, we met with Deloitte – the company that performed a prior assessment of Blue Cross' IT needs – and we met with Highmark to understand its capabilities and plans. We also collected and considered data from Blue Cross and Highmark on their current IT systems and their IT strategies, plans and estimates going forward – including how Highmark plans to achieve compliance with the ICD-10 and HIPAA 5010 mandates – in addition to considering the ongoing affiliation plans, roadmaps and models created by Blue Cross and Highmark.

Q: I'd like to hand up a copy of the Project Delaware KPMG Report, which is in Tab 2 of the binder. Can you identify this document?

A: This is the report generated by KPMG in connection with this matter.

Q: Does this report contain KPMG's analyses and conclusions regarding the matters it was asked to consider?

A: Yes.

Q: Please turn to slides 11 and 12 of the KPMG report. Can you please describe these slides?

A: This chart is a summary of our conclusions with respect to Blue Cross's options from an IT perspective. As you can see, the chart summarizes the costs of each option, as well as a summary of the strategic goals, capability enhancements, ease of implementation and ease of disentanglement for each option.

Scenario 1 - Standalone

Q: What were KPMG's conclusions with respect to the Standalone scenario, starting with the potential costs of such a scenario?

A: We began by considering the conclusions of Deloitte. Deloitte was hired by Blue Cross in 2008 to assess Blue Cross' IT capabilities and recommend solutions to close what we call "capabilities gaps" – which are areas that Blue Cross needs to upgrade in order to remain competitive in the marketplace and compliant with government mandates. We also considered Deloitte's updated analysis from late 2010. At that time, it was important for Blue Cross to have an understanding of its capabilities gaps – and the potential costs of closing those gaps – as Blue Cross was evaluating its strategic options going forward.

Q: Did KPMG agree with Deloitte's capabilities gaps and cost estimates?

Yes, we generally agreed with the capability gaps and solutions set forth by Deloitte, as well as the costs to address Blue Cross' capabilities gaps, which

were estimated by Deloitte to cost between $88 million to $140 million dollars for Blue Cross to upgrade its IT systems on its own. Deloitte also estimated annual costs of over $21 million dollars in 2012, which would increase each year to over $34 million dollars per year beginning in 2016.

Q: On what did KPMG base its conclusions regarding Deloitte's findings?

A: We reviewed documents created by Deloitte, including the 2008 Deloitte report, which is Joint Exhibit 47, and the 2010 update to that report, which is Joint Exhibit 48.

Q: Did KPMG offer additional recommendations based on its review of Blue Cross' IT needs and potential solutions?

A: Yes. Based on the procedures we performed and assumptions regarding market trends and the impact of healthcare reform and other government mandates, we believe there are some things that Blue Cross must do to remain competitive in Delaware if Blue Cross remains a standalone entity. These additional potential capabilities may include the development of private exchanges that provide a defined contribution arrangement for their customers and retail initiatives that can allow Blue Cross to understand, attract and retain individual customers through various channels, such as online marketing and member letters.

Q: Did KPMG reach some conclusions that were different from Deloitte's findings?

A: Yes. Deloitte recommended that Blue Cross perform full remediation, which involves a complete upgrade of all impacted IT applications to meet the new ICD-10 coding structure. This approach may also require a significant reengineering of the existing business processes supported by these applications in order to meet the October 2013 ICD-10 deadline.

In KPMG's view, however, because Blue Cross has not yet begun any substantial ICD-10 remediation work, it may be very difficult for Blue Cross to perform full ICD-10 remediation within the remaining time to meet published deadlines. Therefore, KPMG outlined an option whereby Blue Cross could consider an ICD-10 neutralization approach. This involves adding conversion maps (ICD-9 to ICD-10 and vice versa) around existing ICD-9 systems to help insulate them from the need to address ICD-10 code formats. This approach may allow existing systems and business processes to remain largely unchanged.

Neutralization may be a less expensive and quicker option for Blue Cross to become ICD-10 compliant. Given facts and circumstances associated with time constraints for compliance, this may be the only realistic alternative. However, neutralization may prevent Blue Cross from realizing certain

benefits of ICD-10. These include the potential for greater specificity in clinical documentation, more precise business intelligence to measure and improve resource utilization and patient safety, and the ability to reduce the number of miscoded claims that result from the ambiguity of the ICD-9 codes.

In addition, there are other IT areas that KPMG believes Blue Cross may need to address in order to remain competitive in the Delaware market. For example, Blue Cross may wish to consider hiring a team to lead the execution of its IT upgrades. Blue Cross may also wish to consider offering certain services such as a Private Exchange, whereby employers allow employees to choose how to allocate health care dollars among a variety of health plans and services. Private Exchanges are becoming increasingly popular in the marketplace.

Q: Did these different recommendations increase or decrease the cost of the standalone option?

A: One of the options outlined for Blue Cross' consideration decreased the cost, but overall the estimated cost range increased.

Specifically, ICD-10 neutralization may be approximately 1/3 the cost of full remediation. The remaining recommendations for maintaining Blue Cross'

competitive position in the marketplace, however, were not addressed by Deloitte and therefore may add costs above and beyond those estimated by Deloitte.

Q: What is the estimated overall impact on the one-time cost range in KPMG's report?

A: We estimated that the one-time cost would be $93 to $150 million dollars compared to the $88 to $140 million dollars estimated by Deloitte. Due to the scope of our engagement, we did not estimate the increased annual costs. We do believe, however, that Deloitte's estimated annual costs – which rise from $20 million dollars annually to more than $34 million dollars annually – appear reasonable.

Q: What are the potential benefits of the standalone option to Blue Cross?

A: The main benefit is that Blue Cross could remain self-reliant. The standalone option would allow Blue Cross to upgrade its IT systems to become compliant with government mandates, while at the same time improving its IT capabilities to remain competitive in the Delaware market, all without affiliating or entering into complex contractual relationships with another entity.

An additional benefit, at least as compared to the affiliation and outsourcing options, is that the standalone option eliminates any concerns about the future disentanglement or disaffiliation from another company.

Q: What are the potential risks of the standalone option?

A: There are a number of potential risks. First, in addition to what may be substantial cost of the standalone option, this type of IT upgrade can be highly complex and is inherently risky. These risks could materially increase the level of costs of the transformation to the new technology, as well as delay the expected implementation of the overall project. To complicate matters, the current Blue Cross IT organization has not had experience in delivering such a complex, multi-year transformation project.

In addition, although the standalone option would allow Blue Cross to become compliant with government mandates and remain competitive from a purely IT perspective, 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.

Similarly, the standalone option may also prevent Blue Cross from realizing the economies of scale it may realize through affiliating with a larger entity, which may increase Blue Cross' ability to compete with much larger

competitors. I also understand that the standalone plan may not be consistent with the strategic priorities of Blue Cross, as explained further in the Blackstone report.

Scenario 2 – Long Term Outsourcing Arrangement

Q: What are KPMG's conclusions regarding the option of Blue Cross to enter into a long term outsourcing arrangement, starting with the costs of such an arrangement?

A: Based on the level of preliminary analysis we were able to perform within the scope of our engagement, the results of our work suggests that such a long-term contractual arrangement could cost between $30 and $45 million dollars up-front, with estimated annual costs of between $30 and $60 million dollars. We believe that there could be additional one-time set up costs, although we were unable to obtain precise estimates.

Q: How did KPMG derive its estimated annual costs for the outsourcing option?

A: Our estimates were based on information that KPMG obtained through conversations with IT representatives from several health plans that have contracted for outsourcing services of the type needed by Blue Cross.

Q: Your report describes this as the "Business Process and Information Technology Outsourcing" option. Can you describe those two components?

A: Business Process Outsourcing involves the outsourcing of various "back office" and administrative functions or processes, such as enrollment and claims adjudication, to a third party who typically represents themselves as capable of performing the work more efficiently and at a lower cost.

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). Lower costs can often be achieved through economies of scale, labor arbitrage benefits, and improved processes and/or technology capabilities and solutions.

The outsourcing option can also allow companies to realize cost savings and can provide access to new technology and other benefits.

Q: What are some of the other potential benefits of the outsourcing option?

A: This option may allow Blue Cross to outsource certain of its functions and business processes to vendors who may be able to perform them better, faster and cheaper. These vendors may possess more comprehensive subject matter expertise and may be more current on leading practices in the

industry, thus allowing them to potentially provide access to improved business processes and support capabilities.

In addition, as compared to the affiliation option, potential future disentanglement could be less complex and less costly because of a lesser degree of integration between Blue Cross and the third party.

Q: What are the risks to Blue Cross of the outsourcing option?

A: There is a risk that Blue Cross might have difficulty finding an appropriate outsourcing provider. With the upcoming government deadlines, the demand for outsourcing providers may increase as other companies seek outsourcing to meet government mandates. This increased demand could decrease Blue Cross' leverage to negotiate favorable pricing terms. It may also be difficult for Blue Cross to find a good cultural match with a third party outsourcer.

Further, similar to the standalone option, Blue Cross also appears to currently lack the experience and expertise in managing such a long term contractual relationship, particularly if the outsourcing option requires Blue Cross to outsource with multiple companies to get all of the services it needs.

Finally, even if Blue Cross found a suitable outsourcing partner, given the upcoming ICD-10 compliance deadline, Blue Cross may have to incur $3 million to $5 million dollars in "throwaway" costs – meaning costs that it will have to incur for no other purpose than meeting the deadline and costs that will not otherwise benefit Blue Cross in the long term – to become compliant before it is able to migrate to the systems of the outsourcer that it would partner with.

In addition, many of the business processes that Deloitte identified are not necessarily good candidates for outsourcing. For example, we looked at the 70 affiliation integration projects currently underway between Highmark and Blue Cross, and our experience suggests that over half of the projects may not best be delivered through outsourcing.

Many of the projects that address Corporate Communications and Strategic Planning (for example, Branding Strategy, Market Launch) may not represent good options for outsourcing since they are short-term initiatives that involve strategic decision-making by key business stakeholders. Conversely, back office projects that involve more tactically oriented work, such as programming, (for example, Customer-Service Application System Changes, Membership Enrollment Application System Changes) can often

be good candidates for outsourcing since they involve long-term implementation work that can be staffed with lower cost resources.

Q: What are KPMG's overall views of the outsourcing option as it relates to Blue Cross' goals and ability to implement the arrangement?

A: As with the standalone option, it is my understanding that the outsourcing option does not meet the strategic goals of the Blue Cross Board of Directors. In addition, while the outsourcing arrangement may improve access to process and technology expertise, Blue Cross may not be able to benefit from the full range of other capabilities from its partner, including economies of scale and back-end or centralized support. In addition, Blue Cross may have difficulty implementing the outsourcing option, given the time constraints posed by government mandates and Blue Cross' potential need to manage a complex process, with multiple vendors, to handle all of its outsourcing needs.

<u>Scenario 3 – Affiliation with Highmark</u>

Q: What are KPMG's conclusions regarding the proposed affiliation between Blue Cross and Highmark, starting with the costs of an affiliation?

A: From a cost perspective, Blue Cross and Highmark estimate that Blue Cross' transition to Highmark's systems would cost between $35 and $37 million dollars as a one-time cost, with annual costs for the services that Highmark

will provide under the ASA estimated at between $21 and $23 million dollars.

Q: Does KPMG have a view as to the reasonableness of these estimated costs?

A: Yes, based on our review of affiliation planning documentation, and based on our experience in working on integration projects of similar scope and complexity, we believe that the estimated range of costs is reasonable. In addition, I understand that the Department of Insurance has proposed a condition placing a cap of $42 million dollars on the costs of the integration, which is reflected as Proposed Condition # 17.

The estimated annual charges of $21 million to $23 million dollars also appear reasonable.

Q: Let's talk about these annual charges. Where do they come from and what do they represent?

A: These charges represent both "business as usual" charges, which includes the costs of the day-to-day operations based generally on Blue Cross transaction volumes. The charges will also include Blue Cross' share of the expense of Highmark's legacy modernization project. Blue Cross may derive substantial benefits from Highmark's upgrade, such as new systems

capabilities, and Blue Cross will in turn pay for its share of the cost of the upgrade.

Pursuant to the Administrative Services Agreement, these charges are allocated by Highmark "at cost." In other words, under the agreement, Blue Cross will pay for its fair and reasonable share of the total cost of services being provided without provision for profit to Highmark in providing the services.

Q: Is such an arrangement – the provision of IT integration at cost without profit – common in the industry?

A: Yes. Where there is an affiliation, like the one proposed between Highmark and Blue Cross, it is not unusual for the entity in Highmark's position to charge cost only – with no markup.

Q: Did KPMG review the manner in which Highmark has agreed it will allocate costs to Blue Cross and whether there is the potential for Highmark to over-charge Blue Cross?

A: Highmark states that it will charge Blue Cross for its allocable share of resources and services consumed based on transaction volumes, project related costs and other factors. In an affiliation, it should be in the interest of both parties for Blue Cross to maintain its ability to compete in the marketplace with competitive administrative fees in addition to consumer directed health care products and services. This alignment of interest should

hopefully decrease any motivation for Highmark to enrich itself to the detriment of Blue Cross, but our engagement did not include a review of any process, system or governance controls associated with avoiding this scenario. Further, I understand that the Department of Insurance has proposed a number of conditions relating to cost allocation, and that such conditions are memorialized as Proposed Conditions 9 through 14. These conditions as drafted appear reasonable and should provide the Department of Insurance the opportunity to identify issues relating to cost allocation and a mechanism to address these concerns.

Q: What documents did KPMG review in reviewing the costs of the affiliation?

A: A number of documents, including the Administrative Services Agreement, plus a number of affiliation documents from Blue Cross and Highmark, such as the Blue Cross/Highmark Affiliation Planning Overview, which is Joint Exhibit 80.

Q: What are your views as to the feasibility of the proposed affiliation with Highmark?

A: Based on our review of the affiliation planning process and the work completed to date, the integration effort appears to be on strong footing and the affiliation appears to be a feasible solution for Blue Cross' needs,

including allowing Blue Cross to meet the ICD-10 and HIPAA 5010 guidelines.

The affiliation plan also appears well-suited to address the needs of Blue Cross. The current plan will address each capability concern raised in the 2008 Deloitte report, and will also provide an additional 42 capabilities to Blue Cross. These capabilities include, for example, market leading actuarial, pricing and direct marketing processes, product offerings for dental and vision, consumerism and retail marketing capabilities, and informatics capabilities in data management, reporting and analytics.

Q: What are the potential benefits from a technology perspective to Blue Cross affiliating with Highmark?

A: Blue Cross should be able to benefit from the economies of scale – including lower costs – that should be realized through the affiliation. In addition, Highmark is offering a low-cost structure for Blue Cross to migrate onto its IT systems. For example, as I discussed earlier, administrative services will be provided by Highmark at cost, with no provision for profit to Highmark.

In addition, Highmark has made a material commitment to its IT capabilities, and as a result Blue Cross may gain significant benefits in all areas of its operations. 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. 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 Blue Cross' customer base.

Further, Highmark appears to already be well on track to meet government mandates. For example, Highmark has indicated that it is already HIPAA-5010 compliant, and is scheduled to be ICD-10 compliant well before the 2013 deadline. Because Blue Cross is currently contracting with Highmark for a small subset of services that Highmark would provide under the Administrative Services Agreement – such as electronic data exchange services – Blue Cross is already HIPAA-5010 complaint through its use of Highmark's platform, and Blue Cross should be better positioned to be ICD-10 compliant by the government deadline.

Q: Did KPMG consider the likelihood of success of the affiliation integration effort?

A: Yes. The experience Highmark has gained through a history of what appears to be successful affiliations and system migrations should help mitigate the risks of an unsuccessful affiliation. We also considered the in-depth affiliation integration planning approach undertaken by the Blue Cross and Highmark affiliation planning teams (over 10 months of effort) to

identify and scope required projects, and continually assess and re-assess assumptions and cost estimates throughout the planning process.

In addition, Highmark has up to 18 arrangements with other health plans whereby Highmark offers a variety of services, including back-office functions. This gives Highmark experience in running multiple businesses on a single technology platform, which may result in significant cost savings. This experience and cost savings may improve the chances of a successful affiliation with Blue Cross.

Q: What are the risks, from a technology perspective, of the proposed affiliation?

A: A potential risk is the cost allocation issue that I mentioned previously, although as I stated, the Department has proposed reasonable conditions that should allow the Department the opportunity and mechanism to address any cost allocation issues. In addition, one risk is that, as a relatively small affiliating company, Blue Cross may not receive adequate support for its service requests during the integration of the two companies. Throughout the affiliation, Blue Cross will need to work with Highmark and its other affiliates and partners to ensure that its strategies and other projects are funded and executed. One potential way to mitigate this risk is for Highmark and Blue Cross to execute a Service Level Agreement, which

should establish the target service levels and standards of performance by which Highmark will be measured during the affiliation. Further, ongoing reporting of service level performance to a regulatory agency could help performance targets to be met and avoid other problems with performance. I understand that the Department of Insurance has proposed a condition, memorialized as Proposed Condition # 16, that relates to service levels and reporting.

Q: Did you analyze the risks of a delayed affiliation? In other words, what are the risks if the affiliation is not approved before December 2011?

A: Yes. The work we preformed suggests that delays in affiliation approval may increase the risk and costs for Blue Cross to ensure that its systems are ICD-10 compliant by the government deadline. Delay may mean that outsourcing is not a feasible option, because Blue Cross may not have sufficient time to migrate to a new software platform prior to the government deadlines.

Delay may leave ICD-10 neutralization as the only option, and could also mean that Blue Cross may have to incur "throw away" costs just to ensure its systems are compliant. These costs would range from $3 million to $5 million dollars.

Q: Did you analyze the implications of Blue Cross disaffiliating from Highmark at some point in the future? If so, what were your conclusions?

A: We did. Much of the analysis depends upon how long Blue Cross and Highmark have been affiliated at the time they disaffiliate, and on the operational breadth and depth of that affiliation. In other words, the longer the IT systems of the two companies are integrated and dependent on one another, the greater the complexity of IT separation. We estimate that the disaffiliation effort will mirror the affiliation effort, and that disaffiliation could require two to three years.

Disaffiliation costs will exceed the affiliation integration costs. Based on the current estimated $17 million dollars annual cost that Highmark plans to charge Blue Cross for use of its technology platform, a 2 to 3 year disaffiliation period will involve costs ranging from $38 to $55 million dollars.

This cost range reflects the current terms of the Administrative Services Agreement, which provides that, upon disaffiliation, Highmark will provide transition services to Blue Cross for a period of two years at cost plus 8%. Because of the expected length of time it will take for Blue Cross to disaffiliate, and the potential complexity of such an affiliation, it may be

appropriate for these terms to be modified, such as providing for a longer period of transition services at a different cost structure. I understand that the Department of Insurance has proposed conditions relating to these terms, which are reflected as Proposed Condition #18.

Q: Thank you, Mr. Jackson. No further questions.

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