

Department of Insurance – BCBSD/Highmark Affiliation

Blackstone Direct Examination

Q: Mr. Alderson Smith, could you please introduce yourself?

Good morning, ladies and gentlemen. My name is Martin Alderson-Smith, and I'm employed by The Blackstone Group, which is a leading investment banking firm engaged primarily in financial advisory services and principal investments. I work in Blackstone's mergers and acquisitions advisory group, and my title is Senior Managing Director.

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

I have a bachelor's degree and master's degree from Oxford University and a Master's of Business Administration, or MBA, from Harvard Business School. I have worked for over 25 years in the fields of corporate finance and mergers and acquisitions advisory services, and I have been employed by Blackstone since 1991.

Q: Please give us a brief overview of Blackstone and its experience relevant to the proposed Affiliation.

Blackstone has been retained by the Delaware Department of Insurance to conduct an independent review of specific financial aspects of the Form A application that was submitted in connection with the proposed Affiliation between Highmark Inc. and BCBSD, Inc., which is more commonly known as Blue Cross Blue Shield of Delaware. For the remainder of my testimony, I will generally refer to Blue Cross Blue

Shield of Delaware simply as “Blue Cross” or the “Company.” Blackstone has significant experience advising state insurance regulators on various life insurance and health insurance transactions. During the last several years, Blackstone has advised the Pennsylvania Insurance Department on the proposed consolidation of Highmark and Independence Blue Cross, the New Jersey Department of Banking and Insurance and the New Jersey Attorney General on the proposed conversion and subsequent IPO of Horizon Blue Cross Blue Shield, and the Maryland Insurance Administration on the proposed conversion and subsequent acquisition of CareFirst Blue Cross/Blue Shield by WellPoint. Blackstone has also advised the New York Public Asset Fund, which owns 62 percent of WellChoice, on the sale of WellChoice to WellPoint. Further, Blackstone has advised the Office of the Insurance Commissioner of Washington State on the proposed conversion and subsequent IPO of Premera Blue Cross. Over the course of our work advising state insurance regulators, Blackstone has in some instances recommended approving proposed transactions, and in other instances has recommended denying proposed transactions. Our recommendations are always based on our review of the circumstances of the particular transaction.

Q: When was Blackstone retained by the Delaware Department of Insurance?

Blackstone executed an engagement letter on March 31, 2011 and began work immediately thereafter.

Q: Has Blackstone done any prior work for Blue Cross Blue Shield of Delaware?

No.

Q: Has Blackstone done any prior work for Highmark?

No, Blackstone has never been retained by Highmark nor done any prior work for Highmark. However, as previously referenced, Blackstone has assisted, and may assist in the future, the Pennsylvania Insurance Department in its review of other transactions involving Highmark.

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

No.

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

Yes. We are independent and formed our own view on the proposed Affiliation.

Q: Could you please describe in detail the purpose of your retention by the Department in this proceeding?

The DOI has asked Blackstone to analyze several aspects of the proposed Affiliation as part of the DOI's process of determining whether the Affiliation meets certain of the standards contained in Title 18, Chapter 50 of the Delaware Insurance Code, that are required in order for the Affiliation to be approved. Specifically, Section 5003(d)(1) contains six standards that have been deemed to be applicable to this transaction that must be assessed as part of the Department's review. The Department has asked Blackstone to assist in analyzing five of the six standards.

Q: Please tell us which standards the Department has asked Blackstone to review.

The Department has asked Blackstone to assist in its review of standards “a,” “b,” “c,” “d,” and “f.” The Department has not asked Blackstone to assist in its review of standard “e,” which deals with the assessment of the competence, experience and integrity of the persons who would control Blue Cross. That standard is being handled directly by the Department.

Q: Can you please provide a brief description of each standard in Section 5003(d)(1) that the Department asked Blackstone to review?

Standard “a” involves an assessment of whether, after the proposed transaction is completed, Highmark and Blue Cross would still be able to satisfy the requirements for the issuance of a license to write the lines of insurance in Delaware for which they are presently licensed.

Standard “b” involves an assessment of whether the effect of the Affiliation would be to substantially lessen competition or tend to create a monopoly in Delaware.

Standard “c” involves an assessment of whether Highmark, as the proposed controlling affiliate, might jeopardize the financial stability of Blue Cross or prejudice the interest of Blue Cross’s policy holders.

Standard “d” involves an assessment of whether the plans or proposals that Highmark has to liquidate Blue Cross, sell Blue Cross’s assets or consolidate or merge it with any person or to make any other material change in Blue Cross’s business or

corporate structure or management, are unfair and unreasonable to Blue Cross policyholders and not in the public interest.

Standard “f” involves an assessment of whether the Affiliation is likely to be hazardous or prejudicial to the insurance buying public in Delaware.

Q: Before we start discussing the standards, can you describe the structure of the Affiliation?

Sure. According to the Affiliation Agreement and related documents, Blue Cross will remain a separate, not-for-profit, non-stock Delaware corporation, and Highmark will control Blue Cross and become the sole member of Blue Cross. Blue Cross will become a “controlled affiliate” of Highmark, which will become the primary Blue Cross Blue Shield Association licensee in Delaware.

Q: Can you explain what it means for Blue Cross to become a “controlled affiliate” of Highmark and for Highmark to become the primary Blue Cross Blue Shield Association licensee in Delaware?

The Blue Cross and Blue Shield service marks are the intellectual property of the Blue Cross Blue Shield Association, which I will refer to during the remainder of my testimony as the “National Blue Cross.” The right to exclusively use the Blue Cross and Blue Shield brand, including the names and logos, within certain geographic areas is granted by the National Blue Cross to certain insurers under licensing agreements. National Blue Cross licensees in particular geographic areas are often said to “have the

marks” for that area. Blue Cross Blue Shield of Delaware is currently the National Blue Cross licensee in the service area of the State of Delaware. Upon completion of the proposed Affiliation, Blue Cross will relinquish its National Blue Cross license and Highmark will become the National Blue Cross licensee for the Delaware service area. Blue Cross Blue Shield of Delaware will retain the ability to use the marks within the Delaware service area, however, as a “controlled affiliate” of Highmark. The term “controlled affiliate” is used by the National Blue Cross for purposes of establishing criteria for the relationship between the licensee in a particular area (in this case Highmark) and affiliated organizations that seek to use the service marks that same area (in this case Blue Cross). Among the criteria for Blue Cross Delaware to be a “controlled affiliate” of Highmark, and therefore able to use the marks, are that Highmark must have certain control over Blue Cross Delaware and provide a guarantee of Delaware Blue Cross’s claims.

Q: Is the proposed transaction a merger or an acquisition?

No, it is only an affiliation, not a merger or acquisition. Although affiliations share similarities with mergers and acquisitions, there are significant differences that influence the analysis of the proposed transaction pursuant to the applicable standards of the Delaware Insurance Code.

Q: What are the key differences between a merger or an acquisition, on the one hand, and an affiliation, on the other?

In an acquisition, the buyer typically pays consideration, typically a combination of cash and stock, to the seller's owners in exchange for ownership of the current equity or unassigned surplus, which we hereafter will refer to as "reserves," of the seller, as well as for ownership of the rights to the seller's future profits and economic interests. Usually, once an acquisition has closed, it is typically not subject to being un-wound. The key issue for the seller is whether the total consideration that the seller receives is sufficient, because the seller is selling ownership or control of current equity and future economic interests.

In this proposed Affiliation, Highmark will assume control of Blue Cross in exchange for providing administrative services at cost, a guarantee of Blue Cross's claims, and overall corporate and strategic support. As mentioned before, Highmark will become the primary licensee of the National Blue Cross service marks, though Delaware Blue Cross will be able to use the marks as a controlled affiliate. Highmark is also providing Blue Cross the opportunity to draw upon a \$45 million line of credit to facilitate Blue Cross's IT systems conversion. Highmark is not paying Blue Cross any amount of consideration and will have no right to benefit from either Blue Cross's current reserves or future profits. Blue Cross will retain the right to disaffiliate in the future under certain circumstances, which preserves the Company's ability to sell its equity and economic interests to a third party in exchange for consideration at a future date. Among other items, the key issues for the controlled affiliate in an affiliation of the type proposed by Blue Cross and Highmark include ensuring that the reserves and future profits of the

controlled affiliate are not indirectly transferred to the controlling party and carefully assessing the impact of the change of control on the target and its customers.

Q: Given the particular aspects of the proposed transaction noted and the scope you were assigned by the DOI, could you please describe your overall approach to assessing the five standards?

In evaluating standard “a,” Blackstone analyzed the relevant capital and surplus requirements, per DOI guidance, for each of the domestic insurers involved for issuance of a license. In evaluating standard “b,” Blackstone performed mathematical tests of market share and market concentration, per the Delaware Insurance Code, and analyzed potential mitigating factors for reasonableness where *prima facie* evidence of an anticompetitive impact existed. In evaluating standard “c,” Blackstone analyzed Highmark’s current and expected financial condition as well as the current condition of Blue Cross’s reserves. In evaluating standard “d,” Blackstone analyzed the non-financial benefits to Blue Cross policyholders in this transaction and the potential risks of the Affiliation from a policyholder perspective. In evaluating standard “f,” Blackstone analyzed the manner in which the Affiliation may affect the insurance market in Delaware.

Q: What steps did you specifically take in enacting the approach you just described?

Blackstone's work on behalf of the DOI was extensive. The complete list of work that we did is set forth on pages 13-14 of our Report, but it includes the following highlights:

We reviewed the Form A filing submitted by Highmark in connection with the proposed Affiliation.

We also reviewed Blue Cross's and Highmark's financial statements and financial projections.

We attended public information sessions in three locations in Delaware during May of this year and reviewed the responses provided by Blue Cross and Highmark to questions posed by the public.

We reviewed materials related to the proposed Affiliation produced by the Applicants, including more than 1,500 documents.

We held over 15 discussions with executives and senior management of both Blue Cross and Highmark, and we held discussions with 14 third-party industry participants who provided their perspectives on the proposed Affiliation and its potential impact on the health insurance market in Delaware.

We held discussions with Highmark’s affiliate, Highmark West Virginia, Inc., as well as the West Virginia Department of Insurance for purposes of discussing Highmark West Virginia’s experience affiliating with Highmark.

Q: Are there any limitations to the scope of the work that Blackstone performed?

Yes, Blackstone has not independently verified the accuracy and completeness of financial and other information that is available from public sources or was provided to us by Blue Cross, Highmark or their representatives or otherwise reviewed by us; we did not make an independent appraisal of Blue Cross’s and Highmark’s reserves or assets or expressed any opinion as to either the value of such reserves or such assets or the value of the projected income and cash flow expected to be derived therefrom; we did not perform due diligence on Blue Cross’s and Highmark’s physical properties, sales, marketing, distribution or service organizations or product markets; and we did not express any formal opinion regarding the fair value of Blue Cross, Highmark or the affiliated entity; or consider either the relative merits of the proposed Affiliation as compared to any other transaction that may be available to Blue Cross or the effect of any other arrangement in which Highmark and Blue Cross might engage.

Q: Now that we understand the background of your engagement and the specific approach used in your review, please describe your analysis of Standard “a.”

Standard “a” requires that, after the change of control, Blue Cross would be able to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed.

As set forth on page 48 of our Report, Blue Cross is a health service corporation governed by the licensing and other requirements of Title 18. Based on its original Certificate of Incorporation, which has been entered into the record as a Joint Exhibit, and on information from the Department, following the closing of the Affiliation, Blue Cross will remain a health service corporation and, according to the Department, will be able to continue to write the same lines of insurance after the Affiliation as prior to the Affiliation without acquiring a certificate of authority with the Department.

Also as set forth on page 48 of our Report, Blackstone also verified that Highmark's Delaware-based subsidiaries will meet the capital balance requirements for the satisfaction of their licensing requirements as domestic insurers in the state of Delaware. Specifically, there are three subsidiaries of Highmark that are currently licensed in Delaware and are expected to continue operating subsequent to the Affiliation. The subsidiaries are HM Life Insurance Company, HM Health Insurance Company and United Concordia Life and Health Insurance Company. Highmark provided information to support the conclusion that each of its three current Delaware subsidiaries holds capital balances in excess of the minimum required in Delaware.

Q: What information did Blackstone rely on in its analysis of Standard “a”?

Blackstone received a memorandum regarding Blue Cross's licensing status from Blue Cross management on July 7, 2011 and received information regarding Highmark

subsidiaries operating in Delaware from the Department in a discussion on August 9, 2011.

Q: What are your conclusions regarding Standard “a”?

Both Blue Cross and Highmark’s Delaware subsidiaries would continue to be able to write the lines of insurance for which they are presently licensed. As such, Blackstone believes that the proposed Affiliation would not violate Standard “a.”

Q: Please describe your analysis of Standard “b.”

Standard “b” requires that the effect of the Affiliation would not substantially lessen competition in insurance in Delaware or tend to create a monopoly.

In the course of its examination under this standard, Blackstone applied specific quantitative standards relating to the respective market shares of Blue Cross and Highmark and to recent trends towards increased concentration in the market, as set forth in Title 18, Chapter 50, Section 5003A(d)(2) of the Delaware Insurance Code. If certain quantitative criteria are met, then there is *prima facie* evidence that the competitive standard has been violated. Even if the standard has been violated, however, the Affiliation may nonetheless satisfy the overall standard if there is other substantial evidence that suggests that the Affiliation will not have an anti-competitive effect.

The DOI compiled reports from data from the National Association of Insurance Commissioners (or “NAIC”) concerning the market shares of insurers in Delaware. Based on this data, Blackstone determined that Highmark, through various subsidiaries,

and Blue Cross earned 2010 premium revenue in Delaware in two overlapping product lines: stop-loss and dental insurance. This means that Blue Cross and Highmark effectively compete in the stop-loss and dental segments of the Delaware health insurance market. In order to assess potential anti-competitive impacts of the transaction in these two product lines, Blackstone applied the mathematical tests per standard “b,” but Blackstone was only able to do so in the Dental market.

Q: What prevented you from applying the mathematical tests to the stop-loss market?

According to the Department, complete and consistent data with respect to the Delaware health insurance stop-loss market is not available, because individual insurers report stop-loss premiums to the NAIC using different and inconsistent categories that are not exclusive to stop-loss premiums.

Q: Given the data limitations in the stop-loss market, are there secondary measurements that may indicate whether there would be evidence of a *prima facie* violation of the competitive standard for the stop-loss market?

Yes. Highmark reports total 2010 health insurance premiums written in Delaware – including all categories of health insurance, such as stop-loss and dental – in 2 NAIC categories: “Comprehensive Health” and “Life, Accident and Health.” Blue Cross and several of its primary competitors in Delaware report all of their health insurance premiums in the “Comprehensive Health” category. Although not an “apples to apples” comparison, comparing Highmark’s total insurance premiums to the total premiums

reported in the Comprehensive Health category indicates that Highmark would have a 0.8% market share of the NAIC category that is most closely aligned with the overall market for health insurance in Delaware. Because the threshold for evidence of a *prima facie* violation of the competition standard requires Highmark to have a 1% or more market share, Highmark's market shares in this category would not violate the mathematical competitive standards.

Blackstone believes that this is a conservative calculation, because it compares all of Highmark's activities in the Delaware market – including health insurance, life insurance and accident insurance – against the total premiums written within the Comprehensive Health category only, even though it is likely that other insurers in addition to Highmark report health insurance premiums in categories other than Comprehensive Health. If Highmark's total insurance premiums in "Comprehensive Health" and "Life, Accident and Health" were compared to the total Delaware premiums in those 2 categories, Highmark's market share would be even less than 0.8%.

Blackstone does not view the effect of the Affiliation on the stop-loss market as having any sort of anti-competitive effect in Delaware.

Q: Was the necessary data available to conduct the statutory mathematical test in the dental market?

Yes. Unlike health insurance stop-loss premiums, the NAIC maintains a specific “dental” category, which the Department believes captures most of the dental premiums written in the state.

Q: Did you find evidence of a *prima facie* violation of the competitive standard for the dental market?

Because the market share of the 4 largest dental insurers in Delaware is 97.9%, the market is considered to be highly concentrated. Therefore, there would be *prima facie* evidence of violation of the competitive standards if one of the insurers involved in the Affiliation holds 10% or more of the market while the other holds 2% or more of the market. According to NAIC data provided by the DOI, Blue Cross and Highmark have 11.1% and 5.8% share of the Dental Insurance market in Delaware, respectively. Consequently, there is a *prima facie* violation.

Q: Is it possible to establish the absence of any anti-competitive effect through other factors?

Yes. Although Highmark, via its United Concordia subsidiary, accounts for nearly 6% of dental insurance premiums in Delaware, over 81% of United Concordia’s Delaware dental customers obtain their insurance through their employment with companies that are not located within Delaware. Blue Cross is not a potential provider of dental insurance for these employees, and we believe that pricing actions taken by Blue Cross for dental products in Delaware have little impact, if any, on the pricing of dental

insurance for United Concordia customers outside of Delaware. Therefore, United Concordia is effectively not participating in the same market as Blue Cross.

Blackstone performed two calculations for the purpose of estimating United Concordia's market share after excluding customers employed by out-of-state employers. The first calculation applied the percentage of United Concordia customers located in Delaware to United Concordia's market share percentage based on total premiums in the Delaware market. This calculation resulted in an estimated adjusted market share of 1.2% for United Concordia. The second calculation applied the number of United Concordia members located in Delaware as a percentage of the total number of Delaware residents enrolled in a private dental insurance plan. This calculation resulted in an estimated adjusted market share of 0.8% for United Concordia. Both estimates are below the statutory 2% threshold.

Additionally, Blackstone also considered that Highmark's potential increased presence in the Delaware dental market resulting from the Affiliation may increase competition by providing more of a counter-weight to the current market leader, Delta Dental. Delta Dental's market share exceeds 73%, compared to 15% for Dominion and 11% for Blue Cross, the two next largest competitors. Blue Cross also currently offers only standard reimbursement plans that do not utilize provider networks, but Highmark (via United Concordia) plans to offer dental plans in Delaware which would compare more favorably to the product offerings of Delta. Blackstone believes that these factors,

taken together, may lead to increases in competitive pressures in the Delaware dental market.

Q: Did you have any other concerns or findings related to the impact of the proposed Affiliation on competition in the Delaware market?

Despite the fact that there does not appear to be evidence of the Affiliation having an anti-competitive impact on the Delaware health insurance market, a potential negative impact to consumers could result from the bundling of ancillary Highmark products such as dental and vision insurance with Blue Cross's core health products.

Q: What does "bundling" mean and why might it be a concern?

Bundling would occur if Blue Cross were to condition the sale of their core health products on the simultaneous purchase by the same customer of ancillary products. The risk to consumers stems from the ability of Blue Cross to use the sale of core health products, for which they may already have some level of market power before the Affiliation, as a means of forcing customers to purchase ancillary products for which neither Highmark nor Blue Cross currently enjoy a strong market presence in Delaware. In doing so, Blue Cross could potentially extend existing market power in core health products to newly introduced ancillary products, with the potential consequence of limiting competition in ancillary products markets over the long term. Prohibiting the bundling of ancillary products with core health products could limit the ability of Highmark and Blue Cross to engage in activities that may lessen competition in ancillary product markets.

Q: What are your conclusions regarding Standard “b”?

In summary, based on our analysis and the imposition of a condition (#30) by the Department related to anti-bundling, Blackstone does not believe the proposed Affiliation is likely to substantially lessen competition in any of the markets in Delaware in which Blue Cross and Highmark compete.

Q: What information did Blackstone rely on in its analysis of Standard “b”?

Blackstone received NAIC market share data from the Department on September 12, 2011 and reviewed information provided by Highmark regarding United Concordia’s Delaware market activity.

Q: Please describe your analysis of Standard “c.”

Standard “c” requires that the financial condition of Highmark does not jeopardize the financial stability of Blue Cross or prejudice the interest of Blue Cross policyholders.

Blue Cross and Highmark will remain separate legal entities under the terms of the proposed Affiliation, and Blue Cross will not be responsible for paying any of Highmark’s liabilities. Highmark’s financial condition affects whether Highmark has the ability to fulfill its obligations under the terms of the Affiliation Agreement and the administrative services agreement, including its provision of administrative and corporate services to Blue Cross. Blackstone’s analysis, therefore, focused on three issues: (i)

Highmark's financial condition, in part as evidenced by its risk-based capital ratio, and the likelihood that Highmark will remain a dependable source of services for Blue Cross; (ii) Blue Cross's reserves and the likelihood that Blue Cross will need to rely upon Highmark to support the payment of Blue Cross claims; and (iii) Highmark's proposed affiliation with the West Penn Allegheny Health System and the potential impact that transaction could have on Highmark's overall financial stability.

Q: You mentioned that your analysis involved consideration of Highmark's "risk-based capital ratio." What is that?

In this context, risk-based capital, sometimes called "RBC," represents an insurer's capital base for paying customer claims – in other words, the amount of money needed for an insurer to pay its claims. RBC is calculated according to a particular formula. An insurer's "RBC ratio" is a frequently-used metric in the insurance industry to indicate the financial strength of an insurer, and is intended to capture the risks posed to the insurer. The RBC ratio is equal to the total capital of the insurer divided by the insurer's risk-based capital. For example, an insurer with a 300% RBC ratio has capital equal to three times the insurer's risk-based capital. Although the RBC ratio is not a perfect measure of an insurer's ability to pay customer claims, generally speaking, the higher an insurer's RBC ratio, the stronger an insurer's financial position.

Q: What information did Blackstone rely on in its analysis of Standard "c"?

Blackstone reviewed industry data compiled by CapitalIQ and SNL as of September 2011 as well as pro forma financial information provided by both Highmark and Blue Cross.

Q: Please discuss your assessment of Highmark's financial condition.

Highmark's risk-based capital ratio is approximately 692%, which exceeds the median ratio of 487% among a sample of large, publicly-traded health insurers. This figure 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. Further, Highmark anticipates steady growth in the coming years, resulting from the company's strong market position and an emphasis on cost containment, which is expected to result in growth of the company's investment portfolio and reserves.

Q: How did you arrive at those numbers for Highmark's risk-based capital ratio and its steady growth?

As of December 31, 2010, Highmark's Total Adjusted Capital was approximately \$3.7 billion, and its Authorized Control Level, which is a measurement of risk that is determined and calculated based on statutory guidelines, was approximately \$535 million. Highmark's RBC ratio as of that date is calculated by dividing Total Adjusted Capital by the Authorized Control Level, which yields an RBC ratio of 692%. These numbers are found on Highmark's RBC statement.

Highmark's growth trajectory is observable in the financial projections provided by Highmark to the DOI on August 26, 2011.

Q: Why are Blue Cross's current reserves important in your analysis of this standard?

Although we reviewed the overall projected pro-forma financial condition of Blue Cross in detail as part of our review of Standard "d," we reviewed the current strength of the Company's reserves as part of our review of Standard "c" in order to assess the likelihood that Blue Cross may become dependent upon Highmark for financial stability after the Affiliation. Blue Cross's maintenance of strong reserve levels is important for two reasons. First, given that Highmark has agreed to guarantee Blue Cross's claims, Highmark will be incented to closely monitor Blue Cross's operating and financial condition. Having strong reserves may therefore comparatively strengthen Blue Cross's relative ability to maintain local operational decision making as a result of decreased potential dependence on Highmark for financial stability. Second, Blue Cross's maintenance of strong reserves will be an important element in retaining flexibility in the event of a disaffiliation from Highmark, as the Company is likely to have fewer strategic options available if its reserves are insufficient for it to operate on a standalone basis.

Q: What is the potential impact of the proposed Affiliation between Highmark and the West Penn Allegheny Health System?

The proposed relationship between West Penn Allegheny Health System and Highmark involves a financial commitment from Highmark as well as a change to Highmark's corporate structure and business functions. As a result, Highmark will file Form A applications with state insurance regulators in numerous jurisdictions, including Pennsylvania and Delaware. The final details of the transactions are not yet finalized, and Highmark has not yet filed a Form A with the Pennsylvania Insurance Department, but preliminary financial terms indicate an initial commitment from Highmark in the amount of \$475 million to West Penn, including a mixture of grants and loans.

Q: On what information did you base your analysis of the potential affiliation with West Penn?

Because the terms of the potential transaction involving Highmark and West Penn have not yet been memorialized in definitive documents, our analysis of the West Penn affiliation was based on verbal statements made by Highmark management during a series of phone interviews held in August 2011. Highmark management noted during each conversation that the details discussed were subject to change, pending ongoing negotiation of definitive documents with West Penn.

Q: Will Blue Cross have financial exposure to the West Penn situation?

Blue Cross will not have direct exposure to any liabilities or potential operating losses, and Highmark has stated – and the Department seeks to make this statement a condition – that it will not pass operating costs from the West Penn transaction to Blue Cross. In a “worst-case scenario,” if Highmark were to lose its total potential financial

commitment to West Penn, Highmark estimates its risk-based capital ratio could fall by approximately 60%-115%. We, note this would keep Highmark's risk-based capital ratio above the 375% Association's monitoring threshold, and above the median ratio of 487% among a sample of large, publicly-traded health insurers.

Q: What are your conclusions regarding Standard "c"?

In summary, Blackstone concludes that (i) Blue Cross will not have direct exposure to any liabilities of Highmark and the standalone financial condition of Highmark does not appear to be such that Blue Cross's reliance upon Highmark for the provision of administrative services would jeopardize Blue Cross's ability to effectively serve its policyholders in the foreseeable future, (ii) Blue Cross's current reserve levels are such that it is unlikely that Blue Cross would need to rely upon Highmark to honor Blue Cross's claims in the near future and (iii) Highmark's potential transaction with West Penn is not likely to interfere with Highmark's provision of services to Blue Cross or Highmark's claims guarantee to Blue Cross in the near future.

Based on the above analysis and subject to certain conditions (#9, #14, and #35) to be determined by the Department, Blackstone does not believe that the financial condition of Highmark is such as might jeopardize the financial stability of Blue Cross or prejudice the interest of its policyholders.

Q: Please describe your analysis of Standard "d."

Under Blackstone’s analysis, Standard “d” is one of the most critical standards by which to evaluate this Affiliation. Standard “d” requires that the plans or proposals which the controlling affiliate (in this case Highmark) has to liquidate the insurer (in this case Blue Cross), 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 fair and reasonable to policyholders of the insurer and in the public interest.

Highmark has represented that it has no present plans or proposals to liquidate Blue Cross or sell Blue Cross’s assets or consolidate or merge it with any person, and the Department seeks to make this a condition (#37).

Blackstone notes that the change of control resulting from the proposed Affiliation entails risks to Blue Cross and its policyholders. Those risks, however, must be weighed against the benefits that may accrue to the policyholders as a result of Blue Cross gaining access to enhanced capabilities and overall corporate support services. The Affiliation would result in several different and important changes to Blue Cross’s business, corporate structure, and management. Blackstone examined these plans and agreements to assess whether the changes would be fair and reasonable to Blue Cross policyholders and to determine whether the changes would be against the public interest. Blackstone focused on four general categories: (i) changes to Blue Cross’s corporate structure, governance structure, and market presence; (ii) the anticipated impact of the Affiliation on Blue Cross’s financial condition; (iii) the anticipated impact of the Affiliation on Blue Cross’s

corporate capabilities and provision of services to Blue Cross customers; and (iv) the outcomes of Highmark's past affiliation with Highmark West Virginia.

Q: How will the compensation of Blue Cross's executives be affected by the Affiliation?

Blackstone first reviewed potential changes to Blue Cross management roles and compensation. Subsequent to the Affiliation, Blue Cross's CEO and six vice presidents will be incorporated into the Highmark organizational hierarchy. These executives have employment agreements with provisions that are materially unchanged from agreements that pre-date the proposed Affiliation. These agreements include provisions for payment of severance benefits under certain conditions. Full payment of severance benefits based on termination of all seven executives who have such agreements after the closing of the proposed Affiliation would involve an approximate \$6 million payout. The latest revisions to executive employment agreements, however, did not include provisions for compensation that were specifically tied to the proposed Affiliation. Further, a change of control alone, including the proposed Affiliation, does not allow an executive to collect severance benefits. Instead, there must be an additional trigger such as involuntary termination of the executive's employment, a substantial reduction of duties or compensation or a significant geographic relocation.

Q: Are there any bonuses or personal financial incentives to Blue Cross's executives to enter into the Affiliation?

No.

Q: Are there any separate “side” agreements or understandings between Highmark and Blue Cross executives which give those executives a personal, financial incentive to form the affiliation?

Blackstone has not discovered and is not aware of any such arrangement. The Department seeks a condition (#36) which precludes any such arrangements.

Q: What is Blackstone’s conclusion about the issue of executive compensation?

It is unlikely that Blue Cross management will gain direct financial benefit from the Affiliation at the expense of the Company’s policyholders.

Q: What information did Blackstone rely on in its executive compensation analysis?

Blackstone reviewed an Executive Compensation Analysis prepared for the Blue Cross Board of Directors on May 18, 2011.

Q: Are there any bonuses to any of Blue Cross’s non-executives as a result of the Affiliation?

Yes. Bonuses tied directly to the transaction itself are limited to non-executive employees and are projected to be approximately \$300,000 in total. These bonuses were approved by the Blue Cross Board of Directors, after consultation with an industry advisor, in June of 2010 and range between 25% and 30% of the recipients’ annual salaries. These bonuses were structured as “stay” bonuses for non-executive employees

only and were deemed by the Blue Cross Board to be critical to the success of the proposed Affiliation.

Q: What information did Blackstone rely on in connection with its analysis of the non-executive bonuses?

Blackstone held a discussion on this topic with Blue Cross management on August 30, 2010 and received written information from Blue Cross as well.

Q: How will Blue Cross's governance structure be affected by the Affiliation?

The composition of Blue Cross's Board will change as a result of the Affiliation, if approved. The Blue Cross Board will consist of 4 Class A Directors, 4 Class B Directors and 1 President Director. The Class A Directors cannot be officers or employees of Highmark or Blue Cross. The initial 4 Class A Directors will be chosen by Blue Cross prior to the closing of the Affiliation and will serve staggered terms of 1, 2, 3 and 4 years, and such time thereafter until their successors are elected and qualified. Thereafter, new Class A Directors will be nominated by the current Class A Directors and are subject to election by Highmark. The new Class A Directors will serve 3-year terms, and such time thereafter until their successors are elected and qualified. The 4 Class B Directors are chosen by Highmark and serve 1-year terms. For the first 3 years, Class B Directors will include the Highmark CEO and two Highmark CEO direct reports. The President Director is the President of Blue Cross, who will serve as a director for as long as she/he is President of Blue Cross and whose election is subject to the approval of Highmark. The President Director may serve terms not to exceed 5 years and may be

removed at any time, for any reason or no reason at all, by the Class B Directors. A majority of the Blue Cross Board of Directors must be residents of Delaware. The Class A Directors will have the right to cause Blue Cross to disaffiliate from Highmark upon certain “triggering events.”

Q: What information did Blackstone rely on in connection with its analysis of the post-affiliation governance structure of Blue Cross?

Blackstone reviewed the Statement of Affiliation filed with the Department by Highmark on October 7, 2010 and the Business Affiliation Agreement dated August 19, 2010.

Q: How will Blue Cross’s management structure be affected by the Affiliation?

Blue Cross will retain autonomy as a Delaware-based entity with regard to market-facing functions. Key market-facing decisions, such as how to price products and how to decide which products to offer in the Delaware market, however, will be subject to both input from the Blue Cross Board and approval by Highmark through the annual budgeting process. In addition to the changes in board structure discussed above, the Affiliation will result in some Blue Cross corporate departments and professionals reporting to their corresponding Highmark departments and professionals, such as in the areas of operations and finance. The Blue Cross President will, however, retain relative autonomy when making decisions relating to interactions with Blue Cross customers and the Delaware public. Corporate budgets will be determined at Highmark, but the Blue Cross President and certain Blue Cross personnel will have input into Highmark’s

budget-planning process, so that they can help to address any extraordinary cost issues impacting Blue Cross or to introduce strategic changes in such areas as pricing and product development.

Q: What is Blackstone’s conclusion about the issue of Blue Cross’s management structure?

The Affiliation is structured such that there is a high likelihood that Blue Cross’s market-facing functions will remain locally managed in the foreseeable future.

Q: How do the changes to Blue Cross’ governance and management structures that you’ve just discussed impact a potential disaffiliation?

These changes to Blue Cross’s management and governance structures involve a level of integration with Highmark that is more complex than Blue Cross’s previous affiliation with CareFirst. In light of the CareFirst disaffiliation, Blackstone analyzed the proposed Affiliation in terms of how it addresses any potential disaffiliation between Blue Cross and Highmark. It is noteworthy that Blue Cross’s Class A directors have the option to disaffiliate with Highmark under certain conditions. If there is a disaffiliation, Blue Cross likely would have to disassociate its core administrative and IT functions from those of Highmark. Blue Cross would then have to either find an alternative provider of IT services, as well as a provider of other services, or build its own capabilities to provide those services. Blue Cross would have to navigate this capability-building process while faced with having to repay the funds borrowed under the Line of Credit Agreement (if any amounts are outstanding) and to fulfill the national Blue Cross

Blue Shield Association's requirements related to Blue Cross reestablishing itself as the primary licensee in Delaware.

Q: What is Blackstone's conclusion about the impact of the Affiliation on Blue Cross's ability to disaffiliate?

Blue Cross's contractual option to disaffiliate under certain adverse circumstances will help to protect the Company and its policyholders from potentially unfair and unreasonable outcomes in the context of certain potential Highmark actions, including conversion to for-profit status or insolvency. Although Blue Cross's ability to disaffiliate from Highmark in the future is a key component of the Affiliation Agreement, Blackstone believes that additional conditions (#18, #23, #24, #25, #26, and #27) proposed by the Department regarding Blue Cross's ability to disaffiliate in the future – which addresses among other things, Highmark providing sufficient time and support to Blue Cross during this process – are appropriate.

Q: How does a disaffiliation impact Blue Cross' ability to obtain the marks?

In the event of a disaffiliation, Blue Cross will have to reapply to the National Blue Cross and meet certain requirements of the Association in order to reestablish its status as the sole Association licensee in Delaware. As the Association ultimately governs the process and outcome of the application process, neither Blue Cross nor Highmark can guarantee that the marks will be returned to Blue Cross after a disaffiliation. However, Blackstone believes that a condition (#26) proposed by the DOI requiring Highmark's using "all reasonable best efforts, acting with diligence and in good

faith” and providing active assistance in Blue Cross regaining its status as the primary licensee of the “marks” in Delaware are appropriate for the protection of Blue Cross’s policyholders and the public interest of Delaware.

Q: Let’s turn to the anticipated impact of the Affiliation on Blue Cross’s financial condition. Can you tell us what economic transfers between Blue Cross and Highmark are contemplated by the Affiliation Agreements?

The Affiliation would impact Blue Cross’s financial condition via certain economic transfers to Highmark, including payments made for IT systems upgrades and ongoing administrative services, and the pro forma impact of the Affiliation on Blue Cross’s financial results and reserves as compared to a standalone scenario. If the Affiliation is approved, there can be three types of economic transfers from Blue Cross to Highmark. First, Blue Cross will pay Highmark for upgrades to Blue Cross’s IT systems. Second, Blue Cross will make payments to Highmark for the ongoing administrative and technology services Highmark will provide to Blue Cross. Third, Blue Cross will make interest payments to Highmark on any funds Blue Cross opts to obtain under the Line of Credit Agreement. The Affiliation does not otherwise provide for any mechanism for Blue Cross to transfer funds to Highmark. In addition, the Department has proposed a condition (#9) which would limit the transfers that Blue Cross can make to Highmark to the three transfers I just discussed, thereby prohibiting Highmark from accessing Blue Cross’s funds in any other manner.

Q: Let's discuss the first type of economic transfer: payments from Blue Cross to Highmark for upgrades to Blue Cross's IT systems. Can you explain what those payments are and how Blackstone evaluated them?

Blue Cross has agreed to make payments to Highmark for Blue Cross's migration to Highmark's systems. As noted by KPMG in its Report and testimony, the largest financial impact of the Affiliation can be measured by comparing the costs Blue Cross expects to incur upgrading its IT systems as a standalone entity with the costs Blue Cross expects to incur to transition to Highmark's IT platforms. The total cost of Blue Cross's systems upgrade may reach \$37 million as an affiliate of Highmark, compared to as much as \$150 million if Blue Cross were to achieve the same level of upgrades as a standalone entity. Highmark and Blue Cross have been working cooperatively since December 2010 on a detailed plan of integration, which the Applicants believe fully supports the estimated costs and planned functionalities.

Q: What is Blackstone's conclusion about the reasonableness of the costs for Blue Cross to migrate to Highmark's systems?

Consistent with the KPMG Report and testimony, the 2008 Deloitte Report and 2010 Update, as well as information received during interviews with Highmark West Virginia, the costs of the IT system upgrades to be provided by Highmark are not unreasonable. This is especially true given the level of functionality and service to be obtained, and the fact that the cost to Blue Cross of upgrading via Highmark's IT platform does not appear to be higher than the cost to Blue Cross of achieving the same

level of functionality on a standalone basis. I understand that the Department has proposed, and the Applicants have agreed, to cap this integration cost (Condition #17).

Q: Let's take the second type of economic transfer: payments from Blue Cross to Highmark for ongoing administrative services. Can you explain the parameters behind those payments?

Blue Cross will pay Highmark for ongoing administrative services. The provision of these services is to be governed by an administrative services agreement included in the Form A filed by Highmark. The administrative services agreement contemplates that Blue Cross will compensate Highmark for services in an amount equal to Blue Cross's "fair and reasonable allocable share of the total actual cost without provision for profit to Highmark of providing the Services."

Q: What is the method by which Highmark will charge Blue Cross for services under the Administrative Services Agreement?

Blue Cross will reimburse Highmark for the "fair and reasonable allocable share of the total actual cost" to Highmark of providing these administrative services, but without provision for profit. This share shall be determined in accordance with Highmark's established cost accounting practices as in effect from time to time.

Q: What are the current estimates for the annual amount of payments that Blue Cross will make to Highmark for administrative charges?

Administrative charges from Highmark to Blue Cross are anticipated to reach an annual amount of \$21.7 million by 2015. However, these charges will be offset by projected synergies that are forecasted to amount to \$23.4 million in 2015, and are forecasted to fully off-set the administrative charges.

Q: What happens if there are disputes about the amount of payments?

Although either Blue Cross management or Highmark management will both have the ability to dispute any extraordinary or unfair charges and disputes will be resolved, if necessary, through the Blue Cross Board of Directors and, if still unresolved, through the Highmark Board of Directors. Prohibiting the Highmark Board's involvement and making the Department the final arbiter of any cost-related disputes would be beneficial, and we understand the Department is offering a condition (#19) to this effect.

Q: What is Blackstone's conclusion about the reasonableness of the cost allocation methodology for Blue Cross to migrate to Highmark's systems?

Highmark's methodology for allocating ongoing operational and administrative charges to Blue Cross is not unreasonable, subject to appropriate monitoring, authorization, and dispute controls being implemented as planned. Blackstone believes that additional conditions (#9, #10, #11, #12, #13, #14, and #19) proposed by the Department regarding the Department's oversight of cost allocations, are appropriate.

Q: What is Blackstone's conclusion about whether the Affiliation provides Highmark with a way to access or control the current or future reserves of Blue Cross?

With the additional conditions (#1, #2, #9, #10, #11, #12, #13, #14, #19, and #35) advanced by the Department, the Affiliation does not provide Highmark with the means of accessing or controlling the current or future reserves of Blue Cross.

Q: Has Blackstone reviewed the terms and conditions of the Line of Credit Agreement, and what is Blackstone's view about the reasonableness of that Agreement?

Yes. Highmark will provide Blue Cross with a \$45 million line of credit for the purpose of financing Blue Cross's costs associated with converting its IT systems onto Highmark's platform. Borrowing under the line of credit is at Blue Cross's option, and there are no unused capacity fees or early repayment penalties. At present, Blue Cross does not anticipate drawing on the line of credit. If Blue Cross were to draw on the line of credit, the rate of interest would be the lesser of the prime rate or 1-month LIBOR plus 350 basis points. The balance would be payable on the seventh anniversary of the signing of the Business Affiliation Agreement. Blackstone has reviewed these terms of the proposed line of credit and believes that the pricing and payback period are not unreasonable to Blue Cross.

The terms and interest rate of Blue Cross's Line of Credit Agreement with Highmark, considered as a whole, are not unreasonable. Blackstone believes that conditions (#27,

#28, and #29) proposed by the DOI regarding the terms of the termination and repayment of the Line of Credit are appropriate.

Q: What is Blackstone’s conclusion about the overall financial impact of the Affiliation on Blue Cross?

The overall financial impact of the Affiliation is reflected in two sets of financial projections prepared by Blue Cross management: one set for the situation in which Blue Cross remains a standalone entity and another set for Blue Cross affiliating with Highmark. In general, the standalone projections assume that Blue Cross 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 Blue Cross’s membership will suffer due to these price increases. In the Affiliation scenario, Blue Cross 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.

In order to capture the impact of the proposed Affiliation on Blue Cross’s claims-paying resources, Blackstone assessed the difference in projected levels of reserves between the two scenarios in 2015 and then assessed the differences in projected levels of cash and investments in 2015. Blue Cross projects that its reserves will be \$53 million lower by 2015 if the Company remains a standalone entity, which is largely due to IT-related depreciation and support expense. Blue Cross projects that its cash and

investments will be \$147 million lower by 2015 if the Company remains a standalone entity, which is also due to IT related expenses that have not yet been depreciated by that time and are therefore reflected as capital assets on the Company's balance sheet. As cash and investment are generally significantly more liquid than assets related to IT systems, the Affiliation scenario implies a significantly greater amount of claims-paying resources than the standalone scenario.

Q: Will the affiliation impact employment in Delaware?

Yes. Another anticipated impact of the Affiliation relates to employment levels in Delaware. Although Highmark is contractually obligated to use commercially reasonable efforts to maintain employment levels in Delaware that are proportionate to those employment levels in other Highmark health insurance service areas, Blue Cross employment levels could decline as a result of the Affiliation. There is ultimately a tension between Highmark's goal of enhancing Blue Cross's competitiveness by promoting greater efficiency for Blue Cross and efforts to preserve employment levels. Should there be a significant decrease in Blue Cross's enrollment or market share during the implementation period (for example, from the loss of a large customer) that results in any lost positions, Highmark will not be responsible to replace those lost positions and doing so could potentially hurt Blue Cross's profitability.

Q: What is Blackstone's conclusion about the likely post-affiliation financial condition of Blue Cross?

It is unlikely that the financial condition of Blue Cross will be materially worse in the foreseeable future as a result of an affiliation with Highmark than it would otherwise be if Blue Cross were to remain a standalone entity, and it may well improve as a consequence of the Affiliation.

Q: Has Blackstone reviewed the potential impact and cost of the IT systems upgrades that are planned as part of the Affiliation?

We have participated in discussions with management from both Highmark and Blue Cross concerning the level of IT enhancements that are expected to result from the Affiliation, and we have reviewed the report dated September 6, 2011 by KPMG.

Q: What are Blackstone's conclusions about the cost and functionality of the IT systems upgrades that are planned as part of the Affiliation?

Neither an outsourcing relationship with a business process provider nor investing in additional capabilities as a standalone entity would be expected to provide Blue Cross with capabilities that exceed those anticipated in the Affiliation; furthermore, such arrangements would likely entail greater cost to Blue Cross and would not address Blue Cross's lack of scale and resources in areas such as strategic development, product innovation, and regulatory planning.

Q: How will the Affiliation affect Blue Cross's corporate capabilities and provision of services to Blue Cross customers?

Blue Cross currently faces several challenges as a small nonprofit corporation, including limited technology resources and a limited ability to adapt to regulatory change. Blue Cross's lean operating model also means that Blue Cross has difficulty innovating in the areas of product development and pricing structures. Faced with much larger, national competitors, these pressure points are particularly sensitive for Blue Cross. The Affiliation is anticipated to address many of these capability gaps, particularly given the breadth of experience Highmark has with various affiliations and administrative service agreements. The functionality that Blue Cross anticipates gaining via the Affiliation should address many of the Company's current gaps in capabilities as compared to industry norms and expectations of customers and providers.

Q: How does the proposed Affiliation compare to Highmark's previous affiliation with Highmark West Virginia?

Highmark's affiliation with Highmark West Virginia involved a transaction similar, though not identical to, the proposed Affiliation. Since 2008, Highmark West Virginia has operated with an IT and back-office system that is fully integrated with Highmark's platform, yet has continued to exercise market-focused decision-making authority. Since 1999, Highmark West Virginia has seen significant increases in its reserves, risk-based capital ratio, and membership levels. Specifically, Highmark West Virginia's reserves have increased from \$19 million to \$242 million between 1999 and 2010 and risk-based capital has increased from 276% to 1,013%. The President of Highmark West Virginia also remains locally autonomous with regard to market-facing decisions, and Highmark West Virginia's customers appear to have benefited from

Highmark's operational best practices, national account services, and overall scale. Additionally, 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.

Q: What are Blackstone's conclusions about the effects on the West Virginia Blue Cross Blue Shield as a result of its affiliation with Highmark?

Based on the views of Highmark West Virginia's local president and the West Virginia Department of Insurance, Highmark's Affiliation with Highmark West Virginia has resulted in that company having significant capabilities and corporate support and has not been detrimental to Highmark West Virginia's policyholders.

Q: What are your conclusions for Standard "d"?

Based on these analyses, Blackstone believes that conditions addressing Blue Cross's corporate governance structure (Conditions #3, #20, #21, and #22), the terms of Blue Cross's contractual option to disaffiliate upon certain events (Conditions #23, #25, and #26), certain terms of the Administrative Services Agreement (Conditions #15, #16, #18, and #19 and the Line of Credit Agreement (Conditions #27, #28, and #29), and the terms of any proposed rate increases or any changes to benefits or products (Condition #31) would be appropriate to bring the Affiliation into compliance with the statutory criteria. The specifics of those conditions are within the purview of the Department of Insurance. Based on Blackstone's analysis and the above conditions, the plans and

proposals related to the Affiliation do not appear unfair and unreasonable to Blue Cross's policyholders and do not appear to be against the public interest of Delaware. (See also, generally, Condition #37).

Q: Could you describe your analysis of Standard "f"?

Standard "f" requires an analysis of whether the Affiliation is likely to be hazardous or prejudicial to the insurance-buying public. Given Blue Cross's unique position as the largest locally-based, not-for-profit insurer in the Delaware health insurance market, the proposed Affiliation could have a significant impact on the insurance-buying public. In order to identify potential hazards or prejudices, Blackstone examined Blue Cross's current market position, reviewed Blue Cross's search for a strategic partner, and assessed the feedback received in public information sessions and private interviews with interested parties.

Q: Could you describe Blue Cross's current position in the Delaware insurance market?

Blue Cross provides services to a significant portion of the Delaware population and, as a result, has many stakeholders. Many of these stakeholders in the Delaware market, including customers, providers, employers, brokers, and community members, are generally satisfied with Blue Cross's performance. Blue Cross faces significant challenges, however, including the limited growth potential of the Delaware market broadly, anticipated capital costs to modernize and remain competitive, and the uncertainty posed by federal health care reform. Finally, Blue Cross's small size and lean

business model limit the resources Blue Cross is able to devote to developing new products, improving its data management, and addressing other capability enhancements necessary for Blue Cross to continue its successful performance and service.

Q: What other options did Blue Cross explore before deciding to pursue an affiliation with Highmark?

Blue Cross began its search in December of 2006 and considered various types of transactions, including affiliations, mergers, conversions, and asset sales. Blue Cross assessed various potential partners, including multi-state Blue Cross Blue Shield plans, regional Blue Cross Blue Shield plans and single-state Blue Cross Blue Shield plans. The Board decided to pursue a transaction with either multi-state or regional Blue Cross Blue Shield plans. The Board determined that single-state Blue Cross Blue Shield plans were determined not to be an acceptable solution for Blue Cross's long-term strategic needs. The Board preferred an affiliation to maintain local identity and control. In the spring of 2008, the Board received interest from Highmark and four other health insurers, and after further diligence, the Board chose a national [REDACTED] insurer as an exclusive negotiating partner for a potential acquisition transaction. The Board negotiated with the national [REDACTED] insurer for several months, but the [REDACTED] health insurer's valuation of Blue Cross declined substantially from its initial indication, in our view due in part to the deterioration of Blue Cross's financial outlook and investment portfolio during the U.S. credit dislocation and subsequent recession. The parties remained relatively far apart on other terms of an agreement. In the fall of 2009, the Blue Cross Board reached out to Highmark and, on December 3, 2009, chose to pursue an affiliation with Highmark

on an exclusive basis over an affiliation with another non-profit Blue Cross Blue Shield plan, due in part to the perceived strength of Highmark as a long-term partner and Highmark's operating model, which would provide more local control than other potential partners.

Q: On what basis did Blackstone come to that conclusion?

We reviewed documents produced by the Applicants, including numerous summaries of Blue Cross Board meetings held between December 2006 and July 2010, during which the Company's search for and assessment of strategic options were discussed, Highmark's response to Blue Cross's Request for Information, a Deloitte report prepared for Blue Cross in 2008 and updated in 2010, as well as proposals prepared for Blue Cross by other potential strategic partners.

Q: What feedback was received during the public information sessions and private interviews that were held?

Blackstone both participated in public information sessions and conducted private diligence meetings in order to identify public and private concerns regarding the proposed Affiliation. Of highest priority were these stakeholders' views on: Blue Cross's performance and capabilities relative to its competitors; the importance of having a large non-profit provider in Delaware; the importance of Blue Cross being locally managed; experiences with any prior interactions with Highmark; and the Affiliation's potential impact on competition in the Delaware health insurance market. From these sessions and

meetings, Blackstone gauged the reactions of various Delaware stakeholders to the proposed Affiliation.

Q: What was the greatest concern conveyed to you by interested parties?

The greatest concern conveyed was generally related to Blue Cross's ability to retain a strong local presence and local decision-making authority. Even with these concerns, however, nearly all of the interested parties contacted voiced their support, on balance, for the proposed Affiliation due to Blue Cross's perceived current lack of cutting edge products and capabilities when compared to larger competitors.

Q: What are your conclusions for Standard "F"?

In summary, Blackstone concludes that (i) Blue Cross maintains a leading position in the Delaware health insurance market and offers a unique presence as the only locally-controlled, non-profit health insurance carrier in Delaware; (ii) the Board's determination that Blue Cross's strategic position was jeopardized subsequent to the CareFirst disaffiliation was reasonable, given industry trends that included consolidation among competitors, cost pressure from providers, increasing needs for significant IT investments, and the increasing scope and uncertainty of federal and state health care regulations; (iii) the Board's review of strategic alternatives and search for a partner was reasonable; (iv) the primary concern of Blue Cross's customers and the insurance-buying public relate to Blue Cross's maintenance of a strong local presence and decision-making ability in key market-facing functions; and (v) given the Company's current strategic position and options available to remain a viable health insurance carrier as identified

during the Board's strategic review process, the Board's opinion that an affiliation with Highmark will balance the Company's achievement of long-term strategic goals with the Company's ability to maintain an appropriate local presence is reasonable.

Based on the above analysis, Blackstone believes that conditions (#7 and #8) designed to preserve Blue Cross'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. The specifics of those conditions are within the purview of the Department of Insurance. With such conditions in place, the Affiliation is not likely to be hazardous or prejudicial to the insurance-buying public of Delaware and thus would not violate Standard "f."

Q: In summary, did your analysis of the proposed Affiliation indicate that any of the five standards Blackstone examined – "a," "b," "c," "d," or "f" – would be violated?

Based on our analysis and subject to certain conditions which are properly within the discretion of the Department to impose, the proposed Affiliation does not violate standards "a," "b," "c," "d," or "f."

Q: Do you have any further testimony?

I do not.