

**BEFORE THE INSURANCE COMMISSIONER
FOR THE STATE OF DELAWARE**

**In Re: The Proposed Affiliation of)
BCBSD, INC., doing business as)
Blue Cross Blue Shield of Delaware)
with HIGHMARK INC.)**

Docket No.: 1509-10

DIRECT TESTIMONY OF SCOTT FAD

CALLED BY BCBSD, INC. AT THE HEARING HELD OCTOBER 5 – 7, 2011

Q. *Mr. Fad, please state your full name and title for the record.*

A. My name is Scott Fad, and I serve as the Senior Vice President of Operations at BCBSD. One of my roles with the company is to coordinate the Highmark affiliation business integration effort on behalf of BCBSD.

Q. *Can you briefly describe your background and experience?*

A. I am a native of Newark, Delaware and a graduate of the University of Delaware with a degree in English.

I have 28 years of health benefits experience, serving in a variety of leadership roles inside and outside of BCBSD. At BCBSD I have served as the Director of Customer & Provider Services, Director of Marketing Administration, Assistant Vice President of Business Development, Vice President of Operations, and I now serve as Senior Vice President of Health Plan Operations.

In addition to my experience with BCBSD, I have managed a sole-proprietor management consulting firm, and I spent five years with the local Coventry Health Care

plan where I served as Regional Vice President with responsibility for Sales & Marketing, Regulatory Affairs, Quality Assurance and Communications.

As Senior Vice President of Health Plan Operations at BCBSD, I oversee several BCBSD divisions, including Sales & Marketing, Underwriting, Claims, Customer & Provider Services, National Account Administration, Information Systems, Project Management and Research. I am also responsible for coordinating the Highmark affiliation planning effort on behalf of BCBSD.

Q. *When did BCBSD and Highmark commence affiliation planning and what is the objective of the planning effort?*

A. BCBSD and Highmark began discussions about the affiliation planning effort in September 2010, shortly after the companies entered into the definitive affiliation agreement. The objective of the planning effort has been to develop a detailed roadmap for bringing the operations of the two companies together in the most effective manner possible. We expect to complete the planning phase in 2011. The planning effort was initiated before receiving final approval of the affiliation for two reasons: First, we wanted to conduct a thorough analysis of every phase of BCBSD's business to confirm the overall business assumptions regarding the affiliation. Second, we wanted to position the companies to swiftly implement the plan should affiliation be approved. This affiliation planning effort has been guided by the organizational and operational structure first outlined by Highmark in its response to our request for proposal. The advantages of this successful structure were confirmed during our subsequent due diligence effort.

Under the proposed approach, BCBSD will become Highmark's fourth core regional health market. The other three regional health markets are Western Pennsylvania, Central Pennsylvania and West Virginia.

Q. *Do you anticipate that BCBSD will fit into the Highmark corporate structure in a manner similar to the Highmark Blue Cross Blue Shield West Virginia plan?*

A. Yes, in fact, the proposed BCBSD affiliation structure is generally based on Highmark's affiliation with the West Virginia plan. In our search for an affiliation partner, it was important for us to work with a company that had demonstrated success with implementing an affiliation with a smaller plan. During the due diligence process, BCBSD reviewed the West Virginia model in depth, visited the West Virginia Plan, and met with West Virginia employees and leadership to gain a first-hand understanding of how Highmark's structure and approach works, and how the business integration effort was conducted in West Virginia. Based on these discussions, BCBSD and Highmark were able to leverage the benefits and lessons learned from the West Virginia affiliation when planning a timely and efficient integration for Delaware.

After conducting this extensive research, we were greatly impressed with Highmark's ability to fully integrate the West Virginia plan onto Highmark's industry-leading technology platforms and business solutions. At the same time, West Virginia was able to preserve its local presence as a robust and growing West Virginia employer under local leadership and offering local services. This approach assures the West Virginia Plan remains dedicated to serving West Virginia customers, accounts, health care providers and other local stakeholders, while also providing improved services and products as part of the Highmark platform.

Some key lessons Highmark and BCBSD have learned from the West Virginia affiliation include:

- The importance of maintaining a strong local presence;
- The appropriate organizational structure for managing the business needs and opportunities of a regional affiliate in the most effective manner;
- The need to focus on driving efficiencies that will help create lower premiums for customers; and
- The best approach for managing a core systems migration and other technology integration

Q. *Describe the affiliation planning team*

A. Prior to convening the first group meeting, Highmark and BCBSD issued a request for proposal to three leading consulting experts to assist with our integration planning efforts. After a detailed review of our options, we engaged Deloitte, an international consulting firm, to support our planning efforts.

Deloitte has brought a comprehensive knowledge of the health care industry and of information technology, and has extensive experience with helping companies navigate the path towards successful business integrations. In addition, Deloitte was able to offer a well-tested electronic data room and program management methodology that has provided us with a template and platform upon which Highmark and BCBSD have been able to construct and began to execute our detailed integration plan.

For Highmark and BCBSD, the detailed planning effort began in December, 2010. A meeting was held in Delaware with representatives from all core health care business areas at both companies. Also present were representatives from Deloitte.

Q. *How is the planning process organized?*

A. To facilitate the planning process, we created eleven distinct project teams that represent different disciplines within the companies, such as: Operations, Information Technology Infrastructure, Medical Management, and Provider Relations. We also created three additional cross-functional teams to manage issues that span across departments. These include a Communications team, an Employee Experience Team, and a Financial Analysis Team.

Each of these fourteen teams is led by one leader from BCBSD and one leader from Highmark, who are supported by a project manager and subject matter experts from both companies. The overall effort is being directed by a shared Program Management Office. This office is co-chaired by me for BCBSD and by my counterpart at Highmark, Kathy Colwell, who is the Vice President of the Office of Corporate Strategic Programs. In addition, a team of senior executives at Highmark and Delaware has defined the guiding principles of the planning effort and continues to serve in an advisory and guidance capacity over each step of our progress. At last count, over 400 employees from Highmark and BCBSD have participated in some fashion in this comprehensive planning effort.

Q. *You mentioned guiding principles. What are they?*

A. The guiding principles of the planning effort have been to:

- Preserve market-facing functions in the Delaware market;
- Leverage policies and procedures across both organizations;
- Achieve future efficiencies from enhanced productivity and reduced duplicative functions across both organizations; and

- Retain robust employment levels in Delaware.

Q. *Have BCBSD and Highmark arrived at a model for their combined operations?*

A. Yes. There are three phases to the Integration Plan. The initial phase of the planning effort lasted from December, 2010 through May, 2011, during which the teams met frequently in person, and by video and phone conference. The teams began the planning process by reviewing the proposed BCBSD End State Operating Model, as defined in the original Highmark response to our request for proposal. This model is consistent with the West Virginia affiliation model and provides guidance on how BCBSD would be internally organized upon completion of the integration. The End State Operating Model leverages three distinct organizational structures, *Locally Managed*, *Shared Services*, and *Centralized Support Services*. Different BCBSD functional areas will operate under the structure most appropriate for that area.

The *Locally Managed Model* includes functions that we believe are best managed and delivered locally, thus preserving BCBSD's ability to be responsive to the Delaware marketplace and our local stakeholders. These functions will be located in Delaware, reporting directly to the BCBSD President, with best practices shared among all Highmark affiliates. The functions organized under this model include:

- Sales and account management;
- Provider contracting;
- Government Affairs; and
- Community Affairs.

The second structure is the *Shared Services Model*. These functions are supported and delivered in Delaware, reporting to local BCBSD management who will report to

Highmark senior management, but maintain close coordination with the local BCBSD President. The services will be predominantly delivered locally here in Delaware by local BCBSD employees, but will be moved onto Highmark's technology platforms to assure our stakeholders have access to Highmark's exceptional products and services. Reporting directly to Highmark senior leaders provides the opportunity for the application of best practices across all Highmark locations as well as giving Delaware access to Highmark's considerable back-up staffing support from other locations. This back up support will be extremely valuable for balancing workloads in times of peak claim or phone call volumes.

The functions organized under this model include:

- Customer and provider services;
- Claims processing;
- Billing and enrollment;
- Actuarial and underwriting;
- Corporate communications;
- Product development;
- Human resources;
- Legal;
- Medical management;
- Risk management;
- Audit;
- National account administration; and

- Information technology applications, although some significant IT application work will be centralized at other Highmark locations.

The third model is the *Centralized Support Services Model*. These functions are directly managed by Highmark's experienced business leaders and will be predominantly delivered by staff at central locations that support the entire Highmark enterprise. This includes:

- Computer Operations; and
- Administration of the Federal Employee Program.

This model will also serve certain programs that do not currently exist within BCBSD but which represent expanded product opportunities for Delawareans, such as

- Ancillary products, including Highmark's United Concordia dental subsidiary; and
- Senior products, including Highmark's Medicare Advantage and Medicare Part D plans.

Q. *How do you plan to transition to this end-state model?*

A. With the end-state model as our guide, the project teams looked at BCBSD current business processes and technology and compared these to Highmark business processes and technology. From this, the teams determined the best means for migrating the existing BCBSD business onto Highmark business processes and technology. The product of these efforts is a series of detailed blue print documents that include:

- Analysis of the work required for business and systems migrations;
- The number of people required to do this work;
- The cost required to do this work;

- The synergies and other cost efficiencies gained; and
- Initial project plans, outlining the various steps and timelines required to achieve completion of these projects.

A total of 70 distinct projects were identified by the teams. A few examples are:

- Migrating BCBSD business onto Highmark's core claims processing platforms;
- Upgrading BCBSD web-based services to Highmark capabilities;
- Implementing a comprehensive data warehouse and leading edge medical cost analytics for Delaware business;
- Financial systems integration;
- Human Resources systems integration;
- Pharmacy program migration;
- Product management and product development integration;
- Implementation of a digital strategy in Delaware; and
- Best practice policy and procedure integration – anything from regulatory compliance oversight to human resource policies, and investment management strategy oversight and processes, etc.

A separate group worked with the teams to view all of the projects together, looking for dependencies and pre-requisites between various work streams to assure the projects would be deployed in their proper sequence and in the required timelines. All of the projects and their timelines and major deliverables were then plotted accordingly onto a master project plan.

Q. *The affiliation planning process seems to be quite an undertaking. Can you give us an idea of its scope?*

A. The final eleven project team blue print documents combined are well over 1,000 pages long. The electronic data room in which the overall planning effort is taking place currently includes well over 10,000 pages of draft plans, meeting notes, summaries, executive reviews, analyses, and worksheets. This is an indication of the considerable effort the companies put into assuring the plan has been sufficiently researched and vetted for accuracy and appropriateness.

Q. *So where are you in the process?*

A. This initial phase of the planning effort was concluded in May, 2011. Since then, the project teams have been engaged in the second phase of project planning. In this phase, the teams are examining the data fields on our respective systems and creating the mapping strategies that will support the integration of these systems. The teams are also building out the core systems migration plan in greater detail, and they are researching and refining our cost and human resource requirements.

Full and final business integration between BCBSD and Highmark is expected to be completed eighteen to twenty-four months after an approval of the affiliation. A number of key deliverables will be completed well before the end of this period, including a full turn-key core systems migration now targeted to take place fifteen months after an approval.

Highmark originally applied their experience with the West Virginia affiliation to arrive at a top-down estimate of \$35 million dollars for the cost of the BCBSD integration. Since then, the eleven functional planning teams have been working on the detailed plans in a bottom up analysis to confirm the cost estimate. Based on our current analysis, we estimate the cost to BCBSD for migrating onto Highmark's industry leading

capabilities will be \$37.4 million dollars. We are continuing our work to refine this estimate in our ongoing planning effort. As has been discussed earlier, and has been confirmed in the KPMG review of the proposed affiliation, this represents a considerable savings from the estimated \$100 million to \$140 million that BCBSD would otherwise need to spend to obtain such capabilities as an independent company.

It is important to note that at the conclusion of the integration effort, BCBSD will be able to operate at a much leaner and more efficient manner. This will reduce our overall operating costs, which has a beneficial impact on health care premiums but will also have an impact on the number of employees required to run BCBSD business.

Q. *What will the impact be on employment levels in Delaware following the Affiliation?*

A. In order to achieve the administrative efficiencies, economies of scale and synergies that are so important to the affiliation, the BCBSD end-state employment levels appear to place BCBSD at approximately 435 FTEs. Obviously this is a significant reduction from the current employment level of 617 FTEs; however this is not the end of the employment story.

In negotiating the affiliation transaction, and in the subsequent affiliation planning process, we stressed the importance of preserving robust employment in Delaware. This is reflected in the affiliation documents, including the Business Affiliation Agreement, where Highmark and BCBSD agreed to use commercially reasonable efforts to maintain employment levels in Delaware that are proportionate to the employment levels that Highmark maintains in other geographic areas to directly service its health insurance holders. Highmark has also agreed to maintain BCBSD's corporate headquarters in Delaware.

In addition, Highmark and BCBSD have made three voluntary commitments regarding employment stability if the Affiliation is approved:

- First, Highmark and BCBSD will assure the total number of employees in Delaware will be the same after implementation of the Affiliation is complete (approximately 18 months) as it was at the start of the Affiliation integration activities. As I mentioned a moment ago, this number is currently 617 and we do not expect it to change significantly before we close the transaction. The positions will be either BCBSD positions or Highmark positions located in Delaware. It should be noted that this commitment presumes continuity in enrollment and market share. Should there be a significant decrease in BCBSD's enrollment or market share during the implementation period (for example, from the loss of a large customer) that results in any lost BCBSD positions, Highmark would not be responsible for replacing those lost positions.
- Second, any BCBSD employees whose positions are eliminated due to the implementation will be given the first opportunity to fill any new BCBSD or Highmark positions that are created in Delaware.
- Third, Highmark will make good faith efforts to locate additional positions in Delaware as Highmark's business opportunities arise.

Finally, I would like to note that Highmark and BCBSD have agreed that for a period of 4 years, the companies will maintain account management, customer service and provider service to Delaware customers by Delaware-based staff under the immediate supervision of Delaware-based staff. Although BCBSD expects to maintain a high level of quality for these services at all times, the purpose of this agreement is to

ensure that the present quality of these services is not diminished in the early years of the affiliation.

Beyond these immediate commitments, in our due diligence process we placed considerable importance on the results of the Highmark West Virginia experience. There, although the plan experienced the same significant integration between Highmark and West Virginia that Highmark and BCBSD anticipate, employment has actually grown meaningfully in West Virginia since the affiliation as the plan has grown stronger both financially and in enrollment as the beneficiary of Highmark's business capabilities. BCBSD experienced similar growth in employment following the CareFirst affiliation, and we expect to see it with Highmark as well.