

Pennsylvania Insurance Department
Public Informational Hearing

Proposed Acquisition of Control of Highmark and
Its Pennsylvania Insurance Subsidiaries

Comments of J. Robert Baum, Ph.D., Chairman of the
Board and Acting Chief Executive Officer, and Deborah L.
Rice, Executive Vice President, Highmark Inc.

On Behalf of UPE and Highmark Inc.

April 17, 2012

Thank you Commissioner Consedine. My name is Bob Baum, and I'm the chairman of the board and acting chief executive officer of Highmark. I am also a director of UPE, the applicant in this proceeding. With me today is Deb Rice, Highmark's executive vice president. For simplicity's sake, I will sometimes use the name West Penn Allegheny to refer to the entire West Penn Allegheny Health System organization.

We welcome the opportunity to discuss why the change of control of Highmark and its Pennsylvania insurance subsidiaries, in conjunction with the company's proposed affiliation with West Penn Allegheny, is good for Western Pennsylvania – how it will benefit our individual subscribers, employer groups, physicians, the communities in which we and West Penn Allegheny operate, and the people of Western Pennsylvania. We will also discuss the health care industry environment that is driving change for both health care providers and health insurers on the national level, and the unique market dynamics of the Pittsburgh region that led to this proposed affiliation.

Highmark's long-standing mission is to make sure that all members of the community have access to affordable, quality health care, while also contributing to the economic vitality of the communities we serve. Deb will explain how West Penn Allegheny is a critical part of Highmark's broad plan, in support of our mission, to develop a new and better health care system that holds the promise of more affordable health care for patients, families and businesses in the region.

Finally, Deb will address some of the concerns about the transaction that have been raised by others.

And we look forward to hearing from many others, including those from Western Pennsylvania businesses, public officials, civic and community organizations, and labor leaders, who will share their views of the transaction.

Before I begin our specific remarks, I must say a few words about the recent changes in our CEO position that many of you are probably familiar with.

For decades, the Blue Cross Blue Shield name has stood for something special. In addition to high-quality products and services, the brand has been synonymous with integrity, and maintaining high standards in all aspects of our organization.

As the Highmark board's actions over the past few weeks have demonstrated, that commitment to integrity hasn't changed. The board and our senior management team remain focused on the business strategies that are key to our future success, including finalizing our affiliation with West Penn Allegheny.

While I am now serving as acting CEO and board chairman, our board is moving forward to identify a long-term successor to the CEO position.

Although the audience here today is understandably interested in the benefits of the proposed Highmark and West Penn Allegheny affiliation, it is important to clarify the purpose of this hearing. Highmark and West Penn Allegheny are pursuing this affiliation to create a new integrated health system that maintains a choice of high-quality health services for millions of Western Pennsylvanians.

A new tax exempt 501(c) (3) non-profit corporation has been created under which Highmark will maintain control of its insurance operation, and West Penn Allegheny will retain its federal income tax-exempt status.

This transaction is an affiliation between Highmark and West Penn Allegheny; it is not an acquisition of West Penn Allegheny by Highmark. West Penn Allegheny is retaining its assets, and Highmark is not assuming West Penn Allegheny's debt and pension obligations.

In order to achieve the goals of the affiliation, control of Highmark and its subsidiary companies must be transferred to the new parent corporation.

The Insurance Department is reviewing that change of control based on specific criteria under state law.

To put this transaction in context, I would like to briefly talk about Highmark. We have a very proud tradition. For nearly 75 years, we've operated as a not-for-profit corporation with a long-standing commitment to the community in Pennsylvania and, more recently, West Virginia and Delaware.

To fulfill our mission, we have provided insurance programs to every segment of the population – including seniors, children and those with limited economic means. We've also subsidized many of these insurance programs to hold down the cost of health insurance for these groups.

In addition to developing and supporting these insurance programs, Highmark and the Highmark Foundation have provided a tremendous amount of support to the community through grants and other forms of giving. For example, our contributions have been used to help address pressing human needs:

- Offering free health, dental and vision screenings for the neediest segments of the community,
- Fighting childhood obesity, and
- Helping eliminate disparities in health care.

To quantify our commitment to the community, let's take a closer look at our community contributions in the past five years. From 2007 through 2011, we contributed more than \$760 million in support of our corporate mission.

For generations, Western Pennsylvanians have taken comfort in the fact that they have a choice of physicians, hospitals and other health care professionals, and can choose among excellent health care alternatives available in our region.

By promoting the proposed affiliation, we are striving to maintain choice among multiple health care delivery systems, an important ingredient to controlling rapidly rising health care costs. For example, in 2000, when West Penn Allegheny Health System emerged from the bankruptcy of its predecessor organization, we provided a \$125 million loan to help the system regain sounder financial footing.

Highmark took this step because we wanted to ensure that the provider networks supporting our insurance products included a wide choice of tertiary and quaternary care facilities in Western Pennsylvania.

Two years later, we made \$232 million in grants and loans available to UPMC for construction of a new Children's Hospital in the Bloomfield neighborhood of Pittsburgh.

We supported this project because it continued the tradition of providing high-quality pediatric health care services to families in Western Pennsylvania, the state and nationally. This facility is now a vital community resource that is helping sustain the viability of the community and boosting Pittsburgh's economy by bringing more dollars into the region.

Over the past decade, we have also supported community hospitals across Western and Central Pennsylvania in a variety of ways to help them maintain independence and to better meet the medical needs of the community.

Although you will hear a lot today about business, financial and health care policy issues, I want to highlight a critical point: This transaction is consistent with our long-standing community tradition of trying to maintain choice and access for our subscribers to affordable, quality health care.

This proposed affiliation will not change our mission. In fact, I believe our company will be in a better position after the transaction to fulfill our mission and better serve our individual subscribers and employer group customers. Now, I'd like to turn the discussion over to Deb.

Thanks Bob. Continuing the proud tradition that Bob just discussed is important to us, although we are confronted by a very challenging environment, both nationally and regionally. The health care system is at a crossroads, with increasing concerns about medical costs, quality of care, and access to medical services.

The cost of health care, including hospital and physician services, is ever increasing. As a result, the burden of health insurance costs on individuals and businesses continues to grow.

In fact, a recent report by the Center for Studying Health System Change, found that the share of U.S. children and adults covered by employer-sponsored health insurance dropped by 10% from 2007 to 2010. The main reasons for this drop in private insurance were the recession and rising medical costs.

One of the primary drivers of higher costs is the way doctors and hospitals are paid. A fee-for-service payment system gives health care providers the incentive to do more tests and procedures. As a result, too many health care dollars are wasted, going toward ineffective, repetitive or inappropriate care. We need to find a better way to pay doctors and hospitals.

In addition, we have a fragmented health care delivery system among hospitals, primary care doctors and specialty physicians. This inefficiency leads to poor coordination of care for people with chronic medical conditions, such as diabetes, COPD and heart disease. There is now widespread consensus that by improving quality of care and patient safety, we can slow the growth of medical costs.

We are also seeing health care delivery systems growing larger and larger through consolidations, mergers and acquisitions of smaller hospitals and physician practices. A number of studies show that some of these mega-health systems generate higher health care costs because they can use their size to obtain unreasonable reimbursement levels from private health insurance companies.

Layered on top of these market dynamics is health care reform. The new law is changing the health care marketplace by encouraging doctors, hospitals and health insurance companies to align more closely. As an outgrowth of health care reform, we are starting to see new models of health care delivery and financing organizations called patient-centered medical homes and accountable care organizations.

These models, which are still in their infancy, are designed to change provider payment incentives to promote better care, improve coordination of care and optimize the use of technology to ensure that patients receive the right care, at the right time, in the right health care setting.

Health care reform, combined with private marketplace forces, is also spurring a shift in health care toward greater consumer decision-making. Individual consumers are taking a more active role in all aspects of health care. Because they are more responsible for their costs, individuals are demanding more specific information about the cost and quality of care across providers.

To continue to meet our mission over the long term, Highmark's management team and board of directors determined that we had to evolve as a company. And we have.

During the past few years, we:

- Developed new web-based tools to help consumers make more informed health decisions,
- Worked more closely with hospitals and physicians on new payment systems to reward providers for reducing health care-associated infections, and
- Opened a number of health insurance retail stores across Pennsylvania to offer one-on-one assistance for individuals and small businesses to purchase a health insurance plan.

While these steps have laid a solid foundation to meet shifting marketplace expectations, we had to take bolder action to remain a financially strong company for years to come, more actively control health care costs on behalf of our customers, and preserve health care choices for our subscribers, physicians and other health care practitioners. In other words, Highmark had to evolve from a traditional health insurer to a health and wellness company with a significant role in the delivery of medical care.

Our efforts to put together a new provider system are at the heart of this evolution. Our aim is to work closely with independent doctors, hospitals and other ancillary health providers to improve the coordination and quality of care.

An equally high priority is keeping care in the community – to promote convenience for patients and to support local economies.

We had planned to implement this plan over time, but two game-changing developments in the Western Pennsylvania market have forced us to accelerate our activities. The first was UPMC's demand for a 40% increase in payments from Highmark plus an annual inflation increase for our commercial subscribers, a totally unacceptable demand in light of a 2-3% annual inflation rate.

Because we could not, on behalf of our subscribers, agree to this exorbitant payment demand, UPMC has refused to negotiate with Highmark on new contract agreements that would keep some of its hospitals as Highmark network providers. As a result, Highmark's commercial subscribers won't have in-network access to a number of UPMC facilities after June 30, 2013.

At the same time that UPMC walked away from the negotiating table, West Penn Allegheny Health System's financial condition continued to deteriorate.

Its cash on hand, hospital discharges and outpatient patient volume and other business and financial indicators pointed downward. Institutional investors raised concerns about the system's ability to meet its pension and debt obligations. At the end of 2010, the system closed the emergency room at West Penn Hospital.

We believed that the continued financial decline at West Penn Allegheny would have severe consequences for the general public, Highmark individual subscribers and employer groups, and independent health care providers. These consequences included:

- 1) Reduced consumer access and choice of providers, especially for selected clinical services such as cancer care and ob/gyn.
- 2) Uncontrolled health care cost increases, which would push more employers and individuals to drop coverage.
- 3) Damage to the local economy and the potential loss of thousands of jobs.
- 4) Increased control by UPMC over physicians who continued to leave the West Penn Allegheny system.

5) Increased reliance of community hospitals on UPMC specialists, making it more difficult for community hospitals to remain independent.

6) Inability of West Penn Allegheny to maintain its vital medical education and medical research programs.

Highmark could not passively stand by and let these forces threaten the ability to fulfill our mission and meet the health care needs of the community. Here's why. During the five-year period from 2006 through 2010, our health insurance business in Western Pennsylvania accounted for the majority of Highmark's health care revenue.

A closer look at the Western Pennsylvania health care market region reveals a major problem – out-of-control medical costs.

As you can see, Pittsburgh-area residents spend 25% of their income on health insurance costs, a much higher level compared to other metropolitan areas in the Mid-Atlantic region and the Midwest.

What drives up health insurance premiums? Very simply, high medical costs. Nearly 90 cents of health insurance premiums are used to pay for patient care, such as doctor visits, hospital stays and prescription drugs.

Medical costs are made up of two parts: the use of medical services and the price per service. As costs increase – either because the price per service increases or subscribers use more services, or both – premiums go up proportionately.

Medical costs are high in the region because Pittsburgh-area residents utilize more medical services. They undergo more outpatient procedures and have more MRIs and more lab tests than the average of people in similar Mid-Atlantic regions.

The problem of higher utilization is compounded when there is little provider competition in a market where the price of medical services is essentially set by one health system. In Pittsburgh, that one health system is UPMC. It controls more than 55% of the hospital beds in Allegheny County and owns physician practices employing upwards of 3,000 physicians.

About 80% of the Southwest Pennsylvania market for oncology services is controlled by UPMC, either directly through services that its oncologists provide or indirectly through UPMC affiliations or joint ventures with other hospitals for cancer care.

At a Pennsylvania State Senate legislative hearing last year, UPMC's CEO admitted that UPMC is a monopoly in this region's health care delivery market.

Medical economics research clearly shows that very large health systems are able to use their size to obtain higher private insurance reimbursement rates, which then directly translate into higher insurance premiums. In fact, the Federal Trade Commission recently cited this same concern when it rejected the purchase by a large Toledo-area health system of another hospital in the same market. According to the FTC, the purchase would have allowed the hospitals to charge higher prices and would probably have resulted in higher health care costs for patients, employers and employees.

We are seeing this phenomenon in Western Pennsylvania, where Highmark subscribers who use the dominant health system have significantly higher health care costs on a per employee basis than subscribers who do not use that system as much.

These higher costs translate into higher health insurance premiums for employees living in Western Pennsylvania. They also make our community a less attractive place for businesses to locate or to continue operations.

In short, the Pittsburgh region needs a choice of financially sound health care delivery systems and independent community providers to effectively let market forces hold down cost increases. Otherwise a single, dominant system will continue to obtain unreasonable payment increases from all private health insurance companies, which this region cannot afford.

Facing these immediate challenges, we owed it to our customers and the community to act promptly to preserve provider choice and competition in the Pittsburgh marketplace. For these reasons, we began discussions with West Penn Allegheny Health System.

We conducted a thorough analysis of West Penn Allegheny and found its institutions had strong clinical services, including well-respected specialty care programs in bone and joints, heart disease, neurosciences and transplantation.

Allegheny General Hospital's heart transplant program is one of the busiest in the country and has excellent patient outcome rates that exceed the national average. The system also has a strong commitment to train future generations of health care professionals by offering many graduate medical programs and affiliations with two medical schools and two nursing schools.

Although some physicians and other ancillary providers have begun to lose confidence in West Penn Allegheny as the system's financial performance weakened, the system still has a loyal team of doctors, nurses and other health care professionals who are committed to delivering high-quality patient care. Additionally, the system has a consistent track record of delivering high-quality care at a lower cost than the dominant health system in the region.

What West Penn Allegheny sorely lacked was capital. Because of its tenuous financial position, the system had delayed certain capital improvements and physician practice development which were needed to bolster its infrastructure and strengthen relationships with patients.

We carefully considered different scenarios, evaluating the long-term prospects of keeping our subscriber base if UPMC decides to leave our provider network, and the risk of reduced provider choice if West Penn Allegheny shut down even more clinical services. In the end, we determined that an affiliation with West Penn Allegheny made the most sense. It would preserve the non-profit missions of both organizations and maintain provider choice for our subscribers and all Western Pennsylvanians.

Just last week, the U.S. Department of Justice reaffirmed the positive impact the affiliation would have on competition in the local health care market. According to DOJ, the proposed affiliation has the promise of increasing competition in the Western Pennsylvania health care market by providing West Penn Allegheny with a significant infusion of capital.

With that backdrop, I would like to talk about some specific benefits of the proposed transaction. We believe that a close and enduring partnership with West Penn Allegheny Health System, combined with other elements of Highmark's integrated delivery system, will achieve the following:

- Make health care and health insurance more affordable,

- Improve the quality of health care in Western Pennsylvania, and ultimately improve quality in Highmark's other major service areas, and
- Create a more caring and responsive delivery system at all levels of care to produce a better patient experience.

These goals are real and sustainable because Highmark's new health care delivery system, with West Penn Allegheny as an important component, provides opportunities for improving access to affordable, high-quality care.

The new system will be founded on a clear principle: to preserve health care choices for individuals, employers, physicians, and other health care professionals into the future.

It will include partnerships with community hospitals and physicians who have a shared interest in making health care more affordable, creating a more satisfying experience for patients, ensuring high-quality care and operating as efficiently as possible. West Penn Allegheny Health System has indicated its willingness to embrace these core elements of our new integrated delivery network to achieve more affordable care for patients.

The new integrated health care delivery and financing system that Highmark envisions is intended to offer integrated care across a variety of settings, including primary and specialty physician offices, urgent care centers, ancillary services, ambulatory surgical centers, hospitals, outpatient medical malls and post-acute services.

Depending on the needs of a particular community, the medical malls will house urgent care centers, lower-cost ancillary providers, primary care medical homes, specialty outpatient clinics and retail outlets such as pharmacies or vision retail stores.

While traditional hospitals are necessary to provide more advanced and specialized services, we believe that with steady improvements in medical technology, more care can and should be appropriately delivered in less costly outpatient settings.

To better align the incentives that encourage too much patient care, our network will focus on provider payment models that pay providers more for high quality, better outcomes, and higher patient satisfaction than for providing more and more services. A pay-for-value payment system promotes care based on best medical practices and discourages unnecessary utilization of medical services.

We must move the marketplace away from the long-standing fee-for-service payment system which gives hospitals and physicians no incentive to coordinate care, invest in higher quality, or even consider the cost of care. This outdated payment model has contributed to steady cost increases for Highmark employer groups and individual subscribers.

The foundation of the new system will be information technologies. We plan major investments in health information technology tools to help physicians and hospitals retrieve relevant clinical information faster and make more informed clinical decisions for their patients.

An important element of our technology platform is a health information exchange. The exchange will be designed to encourage provider collaboration in the appropriate and secure use of health care data to improve quality of care for all our subscribers.

While other features of the integrated delivery network we intend to create are detailed in the filings with the Department, the relevant question for the people here today is how, specifically, will Pennsylvanians benefit by the proposed affiliation and by our new care delivery network?

First and foremost, our community, which includes many of our subscribers, will have the security of knowing they have a variety of high-quality health options to choose from when selecting a physician, hospital, or health care professional. The new Highmark network, anchored by a vibrant West Penn Allegheny Health System, will ensure that our individual subscribers and employer groups have access to the care they need, regardless of whether UPMC follows through on its threat to leave the Highmark network.

To maintain an adequate number of providers in certain clinical areas where UPMC virtually controls the market, such as oncology, Highmark and West Penn Allegheny will work together to hire and partner with cancer specialists and expand the new network's technology capabilities to handle a higher volume of cancer patients in the system.

The transaction will also help expand provider choice and access to primary care, addressing the shortage of primary care doctors in Western Pennsylvania.

Highmark's financial commitment to West Penn Allegheny Health System also includes money to fund scholarships for students attending medical schools affiliated with West Penn Allegheny, and to support other health professional education programs to help keep physicians in Western Pennsylvania.

As part of our broader provider network strategy, we will form close partnerships with primary care practices to help ensure adequate choice of primary care.

In addition to preserving choice and access, we believe this transaction will help slow the rise in the region's health care costs and ultimately improve the affordability of health insurance. Here's how we plan to do this.

Allegheny General Hospital is an important part of our goal to control regional medical costs. As the primary site to handle patients who require the most advanced and costly care, Allegheny General will be critical to provide a lower-cost alternative to the region's dominant health system.

Allegheny General has a good track record of delivering high-quality care at an affordable cost. This transaction will solidify Allegheny General's standing as a high-performing, competitive referral center and a training ground for health care professionals.

Another way to control costs is by ensuring that people receive the care they need in the most economical health care setting, without compromising quality. For example, Highmark's average payment for a spinal MRI is generally more than two times higher at a hospital than at a free-standing imaging center. If the quality of a service is the same at both settings, it makes sense that patients should receive this service at the lower cost and often more convenient location.

The new delivery system we envision will focus on shifting more care, when appropriate, to outpatient, community settings that are less expensive than going to a hospital.

Our new provider network will serve as a building block for new insurance products we are beginning to develop that will have lower premiums than any Highmark product that would include UPMC at the 40% increase in payment levels it has demanded.

Historically, health insurance programs have offered only limited cost and quality information to consumers, leaving them with inadequate information to make an informed, value-conscious choice of health benefits and their health care provider. We will now accelerate our efforts to more deeply involve our individual subscribers in health care decisions.

First, we are expanding our information transparency tools so that subscribers can clearly compare cost and quality differences across providers. These tools will help our subscribers better understand the cost and quality trade-offs when selecting a physician or hospital.

Second, we will offer less costly products that include incentives for subscribers to use physicians and hospitals that have proven they can deliver quality care at a lower cost.

These tiered benefit products are becoming more widely accepted in the health insurance industry as a vital tool to control the cost of health insurance. I want to be clear on one point: At no time will Highmark force our subscribers to choose any provider.

Our collective efforts to build an innovative, forward-looking delivery system are intended to produce a better patient experience. Patients will have the option to receive care at more convenient locations in the community. They can expect better care if they need to visit more than one doctor or require multiple medical services, because our new payment models will reward quality, good outcomes and coordination of care.

And, unlike some health systems that exclude certain insurance programs, Western Pennsylvanians will not have to worry about whether West Penn Allegheny Health System will accept their insurance card. West Penn Allegheny will contract with all insurance carriers that want to have a contract with it.

Over the past two years, we have met with many provider groups and organizations. Health care providers are deeply concerned that the changes taking place in the region's health care are interfering with their commitment to put patients first, and reducing their referral choices.

They also worry that they lack the financial resources to buy new practice management tools and information systems to operate their practices more efficiently.

We believe the proposed affiliation and the new provider network will benefit independent hospitals, physicians and other health care providers.

Through a variety of support programs and activities, we can assist community hospitals that desire to remain independent, while helping them attract more patients and reduce administrative costs.

The new integrated delivery system will work with community hospitals on new reimbursement models that reward high-quality care and more appropriate use of services. We will encourage these institutions to invest in the new community-based outpatient medical sites and the health information exchange.

Highmark and West Penn Allegheny will also work cooperatively with independent community hospitals to maintain an adequate supply of future physicians at the community level through expanded internship and residency training programs.

The new network will also offer a variety of tools to help physician practices remain independent. We will offer them more affordable access to a shared platform of advanced administrative services, including electronic health records and practice management tools, which they are often unable to afford on their own.

Armed with these information technology tools, our aligned physician practices will be in a better position to meet the federal government's guidelines to qualify for additional Medicare and Medicaid payments.

Similar to consumers, independent physicians also benefit from multiple health system options. They will be able to offer more referral choices to their patients, sustain adequate patient volume to retain a viable office practice, and avoid the untenable choice of either selling their practice to a dominant provider system or relocating out of Western Pennsylvania.

Preserving provider competition and choice also benefits our community. It boosts the economic vitality of Western Pennsylvania. The health sector is one of the key economic engines for the region.

By maintaining multiple health delivery systems here, we can save existing jobs, create more employment and preserve stronger, more economically viable communities throughout Western Pennsylvania.

Although I have concentrated mostly on Western Pennsylvania, the benefits of this transaction and our new integrated delivery network extend beyond our region. Highmark insurance programs cover many employer groups that have headquarters in other parts of the Commonwealth and other states but who have employees working in Western Pennsylvania. These employers will reap the benefits of greater choice and competition if their employees choose to obtain care through the West Penn Allegheny Health System and the lower-cost network that we are building.

The integrated delivery network and the new payment methods we are putting in place will not be confined to Western Pennsylvania. Our goal is to expand these approaches to all our service areas.

For example, we plan to partner with physicians to improve coordination of care for thousands of Highmark subscribers through patient-centered medical homes. We currently have 13 medical home programs with physician practices throughout Western and Central Pennsylvania and West Virginia.

We also believe that the benefits of our health information exchange will extend beyond Western Pennsylvania. Although the first health care organizations to join this project are in Western Pennsylvania, we envision developing a statewide exchange to improve patient care across the Commonwealth through prudent sharing of information.

Before I close, I'd like to address some specific issues that have surfaced during the regulatory review process and in discussions with employer groups, public officials and other stakeholders.

The first question is whether Highmark is serious about following through on the proposed affiliation. The answer is a definite yes -- and I think our actions thus far back up our resolve.

We've already advanced \$150 million to West Penn Allegheny, and we have every intention of honoring our total financial commitment of up to \$475 million over four years.

We have also acquired other important assets, including a multi-specialty physician practice in the eastern suburbs of Pittsburgh, to ensure access to primary care and specialty physicians in the Monroeville area.

To further underscore our commitment, we recently sold a Highmark subsidiary company that for many years had successfully processed claims for the federal Medicare program. This was a difficult choice, since we had a strong partnership with the federal government. But because of a perception of a potential conflict of interest which would result from the affiliation with West Penn Allegheny and our determination to be more involved in health care delivery, we had to take this action. Fortunately, we found a buyer who was committed to preserving the jobs of this company in Pennsylvania.

We owe it to our customers and the community to make this affiliation work in order to preserve provider choice and competition in the Western Pennsylvania market.

A set of financial-related questions has been raised. The first is whether this use of our resources will represent a financial drain on Highmark and jeopardize the financial soundness of our insurance business.

We believe the proposed affiliation is a prudent use of resources that will not negatively affect our insurance business. When opportunities arise, we examine them very carefully.

Here are some of the issues we evaluate: (1) Will this use of resources reinforce our core mission? (2) Will it improve the health of our subscribers? (3) Will it address the issue of rising costs? (4) Does the expenditure have the potential to generate jobs and thereby improve the economy in one of our core markets? 5) Will the expenditure affect our ability to meet the financial obligations to our subscribers and group customers to pay medical claims?

We have carefully and thoroughly evaluated the West Penn Allegheny affiliation against all these criteria. We believe that with our support, West Penn Allegheny can be restored to a vibrant care delivery system.

Furthermore, we believe West Penn Allegheny has the clinicians, staff and core facilities to be a vital part of our provider strategy, offering the option to our customers and the community at large of more affordable access to high-quality care.

As part of our assessment, we looked at the cost of this expenditure and the cost to Highmark and the community of a new contract with UPMC.

Our conclusion was clear: providing funding of up to \$475 million in West Penn Allegheny was much less than the \$2 billion in additional health care costs that would be passed on to the community over three years if Highmark agreed to UPMC's demands for a 40% increase in payments plus an annual inflation adjustment for our commercial customers.

Another question focused on an independent auditor's report that expressed doubt about whether West Penn Allegheny Health System can continue as a going concern.

The report was based on the system's financial performance for the period from July 2010 through June 2011. Since the auditor's report was consistent with the assessment Highmark's consultants had performed prior to our decision to affiliate, we were not surprised by the opinion.

However, during the past few months, there have been some encouraging developments to demonstrate that West Penn Allegheny, with Highmark's support, is moving in a positive direction. For example, the system has begun upgrades at Forbes Regional Hospital to successfully compete in the east Pittsburgh suburbs.

In February, West Penn Hospital reopened its emergency department. This was an important milestone not only for West Penn Allegheny and the people who work there, but also for the Bloomfield neighborhood. Since the reopening, the patient volume at West Penn's emergency department has been steadily increasing.

Another sign of progress during the past few months is the system's continued recruitment of new primary care and specialty physicians.

The momentum of support for West Penn Allegheny among physicians is a telling sign that more independent physicians and those seeking employment have more assurance that West Penn Allegheny will become a stable and sustainable health care system.

In closing, I think it is important to note that no two organizations, alone, can solve all the problems of Western Pennsylvania's health care system.

However, a close and sustainable partnership with West Penn Allegheny is essential to Highmark's vision of building an innovative integrated health system, one which holds the promise of positive change in the delivery of patient care.

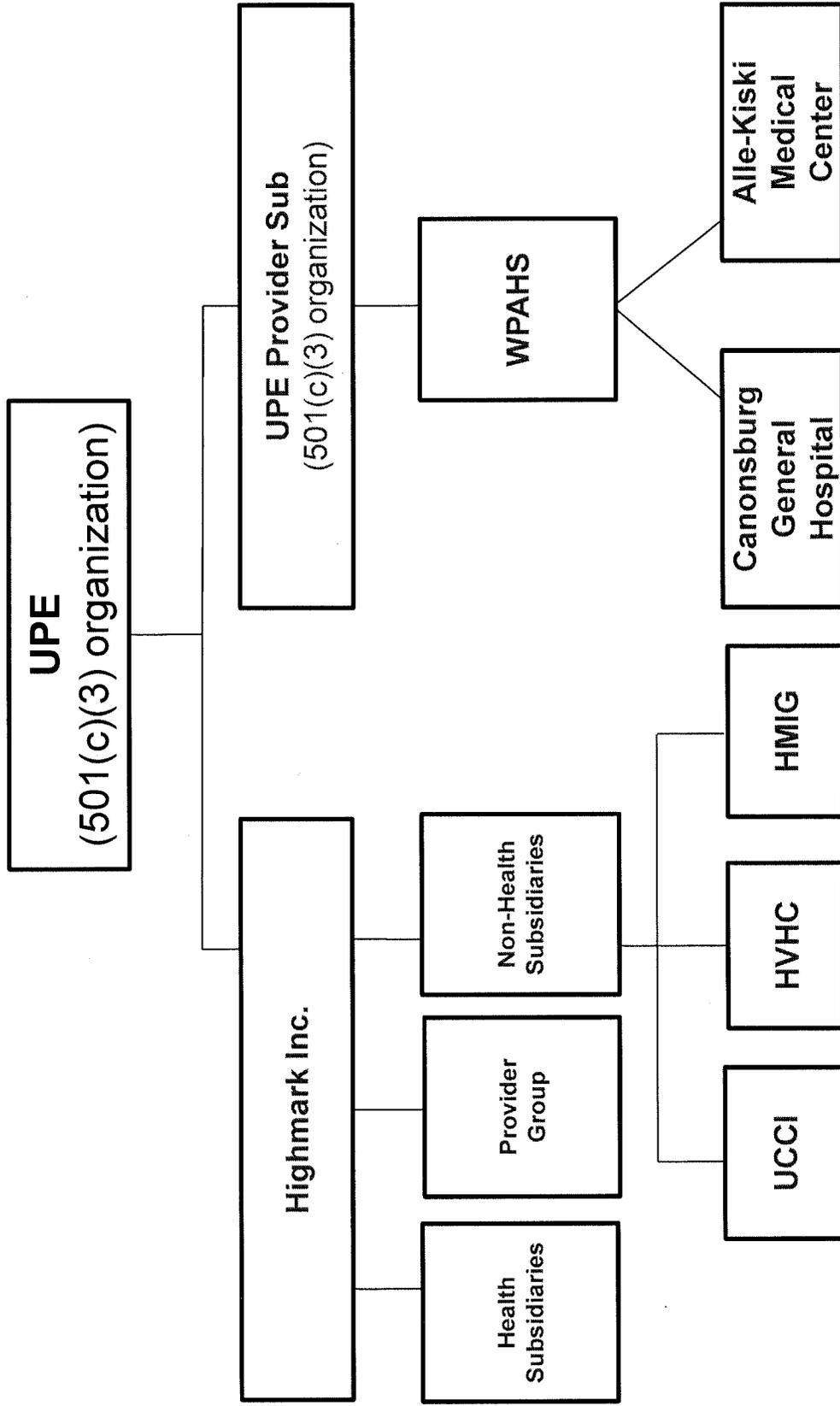
West Penn Allegheny is an important provider of primary and specialty care in the region, and offers the only referral alternative to UPMC for very advanced and complex medical services. The system has openly expressed its intention to work with Highmark to help lower costs and develop new care delivery models built around improving quality and the patient experience.

We believe this transaction is a stepping stone toward reassuring our individual subscribers and employer groups that they are getting real value for their health care dollar. It can also spur investments in more customized products and services, such as lifestyle and worksite wellness programs, to meet the health care needs of more informed and demanding consumers.

Finally, we appreciate the fact that the Department's review of our filing is moving forward quickly because we believe this transaction will preserve a choice of multiple health delivery system options in Western Pennsylvania for Highmark subscribers and the entire community.

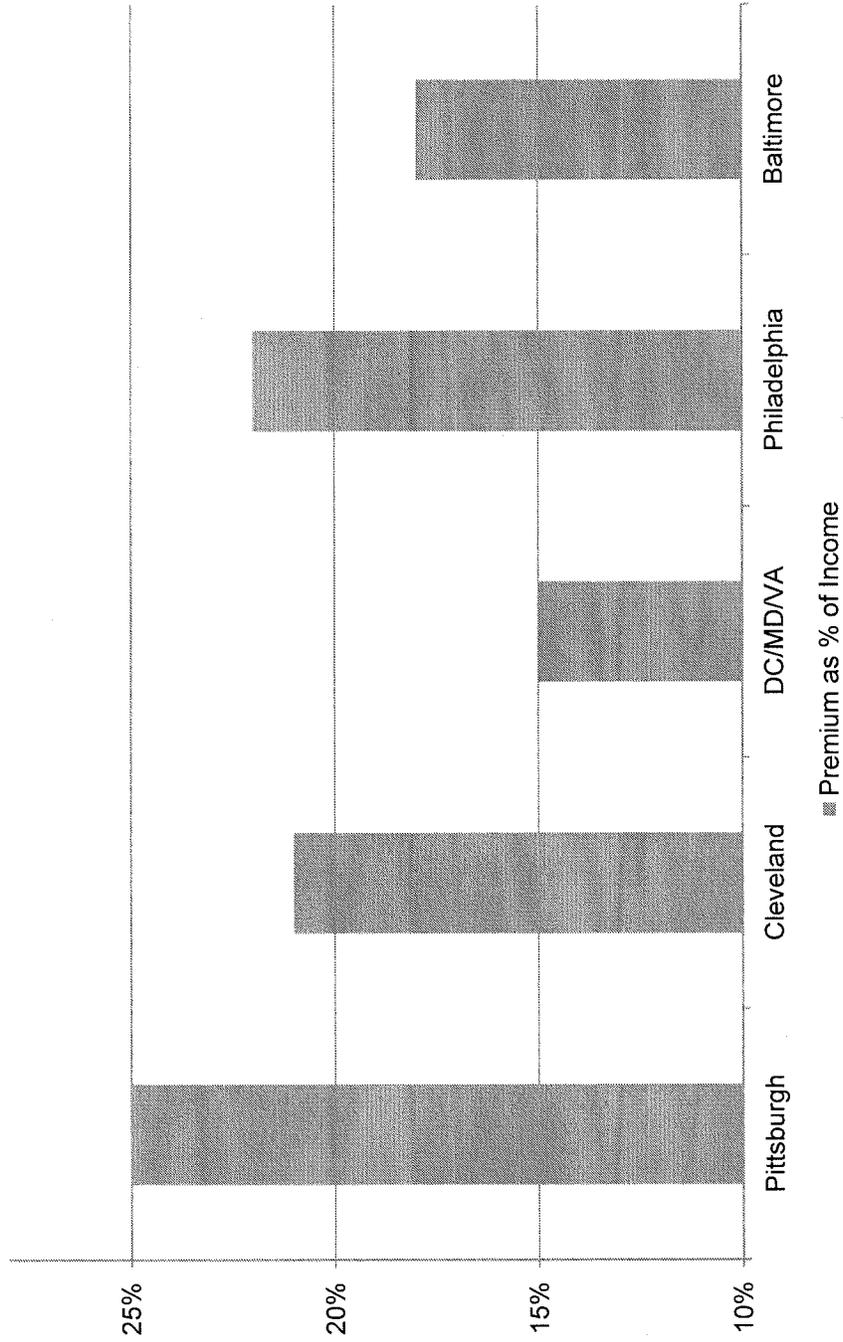
Thank you and we are prepared to answer any questions.

Proposed Corporate Structure



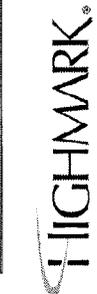
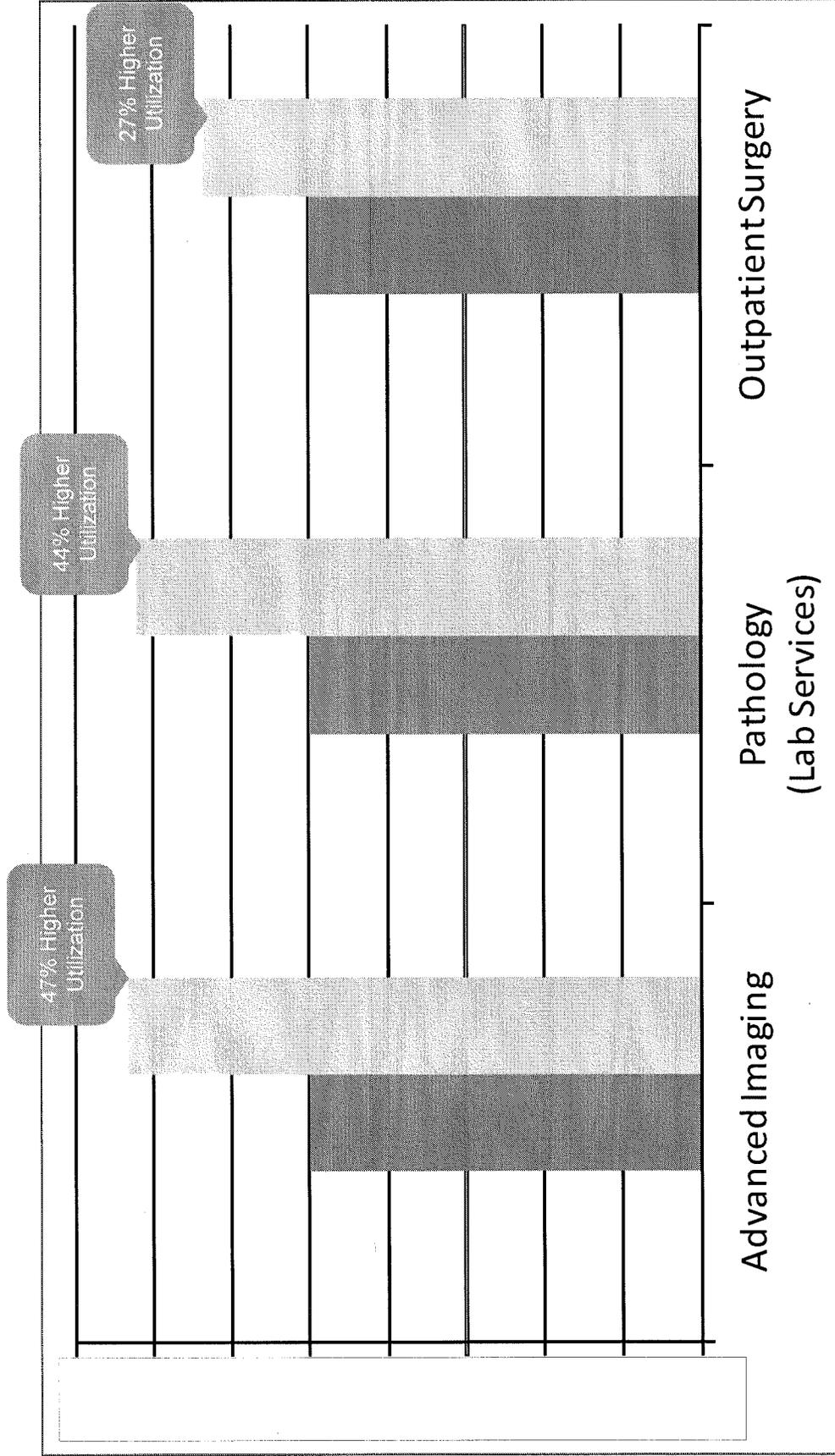
Relative Costs of Health Care

Premium as % of Income



Sources: Milliman Group Insurance Survey 2010 - PPO Standard Plan Rates by MSA; Federal Housing Finance Agency (FHFA) 2010 Area Median Incomes

High Utilization of Outpatient Services in Pittsburgh Region



Source: Blue Cross Blue Shield Association Claims Data

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