Preliminary – Subject to Public Review

Report on Highmark Inc.'s Proposed Change of Control and Affiliation with West Penn Allegheny Health System, Inc.

April 8, 2013

This draft report has been prepared and is being filed to assist the Pennsylvania Insurance Department ("PID") in its ongoing consideration of the Form A Application of UPE, dated November 7, 2011, as amended. This report will not be complete until the public has had appropriate opportunity to review, and Blackstone reserves the right as may be required in its judgment to amend and/or supplement this report based upon additional or new information that may be provided during the public comment period or thereafter or in response to comments by the Applicants, the public or PID officials.

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I. Background

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Introduction

Blackstone Advisory Partners L.P. is serving as financial advisor to the Pennsylvania Insurance Department (the "PID") in connection with the PID's review of the proposed change of control of Highmark Inc. and related insurers[(1)] (individually and, when appropriate, collectively, "Highmark"), as well as Highmark's affiliation (the "Affiliation") with West Penn Allegheny Health System, Inc. ("WPAHS"), (the "Transaction").

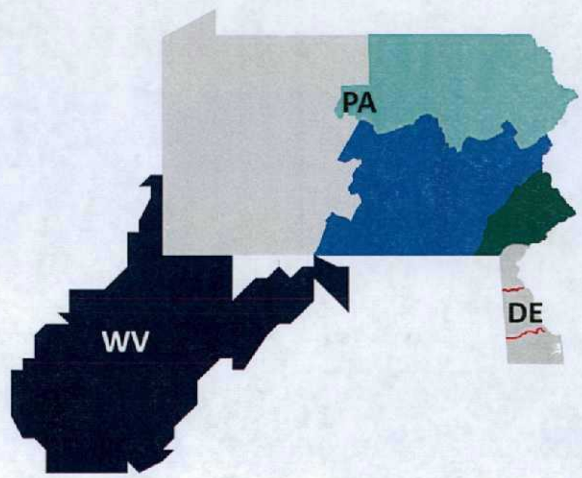
- Highmark and WPAHS have entered into an agreement pursuant to which Highmark and WPAHS will affiliate to establish an integrated health system (the "Affiliation Agreement")
  - On October 20, 2011, a new nonprofit parent company, UPE, was formed and will become the sole corporate member of Highmark
    - Highmark is to maintain control of its insurance operations
  - On October 20, 2011, a new nonprofit subsidiary of UPE, UPE Provider Sub, was also formed and will become the sole corporate member of WPAHS. UPE Provider Sub is a provider-focused entity
    - WPAHS will retain its federal income tax-exempt status
- Highmark, based in Pittsburgh, is one of the 10 largest health insurers in the country with a total membership, across all product lines, of 32 million, of which 4.7 million are health plan members
- WPAHS, also based in Pittsburgh, includes five hospitals with approximately 1,600 beds, 1,700 physicians (employed and private practice) and over 230 specialty care practice sites throughout western Pennsylvania
- The proposed Transaction is subject to review by, and the approval of, the PID
- The PID has asked Blackstone to analyze several aspects of the proposed Transaction as part of its process of determining whether the Transaction meets certain of the standards contained in 40 P.S. § 991.1402(f)(1)

(1) Highmark Inc.'s related insurers include: First Priority Life Insurance Company, Inc., Gateway Health Plan, Inc., Highmark Casualty Insurance Company, Highmark Senior Resources Inc., HM Casualty Insurance Company, HM Health Insurance Company (d/b/a Highmark Health Insurance Company), HM Life Insurance Company, HMO of Northeastern Pennsylvania, Inc. (d/b/a First Priority Health), Intercounty Health Plan, Inc., Intercounty Hospitalization Plan, Inc., Keystone Health Plan West, Inc., United Concordia Companies, Inc., United Concordia Dental Plans of Pennsylvania, Inc., and United Concordia Life and Health Insurance Company.

Highmark Overview

Highmark is a non-profit corporation and operates as a hospital plan and a professional health services plan in the Commonwealth of Pennsylvania. As a licensee of the Blue Cross and Blue Shield Association, Highmark underwrites various indemnity and managed care health insurance products.

- Headquartered in Pittsburgh, Pennsylvania
- Approximately 4.7 million health plan members
  - 3.1 million in Western Pennsylvania
  - 856,000 in Central Pennsylvania / Lehigh Valley
  - 330,000 in Northeastern Pennsylvania
  - 395,000 in Delaware
  - 213,000 in Southeastern Pennsylvania
  - 265,000 in West Virginia
- Pennsylvania service area includes:
  - 29 counties in Western Pennsylvania
  - 21 counties in Central Pennsylvania
- Jointly markets various health insurance products with i) Blue Cross of Northeastern Pennsylvania ("BCNEPA") and ii) Independence Blue Cross ("IBC")
- Highmark West Virginia, Inc., a West Virginia non-profit health services corporation, is a controlled affiliate of Highmark
- Highmark BCBSD Inc., a Delaware non-profit health services corporation, is a controlled affiliate of Highmark
- Approximately 19,700 employees
- Highmark Combined 2011 Total Revenue and Net Income of \$14.8 billion and \$445.5 million, respectively[(1)]



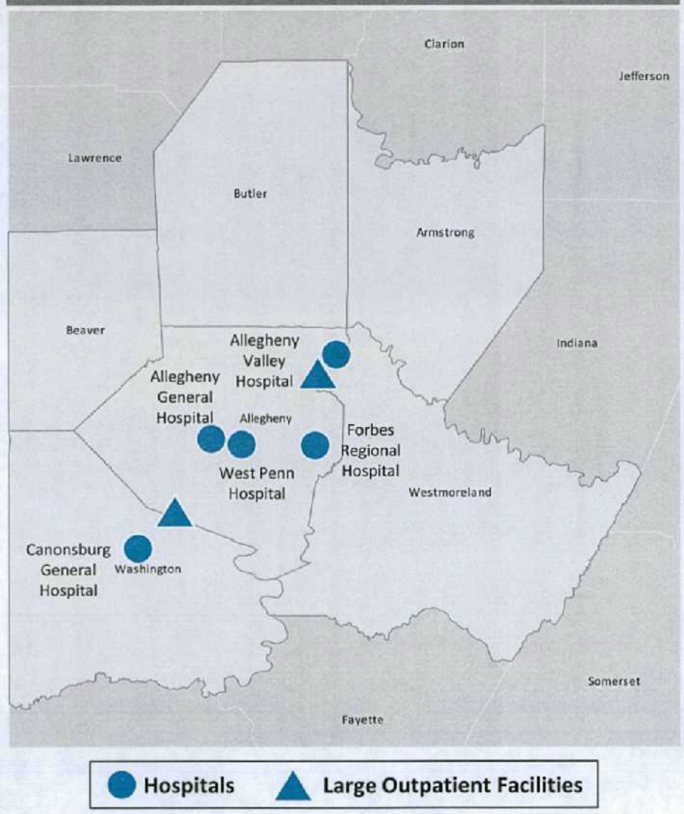
(1) Represents GAAP results; GAAP Total Revenue is equal to Total Operating Revenue plus Net Investment Income and Net Realized Gain (Loss) on Investments.

West Penn Allegheny Health System Overview

WPAHS is a regional health provider serving Allegheny, Armstrong, Butler, Beaver, Washington and Westmoreland counties.

- In November 1999, the Western Pennsylvania Health System acquired the western Pennsylvania affiliates of the former Allegheny Health Education and Research Foundation: Allegheny General Hospital, Allegheny Valley Hospital, Forbes Health System, Canonsburg General Hospital and affiliated physician practices
  - Today WPAHS includes five acute care hospitals that operate ~1,600 inpatient beds and provides a full range of clinical services
  - The System's hospitals have over 1,700 physicians on the Medical Staff and the System's Physician Organization (or "PO") employs 600+ physicians
  - The System provides training for 450 medical residents and 250 nursing and allied health students annually
- WPAHS is the 2nd largest healthcare provider in the Greater Pittsburgh market
  - ~11,000 employees
  - ~17% of inpatient market share (vs. ~41 % market share of UPMC) in Greater Pittsburgh

Location of WPAHS Facilities in Six County Region



Source: WPAHS.
Note: In addition to WPAHS, UPE is affiliated with Jefferson Regional Medical Center ("JRMC") and plans to affiliate with Saint Vincent Health System ("SVHS"), as additional hospitals within its provider organization.

Transaction Overview

The Transaction structure, as defined in the Affiliation Agreement and as described more fully later in this report, is summarized below.

- At closing: UPE will become the sole corporate member of Highmark
  - A second Pennsylvania nonprofit corporation ("UPE Provider Sub") has been formed; UPE is its sole member
  - UPE Provider Sub will become the sole member of WPAHS
  - Highmark and WPAHS will become affiliated companies, with UPE as their common ultimate sole parent and, at least initially, with certain overlapping board members

UPE:

- Is a Pennsylvania nonprofit, non-member corporation
- Has qualified for exemption from federal income tax as per section 501(c)(3) of the Internal Revenue Code
- Will not write health insurance or take any insurance risk
- Will prepare financial statements in accordance with generally applicable accounting principles ("GAAP")
- Will hold certain reserved powers with respect to Highmark

Highmark:

- Will continue to be a Pennsylvania nonprofit corporation
- Will be subject to control by UPE
- Will retain its existing assets, liabilities and operations
- Will be authorized to transact the business of a hospital plan corporation and a professional health services plan corporation
- Will continue to operate a nonprofit hospital plan and nonprofit professional health services plan
- Will be licensed by the Blue Cross and Blue Shield Association (or "BCBSA") as a risk-assuming controlled affiliate licensee
- Will continue to participate in BCBSA regulated programs
- Will retain its existing trade names

Blackstone's Mandate

The PID has asked Blackstone to assist it in preparing analyses that are relevant to five of seven applicable statutory criteria under 40 P.S. § 991.1402(f)(1) that have been deemed applicable by the PID to the proposed Transaction.

40 P.S. § 991.1402(f)(1) states that "The department shall approve any merger, consolidation or other acquisition of control referred to in subsection (a) unless it finds any of the following:

1) After the merger, consolidation or other acquisition of control, the domestic insurer referred to in subsection (a) would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed

2) The effect of the merger, consolidation or other acquisition of control would be to substantially lessen competition in insurance in this Commonwealth or tend to create a monopoly therein.[1] In applying the competitive standard in this subparagraph:

    a) the informational requirements of section 1403(c)(2) and the standards of section 1403(d)(2) shall apply;

    b) the merger, consolidation or other acquisition of control shall not be disapproved if the department finds that any of the situations meeting the criteria provided by section 1403(d)(3) exist; and

    c) the department may condition the approval of the merger, consolidation or other acquisition of control on the removal of the basis of disapproval within a specified period of time

3) The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interest of its policyholders

4) The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable and fail to confer benefit on policyholders of the insurer and are not in the public interest[1]

5) The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger, consolidation or other acquisition of control[2]

6) The merger, consolidation or other acquisition of control is likely to be hazardous or prejudicial to the insurance buying public

7) The merger, consolidation or other acquisition of control is not in compliance with the laws of this Commonwealth, including Article VIII-A[2]"

(1) The PID , through its counsel, Blank Rome LLP, has engaged Margaret Guerin–Calvert of Compass Lexecon to review matters related to Standard 2. Ms. Guerin–Calvert, in coordination with Blackstone, has also reviewed matters related to Standard 4.
(2) The PID has not asked Blackstone to consider matters related to Standard 5 or Standard 7.

Analytical Framework

The following illustrates Blackstone's framework for preparing analyses relevant to the statutory criteria.

Standard	Blackstone's Approach	Methodologies Utilized
1) Satisfy license requirements	▸ Analyzed the relevant capital, surplus and net worth requirements for each of the domestic insurers involved for issuance of a license	▸ Compared capital, surplus and net worth requirements, as appropriate, based on type of company to the actual capital and surplus of each of the relevant domestic insurers
2) Not substantially lessen competition or tend to create a monopoly	▸ The PID, through its counsel, Blank Rome LLP, has engaged Compass Lexecon, a consulting firm specializing in antitrust economics and applied microeconomics, to assess the competitive effects of the proposed Transaction	▸ Blackstone refers to the report of Margaret Guerin Calvert, of Compass Lexecon, dated April 8, 2013 for conclusions regarding potential anti-competitive effects of the Transaction
3) Not jeopardize financial stability or prejudice the interest of Highmark policyholders	▸ Analyzed the expected financial condition of UPE, which will assume control of Highmark, at the time of the proposed Transaction ▸ The expected financial condition of UPE taking into account its anticipated affiliation with WPAHS and other IDN-related entities, which is expected to occur subsequent to the change of control, and other provider initiatives, is relevant to Standard "4"	▸ Reviewed UPE's expected balance sheet and capital position at the time of the proposed change of control
4) Any Highmark plans or proposals are not unfair and unreasonable to Highmark policyholders and not in the public interest	▸ Analyzed the proposed benefits of the Transaction to Highmark policyholders ▸ Public interest primarily addressed in Standard "6" ▸ Blackstone also refers to the report of Margaret Guerin-Calvert, of Compass Lexecon, dated April 8, 2013	▸ Analyzed Highmark's current and projected financial condition and liquidity ▸ Analyzed WPAHS' current and projected financial condition ▸ Assessed Highmark's capital commitments to WPAHS and to the overall IDN strategy ▸ Analyzed the potential benefits to policyholders resulting from Highmark's transaction-dependent WPAHS and IDN investments
6) Not hazardous or prejudicial to the insurance buying public	▸ Assessed the manner in which the insurance market and the insurance buying public will be affected by the Transaction	▸ Reviewed input from written public comments sent to the PID, comments made at public hearings and comments made during private interviews conducted by Blackstone

Scope of Blackstone's Work

As part of its work on behalf of the PID, Blackstone has completed the following:

- Reviewed the Form A filings, as amended, submitted by UPE in connection with the proposed Transaction
- Reviewed Highmark's and WPAHS's audited GAAP financial statements for the years ended 2007 to 2011, and WPAHS management's unaudited financial statements for the year ended 2012, where applicable
- Reviewed Highmark's and WPAHS's financial projections, including multiple projection scenarios
- Reviewed materials related to the proposed Transaction submitted by UPE, UPE Provider Sub, Highmark and WPAHS
- Reviewed responses submitted by Highmark and WPAHS to the PID's requests for additional materials and information
- Attended a public information session in Pittsburgh on April 17, 2012 and reviewed respective transcripts and the responses provided by Highmark and WPAHS to questions posed by the public
- Reviewed public comments submitted to the PID by concerned parties
- Held discussions with third-party industry participants and observers who provided their perspective on the proposed Transaction and its potential impact on the health insurance and provider markets in Pennsylvania
- Held discussions with the members of management of both Highmark and WPAHS to discuss their respective businesses, operating environments, financial conditions, strategic objectives and other Transaction related subject matter
- Reviewed the report of Margaret Guerin–Calvert of Compass Lexecon, dated April 8, 2013, assessing the competitive impact of the proposed Transaction
- Reviewed such other information, performed such other studies and analyses and took into account such other matters as was deemed appropriate

Scope of Blackstone's Work (cont'd.)

As part of its work on behalf of the PID, Blackstone has not done the following:

- Independently verified the accuracy and completeness of financial and other information that is available from public sources or was provided to us by Highmark, WPAHS or their representatives or otherwise reviewed by us
- Made an independent appraisal of Highmark's and WPAHS'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
- Performed due diligence on Highmark's and WPAHS's physical properties, sales, marketing, distribution or service organizations or product markets
- Expressed any formal opinion regarding the fair value of Highmark, WPAHS, UPE or UPE Provider Sub
- Made any legal conclusions with regard to the applicable statutory criteria under 40 P.S. § 991.1402(f)(1)

II. Overview of Proposed Transaction

Blackstone

History of Highmark / WPAHS Business Relationship

Highmark's business relationship with WPAHS dates to 1996, when Highmark executed indemnity hospital agreements with the various hospitals that now comprise WPAHS.

- In 1996, Highmark executed indemnity hospital agreements with the western Pennsylvania hospitals owned by the Allegheny Health, Education and Research Foundation ("AHERF"), including Allegheny General Hospital ("AGH"), Forbes Regional Hospital ("FRH"), Allegheny Valley Hospital ("AVH"), Canonsburg Hospital ("CGH") and The Western Pennsylvania Hospital ("WPH" or "West Penn")
- In 1997, Highmark executed managed care hospital agreements with these hospitals
- In 1998, AHERF declared bankruptcy, and in 2000 its western Pennsylvania hospitals came together to form West Penn Allegheny Health System, Inc. Highmark provided the hospital system with a $125 million loan, which was subsequently repaid by WPAHS
- WPAHS has struggled financially, posting annual operating losses of ($19) million[1], ($52) million[1] and ($113)[2] million in 2010, 2011 and 2012, respectively. In 2010, this distress resulted in a restructuring of WPAHS that included a reduction of services at West Penn under what was known as the Urban Consolidation Plan. WPAHS has experienced senior management turnover as 6 CEOs have led the system since 2000
- In April 2011, Highmark's Board received a report describing WPAHS' need for a $25 million cash advance on claim payments prior to April 11, 2011, for working capital purposes of WPAHS
- In June of 2011, Highmark and WPAHS announced their intentions to enter into an agreement whereby Highmark and WPAHS would affiliate. In November 2011, Alvarez and Marsal was hired as WPAHS' interim management team
- In July 2011, Highmark's Board received a report on the corporate structure and governance for the proposed Highmark – WPAHS affiliation
- In October 2011, Highmark and WPAHS entered into an affiliation agreement (the "Affiliation Agreement") pursuant to which Highmark and WPAHS would affiliate to establish an integrated health network

(1) Per WPAHS 2010 – 2011 Audited Financial Statements.
(2) Per WPAHS 2012 Unaudited Financial Statements, which can be found at: http://www.wpahs.org/sites/default/files/file/FY2012_annual.pdf.

History of Highmark / WPAHS Business Relationship (cont'd.)

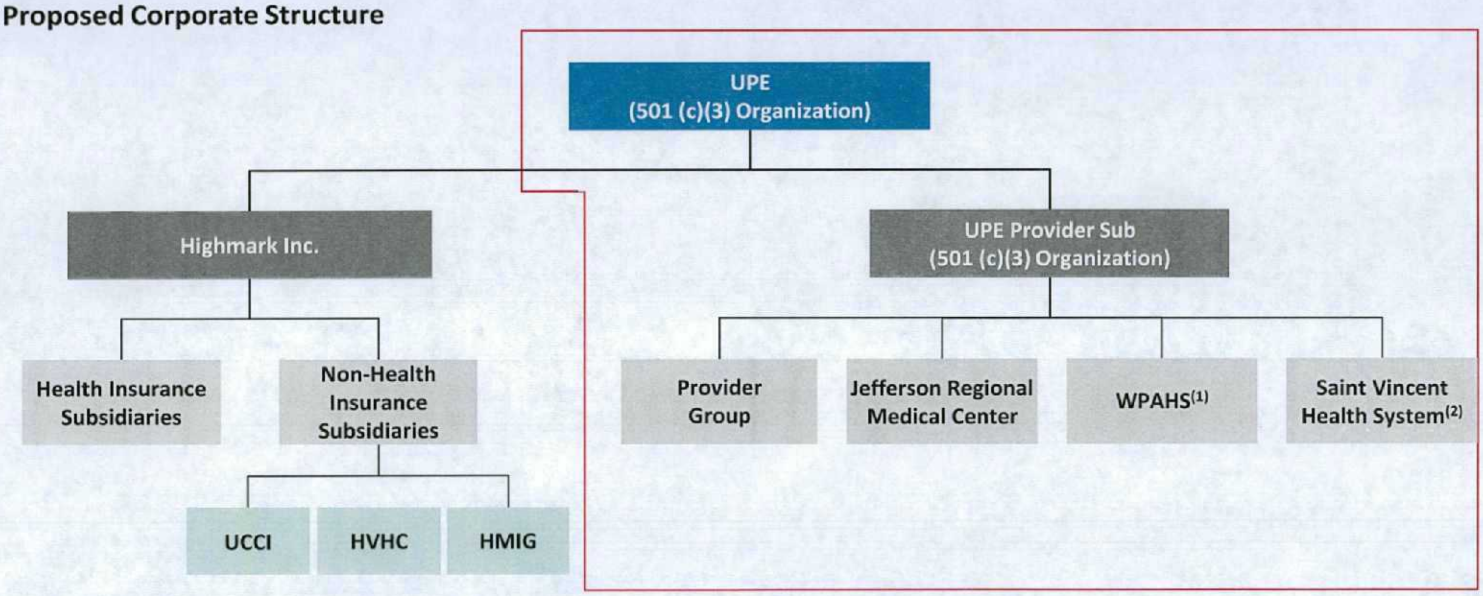
- In April 2012, Highmark authorized an unrestricted contribution of up to $8 million in 2012 to WPAHS to engage management consultants to assist it in improving its financial condition
- In May 2012, Highmark's Board approved resolutions authorizing Highmark to proceed with negotiating and executing a letter of intent regarding affiliation with Jefferson Regional Medical Center
- In July 2012, Dr. William Winkenwerder Jr. was hired as Highmark's President and CEO
- In July 2012, Hammond Hanlon Camp LLC ("H2C"), an independent investment banking and financial advisory firm, delivered a report to Highmark's Board, regarding the financial situation of WPAHS and various strategic options, including WPAHS bond debt restructuring
- In July of 2012, Highmark's Board approved a resolution stating that WPAHS must dismiss with prejudice the action captioned *West Penn Allegheny Health System, Inc. v. UPMC et al.*, Case No 2:09-00480-JFC, filed in the United States District Court for the Western District of Pennsylvania, contingent on the dismissal, with prejudice, of the action captioned *UPMC v. Highmark Inc. and West Penn Allegheny Health System, Inc.*, Case No. 2:12-CV-00692-JFC, filed in the United States District Court for the Western District of Pennsylvania
- In August 2012, Highmark and WPAHS began regular meetings to discuss a potential restructuring of WPAHS bonds
- In September 2012, WPAHS claimed that Highmark had breached the Affiliation Agreement, and announced a termination of the agreement; the subsequent litigation was resolved in favor of Highmark
- In October 2012, Highmark's Board approved resolutions authorizing Highmark to proceed with negotiating, executing and delivering an affiliation agreement with Saint Vincent Health System; the Board also agreed that Highmark management should urge WPAHS to change its position and disavow its claim of an affiliation breach by Highmark
- In January 2013, Highmark's Board approved the proposed tender offer transaction for WPAHS bonds and Highmark's intention to refinance the purchase of the Bonds acquired in the tender offer transaction with the proceeds of a subsequent tax-exempt bond issue

Overview of Affiliation Structure

Highmark and WPAHS signed an Affiliation Agreement on October 31, 2011 containing key provisions between the various entities involved.

- Parties to the Affiliation Agreement included WPAHS and Highmark
- Closing of the Affiliation Agreement subject to regulatory approvals
  - Outside date for closing is April 30, 2013 / May 31, 2013, subject to extension beyond that date with certain approvals

Proposed Corporate Structure



Source: Highmark.

(1) WPAHS' directly and indirectly owned five affiliated hospitals include Allegheny General Hospital ("AGH"), West Penn Hospital ("WPH"), Forbes Regional Hospital ("FRH"), Allegheny Valley Hospital ("AVH") and Canonsburg General Hospital ("CGH").

(2) Transaction involving Saint Vincent Health System has not closed.

Overview of UPE: Governance

UPE, the new nonprofit parent company, will hold certain reserved powers with respect to Highmark, and both UPE and UPE Provider Sub will have certain reserved powers in WPAHS.

- UPE was formed on October 20, 2011 as a non-member Pennsylvania nonprofit corporation
  - UPE was organized for scientific, educational and charitable purposes and in this connection has been recognized by the Internal Revenue Service ("IRS") as exempt from federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code
- UPE's Board of Directors will consist of at least three individuals, including the then serving CEO of UPE, who will be a director during his or her term of office
  - The directors are divided equally into three classes so that one-third of the directors are chosen each year, in addition to the CEO
  - All directors, with the exception of the then CEO, will serve terms of three years
  - All initial UPE directors will be drawn from the directors of Highmark
- At closing, the senior officers of UPE will be the same as the current senior officers of Highmark
  - William Winkenwerder Jr., President and CEO
  - Thomas VanKirk, Secretary
  - Nanette P. DeTurk, Treasurer

Source: Form A submitted on November 7, 2011.

Overview of UPE Provider Sub: Governance

UPE Provider Sub is a nonprofit entity and will be the sole corporate member of, and will have certain reserved powers in, WPAHS.

- UPE Provider Sub was formed on October 20, 2011 as a Pennsylvania nonprofit corporation, of which UPE is the sole member
    - The corporation was organized to promote, support and further the scientific, educational and charitable purposes and interests of WPAHS, Canonsburg General Hospital and Alle-Kiski Medical Center and in this connection has been recognized by the Internal Revenue Service ("IRS") as exempt from federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code
- UPE Provider Sub has one member, UPE, which has certain reserved powers with respect to UPE Provider Sub, such as electing its Board of directors and officers and approving its strategic plans and annual budgets
- The size and composition of UPE Provider Sub's Board of Directors is determined by UPE, subject to limitations
    - Upon closing of the WPAHS Affiliation Transaction, UPE will be required to elect one director designated by WPAHS
    - Under the terms of the JRMC Affiliation Transaction, an individual will be appointed by the pre-closing JRMC Board (a "Jefferson JRMC Board Appointee") to serve on the Board of Directors of UPE Provider Sub, subject to the approval and election of the UPE Board
    - Prior to four years after closing, any vacancy caused by the absence of the WPAHS director will be filled by UPE from candidates nominated by WPAHS
    - Upon closing, UPE will also elect at least one person who is also serving as a member of the board of each WPAHS subsidiary hospital
    - The directors will be divided equally into three classes so that one-third of the directors may be chosen each year
    - All directors (other than the initial directors) will serve terms of three years

Source: Form A submitted on November 7, 2011, as well as Amendment No. 2 to Form A submitted on January 18, 2013.

Overview of WPAHS: Governance

UPE and UPE Provider Sub will hold reserved powers and rights to exercise significant control over WPAHS.

- Upon closing, WPAHS will have one member, UPE Provider Sub, which will have the power to make recommendations to UPE with respect to actions on matters reserved to UPE, including, subject to limitations, determining the size and composition of WPAHS' Board of Directors, approving the appointments of all officers, approving annual budgets and dissolving, selling or merging all or a part of WPAHS
- WPAHS' Board of Directors will be elected by UPE
  - At least 25% of the WPAHS board will consist of self-perpetuating directors who are either:
    - Initial directors designated prior to closing who are community representatives and physicians affiliated with WPAHS
    - Directors chosen by the remaining self-perpetuating directors when there is a vacancy caused by the absence of a self-perpetuating director
  - The directors will be divided equally into three classes so that one-third of the directors is chosen each year
  - All directors (other than the initial directors) will serve terms of three years

Source: Form A submitted on November 7, 2011.

Summary of Affiliation Agreement

Financing and Capital Commitments

- Highmark has committed to funding $475 million to WPAHS as follows:
  - **First Funding Commitment:** $50 million unrestricted contribution made upon execution of Term Sheet (June 28, 2011)
  - **Second Funding Commitment:** $50 million unrestricted payment and $50 million loan made upon signing of the Affiliation Agreement (October 2011)
  - **Third Funding Commitment:** $50 million loan made on six-month anniversary of Affiliation Agreement (April 2012)
  - **Fourth Funding Commitment:** In connection with entering into tender agreements with certain of WPAHS' bondholders, Highmark has placed $50 million into an escrow account. If closing occurs on or before April 30,2013, or any agreed upon extension of that date, the $50 million and another $50 million from Highmark will be advanced to WPAHS at closing in the form of a loan, subject to reduction for positive cash flow. If closing does not occur by April 30, 2013, or any agreed upon extension of that date, the $50 million escrow amount is paid to WPAHS, absent certain defaults
  - **Fifth Funding Commitment:** $100 million loan (reduced by any WPAHS positive cash flow) to be made on the later of the date of closing or April 1, 2014. Not payable if parties do not close the Transaction
  - **Additional Grant of $75 Million:** Highmark will fund $75 million at the time of closing, less any advances against such amount up to $33.6 million that may be made by Highmark to WPAHS prior to the closing to pay certain of WPAHS's obligations coming due prior to the closing
- In addition to Highmark's $475 million commitment, as described above, Highmark also will provide $10 million of supplemental payments to WPAHS in each of the next five years as part of its provider rate negotiations. This increase is equivalent to the standard medical index

Source: Highmark.

Summary of Affiliation Agreement (cont'd.)

Terms for Loan Agreements

- Repayment terms for the loans associated with 50% of the Second Funding Commitment and the entire amounts of the Third, Fourth and Fifth Funding Commitments include the following:
  - 50% of the Second Funding Commitment ($50 million funded in FY2012): $25 million due in 2023; $25 million due in 2024
  - Third Funding Commitment ($50 million funded FY2012): $25 million due in 2023; $25 million due in 2024
  - Fourth Funding Commitment ($100 million to be funded in FY2013): $50 million due in 2025; $50 million due in 2026
  - Fifth Funding Commitment ($100 million to be funded in FY2014): $50 million due in 2027; $50 million due in 2028
- All loans subject to variable interest rate based on the prime rate plus 200bps (subject to a 6% cap), to be re-set annually each July 1st
- All accrued and unpaid interest on the Second Funding Commitment Loan and Third Funding Commitment is due and payable on the Effective Date of the Amendment. Interest is to be payable under the Loan Agreements annually 30 days subsequent to WPAHS's Fiscal Year end date for the Fiscal Year immediately preceding
- Interest accruing on any Loans during any Fiscal Year will be forgiven, commencing with Fiscal Year 2013, if the Fiscal Year ending calculation of the WPAHS Parties' Debt Service Coverage Ratio for such year is less than 3.0x
- Mandatory prepayment of the Loans is required if at any time WPAHS' Days Cash On Hand exceed 100 days as measured at the end of each fiscal quarter and at the end of the month immediately preceding the last month of each Fiscal Year
  - The amount of such mandatory payments will be equal to the excess cash on hand over 100 days which will be applied toward such Loans as Highmark will determine
  - No payments may be made by WPAHS on WPAHS's Floating Rate Restructuring Certificates unless and until all Loans extended by Highmark pursuant to the Funding Commitment have been paid in full

Source: Confidential Supplement Submitted with Form A on January 18, 2013.

Summary of Affiliation Agreement (cont'd.)

Governance of WPAHS Post-closing

- For a period of four years post-closing, not less than 25% of the WPAHS board is to consist of directors selected by WPAHS from community representatives and physicians affiliated with WPAHS

Representations and Warrantees, Covenants and Conditions; Termination

- Effectiveness of the Transaction is conditioned upon Highmark and WPAHS having resolved all pending litigation and dispute resolution proceedings between them, including the then pending antitrust litigation and oncology arbitration cases
- Conditions to closing include receipt of approval from various regulatory bodies including the PID, Pennsylvania Attorney General and Pennsylvania Orphans' Court, approval from BCBSA confirming that the Transaction is in compliance with all BCBSA guidelines, no pending governmental proceeding to restrain or prohibit the Transaction and determinations from the IRS that the parent entities of WPAHS are recognized as 501(c)(3) tax-exempt organizations
- In addition to certain other termination rights, either party may terminate the Affiliation Agreement if closing does not occur by April 30, 2013, unless such date is extended

Source: Highmark.

Summary of Affiliation Agreement (cont'd.)

Acceleration Rights

- WPAHS "material defaults" (referred to as "WPAHS Category 1 Material Defaults" in the Affiliation Agreement) – Generally:
  - Fraudulent or willful material misrepresentation of finances or service lines
  - Intentional interference in Highmark regulatory approvals
  - Material breach of no-shop covenant
  - Unilaterally attempting to terminate the Affiliation Agreement
  - Failure to implement corporate changes to articles and bylaws and to perform certain other obligations
- If WPAHS is in material default, upon demand from Highmark, WPAHS must pay both $100 million and the Second and Third Funding Commitments
- If Highmark is in material default, as defined in the Affiliation Agreement, that is not cured, the Third Funding Commitment is required to either be paid early as a break-up fee or will convert from a loan to a full grant if already paid at the time of such default based upon the timing of the default as provided in the Affiliation Agreement
  - WPAHS is released from certain other obligations under agreement

Termination without Closing

- If the cause of termination is a breach by WPAHS of certain reps exceeding $50 million in value, the Second Funding Loan and Third Funding Commitment remain loans and WPAHS must use best efforts to cause the loans to be secured under the master indenture at that time
- Highmark was required to deposit $50 million into escrow upon the signing of the lockup agreements with the bondholders and signing of the Amendment to the Affiliation Agreement, to secure its performance with respect of the tender offer
  - If closing does not occur by April 30, 2013, subject to any permitted extension, WPAHS may receive a release of the $50 million escrow and will have no repayment obligation with respect to the loans unless WPAHS has made a material default
- WPAHS may retain the $50 million escrow and will have no repayment obligation for the loans advanced if the Affiliation Agreement is terminated by WPAHS because Highmark advises that the terms and conditions of any approval Order are not acceptable
- In case of termination due to a certain Highmark material default, Highmark must fund the Third Funding Commitment immediately if not previously paid; if paid, it becomes a grant

Source: Highmark.

III. Summary Observations

Executive Summary

Blackstone notes the following summary observations related to its assessment of matters concerning UPE's Form A filing:

- Blackstone's financial analysis is focused on the potential impact of the Transaction on (i) Highmark's financial stability, (ii) costs and benefits to policyholders and (iii) competition and the insurance buying public
  - Based on our analysis, Blackstone has developed a set of summary conclusions regarding the three primary elements of potential impact examined and notes various types of conditions that may be appropriate were the PID to consider approval of the Form A
  - Refer to subsequent sections of this report for detailed analyses and conclusions with respect to each of these topics
- Concurrent with the proposed change of control and affiliation with WPAHS, Highmark intends to implement a broader integrated delivery network ("IDN") strategy. Highmark has described $1.834 billion of total capital commitments and spending related to its IDN Plan, of which $646 million is contingent upon Form A approval. This report will principally address the elements of Highmark's IDN strategy that are contingent upon approval of the Form A under applicable statutory requirements
- Conditions in the Western Pennsylvania ("WPA") healthcare market have evolved over a long period of time and are unlikely to be resolved solely via action related to UPE's Form A filing. Blackstone notes that the PID's ability to address market-wide issues in the WPA region, including competitive imbalances among providers and payers and employment levels at specific systems and facilities, in the context of the current Form A is limited by:
  - the PID having limited purview over non-insurance market activities and
  - over-capacity in the provider market, which may lead to capacity reductions irrespective of whether the WPAHS transaction is consummated
- Highmark has characterized nearly $680 million of payments related to its IDN Plan as business expenses that are subject to limited PID review. Many of these payments will be (or have already been) made in conjunction with the receipt of governance rights. Highmark has asserted that no PID filing is required with respect to these funds; the PID has reserved its right to further consider Highmark's assertion on this issue
- Highmark viewed its contract dispute with UPMC as a grave threat to its health insurance franchise in Western Pennsylvania and pursued the Affiliation with extreme urgency as a consequence. Although Blackstone believes that Highmark's competitive concerns were likely founded in substance, the manner in which Highmark pursued the Affiliation may have resulted in significant expenditures for which Highmark's policyholders may receive limited value in the form of tangible financial assets

Blackstone Areas of Focus

Blackstone's financial analysis is primarily focused on the potential impact of the Transaction on (i) Highmark's financial stability, (ii) potential costs and benefits to policyholders and (iii) competition and the insurance buying public.

Blackstone has been asked by the PID to assess various financial elements of the Transaction in order to assist the PID in its review of the Form A filing. The potential risks and concerns noted below and on the pages that follow are neither comprehensive nor intended to address each of the specific criteria upon which approval/disapproval of the Form A may be rendered by the PID

1) Financial Impact to Highmark:

- Identification of risks associated with Highmark's financial commitments to WPAHS and other provider capital outlays that are contingent upon the Transaction, including whether the impact of the Transaction may be to jeopardize Highmark's financial stability

2) Potential Costs and Benefits to Highmark's Policyholders:

- Comparison of (i) the potential gap in value between the amount of capital that Highmark is committing to WPAHS and other provider initiatives and the value of tangible financial assets received by Highmark in return, vs. (ii) the potential benefit received by policyholders via savings in the cost of care delivery and policy premiums

3) Competition and the Insurance Buying Public:

- The PID, through its counsel Blank Rome LLP, has engaged Margaret Guerin–Calvert, Senior Consultant of Compass Lexecon ("CL"), a consulting firm specializing in antitrust economics and applied microeconomics, to assess the competitive effects of the proposed Transaction; Blackstone participated in the review of potential effects on competition and the insurance buying public primarily by facilitating discussions with numerous industry participants in the WPA healthcare industry and working with CL in assessing certain aspects of the financial benefits that may accrue to policyholders

4) Other Analyses:

- Consideration of (i) the financial condition of UPE at the time of Transaction closing, (ii) Highmark's satisfaction of certain licensing requirements and (iii) the impact of executive compensation on Highmark's rationale for the Transaction

Scope of Transaction and PID Review

Concurrent with the proposed change of control and affiliation with WPAHS, Highmark intends to implement a broader integrated delivery network ("IDN") strategy (the "IDN Plan"). This report will principally address elements of the IDN Plan that are contingent upon approval of the Form A.

- On June 28, 2011, Highmark announced its intention to enter into an affiliation with WPAHS as part of a broader strategy to become an integrated delivery network
- In the initial public filing, dated November 7, 2011, Highmark disclosed total capital commitment of $475 million for the proposed affiliation, 100% of which was related to WPAHS
- In its first amended public filing on August 24, 2012, Highmark described additional capital commitments related to its implementation of a broader IDN strategy, including an affiliation with Jefferson Regional Medical Center ("JRMC"), bringing the total commitments to the IDN Plan to $1 billion
- In its latest amended filing on January 18, 2013, Highmark described total capital commitments related to the IDN totaling $1.8 billion, including up to $646 million for the purchase of bonds issued by WPAHS, $100 million of external financing for purposes of building medical malls and which may retain a Highmark guarantee or other credit enhancement, $33 million of grants and advances paid to WPAHS outside of the Affiliation Agreement and $55 million in potential capital grants to JRMC
- In the absence of a UPE change-of-control, various elements of the IDN Plan will be, or have already been, implemented directly under Highmark, and absent PID approval of the Form A, Highmark has stated that a UPE change-of-control will be sought without WPAHS
  - Approximately $382 million of the total planned IDN budget, including $233 million at WPAHS, was expended or invested as of 12/31/2012
  - Highmark has informed the PID of its plans to make $806 million of additional expenditures and investments related to the IDN Plan irrespective of the PID's decision with respect to the Form A, including $84 million to WPAHS, $321 million to physician practices and medical malls and $401 to community hospitals, which increases the amount of total capital that is not contingent upon the Transaction to $1.188 billion
  - Thus, of the $1.834 billion of total capital Highmark describes as part of the IDN Plan, $646 million is contingent upon Form A approval

Given the above, Blackstone's analyses and conclusions in this report are focused on the portions of Highmark's IDN Plan that are contingent upon the proposed Transaction, including the proposed UPE change of control and affiliation with WPAHS. Other elements of Highmark's IDN Plan that are not contingent upon the proposed Transaction (including the affiliation with JRMC, the proposed affiliation with SVHS and capital commitments related to medical malls and physician practices) are referenced in this report solely insofar as they may impact Highmark's plans to implement the UPE change of control and WPAHS affiliation. Analyses and conclusions regarding the appropriateness of Highmark's plans to implement portions of the IDN Plan that are not contingent upon the Form A are outside of the purview of this report, but are not necessarily outside of the PID's jurisdiction

Market Circumstances in Relation to the Form A Filing

Conditions in the Western Pennsylvania healthcare market have evolved over a long period of time and are unlikely to be resolved solely via action related to UPE's Form A filing. As such, Blackstone notes the following limitations regarding the impact of the PID's review of the Form A filing:

Challenges in The Western Pennsylvania Healthcare Market:

- The provider and payer markets in Western Pennsylvania are both highly concentrated, with challenging circumstances in these markets that have evolved over a long period of time and that are unlikely to be fully addressed by the outcome of the WPAHS transaction alone; the PID has limited authority over non-insurance activities in healthcare markets and cannot be expected to resolve market-wide imbalances in Western Pennsylvania via its decision on WPAHS

Blackstone is not in a position to conclude as to whether the circumstances in the Western Pennsylvania healthcare market are a result of actions taken by Highmark or others, but notes that Ms. Guerin–Calvert of Compass Lexecon, the PID's economic consultant, addresses various of the factors that are impacting the cost and delivery of health insurance and care in the region in her report to the PID dated April 8, 2013

Future of WPAHS:

- Highmark has stated that up to 11,000 jobs may be at risk if the Transaction is not approved; as Ms. Guerin–Calvert of Compass Lexecon noted in her report to the PID, however, the region has significant overcapacity and rationalization of facilities and employment may occur regardless of the Transaction outcome
  - "The Pittsburgh Metropolitan Statistical Area (MSA) has among the highest rates of beds per population for MSAs with more than two million residents. For every thousand inhabitants of the Pittsburgh MSA, there are 3.12 hospital beds. The national average is 2.6 beds-per-thousand. For cities with more than two million residents, the average is 2.24 bed-per-thousand and the median is 2.15.....With or without the Affiliation, there will likely be substantial change and re-alignment of capacity, including downsizing, mergers, or closing of facilities"*

Although termination of the proposed Highmark-WPAHS affiliation would likely cause a high degree of near-term uncertainty and potential dislocation of employment at WPAHS facilities, a rationalization of healthcare capacity and employment in Western Pennsylvania may occur irrespective of the proposed Affiliation. Blackstone has therefore not specifically assessed changes in WPAHS employment as a potential community benefit rationale for the Transaction, but has instead, together with Ms. Guerin-Calvert of Compass Lexecon, focused on potential benefits to policyholders and the insurance buying public that may accrue via enhanced provider choice and cost savings resulting from the Transaction

*Source: *Economic Analysis of Highmark's Affiliation with WPAHS and Implementation of an Integrated Healthcare Delivery System*, Margaret E. Guerin-Calvert, April 8, 2013.

Highmark's Unrestricted Grants

Whereas the degree of PID oversight with respect to Highmark's ordinary investment portfolio generally increases with the degree of risk and size of the related investment, Highmark asserts that there is a decreased level of oversight with respect to unrestricted grants given to other charitable organizations; Highmark characterizes these grants as business expenses that are subject to very limited PID review even though they have been made in conjunction with the receipt of certain governance rights with respect to the recipients of the grants.

Highmark Expenditures Subject to PID Review:

- Highmark has informed the PID of its intent to spend $680 million cumulatively in connection with the IDN Plan in the form of unrestricted payments, including $208 million related to WPAHS; Highmark asserts that these expenditures can be made without filing with the PID and will be completed irrespective of the PID's approval/disapproval of the WPAHS affiliation
- If the PID disapproves the Affiliation, over $167 million of grants will already have been made to WPAHS[1][2], in addition to commitments of $175 million to JRMC[3], $35 million to SVHS and $262 million to various other provider initiatives, totaling $639 million in a no-transaction scenario
- Thus, only $41 million[2] of total IDN related unrestricted payments are contingent upon the PID's approval of the Form A, although the total expenditures may still fall under the PID's jurisdiction given its general authority to regulate the surplus of Pennsylvania-domiciled Hospitals and Professional Health Service Plans

As per the above, Blackstone notes that Highmark has already spent, or has committed to spend, $639 million that it asserts is subject to very limited PID review and is not contingent upon PID approval; if the Transaction is approved, the PID may wish to consider conditions that may limit the amount of unrestricted payments that Highmark may commit in the future without PID review

(1) Includes $25 million cash advance paid to WPAHS for WPH and AGH on 4/18/2011 and $8 million unrestricted payment to WPAHS for fees to A&M paid on 4/18/2012.
(2) Excludes $50 million escrow payment made by Highmark related to its tender offer for certain WPAHS bonds, which, if the Transaction is not consummated, will be released to WPAHS.
(3) $175 million includes $75 million unrestricted payment to JRMC, as well as the maximum potential capital expenditures commitment of $100 million to JRMC, of which Highmark projects $45 million will be funded.

Highmark's Approach to the Transaction

Highmark viewed its contract dispute with UPMC as a grave threat to its health insurance franchise in Western Pennsylvania and pursued the Affiliation with extreme urgency as a consequence. Although Blackstone believes that Highmark's competitive concerns were likely founded in substance, the manner in which Highmark pursued the Affiliation may have resulted in significant expenditures for which Highmark's policyholders may receive limited value in the form of tangible financial assets.

Highmark considered speed and control to be critical in its execution of the Agreement due to (i) the deteriorating contract dispute with UPMC, (ii) the rapid decline of WPAHS' financial condition, (iii) the potential for accelerated physician losses at WPAHS and (iv) the possibility that Highmark could find itself without either a UPMC contract or WPAHS to serve as the foundation of its provider strategy

- As a result of the urgency with which Highmark pursued the Affiliation, the depth of Highmark's pre-signing assessment of the proposed Transaction may have been more limited, in certain respects, than would typically be expected for a transaction of this magnitude
  - Limited explicit consideration of the level of potential cost at which the transaction would cease to be acceptable
  - No evidence of a valuation review for the assets to be received in exchange for capital granted to, and invested in, WPAHS
  - Limited downside analysis of potential transaction outcomes at WPAHS and optimistic patient volume projections
  - Limited consideration of unsecured creditor positions in the event of a post-signing WPAHS bond covenant default or restructuring
  - No economic study of the market-wide competitive impact of the Transaction
- Highmark has stated that there were unlikely to be other buyers for WPAHS, but performed only a limited search for alternative partners prior to signing the Agreement in 2011, and refused to allow WPAHS to conduct a market test in connection with the bond restructuring in late 2012
- In exchange for financial terms that were deemed by WPAHS' financial advisors to be highly favorable to the hospital system, Highmark received limited contractual flexibility in the Affiliation Agreement to respond to certain adverse changes in WPAHS' financial profile, including bond covenants defaults, between signing and closing of the Transaction
- In order to expedite execution of the Agreement and maximize control of WPAHS, Highmark chose not to pursue a restructuring of WPAHS debts prior to signing, and thus appears to have ceded considerable leverage to WPAHS bondholders in subsequent restructuring negotiations
  - $233 million of cash injected into WPAHS by Highmark since signing the Agreement is now, at least in part, supporting the value of the bonds that Highmark is seeking to purchase, amounting to a transfer of funds from Highmark to the bondholders for which Highmark may receive little tangible value in return
  - In connection with the agreement reached between Highmark and WPAHS bondholders in early 2013, Highmark accepted provisions calling for financial penalties to be paid by Highmark based upon failure to meet an aggressive timetable for closing of the Transaction

Blackstone notes that if the PID were to approve the Transaction, conditions limiting the amount of future capital that Highmark may commit to non-insurance initiatives, and specifying the standard of review that must be undertaken prior to Highmark entering into agreements to commit such capital, may help to address the possibility of similar circumstances arising in the future