

**REQUEST FOR APPROVAL  
of a  
Transaction Pursuant to Condition 11  
of the  
Approving Determination and Order  
Issued by the Commissioner  
Dated  
April 29, 2013  
Order No. ID-RC-13-06**

**RECEIVED**  
Corporate & Financial Regulation  
MAY 07 2014  
Pennsylvania  
Insurance Department

**Filed with the  
Insurance Department of the Commonwealth of Pennsylvania  
on behalf of**

**Highmark Inc.**  
120 Fifth Avenue  
Fifth Avenue Place  
Pittsburgh, PA 15222

**NAIC Group Code: 00812  
NAIC Company Code: 54771  
State of Domicile: Pennsylvania**

**May 7, 2014**

**Name, title, address, telephone number, and fax number of the individual to whom  
notices and correspondence concerning this Request for Approval should be  
addressed:**

**Edward A. Bittner, Jr., Esquire**  
120 Fifth Avenue  
Pittsburgh, PA 15222  
(412) 544-8529  
Facsimile (412) 544-4203  
[ed.bittner@highmarkhealth.org](mailto:ed.bittner@highmarkhealth.org)

**Diana E. Leech, Esquire**  
120 Fifth Avenue  
Pittsburgh, PA 15222  
(412) 544-7551  
Facsimile (412) 544-4203  
[diana.leech@highmarkhealth.org](mailto:diana.leech@highmarkhealth.org)

**Jack M. Stover, Esquire**  
Buchanan Ingersoll & Rooney PC  
409 N. Second Street, Suite 500  
Harrisburg, PA 17101  
(717) 237-4837  
Facsimile (717) 233-8052  
[jack.stover@bipc.com](mailto:jack.stover@bipc.com)

**ITEM 1:      IDENTITY OF PARTIES TO TRANSACTION**

- (A)    Highmark Inc. (“Highmark”)
- (B)    1800 Center Street  
Camp Hill, PA 17011
- (C)    120 Fifth Avenue  
Pittsburgh, PA 15222
- (D)    Pennsylvania nonprofit corporation
- (E)    Maintaining and operating a nonprofit hospital plan and a professional health service plan
- (F)    Highmark, a Pennsylvania nonprofit corporation, is organized on a non-stock membership basis and has no voting securities. Highmark Health is the sole member of Highmark.
- (G)    Highmark Health (see below for description of transaction)

**ITEM 2:      A.      BACKGROUND INFORMATION WITH RESPECT TO THE TRANSACTION**

Condition 11(C) of Commissioner Consedine’s Approving Determination and Order (the “Order”) provides as follows:

**Transactions Requiring Department Approval.** Without the Approval of the Department, no Domestic Insurer shall make or agree, directly or indirectly, to make any Financial Commitment if:

- (i) the amount thereof, together with all other Financial Commitments made or agreed to be made directly or indirectly by all of the Domestic Insurers within the immediately preceding consecutive twelve (12) months, equals or exceeds \$250,000,000;
- (ii) the amount thereof is made in connection with a Financial Commitment made or agreed to be made to a Person (including but not limited to any Affiliates), together with all other Financial Commitments between or among one or more of the UPE Entities, on the one hand, and such Person (including but not limited to any Affiliates), on the other hand, aggregate \$250,000,000 or more; or
- (iii) the RBC Rating of Highmark is, or as a result of the Financial Commitment is likely to be, 525% or below.

Appendix 1 of the Order defines Financial Commitment as follows:

“Financial Commitment” means any direct or indirect payment or transfer of any cash or other property, any Donation, provision of services, encumbrance upon or granting of any security interest in or to any assets or properties, or the direct or indirect guaranty or incurrence of any contractual obligation or liability. The term “Financial Commitment” includes, but is not limited to, the acquisition of any assets or properties of or interests in, the merger, consolidation or affiliation with, or the entering into of any financial or contractual relationship with, any Person, except for: (i) any Financial Commitment made in the ordinary and usual course of the UPE Entity’s business; or (ii) any amounts expressly required to be paid without any further consent of any Person and pursuant to the current provisions of the Affiliation Agreement, JRMC Affiliation Agreement and/or any affiliation agreement between Highmark and SVHS acceptable to the Department. Without limiting the generality of the foregoing, (i) until June 30, 2017, a Financial Commitment shall include but is not limited to (A) any advance payment by a Domestic Insurer to a WPAHS Entity pursuant to or in connection with a contract or arrangement for the payment or reimbursement for Health Care Services; or (B) an increase in contractual rates pursuant to or in connection with a contract or arrangement for the payment or reimbursement for Health Care Services between or among any Domestic Insurer and any WPAHS Entity in excess of the level of increase set forth in the Base Case Financial Projections; and (ii) in no event shall any Financial Commitment relating to the acquisition of any assets or properties of or interests in, the merger, consolidation or affiliation with, or any Donation to or investment in, any Person in connection with the IDN Strategy, as it may be renamed, modified or replaced, be considered to be in the ordinary course of business.

This Request for Approval is submitted pursuant to Condition 11(C) of the Order.

**B. DESCRIPTION OF THE TRANSACTION**

**1. The Transaction**

Highmark entered into an Affiliation Agreement (the “Affiliation Agreement”) dated as of October 31, 2011, as amended as of January 22, 2013, together with UPE, a Pennsylvania nonprofit corporation, now known as Highmark Health, and UPE Provider Sub, a Pennsylvania nonprofit corporation, now known as Allegheny Health Network (the “UPE Parties”), and West Penn Allegheny Health System, Inc. (“WPAHS”), Canonsburg General Hospital, Alle-Kiski Medical Center and other WPAHS affiliates (the “WPAHS Parties”) pursuant to which the UPE Parties and the

WPAHS Parties agreed to enter into an affiliation transaction that formed an integrated health care financing and delivery system that now operates in Western Pennsylvania. The affiliation transaction was consummated on April 29, 2013.

Prior to the affiliation, the Allegheny County Hospital Development Authority (the "Authority") had issued \$752,370,000 Health System Revenue Bonds (West Penn Allegheny Health System), Series 2007A (the "2007A Bonds"). The proceeds of the 2007A Bonds were loaned by the Authority to WPAHS.

Highmark requested and received approval from the Department for the change of control permitting the affiliation to be consummated and a tender offer for the outstanding WPAHS Series 2007A bonds (the par amount outstanding of which at that time was \$709,685,000).

In conjunction with the affiliation and as contemplated by the Affiliation Agreement, as amended, Highmark acquired on the effective date of the affiliation \$604,170,000 (85.13%) of the aggregate principal amount of the 2007A Bonds outstanding pursuant to a tender offer to existing holders (the "Tendered Bonds"). The purchase price was 87.5% of the par amount of the 2007A Bonds, plus accrued and unpaid interest to the tender date. Highmark financed the purchase of the Tendered Bonds with proceeds of a loan from a commercial bank (the "Bank").

Subsequent to the purchase of the Tendered Bonds, Highmark purchased an additional \$59,735,000 of 2007A Bonds at a purchase price of 87.5% of the par amount, plus accrued and unpaid interest (collectively, with the Tendered Bonds, the "Highmark Bonds"). As a result, Highmark currently holds \$663,905,000 par amount of the WPAHS 2007A Bonds.

There are currently \$34,215,000 in outstanding 2007A Bonds that are held by third-party bondholders (the "Non Tendered Bonds").

As described more fully below, WPAHS and Highmark have investigated various options to refund or refinance the 2007A Bonds in order to achieve interest rate savings for WPAHS and to improve the quality of Highmark's investment portfolio and reduce its financial leverage.

As a result of this investigation, WPAHS and Highmark have determined that their preferred option is for WPAHS to obtain a syndicated bank Term Loan in the amount of \$700,000,000, as more fully described below. Among other uses described herein,

proceeds of the Term Loan may be used by WPAHS to redeem or repurchase the Highmark Bonds and to defease the Non-Tendered Bonds. Highmark will use the proceeds received by it to satisfy all of its obligations to the Bank with respect to the currently outstanding term loan.

The annual net pre-tax impact on Highmark's investment earnings associated with the redemption of the Highmark Bonds, considering interest foregone on the Highmark Bonds and net of the cost of borrowings used to purchase the Highmark Bonds, is approximately \$32.1 million.

WPAHS's obligations with respect to the Term Loan will be guaranteed by Highmark and secured by a pledge of cash and/or securities held by Highmark. WPAHS is also considering hedging interest rate risk on the Term Loan (via a simple interest rate swap agreement). Highmark's exposure on its guarantee will be secured by WPAHS with the same assets that currently secure the 2007A Bonds and the assets that currently secure certain loans that Highmark previously made to WPAHS pursuant to the affiliation.

### **TERM LOAN**

General. Following is a summary of the term sheet for the Term Loan.

Parties. WPAHS, as Credit Group Representative on behalf of itself and each Member of the Obligated Group (collectively, the "Borrower"), Highmark, as Guarantor, and various Lenders.

Closing Date. May 1, 2014, or as promptly thereafter as practicable following receipt of Department approval (the "Closing Date").

Maturity Date. Five (5) years from the Closing Date.

Interest Rate. The Term Loan shall bear interest, at the Borrower's option, at a rate based on LIBOR or the Base Rate, plus a margin.

Guaranty. Borrower's obligations to the Lenders in connection with the Term Loan will be secured by a guaranty from Highmark to the Lenders.

Borrower Collateral. A lien on Gross Revenues and the Mortgaged Property pursuant to the Master Trust Indenture dated as of May 1, 2007, as amended, and the Mortgages, respectively.

Guarantor Collateral. Highmark's obligations under the Guaranty will be secured by a pledge of cash and/or securities with an

aggregate Maintenance Value of not less than 100% of the outstanding Term Loan borrowings.

Borrower and Guarantor Covenants: Certain financial covenants that will be set forth in the definitive agreements.

Use of Proceeds. The proceeds of the Term Loan may be used by WPAHS (a) to refund, at Highmark's cost, the Highmark Bonds (approximately \$581M), (b) to pay accrued interest on the Highmark Bonds (approximately \$33.16M), (c) to defease the Non-Tendered Bonds, (d) to pay transaction costs, and (e) for operational needs such as debt restructuring and/or capital projects.

## **2. EFFECTIVE DATE OF THE TRANSACTION**

The proposed effective date of the transaction is May 9, 2014, or as promptly thereafter as practicable following receipt of Department approval.

## **3. ADDITIONAL INFORMATION**

WPAHS and Highmark independently support the current refunding of the Highmark Bonds. WPAHS supports the refunding to achieve interest rate savings, thus resulting in a financially stronger health system that can benefit its stakeholders and the community. Projections prepared in anticipation of the proposed refinancing demonstrate that the refinancing will result in the following financial impacts on WPAHS:

- Estimated annual interest savings of \$16-\$19 million.
- Provide funding for repayment of approximately \$33 million of accrued interest due to Highmark.
- Generate additional funds for operational needs such as debt restructuring and/or capital projects within WPAHS.
- Provide an extended period of time, from July 2015 to May 2018, for WPAHS to restructure its operations and be in a position to refinance its existing debt on its own.

Highmark is in favor of the refunding because the transaction will improve the quality of its investment portfolio and reduce its financial leverage. Projected impacts for Highmark are as follows:

- Reduce the amount of non-investment grade investments by approximately \$581 million.

- Reduce Highmark's debt and related debt service obligations as a result of repayment of the Bank term loan.
- Increase Highmark's risk-based capital position.
- Improve the average quality rating of the Highmark fixed income investment portfolio from the current Baa1 to Aa3 after the 2007A Bonds are removed from its portfolio.
- Enhanced reputation in the market and community from a stronger WPAHS network, increasing Highmark's ability to retain membership and attract customers to Highmark's Community Blue product, which is a lower cost market alternative.

The value of the Highmark guarantee is estimated to be approximately \$100 million.<sup>1</sup> In valuing the guarantee, consideration was given to the cost of existing WPAHS debt and the market interest rates for comparable debt in relation to the cost of funding under the proposed term loan, along with the value of similar credit enhancements.

In addition, the guarantee calculation considers the estimated benefit Highmark will receive from the improved financial performance of WPAHS during the period of the Term Loan. It is anticipated that this benefit would be a basis for Highmark to reduce the amount of the guarantee liability recorded on its financial statements.

The refinancing should result in a financially stronger WPAHS since the Term Loan will lower the amount of future debt service of WPAHS, enabling stronger future cash flows. A financially stronger WPAHS results in a stronger affiliate of Highmark and may speed the repayment of other loans made to WPAHS by Highmark. WPAHS is the cornerstone of Allegheny Health Network, which includes the quaternary care provider that is at the heart of the select network underlying Highmark's Community Blue product.

As noted above, Highmark and WPAHS considered various financing structures prior to determining that the Term Loan represented their preferred option. The parties evaluated each option against the likelihood of allowing them to obtain the desired benefits while minimizing or reducing execution or other risks.

---

<sup>1</sup> The calculation of the value of the guarantee is in the process of being finalized by advisors for Highmark and may vary from this amount.

Various tax-exempt and taxable structures were considered and multiple financial institutions and advisors were involved in discussions. Consideration was given to debt service savings, structure, pricing and fees, tax status, and preservation of the ability to do future tax-exempt financing, ability to execute a transaction in a timely manner, financial flexibility, risk tolerance, restrictions, and ability of any counterparties to perform.

On February 26, 2014, the Board of Directors of Highmark and Highmark Health, the ultimate parent company of WPAHS, were presented with the Term Loan proposal, including the transaction background, the refinancing objectives, a recommendation to pursue a cash-secured taxable bank facility, and next steps.

On April 24, 2014, the appropriate committees of the Boards of Directors of Highmark and Highmark Health reviewed the Term Loan proposal, including the term sheet for the Term Loan, and approved the refinancing on the terms set forth therein.

**ITEM 3: SIGNATURE AND CERTIFICATION**

Highmark has caused this Request for Approval to be duly signed on its behalf in the City of Pittsburgh and Commonwealth of Pennsylvania on the 7<sup>th</sup> day of March, 2014.

(SEAL)

**HIGHMARK INC.**

By: Nanette P DeTurk Title: Treasurer

Attest:

By: Thomas Wankel Title: Secretary

**CERTIFICATION**

The undersigned deposes and says that he/she has duly executed the attached application dated May 7, 2014 for and on behalf of Highmark Inc.; that he/she is the Treasurer of such company; and that he/she is authorized to execute and file such instrument. Deponent further says that he/she is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his/her knowledge, information and belief.

Signature: Nanette P DeTurk  
Typed Name: Nanette P. DeTurk