Historically, For-Profits Have Continued to Contribute to Their Communities

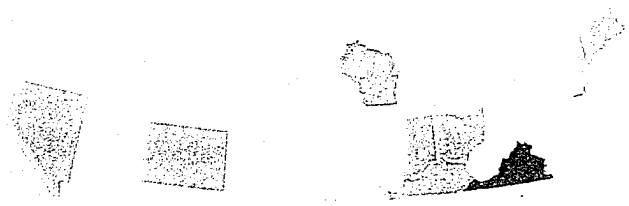
Even with a conversion to a for-profit status, CareFirst could continue to contribute to the community. WellPoint's actions in other states suggest WellPoint believes continued support for the community is positive for business. Both Blue Cross of California and Blue Cross Blue Shield of Georgia have continued contributing to the community. In each of these plans, charitable giving increased post-conversion[A.13].

The Number of Uninsured has been Decreasing

Although it may be due to a combination of factors, the overall percentage of uninsured citizens has decreased faster than the national average since 1998 in both California and Georgia where Blue conversions involving WellPoint have occurred and foundations have been established[A.14]. Although the evidence is not conclusive, it supports the theory that availability, accessibility and affordability have not been adversely impacted as a result of the conversions in California and Georgia.

Trend in Uninsured Population in States with Converted Blue Health Plan*

	CAGR** '95-'97	CAGR** '98-'00	Current Uninsured
National	+2.2%	-3.4%	14.0%
Anthem			
Colorado	+1.0%	-1.5%	*13.3%*
Connecticut	+16.8%	-11.7%	*8.5%*
Indiana	-4.9%	-3.2%	*11.9%*
Kentucky	+1.4%	-0.8%	*13.0%*
Maine	+5.1%	+0.4%	*11.8%*
Nevada	-3.3%	-7.9%	*15.7%*
New Hampshire	+8.6%	-16.7%	*6.8%*
Ohio	-1.7%	+6.1%	*10.8%*
Cobalt			
Wisconsin	+4.7%	-16.0%	*7.4%*
Trigon			
Virginia	-3.4%	-1.2%	*12.7%*
WellPoint			
California	+2.2%	-6.6%	*17.9%*
Georgia	-0.8%	-6.0%	*14.4%*
Missouri	-7.1%	+8.3%	*10.8%*



* BCBS health plans in thirteen states converted to for-profit status prior to 2000 and are now operating as Anthem, Cobalt, Trigon and WellPoint. Although Anthem has announced its intent to acquire BCBS of Kansas, this state was excluded from our analysis because BCBS of Kansas has not yet completed its conversion. RightCHOICE/BCBS MO was placed with other WellPoint plans since WellPoint and RightCHOICE have announced intent to merge.

** The U.S. Census Bureau added a "verification" question to its 2000 survey which produced a lower and more accurate estimate of the uninsured. Only 1998 and 1999 survey results have been modified. A trend can not be drawn between uninsured rates reported prior to 1998.

Source: U.S. Census Bureau, *Current Population Reports – Health Insurance Coverage: 2000*, September 2001; U.S. Census Bureau, *Current Population Reports – Health Insurance Coverage: 1997*, September 1998.

B. Competition –

Would the transaction be likely to give CareFirst additional market power that could affect availability, accessibility, and affordability?

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CareFirst will not gain additional market power of significance in this transaction.

The health care market in the Mid-Atlantic region is highly competitive. According to InterStudy, there are 54 companies that provide HMO or PPO health care services in the states of Maryland and Delaware and Washington, D.C.[B.1] In its Mid-Atlantic service area, CareFirst provides medical coverage[B.2] to 2.5 million members. WellPoint's UNICARE subsidiary will add approximately 53,000 members to CareFirst's Mid-Atlantic service area, thereby increasing CareFirst's overall market share, measured by members, by less than one percent[B.3]. Per jurisdiction, market share increases are 0.1% for Blue Cross Blue Shield of Delaware, 0.6% for Blue Cross Blue Shield of Maryland, and 1.1% for Blue Cross Blue Shield of the National Capital Area. This, combined with the fact that in the past few years the combined market share of CareFirst's three largest competitors in the region appears to be increasing (the market share of CareFirst's three largest competitors increased from 22% to 37% from 1995 to 2000[B.4]), makes it unlikely that CareFirst's market power would increase. As a result, CareFirst's ability to impact the availability, accessibility, and affordability of health care due to increased market power likely would not change to any significant degree.

C. Availability and Accessibility of Doctors and Hospitals –

Would CareFirst's doctor and hospital networks or the overall supply of doctors and hospitals in CareFirst's jurisdictions be impacted?

If CareFirst's conversion follows trends from other for-profit conversions, it is likely that CareFirst's networks would at least remain at their present level and could increase in overall size. WellPoint indicates that it would support expansion of CareFirst's networks. In addition, it is unlikely that the overall supply of doctors and hospitals in Maryland, Delaware, and Washington, D.C. would be affected by this transaction.

Physician and Hospital Networks at Converted Blues Plans Have Increased

The number of primary care physician, specialty physician and hospital contracts in the networks of Blue Cross of California (BCC) and Blue Cross Blue Shield of Georgia (BCBS GA) increased since each plan's conversion/merger[C.1, C.2]. The health plans appear to be *expanding* availability, not adversely affecting it. For Blue Cross Blue Shield of Georgia, the number of physician and hospital contracts has increased steadily since 1992, rising uninterrupted through the conversion and merger with WellPoint:

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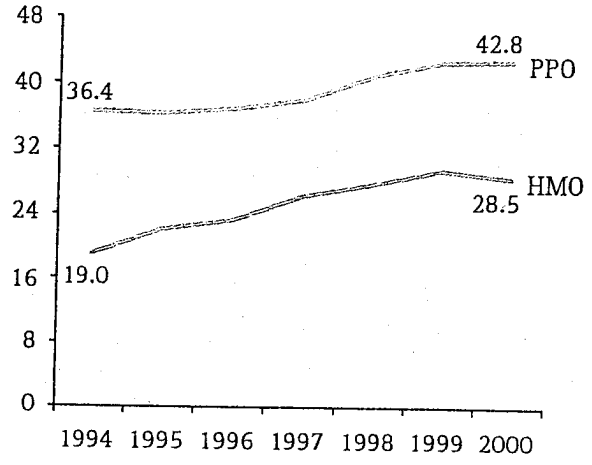
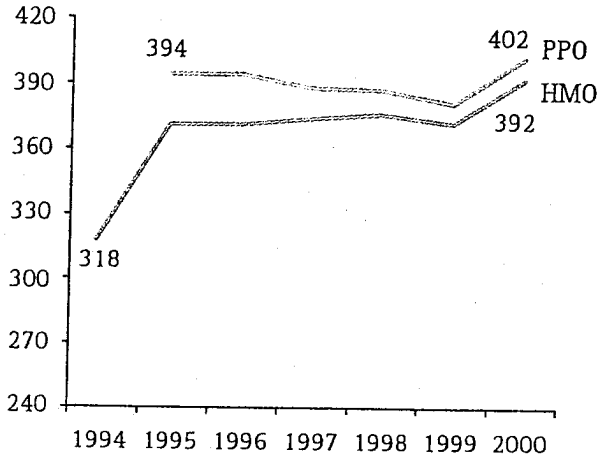
BCC – Physician Contracts*
(1994–2000, Contracts in 000's)

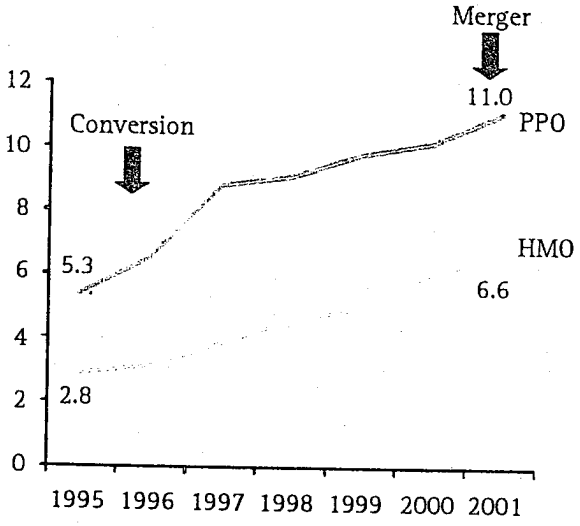


BCC – Hospital Contracts*
(1994–2000)

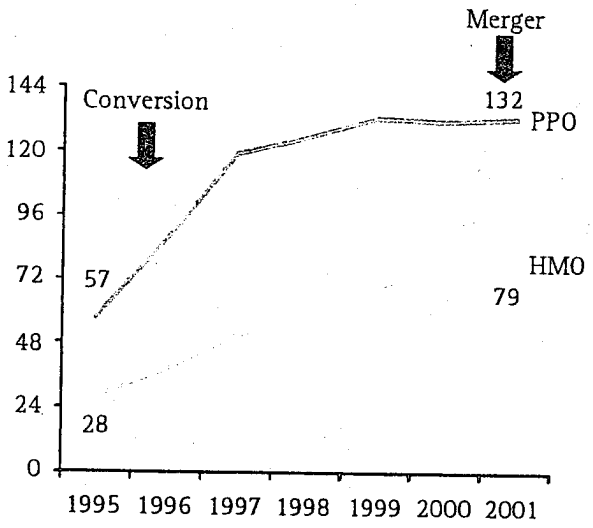


* Contract counts are as of December 31 of each year.
Source: WellPoint internal contracting data.

BCBS GA – Physician Contracts*
(1995–2001, Contracts in 000's)



BCBS GA – Hospital Contracts*
(1995–2001)



* Contract counts are as of March 31 of each year.
Source: BCBS GA internal contracting data.

To the extent CareFirst's experience is similar, the availability of physicians in CareFirst's service area would be positively affected.

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Physician Supply Does Not Appear to be Correlated With Conversion of Blues Plans

The American Medical Association publishes annual tracking reports on physician statistics. Its latest data shows a cumulative annual growth rate in the number of physicians per 100,000 residents to be 2.3% nationally over the period 1994 - 2000[c,3]. Looking at trends for this measure across states, we see:

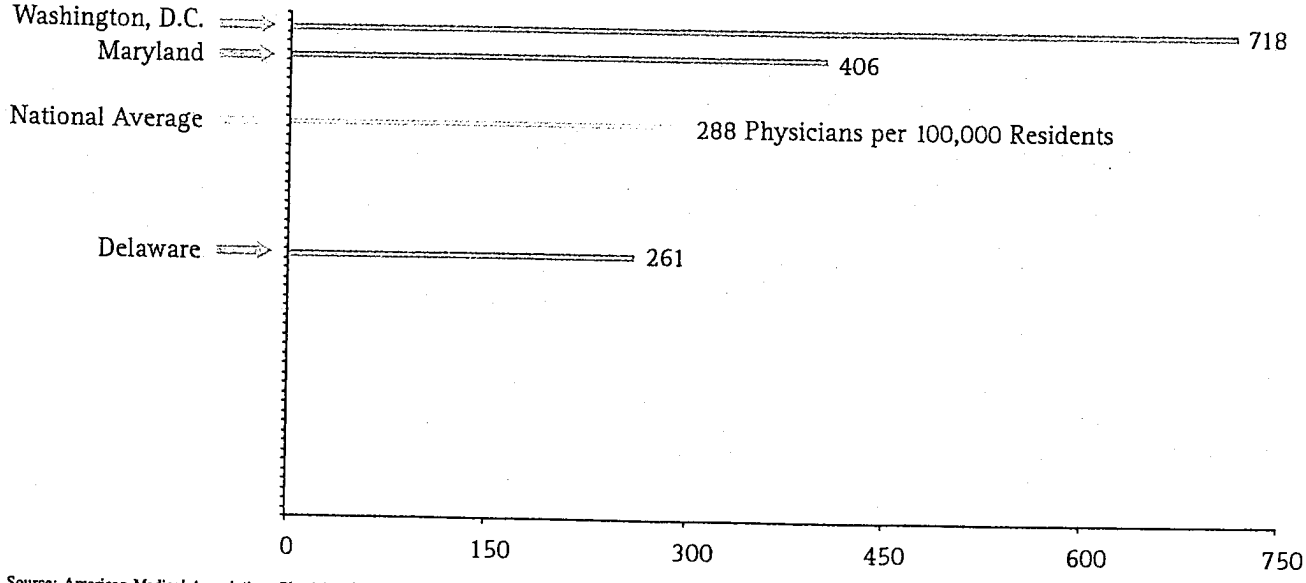
- For states where the local Blues plan has converted to for-profit status:
  - Five states (IN, KY, ME, NV, NH) grew at or above the 2.3% national growth
  - Four states (GA, OH, VA, WI) grew at a slightly slower pace of between 2.0% and 2.3%
  - Four states (CA, CO, CT, MO) grew at a rate of less than 2.0%
- Of the remaining thirty-seven states and Washington, D.C. where no conversions to for-profit have occurred, more than half grew at a rate of 2.3% or lower.

Of course, changes in either the number of physicians in each state, or the state's population would affect this measure. As a result, it is difficult to draw many firm conclusions regarding the physician supply from these statistics. We can conclude that the number of physicians nationally and in certain states is growing at a faster rate than the population. However, we can find no obvious correlation between the conversion of Blues plans and changes in physician supply.

Maryland, Delaware and Washington, D.C. Appear to Have a Good Supply of Physicians

Each of Maryland, Delaware and Washington, D.C., experienced a physician-to-population ratio growth rate of less than 2.0% from 1994 to 2000. However, the supply of physicians within Maryland and Washington, D.C. appear to be quite high relative to national averages. In 2000, the number of physicians for every 100,000 residents was 406 in Maryland and 718 in Washington, D.C. These ratios exceed the national average of 288 by approximately 40% for Maryland and 250% for Washington, D.C. Delaware, which had 261 physicians for every 100,000 residents in 2000, is 9.4% below the national average.

Physician-to-Population Ratio
(Physicians per 100,000 Residents, 2000)



Source: American Medical Association, *Physician Characteristics and Distribution in the U.S.*, 2002 edition.

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CareFirst's Contracting Strength with Physicians Unlikely to Change

Because it is unlikely that CareFirst would gain significant additional market share under the proposed transaction, CareFirst's negotiating power vis-à-vis physicians and hospitals is unlikely to change. Therefore, its ability to impose reductions in network size would not be affected.

Due to the way medical care and its financing has evolved, where a balance must be arrived at between managing affordability while supporting access to care, an economic tension has developed between doctors and health plans. The intensity of this economic tension varies from geography to geography and from situation to situation. In California, Blue Cross of California's relationship with doctors appears to have been strained. It appears that WellPoint is acting to address this. During a call with equity analysts after the announced WellPoint-RightCHOICE merger, WellPoint CEO Leonard Schaeffer specifically mentioned RightCHOICE's strong physician relationships, and stated WellPoint's intention to use RightCHOICE's physician best practices to improve physician satisfaction in other WellPoint regions[C.4]. WellPoint also hired a new Chief Medical Officer in August 2000[C.5]. Executives at Blue Cross Blue Shield of Georgia have stated to us that they believe that the merger with WellPoint has led to no substantive changes in provider contracting or network management policies or operations--despite initial community fears to the contrary.

The situational variability suggests the nature of the doctor/health plan relationship may depend more on the local practices and policies, and the local perspectives of physicians and health plans, than on health plan corporate form (i.e., non-profit or for-profit) or health plan scale. As the size and scope of a health plan's doctor and hospital networks are key customer purchase criteria, CareFirst and WellPoint have an incentive to expand their networks, not reduce them.

Hospitals are Likely to Maintain Contracting Strength in the Mid-Atlantic Region

The Maryland Health Services Cost Review Commission (HSCRC) establishes inpatient hospital payment rates paid by health plans[C.6]. This rate setting mechanism provides financial stability and leverage for the hospitals in hospital contract negotiations with health plans. Because the HSCRC establishes rates based on hospital costs, Maryland hospitals are protected against third party payors, such as CareFirst or WellPoint, using their market position to negotiate favorable contracts.

Additionally, many hospitals in CareFirst jurisdictions are members of large, multi-hospital systems and appear to have a solid negotiating position vis-à-vis the local health plans. According to the American Hospital Association, there are fifteen multi-hospital health care systems operating within Maryland, Delaware and Washington, D.C. Seven of these health care systems have national or regional operations that extend beyond CareFirst jurisdictions. The parent organizations for five of these seven systems are ranked in the top fifty of Modern Healthcare's *2001 Hospital Systems Survey*. Four of the remaining eight health care systems, which operate solely within CareFirst's Mid-Atlantic region, are ranked in the top 125. The survey, which is published annually by the established health care media publisher and which ranks multi-hospital health care systems by net patient revenue, included 227 health care systems in 2001.

Of the eight health care systems that operate solely within the Mid-Atlantic region, six operate solely in Maryland, one operates solely in Delaware and one operates in both Maryland and Washington, D.C. These eight multi-hospital health care systems, many of which also provide various outpatient care and related services, are profiled below[C.7]:

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- *Adventist Healthcare*, a two-hospital health care system based in Rockville, MD
- *Christiana Care Health System*, a two-hospital health care system based in Wilmington, DE managing over 850 beds. Approximately 41,000 admissions were logged by Christiana Hospital, representing nearly 50% of Delaware's admissions in 2000. The system did not participate in Modern Healthcare's *2001 Hospital Systems Survey.*
- *Dimensions Health Corporation*, a two-hospital health care system based in Largo, MD
- *Johns Hopkins Health System*, a three-hospital system based in Baltimore managing approximately 1,650 licensed beds. Over 72,000 patients received care from Johns Hopkins hospitals in 2000, representing over 12% of total Maryland admissions. The system ranks 51st in Modern Healthcare's *2001 Hospital Systems Survey.*
- *LifeBridge Health*, a three-hospital system based in Baltimore controlling over 5% of total Maryland admissions. The system ranks 125th in Modern Healthcare's *2001 Hospital Systems Survey.*
- *MedStar Health*, a health care system operating four hospitals in Maryland and two hospitals in Washington, D.C. Collectively, the four Maryland hospitals manage nearly 1,200 licensed beds and account for 6.5% of total Maryland admissions. In Washington, D.C., the National Rehabilitation Hospital and the Washington Hospital Center manage over 900 licensed beds and control 31% of admissions. MedStar Health is based in Columbia, MD and ranks 37th in Modern Healthcare's *2001 Hospital Systems Survey.*
- *University of Maryland Medical System*, a six-hospital system based in Baltimore managing nearly 1,600 licensed beds and controlling 9.5% of total Maryland admissions. The system ranks 78th in Modern Healthcare's *2001 Hospital Systems Survey.*
- *Upper Chesapeake Health System*, a two-hospital health care system based in Fallston, MD

Data published by the American Hospital Association (AHA) for the year 2000 indicate that hospitals operating in CareFirst jurisdictions are, on average, larger and more integrated than hospitals in other states[C.8]. Mid- to large-sized hospitals comprise over 80% of hospitals based in Maryland, Delaware and Washington, D.C. while the national average is approximately 55%. Small hospitals comprise only 16% of Maryland hospitals and 9% of hospitals in Washington, D.C, but represent 46% of hospitals nationally. We know of no small hospitals operating in the state of Delaware (i.e., out of the six hospitals located in Delaware listed in the AHA data, none have 99 beds or fewer). On average, 45% of all hospitals nationally are affiliated with a health care system; however, more than 70% of hospitals in both Maryland and Washington, D.C. are in a system.

Given these facts, hospitals operating in CareFirst's jurisdictions appear to have the ability to participate fairly in contract negotiations with health plans. As neither the hospital payment rates, nor CareFirst's market power appear likely to change as a result of the proposed transaction, we would not expect the negotiating balance between hospitals and CareFirst to change. Therefore, CareFirst would not have an increased ability to adversely affect the availability, accessibility, and affordability of health care in Maryland, Delaware and Washington, D.C. based on changes in relationships with hospitals.

Blue Cross Blue Shield of Georgia's Experience Shows Growth in Hospital and Physician Networks

We note that, with Blue Cross Blue Shield of Georgia, WellPoint assigned responsibility for local physician and hospital negotiations to Blue Cross Blue Shield of Georgia. Blue Cross Blue Shield of Georgia's networks have increased in size since WellPoint acquired the Georgia plan[C.9].

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D. Medical Management Policies and Practices –

Would the rules by which members access care be likely to change as a result of the transaction?

WellPoint's ability to impose significantly more restrictive medical management policies in Maryland, Delaware, and Washington, D.C. would likely be limited, because customers would choose other health plans if WellPoint were to do so. In Georgia, WellPoint has not instituted substantive changes to medical management policies.

Limited Ability to Restrict Medical Management Policies and Practices

Whenever a for-profit health plan acquires a non-profit health plan, the concern exists that the acquiring plan would restrict access to health care in order to reduce medical costs, so as to increase shareholder returns. WellPoint's ability to impose more restrictive or arbitrary medical management policies in Maryland, Delaware, and Washington, D.C. would likely be limited. This is because CareFirst's market power would not change significantly as a result of the transaction. If CareFirst were to make such changes, it would risk the loss of a substantial portion of its business to competitors whose policies remain less restrictive.

Medical policy varies from geography to geography across the U.S. The market would not accept substantive change to medical policy in the short-term. Any near term changes that were not generally accepted in the medical community would be rejected and detrimental to membership growth objectives and therefore would be counterproductive.

Blue Cross Blue Shield of Georgia Reports No Substantive Changes to Medical Policies or Practices

Blue Cross Blue Shield of Georgia executives reported to us that there have been no substantive changes to medical policy or approaches to utilization management as a result of their plan's conversion and merger with WellPoint–despite initial community fears to the contrary[D.1].

WellPoint Has Indicated an Intent Not to Restrict Access to Care

We asked WellPoint a direct question about its intentions regarding medical management policy: "Does WellPoint intend to modify medical management policies and practices [in CareFirst's service area] in a way that would adversely impact the accessibility, availability, or affordability of health care?" WellPoint responded[D.2]:

> *"No. WellPoint's goal is to offer consumers choice. WellPoint believes that one of the keys to its past and future success is its ability to introduce products that improve accessibility and affordability, especially for individuals and small employer groups. We do not intend to modify medical management policies and processes in any way that would adversely impact availability, accessibility or affordability of health care services. Of course, WellPoint complies with applicable state laws and regulations regarding medical management."*

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Combined Knowledge and Systems Could Reduce Unnecessary Care Over the Longer Term

To the extent CareFirst's merger with WellPoint results in combined knowledge and systems to help doctors make better medical decisions, and those better medical decisions lead to improved overall public health

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and lower long term medical costs, affordability for members may be improved. Evidence demonstrates that some medical procedures are performed inappropriately, or with incorrect frequency. For example[D.3]:

- In the Journal of the American Medical Association (JAMA), Nov. 13, 1987, p. 2533-2537, the following procedures were shown to be done inappropriately at the following rates –
  - Carotid Endarterectomy 32%
  - Coronary Angiography 17%
  - Upper GI Tract Endoscopy 17%
- In JAMA, May 12, 1993, p. 2398-2402, Hysterectomies were shown to be done inappropriately 16% of the time
- In JAMA, March 1, 1995, p. 697-701, Tympanostomies with tubes were shown to be done inappropriately 41% of the time
- Wide variation in procedure rates by geography suggest that variability is due to differences in local medical practices, not differences in patients' need for procedures. For example, the *Report on Medical Guidelines and Outcomes Research* from March 1997 states that Medicare women in the northeast are twice as likely as Medicare women in the south to undergo lumpectomy versus mastectomy.

The more information a health plan has on appropriate procedure patterns and regional practice variation, the more information it can provide doctors who can use the insight to make more informed care decisions. Studies show that when doctors are educated on medically-evidenced treatment guidelines, and those doctors in turn reference these guidelines when educating their patients regarding treatment options, some forms of inappropriate care decrease[D.3]. WellPoint's multi-region presence may benefit CareFirst in this regard, through the ability to gather broader information on an array of best practices and practice variations. Also, WellPoint has disease management programs, some of which are similar to CareFirst's existing programs, with a proven track record. When asked about this, WellPoint executives stated[D.4]:

> *"WellPoint believes that it can provide benefits to affected members through its medical management programs. Certain of WellPoint's disease management programs, such as its congestive heart failure, diabetes and asthma programs, have resulted in documented improvements in member health status and quality of life."*

E. Operations –

Will service be affected as a result of the proposed transaction?

Incentives exist to maintain long-term high service levels; however, merger integration activity has the potential to cause temporary disruption to service. Due to sharing of best practices, service has the potential to improve over the long term.

<u>*Competitive Forces Call for Maintaining High Levels of Service*</u>

CareFirst's level of customer service today, as measured in BCBSA-required quarterly performance surveys, is generally better than the median of all Blues plans nationally[E.1].

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CareFirst Ranked Against All Other BCBS Plans
(Member Service "Touchpoints" only)

Member Touchpoints	CareFirst of MD	GHMSI	BCBS of DE
Enrollment Process	⇧	⇩	⇧
Proactive Member Contacts	⇧	=	⇧
Access to Providers	⇧	=	⇧
Claims Handling	⇧	=	=
Customer Service (Question or Problem Resolution)	=	=	⇩

⇧ Better than the median rating of all BCBS plans
= Equal to the median rating of all BCBS plans
⇩ Below the median rating of all BCBS plans

Source: BCBSA Survey, 12 months through second quarter, 2001.

As discussed in the Competition section of this Report, the Mid-Atlantic region's health insurance market is highly competitive. Thus, CareFirst and WellPoint appear to have strong incentives to maintain high levels of service, so as to retain CareFirst membership. We found no terms in the Merger Agreement that would adversely impact customer service directly.

Potential for Merger-Based Disruption; Effective Consolidation Management Can Minimize or Avoid This Risk

Mergers often involve the consolidation of systems and processes, which frequently disrupt customer service levels. This potential disruption is not unique to the transaction proposed by CareFirst and WellPoint; it is a challenge faced by every merger or acquisition. Effective management of the consolidation can minimize or avoid this potential disruption. Commenting on WellPoint's post-merger integration work with Blue Cross Blue Shield of Georgia, WellPoint's CFO David Colby stated[E.2]:

> *"We are particularly pleased with the financial performance of BCBSGA because it demonstrates our focus on successful integration planning"*; and *"Our goal is to have each integration to go smoother than the one before it. This* [CareFirst] *is not a broken plan that needs heavy lifting."*

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WellPoint is in the process of acquiring RightCHOICE. It appears that this acquisition will close at least one year ahead of the potential closing of the merger with CareFirst. Because the closings may be a year or more apart, the risk of these integration efforts interfering with each other is lessened.

This attention to customer service during integration appears to be a focus of WellPoint. The customers of Blue Cross of California that we spoke with through our focus groups and personal interviews were, on average, satisfied with the service they have received from their "restructured" health plan. We interviewed 85 Californians who had experience with Blue Cross of California both before and after its initial public

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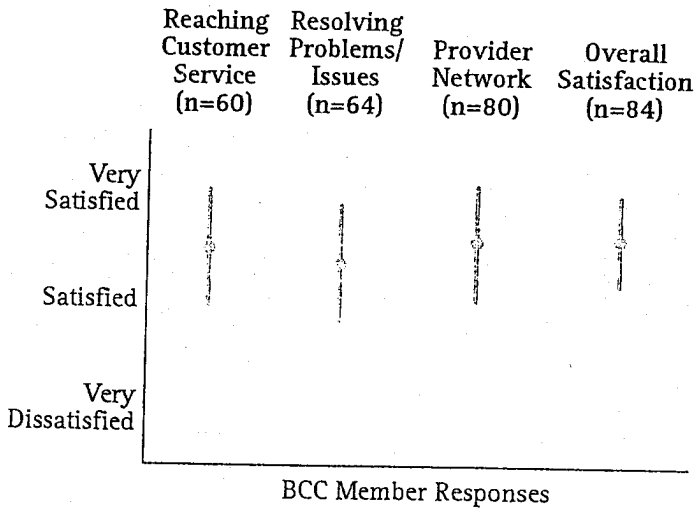
offering (IPO)[E.3]. On average, those people reported a slight increase in satisfaction after the IPO compared to before the IPO.

Current Level of Customer Satisfaction*



Interview Quotes

Member, BCC: I go in a lot with my kids. It's seamless to me. I pay $10 and we get out the door.

Member, BCC: I stay with Blue Cross of CA because of its good reputation, and if I have an accident, I think that they will come through.

Dave Helwig, Group President, Large Group Div, WellPoint: We have kept rate increases very steady, very predictable. As a result, retention is fantastic. We are not moving from one panic swing to another.

Broker: The conversion was transparent to us. I didn't notice any change and neither did my employers. I have noticed that things [BlueCard program] have gotten better in the last few years.

Member, BCC: Blue Cross of CA has a better network and better rates.

* For all line charts, the dot represents the average and the lines represent + or - one standard deviation.
Source: Focus group surveys and transcripts, November 2001.

Due to Sharing of Best Practices, Service May Actually Improve Over the Long Term

When health plans merge, there is an opportunity to share best practices, performance measures and standards, and to leverage common systems and infrastructure. Examples of how this can lead to improved performance include[E.4, E.5]:

- Some merged health plans have linked local customer service operations, so if one service center is overloaded, additional inquiries may be accommodated at other service centers, reducing response times.
- Introduction and/or standardization of performance scorecards, targets, and monitoring practices can increase the focus on key customer service measures such as response times, turnaround (i.e., cycle) times, productivity rates, etc.
- Elimination of out-dated, non-service oriented business processes and computer systems through the integration of "best of breed" capabilities across like products of merged plans can lead to more efficient processes and increased productivity.
- WellPoint has stated to us that they intend to use innovations in eCommerce technology in each of their plans, reducing development and deployment times, and offering another means to provide service to members, employers and physicians.

WellPoint Has a History of Proactive Investment

Looking at precedents, WellPoint's history and business incentives suggest it would choose to invest to enhance availability, accessibility, and affordability. WellPoint has a strong track record of proactive investment. Peter Kongstvedt, MD, author of The Managed Care Handbook, states[E.6]:

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