

**MINUTES OF THE APPRAISAL COMMITTEE
for the Conversion of
Blue Cross & Blue Shield United of Wisconsin**

Thursday, January 27, 2000
Conference Rm. 6 of the Lake Terrace State Office Building
121 East Wilson Street
Madison, Wisconsin

Committee members present: Randy Blumer, Mark Femal, and Patricia Lipton

OCI staff members present: Guenther Ruch, Fred Nepple, Julie Walsh, and Steven J. Junior

Representatives of Deutsche Banc Alex. Brown: Thomas W. Johnson, Giles E. Harrison, Kenneth M. Trujillo, and Patrick T. Brennan

Other members of the public present: Ben Adams, Stephen E. Bablitch, Sybil Better, Tim Cullen, L. Jane Hamblen, Gail L. Hanson, Thomas Luljack, William Toman, and Wade M. Williams

Prior to the meeting, each Appraisal Committee member, OCI staff member, and public attendee received a packet of documents, including the following items:

1. Draft agenda for the meeting of January 27, 2000.
2. Draft minutes for the meeting of January 14, 2000.
3. A draft report entitled, "Project Badger Appraisal Committee Conversion Resource Book" dated January 27, 2000.
4. A draft summary of valuations accorded to publicly traded stocks within the managed care universe.
5. A draft chart entitled, "Market Capitalization Weighted Relative Price Performance of Public Blue Cross Blue Shield Plans", consisting of stock index performance comparisons, dated January 16, 2000.
6. A draft chart entitled, "Market Capitalization Weighted Relative Price Performance of Public Blue Cross Blue Shield Plans", consisting of a comparison of certain individual stock issues with one another and the Standard & Poor's 500 Stock Index, dated January 16, 2000.
7. A draft chart entitled, "Market Capitalization Weighted Relative Price Performance of Public Blue Cross Blue Shield Plans", consisting of stock index performance comparisons, dated December 16, 1999.
8. A draft chart entitled, "Market Capitalization Weighted Relative Price Performance of Public Blue Cross Blue Shield Plans", consisting of a comparison of certain individual stock issues with one another and the Standard & Poor's 500 Stock Index, dated December 16, 1999.

The Appraisal Committee meeting commenced at 9:07 a.m.

Mr. Femal, the committee's chairman, introduced the draft of the minutes of the appraisal committee meeting as of January 14, 2000, and said that he had been informed that the Deutsche Banc representatives had changes to suggest. He inquired if any committee members had changes of their own to discuss. Mr. Femal suggested that Deutsche Banc discuss their suggested changes with OCI staff. OCI staff would distribute revised minutes for the committee's review, and, if there were no objections from the members, the minutes would be posted to OCI's website. Mr. Blumer moved to adopt the suggested course of action, which was then seconded by Ms. Lipton and carried unanimously.

Mr. Johnson notified the committee that Deutsche Banc wanted to provide some clarification to the summary of their comments related in the minutes to the appraisal committee meetings of December 9 and 17, 1999. The minutes to these meetings had already been approved. After some discussion, the committee asked that the clarifications be provided to OCI staff and posted to the OCI website.

Mr. Femal introduced the agenda for today's meeting, and asked if anyone on the committee had any changes to suggest. Hearing none, the committee approved the agenda by unanimous consent.

Mr. Femal recognized Mr. Ruch for the purpose of providing an update on progress on the work plan. Mr. Ruch noted that two of the issues on the committee's working list had been addressed at the last meeting; namely, whether 100% of the outstanding stock of United Heartland Group, Inc. ("UHG") constitutes 100% of the value of Blue Cross & Blue Shield United of Wisconsin ("BCBSUW" or "Blue Cross") and the impact of past and present inter-company transactions on that value. Progress on the remaining items is moving along quite well. The intended meeting with the management of American Medical Security (AMS) had not yet occurred. Mr. Ruch finished his summary with the information that OCI and Deutsche Banc were working on a draft appraisal committee report in accordance with the committee's instructions.

Mr. Harrison and Mr. Nepple described plans for a meeting involving representatives of OCI, Deutsche Banc, and a coalition of public advocacy groups. At this meeting, the public advocates could express their concerns with the Blue Cross conversion and ask questions on valuation matters and other issues. Mr. Nepple said that, while the details had yet to be resolved, there might be a second, one-day hearing in late February during which the public advocacy groups could enter additional information into the record of hearing. Mr. Nepple explained that this hearing could involve matters outside the scope of the committee's charge and would, in any case, at the request of the coalition of public advocacy groups, be after the Appraisal Committee issued its report.

Mr. Femal recognized Mr. Johnson for the purpose of taking the committee through the documents presented to them immediately before the meeting. Mr. Johnson noted that today's presentation would address all issues remaining from the last meeting except one. He would not discuss the value of the Blue Cross and Blue Shield service marks. Deutsche Banc will not be able to set a fixed dollar value, or even a range of value, on the service marks. However, the service marks are very important to Blue Cross and United Wisconsin Services, Inc. ("UWS") as organizations. Work is in progress on this question, and Deutsche Banc will prepare information that will provide the committee with a sense of the value and importance of the service marks. Mr. Johnson related that work is progressing on a study of how Blue Cross' net operating losses (NOLs) would have been utilized if not for the tax-sharing agreement with UWS. Deutsche Banc is close enough to completion to know that the NOLs were more effectively utilized by the tax-sharing agreement than would have been possible in its absence. However, certain detailed figures remain to be finalized, and so this study will be presented at the next meeting.

Ms. Lipton inquired whether the committee would be presented with information on Blue Plan conversions in other states. Mr. Johnson confirmed that a substantial portion of the "Project Badger Appraisal Committee Conversion Resource Book" is devoted to just that very subject.

Mr. Femal asked whether the committee would receive answers to the questions it posed to Deutsche Banc during the last meeting. Mr. Johnson said that he had the following items listed as outstanding that would not be addressed today: the reason for the increase in the volume of inter-company transactions in 1996; the question surrounding the value of losing the Blue Cross and Blue Shield service marks; Ms. Lipton's question on net operating loss carry-forwards; and

Ms. Lipton's question on a range of reasonableness parameters for Deutsche Banc's analysis of historical transactions between Blue Cross and UWS.

Mr. Johnson directed the attention of those assembled to the "Project Badger Appraisal Committee Conversion Resource Book" (conversion resource book). He explained that this book contained information compiled by Deutsche Banc in the course of its research with respect to how the corporate governance, anti-takeover provisions, capital structures, and stock options of the Blue Cross conversion proposal compare with other Blue Plan conversions completed and pending. The book contains information on alternatives for obtaining liquidity from the perspective of the proposed Foundation. Mr. Johnson cautioned the committee that the conversion resource book, though substantially complete, was still a draft, with some work still to be done before this informational resource is complete. Some materials were received from AMS earlier this week, and study of these is ongoing. Mr. Johnson reminded the committee of the open issues still pending. He told the committee that they would find blank space in the conversion resource book that was reserved for information on Empire Blue Cross & Blue Shield ("Empire"), the Blue Plan conversion pending in New York. Mr. Johnson indicated that it was his understanding that the New York Insurance Department and the BlueCross BlueShield Association ("BCBSA") have both approved the Empire conversion plan. However, Deutsche Banc was still in the process of determining whether this assumption is accurate. Accordingly, Deutsche Banc believes, but must confirm, that the Empire conversion plan is as state of the art as RightChoice in terms of what is acceptable to the BCBSA. Deutsche Banc is trying to obtain access to the conversion plan documents filed with the New York Insurance Department. The New York Insurance Department denied Deutsche Banc's public information request for access to these documents. Deutsche Banc challenged this determination and there are about five days to go before the New York Insurance Department will be obliged to formally respond to the challenge. Mr. Johnson explained that his firm was seeking information from Donaldson, Lufkin, & Jenrette, the firm that advised Empire on its conversion and is now advising Blue Cross, and the BCBSA. He stated that there remains the possibility of assistance from Blue Cross itself. According to Mr. Johnson, Thomas Hefty, Blue Cross' president, must have seen the Empire conversion plan, because he had to vote on its approval by the BCBSA.

Mr. Johnson noted that shareholders in the United States, as a consequence of their ownership rights, typically have certain normal and customary rights relating to stewardship (i.e., the right to vote), creation of value (i.e., the right to sue for actions taken or not taken), and liquidity (i.e., the right to sell). Ideally, the Foundation should have every option and opportunity that any other person would have as the sole owner of a corporation. The conversion resource book indicates the impediments that exist to the normal, free exercise of ownership, and provides a comparison to the other publicly traded managed care companies.

Mr. Johnson noted that there are certain situational constraints that limit the flexibility of the Foundation in the options and opportunities of ownership. The first is that the Foundation is a 501(c)(4) organization as defined by the Internal Revenue Code. The Foundation exists to further certain social goals that will be financed through the sale of shares of United Heartland Group, Inc. The second factor restricting ownership flexibility is the license restrictions of the BCBSA, which impose various requirements intended to preserve the type and standard of care provided by the members of the Association and advance public regard for the Blue Cross and Blue Shield service marks.

Mark Femal noted that the Foundation was not formed for the purpose of exercising ongoing management and control of Blue Cross as a business, but rather to fund its mission through sale of the stock it would be provided with under the conversion plan.

Mr. Johnson affirmed Mr. Femal's statement, but said that, typically, a shareholder may intervene to protect or enhance the value of his investment, regardless of that investor's personal objectives in holding the investment. Mr. Johnson stressed that corporate governance provisions do impact value.

Mr. Blumer stated that many of the restrictions on corporate governance are simply part of the reality of being a Blue Plan. The committee could mitigate some of the effects of this through its work on questions #3 and #6 on its working list of issues. Distinction should be made between governance provisions required by the BCBSA and those that are not. Careful consideration should be given to various monetization alternatives to protect the Foundation's interests.

Mr. Johnson continued his presentation by indicating that section 1 of the conversion resource book cross-references the Deutsche Banc work plan, which is directly based on the committee's working list of issues, to information contained in the conversion resource book. Mr. Johnson explained that it would be very confusing to go through the conversion resource book by following the order of the work plan. He continued that today's presentation would be one of many details, rather than broad concepts, but some of these details would prove to be very important.

Mr. Johnson provided the committee with an overview of the BCBSA. The association's ultimate governing body, its Board of Directors, consists of the highest-ranking executive of each independent Blue Plan. There are approximately 50 such Blue Plans. Given the membership and structure of the governing body, it is very analogous to a legislature. The governing body delegates much of its work to a variety of committees. One of these committees is the Plan Performance & Financial Standards Committee (PPFSC), which may be understood as the quality control committee. The Board of Directors meets four times per year. Voting on the Board of Directors follows a bicameral concept. Proposals to the Board require approval by three-quarters of the member plans by number and three-quarters of member plans by current enrollment weighting, though certain proposals require only a majority of the members under both methods of voting.

Mr. Johnson related that the BCBSA Board of Directors must approve all conversion transactions among its membership. The board has already approved the conversion plan proposed by Blue Cross in its present form. Mr. Johnson explained that any material change in the conversion plan that is prompted by the commissioner's decision on this case, whether or not in response to the appraisal committee's report, will require the approval of the BCBSA Board of Directors.

Mr. Johnson went on to describe the "Five Cs" of the BCBSA. These are as follows:

- Commitment to the nationwide provision of quality cost effective health care services to the public.
- Commitment to excellence in service and financial stability.
- Commitment to independence from special interest groups.
- Commitment to local focus and presence.
- Commitment to promoting and enhancing the value of the Blue brands.

Mr. Johnson said that it is the specific measures proposed in the Blue Cross conversion plan to achieve the commitment to independence from special interest groups that will be the subject of today's presentation. This commitment is pursued by a combination of ownership limits, divestiture requirements for stockholders that exceed these limits, restrictions of the constitution of the member Blue Plan's board of directors, and controlled voting rules for foundations that own publicly traded Blue Plans.

Mr. Johnson described BCBSA license provisions specific to for-profit plans, including ones which, if violated, would result in automatic revocation of the license. Mr. Johnson noted that normally for-profit Blue Plans are prohibited from having "Blue Cross" or "Blue Shield" in their legal name. This provision was waived in response to the grave reservations expressed by OCI concerning the use of a trade name that differs substantially from the legal name.

During Mr. Johnson's discussion of ownership limitations, Randy Blumer asked Deutsche Banc representatives to explain the difference between institutional and retail investors. Mr. Harrison responded that an institutional investor is defined by laws and regulations administered by the Securities and Exchange Commission. For simplicity's sake, in this context, Mr. Harrison suggested that one should think along the lines of a pension plan or mutual fund. Mr. Harrison said that the Foundation that is slated as the recipient of stock in the conversion plan is likely to be classified as an individual investor subject to the 5% ownership limit.

Mr. Femal asked Mr. Johnson who is responsible for monitoring share ownership limitations. Mr. Johnson replied that the Plan Performance & Financial Standards Committee was most likely the party within the BCBSA that was charged by their member Blue Plans with this responsibility. Mr. Johnson noted that the corporation must also monitor its investor base and be aware of the composition of its large shareholders in order to meet reporting requirements of the Securities & Exchange Commission, as well as to maintain its license from the BCBSA. The SEC also requires institutional investors who acquire more than certain amounts of any stock to make certain disclosures. Mr. Harrison added that, as provided in the Application for Conversion submitted to OCI, the ownership restrictions are required to be printed directly onto United Heartland Group's stock certificates.

Mr. Femal inquired about restrictions that apply to shareholders acting in concert in a coordinated effort. Mr. Johnson described the operation of the rule. He proceeded to explain that the BCBSA licenses would be revoked if shareholders ever installed a board majority composed of non-Independents. In addition, any hostile takeover of UHG would also precipitate revocation of the BCBSA license. If an individual shareholder should, whether purposefully or accidentally exceed 5% ownership of the company, there are provisions in the articles of incorporation that permit the corporation to seize the excess stock, sell it, and remit the net proceeds to the owner. The Foundation will seek a waiver of these ownership limitations, subject to a divestiture schedule, a voting trust, and other restrictions.

Mr. Johnson noted his impression that one of the reasons for the recent statutory accounting change sought by Blue Cross, whereby it would report the value of its shares of publicly traded affiliates at statutory book value instead of discounted market value, was prompted by the BCBSA requirement that Blue Plans seeking to convert must be in full compliance with BCBSA rules and standards, namely, minimum capital requirements.

Mr. Johnson resumed his detailed presentation of share ownership limitations required by the BCBSA and reflected in UHG's proposed articles of incorporation. The Foundation has one year from the date of conversion to fall below 80% ownership. This can be accomplished by the Foundation selling shares, the corporation selling newly-issued shares (i.e., for primary capital) or both.

Mr. Johnson went on to describe the operation of the voting trust. The trustee of the voting trust is required to vote the shares of the Foundation as the "independent board majority" of UHG's board directs. The only exception to this is that the Foundation's board may direct the trustee's vote in the event of a change of control proposal other than a merger with UWS.

Mr. Harrison said that the BCBSA regards the governance structure and the anti-takeover provisions of each conversion plan as a complete package. The BCBSA has few bright line rules on each individual component of the package, but must be comfortable with the package of protections as a whole. He said that it is up to the BCBSA to decide what it is willing to accept in a conversion plan.

Ms. Lipton noted that the committee would have to form an opinion on the acceptability of the governance structure and anti-takeover package in light of what the BCBSA might reasonably require to preserve and further the standards of the association and the Blue Cross and Blue Shield service marks.

Mr. Johnson proceeded to discuss past and pending conversions with respect to the liquidity of shares held by their respective foundations. Trigon was a mutual insurer, so its shares were widely disbursed among its policyholders, and charitable obligations were discharged through a one-time payment to the Commonwealth of Virginia. RightChoice was already publicly traded at the time of its conversion plan approval. The Empire conversion, which bears the closest resemblance to Blue Cross', provides for an initial public offering within six months of the conversion. Mr. Johnson noted that Blue Cross' conversion plan does not specify any immediate liquidity event. Mr. Harrison interjected that, in every other Blue Plan conversion, either there was a planned liquidity event (via outright sale or IPO) or a public market already existed.

Mr. Harrison referred to a chart within the conversion resource book indicating the ratio of issued and outstanding shares to authorized common shares, and noted that the proposed capitalization structure is well in line with other corporations in the managed care sector. Mr. Johnson cited the authorization of blank check preferred stock as being quite common.

The presentation turned to a comparison of the Blue Cross conversion plan with past and pending Blue Plan conversions with respect to holding company governance provisions. Mr. Harrison stated that BCBSA does not permit influence or control of any primary licensee to reside other than with an independent board majority. He continued that independence, from the perspective of the BCBSA, is a function of being a director at the time of the conversion or the chosen successor of such directors. He noted that under the Blue Cross conversion plan, independents would not represent less than an 80% of the board; that is, if one assumes nine board seats in total, shareholders other than the Foundation could nominate and perhaps elect one director, if a mechanism were put in place to allow this. There followed a discussion of instances of boards in which parties independent of the self-perpetuating directors and the stockholders appoint a minority of the directors.

Discussion turned to the possibility that the Foundation should perhaps be given observation rights at UHG board meetings, or contingent observation rights.

Discussion continued on matters related to the structure of corporate governance under the Blue Cross conversion plan. Mr. Johnson noted that the Blue Cross conversion plan mirrored that of RightChoice with respect to the removal of directors by shareholders. RightChoice's provisions are clearly the most extreme in the entire managed care sector (i.e., most in favor of the board). Effectively, shareholders may not remove any director or group of directors until the director or directors have been convicted of a felony, exhausted all rights of appeal, and 75% of the total shares outstanding, not merely of those voting, vote in favor of removal. The Foundation would not be permitted to direct the voting of its own shares on such a matter. Mr. Johnson suggested that the committee might wish to consider changing the definition of cause that permits consideration of removal, lowering the percentage of shareholders required to vote for removal, or both. Mr. Johnson noted that the Foundation must rely on the board to act with proper regard for its fiduciary obligations, because the Foundation has no impact on the UHG board.

Ms. Lipton suggested that the committee should look at the incentive structure of the UHG board and seek means to align the interests of the board to those of the Foundation.

There was a brief discussion of a provision in the conversion plan that would indemnify directors who voted to protect compliance with BCBSA guidelines, even if such a vote would be contrary to the interests of the shareholders. To explain the implications of this, Mr. Johnson cited the theoretical possibility of a corporation that is not a Blue Plan offering a huge premium over the current market value in a bid for acquisition of all outstanding stock. In such an instance, the directors could vote against the acquisition to preserve the corporation's status as a primary licensee of BCBSA without liability to the shareholders for any alleged disregard for their interests. In this instance, the directors would be acting to preserve the value of the BCBSA license and its geographical franchise.

Ms. Lipton expressed the view that the provisions within the conversion plan that strongly discourage any acquisition of control by any corporation that is not a BCBSA licensee or which could not qualify as a Blue Plan licensee, do constitute a constraint on the Foundation's flexibility to realize value.

After discussion of various restrictions placed on the Foundation, Mr. Femal noted that the Board of Directors of the BCBSA, having approved the conversion plan, must have been aware of these restrictions on the flexibility of the Foundation. Mr. Johnson responded that the governance provisions of the conversion plan clearly preserve the status quo and the complete independence of the board from control by shareholders. Mr. Johnson indicated that the BCBSA is committed to self-preservation, furtherance of its standards, maintenance of the national network and public regard for the Blue Cross and Blue Shield service marks. The BCBSA is indifferent to the achievement of value by the Foundation.

Ms. Lipton observed that there is within the conversion plan a tacit trade-off between the intangible worth of the Blue Cross and Blue Shield service marks and the restrictions demanded by the license for their use. She inquired whether Deutsche Banc will evaluate the economics of this trade-off.

Mr. Johnson said that Deutsche Banc's analysis will center on what business would disappear if membership in the BCBSA were lost. He indicated that there would be a very significant decline in the volume of business, with adverse results for profitability and therefore value.

Ms. Lipton stated that the committee must be convinced that the impact of the Foundation's lack of autonomy is more than offset by the impact that would result from the loss of membership in the BCBSA.

Mr. Johnson responded that one should see the provisions of the conversion plan as a continuum of value, terminating at some point after which either Blue Cross terminates its application and there is no stock to give to the Foundation, or BCBSA terminates the license, which has the same outcome. Mr. Johnson continued that the BCBSA does recognize that some of its members feel the need to access the public capital markets to remain competitive within their market, to increase their capital, or to gain access to an acquisition currency, and it is amenable to various corporate organizational forms, but some basic governance protections must be in place, even if they have a negative impact on valuation.

Mr. Nepple advised the committee that board and management independence has some positive features. The conversion resource book clearly indicates shareholder restrictions in favor of board and management, including anti-takeover provisions, are fairly common among managed

care companies. There are some advantages to Blue Cross remaining an independent company with operations based in the State of Wisconsin.

Discussion turned to the provisions of the articles and bylaws of the Blue Cross & Blue Shield United of Wisconsin Public Health Foundation. Mr. Johnson noted that one feature of the Foundation's articles of incorporation that is unlike that of any other Blue Plan conversion is the requirement that the articles may not be amended without the consent of Blue Cross, whether before or after the conversion. In other conversions, the Foundation's boards have considerably greater independence. Mr. Harrison noted that there is deliberation within OCI with respect to Foundation matters that is not within the purview of the Appraisal Committee or Deutsche Banc, but that the structural independence of the Foundation board has implications with respect to the achievement of value on behalf of the Foundation.

Mr. Johnson noted that the Foundation's bylaws are reasonably straightforward and the main issues had already been covered in the prior discussion on the articles of incorporation.

Mr. Johnson proceeded to discuss the voting trust and the foundation's options for achieving liquidity within the framework of the conversion plan. Mr. Johnson noted that the Foundation may only direct the vote of the trustee in the event that the UHG board presents a change of control proposal, other than a merger with UWS, to the shareholders.

Mr. Johnson advised the committee to think about certain questions in relation to the Foundation:

- Should the Foundation have the right to direct the vote of its shares even on a UWS merger?
- What oversight role might be appropriate for OCI in a UWS merger?
- Should the conversion be timed to coincide with the UWS merger?
- Should there be a limit on the time that may elapse between the Commissioner's decision approving the conversion and effective date of the conversion?

Mr. Johnson noted that the respective foundations of the RightChoice and Blue Cross conversion plans may only direct the vote of their shares with respect to change of control proposals. The committee may wish to recommend that UHG notify the Foundation of any change of control proposals, whether solicited or not. This would be symmetrical with the Foundation's obligation to inform UHG of any share acquisition offer directed to it.

While the foundation of the RightChoice conversion has the right to join in litigation against the RightChoice board and management initiated by shareholders other than itself, the Blue Cross conversion plan's foundation does not.

Mr. Femal said that the Blue Cross conversion plan, in a sense, does provide a plan for having the Foundation achieve liquidity in the form of a divestiture schedule. Mr. Harrison responded that the divestiture schedule is an obligation of the Foundation. Mr. Harrison continued that UHG has no compelling incentive to help effectuate divestiture, and that the Foundation needs the committed assistance of UHG to conduct successful stock offerings.

Mr. Johnson turned to the subject of the registration rights agreement. During this discussion, he disclosed RightChoice's provision for automatic extensions at certain points within the five-year divestiture schedule. Mr. Johnson suggested that, while the circumstances that trigger these extensions may be narrow in scope, they contribute usefully to the Foundation's flexibility. Ms. Lipton agreed that it is desirable to extend the Foundation's flexibility in these circumstances.

Mr. Femal recessed the committee at 11:20 a.m.

Mr. Femal reconvened the meeting to order at 11:40 a.m.

Mr. Johnson resumed his presentation on the registration rights agreement.

Mr. Johnson noted that the registration rights agreement limits the number of times that the Foundation may demand that UHG proceed with a registration of the Foundation's shares. He stated that having more opportunities for registration is clearly better than having less. He explained that this would be painless for UHG, and that Blue Cross should be willing to go along with stronger demand rights. Mr. Johnson predicted that the limitation on the Foundation's demand rights would lead to a cat-and-mouse game between the Foundation and UHG that the Foundation would lose due to the compulsions of the divestiture schedule.

Mr. Harrison noted that sometimes market conditions permit doing offerings within a few months of one another, while at other times the time lag might be greater. This fact argues for greater flexibility in the Foundation's demand rights.

Mr. Johnson described the piggyback rights of the Foundation, whereby the Foundation may choose to sell shares at the same time as UHG was seeking to raise primary capital. The Foundation would benefit from the increase in float brought about by new shares issued as primary capital.

Mr. Johnson explained a provision in the registration rights agreement that would permit UHG to purchase shares from the Foundation, thereby converting the shares to treasury stock, if the Foundation demands registration of its shares. Mr. Johnson asserted that this is a good provision to have. However, the period of time UHG may take to close the purchase is excessive. UHG is very unlikely to exercise this right given its present capital position. Capital is dear, and corporations prefer to hang onto it, unless they generate substantial cash.

Mr. Harrison noted that the purchase right described by Mr. Johnson is only one of several in the agreement, and that none of them are requirements of the BCBSA.

Mr. Johnson mentioned that the Foundation does not possess observation rights. Mr. Femal said that the Foundation's board would certainly have favorable and timely access to information from the board and management of UHG, given who is appointing them. Mr. Johnson responded that the proposed board of the Foundation does not overlap with that of UHG.

Mr. Johnson noted that it is normal and customary for corporations to bear registration expenses. Mr. Harrison added that the registration rights agreement actually goes further by requiring the Foundation to pay a portion of registration expenses based on the proportion of its shares that are registered for sale in an offering and not the proportion of shares actually sold.

Mr. Johnson explained that the provisions of the registration rights agreement related to UHG's right of first refusal on any private placement effectively work to eliminate the possibility of successfully negotiating any private placement. The BCBSA does not require these provisions. The limitations that apply to the level of any individual's or institution's ownership, which are required by the BCBSA, also work against actual conclusion of a private placement, because these levels are below those generally sought by participants in the private placement market.

Discussion turned to a provision within the registration rights agreement that would permit UHG to make purchases of the Foundation's UHG stock at UHG's sole discretion. Mr. Johnson and Mr. Harrison both described the adverse possibilities of having stock bought away from it during temporary setbacks in the market. While they acknowledged that the likelihood of share

repurchase under these circumstances is remote, it is unlikely that the circumstances under which such repurchase would take place would be favorable to the Foundation.

Discussion turned to anti-takeover provisions present in the Application for Conversion. Mr. Johnson affirmed that a package of anti-takeover provisions is required by the BCBSA as a condition of conversion. The BCBSA licenses its members to operate in geographically exclusive territories. An abrupt loss of any member would create a hole in their service network that would be detrimental not only to the membership of the BCBSA, but also create hardship for policyholders who travel out of the service area of their own Blue Plan. Mr. Johnson explained that hostile takeovers are not common in the health insurance and managed care sector. However, UHG will not be immune from a friendly approach to its board and management by another Blue Plan. Mr. Johnson noted that, from a valuation standpoint, companies with anti-takeover provisions and large shareholder blocks typically trade at a discount, particularly in difficult times.

Mr. Blumer indicated that there are interests of the policyholders of Blue Cross and its affiliates, and of the public of this State that may justify a view of potential takeovers that looks further than immediate advantages to the Foundation. Mr. Johnson acknowledged that there might well be issues of larger social significance to the State of Wisconsin, but that impediments to merger could have an adverse effect upon valuation.

Mr. Johnson discussed the range of corporate governance and anti-takeover provisions that exist within the health insurance and managed care sector. Within reason, shareholders should grant some patience with the directors and officers of a corporation in which they hold an investment. However, all of the converted Blue Plans have corporate governance and anti-takeover provisions that tend further from the norm in favoring management and discouraging shareholder activism.

Ms. Lipton asked that, given their impact on valuation, anti-takeover issues be addressed in the draft report of the appraisal committee. Mr. Johnson and Mr. Ruch confirmed that these issues would be addressed.

Mr. Johnson referred the committee to an exhibit within the conversion resource book related to stock option programs among companies in the managed care sector. He noted that the percentage of shares under option at UWS in relation to total shares outstanding is not out of line. In some respects, the high percentage is a function of the small size of the company.

Mr. Femal accepted an offer of commentary from Gail Hanson, Blue Cross' treasurer, concerning the common shares under option. She told the committee that one million of the shares under option as indicated in the exhibit being reviewed were held by outsiders with no present affiliation with the company. In response to this information, Mr. Johnson assured the committee that he would review the matter with Blue Cross management and get back to the committee with additional information.

Discussion turned to how the Foundation could achieve liquidity. Ms. Lipton asked the Deutsche Banc representatives to comment on the real flexibility for a public offering in the summer or fall of 2000. Mr. Johnson replied that, given the short-tail nature of their business, an offering could be viable if the financial results of the second and third quarters reflect good pricing decisions and favorable trends in enrollment.

Mr. Blumer observed that the longer the Foundation waits to reduce its ownership percentage post-conversion, the more prominently the divestiture schedule looms as a factor.

Mr. Femal requested that Mr. Johnson explain his views concerning how the various liquidity options affect value. Mr. Johnson responded by drawing an analogy to insurance company demutualizations. In demutualizations, the newly issued stock often trades, at first, at a discount to book value. Efficiencies gained from reorganization and successful execution of the business plan that motivated the demutualization, if forthcoming, generally cause improvement in valuation.

Mr. Johnson continued to explain his perspective on liquidity alternatives for the Foundation. Conducting a sale of shares sooner rather than later takes pressure off the Foundation to meet the first year's divestiture target. A follow-on offering after a merger with UWS would be preferable to an initial public offering of UHG as a stand-alone entity. UWS provides senior management and necessary service capacity to BCBSUW. The ties to UWS could seriously cloud the investment community's understanding of UHG if UHG were to remain a stand-alone company.

Mr. Johnson discussed the advantages, from the Foundation's perspective, of a takeover of UHG, with or without a merger with UWS. He described how the requirements of membership in the BlueCross BlueShield Association make the possibility of a non-Blue acquirer a non-starter. One is limited to active consolidators among fellow Blue Plans.

Ms. Lipton commented that the limited universe of potential acquirers would represent a significant disadvantage should Blue Cross ever seek to put itself up for sale, which would be expected to reduce value received by the Foundation.

Mr. Harrison described the ability of the Foundation to direct the voting of its shares with respect to change of control events other than a merger with UWS, and how this ability compares to other foundations established by Blue Plan conversions. Mr. Blumer commented that the Foundation would possess the right to veto any sale of the company put before it, other than a merger with UWS. Mr. Blumer said that if the Foundation's board feels the price is not right, it could refuse an offer. Mr. Johnson affirmed that, at first, the Foundation would possess a veto of any change in control, but as the sell-down of its shares proceeds the Foundation steadily loses influence on such matters.

Mr. Blumer solicited Mr. Johnson's opinion on whether an initial public offering establishes a definitive value. Mr. Johnson explained that a merger with UWS or an initial public offering establishes a price, but whether or not it establishes a fair price or provides liquidity for the Foundation to execute orderly future sales depends upon the circumstances. The committee could follow the example of many demutualizations and recommend that the company be required to conduct an IPO within a set time frame. If a UWS merger were to precede an offering of the Foundation's shares, the Foundation may or may not be close to meeting the 20% reduction in ownership mandated by the divestiture schedule. Regardless of the progress it achieves toward that end, it would serve to reunite management and service entities with the risk-bearing entity. From the investment community's perspective, this would permit clearer articulation of management's strategy going forward.

Ms. Lipton noted that the conversion plan makes specific reference to September 30, 2000, and inquired whether this is a drop-dead date for a UWS merger. Mr. Johnson responded with information on the Morris Trust doctrine. September 30, 2000, does not represent the latest acceptable date for a merger with UWS, but is perhaps the earliest date. He expressed the belief that the company wants to wrap up the merger.

Mr. Johnson proceeded to describe factors that would come into play in the event of a merger. If the merger is conducted so as to leave a stub outstanding, there will be public price quotations on

the stock. An exchange ratio that favors the Foundation will result in lower quotations, while an exchange ratio that favors UWS shareholders will result in higher quotations.

Discussion turned to the mechanics of how the merger would proceed. Mr. Johnson described the process whereby the respective boards of United Heartland Group, Inc. and United Wisconsin Services, Inc., would form special committees to exclude directors who serve on both boards. Each corporation would hire investment bankers and independent counsel to negotiate on their behalf, under the direction of their respective special committees. The negotiations, if concluded and not abandoned, would end with the determination of a mutually agreeable ratio of exchange that would determine the number of shares that the shareholders of UHG would receive in UWS (presumably the surviving company, although the UHG name may be adopted by it).

Mr. Harrison remarked that, in the recent past, the respective special board committees of Blue Cross and UWS were unable to agree on the terms of a debt for equity exchange, whereby UWS would retire its \$70 million loan from Blue Cross in exchange for additional common shares of UWS.

Mr. Blumer commented that the mechanics of the process do not provide the Foundation with any scope for participation. Ms. Lipton said that the committee would have to work on having the Foundation have some voice at the table where the merger exchange rate is decided.

Mr. Blumer stated that merger would set a definitive valuation on the Foundation's shares in the surviving corporation. Mr. Johnson replied that the stub would set a value for the whole company, but what kind of value would be based on how well the merged company is explained to investors, and this reinforces the need for the Foundation to have some representation in the merger process.

Mr. Blumer asserted the need for the committee to establish a test for when the Foundation achieves a definitive base of valuation. Mr. Johnson said that a merger would provide some sense of value and provide a market. It does not automatically assure that the management of the merged entity has articulated the company's story to the investing public in a way that will result in a stock price that truly reflects the value of the merged company going forward. Mr. Blumer rejoined with the question of when regulatory review ceases to be necessary. After some discussion, Mr. Nepple interjected with a question as to whether comment on the appropriate float and structure would be informative to Mr. Blumer's question. Mr. Johnson rhetorically stated that he was not sure whether it is better to sell into a mispriced market and then try to correct misperceptions, or to articulate the strategic vision first and then do the offering.

Mr. Nepple asked Mr. Johnson to describe what he would see as the attributes of a combined UHG/UWS entity. Mr. Johnson stated that it was for management to articulate its strategic vision in a high-profile road show. He explained that the first post-merger follow-on offering would be a redefining moment for the corporation. One cannot know how the corporation's security will trade until the strategic redefinition is tested in the market.

Mr. Ruch reminded the committee members that the conversion plan itself provided several routes for the Foundation to achieve liquidity. This comment directed attention to the possibility of an offering by UHG on a stand-alone basis. Mr. Blumer observed that the complexity of the holding company structure would almost have to result in a disadvantage if UHG were to be offered on a stand-alone basis as opposed to a merger. Mr. Johnson affirmed that many mutual fund complexes prefer less complicated stories, and that a merger with UWS prior to a public offering clearly makes more sense.

After further discussion on routes whereby the Foundation could achieve liquidity, Mr. Blumer suggested that the committee had most of the information necessary to begin drafting its report. While the committee has not come to specific resolutions, the options have been laid on the table.

Mr. Ruch suggested that OCI staff, in consultation with Deutsche Banc, prepare a draft report based on the committee's discussions to date. The draft report would provide the committee with various options at the decision points that became apparent through discussion at the committee meetings. The committee agreed to Mr. Ruch's suggested course of action.

A brief discussion ensued on whether the committee should consider factors related to whether the offering would be directed to retail or institutional investors. Mr. Johnson advised the committee to refrain from attempting to recommend specifics of how the underwriting would be done, because a successful offering is more an art than a science. He expressed doubt that Mr. Hefty, BCBSUW's chief executive officer, would pursue a regional retail strategy in preference to one that would emphasize a more national and institutional market.

The committee decided to forward any information or questions that related to construction of the draft report to either Mr. Ruch or Mr. Junior.

Discussion then turned to the next available meeting dates. The committee tentatively agreed to hold its next meeting on Wednesday, February 9, 2000, from 1:00 p.m. to 4:00 p.m., with a continuance on Thursday, February 10, 2000, from 9:00 a.m. to 12:00 p.m. (Noon). OCI staff would see that proper notice of the final date was issued.

Ms. Lipton moved to adjourn. The motion was seconded by Mr. Blumer, and carried unanimously. The committee adjourned at 1:24 p.m.