

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

February 9 – 10, 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, Eileen Mallow, Fred Nepple, Julie Walsh, and Steven J. Junior

Representatives of Deutsche Banc Alex. Brown: Thomas W. Johnson and Giles E. Harrison

Other members of the public present: Ben Adams, Stephen E. Bablitch, Sybil Better, Joseph C. Branch, L. Jane Hamblen, Gail L. Hanson, William Tolman, Wade M. Williams, and Jeanne Wittig

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

- a. Draft agenda for the meeting of February 9 – 10, 2000
- b. A draft report entitled, "Report of the Appraisal Committee for the Conversion of Blue Cross & Blue Shield United of Wisconsin", dated February 10, 2000
- c. A draft document entitled, "Project Badger Appraisal Committee Conversion Resource Book" dated February 9, 2000.

The Appraisal Committee meeting commenced at 1:05 p.m.

Mr. Femal, the committee's chairman, introduced the materials distributed to all in attendance, and described the two-day schedule. Mr. Femal noted that the draft minutes of the last meeting were not yet available due to the OCI staff's focus on preparing the draft appraisal committee report in time for today's meeting. The chairman deferred the question of how the minutes would be distributed and reviewed until later in the meeting. Mr. Femal thanked the OCI staff and Deutsche Banc for their work on the discussion draft. He thanked the public attendees and Blue Cross & Blue Shield United of Wisconsin's ("Blue Cross" or "BCBSUW") management for their patience with the process, though noting that the committee had proceeded to fulfill its charge as expeditiously as may be expected given the careful and thorough review that they were charged to perform.

Mr. Femal recognized Mr. Johnson, managing director with the firm of Deutsche Banc Alex. Brown, for the purpose of responding to open items from the last meeting.

Mr. Johnson provided the committee with an oral report on the meeting that Deutsche Banc had with the management of American Medical Security Group, Inc. ("AMS"). He described AMS as a company in transition. The management team is dealing with a multistate set of regulatory issues. Their business plan seems a sound one, though they must follow through with its execution. AMS trades at about 40% of its book value. Mr. Johnson's view was that there would have to be a minimum of two calendar quarters of solid performance in relation to financial expectations in order to assess actual progress in the corporation's direction.

Mr. Harrison related that the increase in the volume of intercompany transactions noted in 1996 on a gross basis was due to a transfer of certain management functions that had been performed by the office of Compcare's president to Blue Cross.

Mr. Johnson referred the committee to a page in the conversion resource book that compared Blue Cross' utilization of its net operating loss carryforwards under its tax-sharing agreement with United Wisconsin Services, Inc. ("UWS") from 1991 to 1994 to the benefit that would have been derived in the absence of this agreement. Mr. Johnson specifically referred to the period in 1994 and 1995 when Blue Cross reported pre-tax earnings but was unable to utilize any NOL to reduce its taxes because those NOLs had been previously exhausted due to the tax-sharing agreement with UWS. Even after taking this period into account, the tax-sharing agreement was clearly of advantage to Blue Cross.

Mr. Johnson explained that he had not prepared a tolerance range for the accuracy of the "BCBSUW/UWS Capital Contribution Analysis" of section 10 in the conversion resource book. Since this analysis was first presented to the committee, BCBSUW management thoroughly reviewed the numbers at Deutsche Banc's request. As a result of this review, as well as an updating of the analysis by Deutsche Banc, some modifications were made, but the overall order of magnitude of the results remains unchanged, as expected.

The committee concluded that the intercompany transactions between BCBSUW and its affiliates, taken as whole, did not adversely impact, in fact, may have enhanced, the value of BCBSUW.

Mr. Johnson then directed the committee's attention to page 16 of the draft appraisal committee report, and described five adjustments to the value of BCBSUW that could result if its membership in the BlueCross BlueShield Association ("BCBSA") were revoked or surrendered. The net estimated effect of such a loss of membership was approximately \$90 million.

Mr. Femal asked the Deutsche Banc representatives if the BCBSA termination fee is legally enforceable. Mr. Johnson disclaimed having done an independent legal analysis, but noted that the termination fee is contractual and BCBSA has successfully collected it in the past.

Mr. Femal asked the Deutsche Banc representatives what volume of business would be lost in the event that BCBSUW lost its Blue Plan status. Mr. Harrison responded that BCBSUW estimates that some \$350 million out of approximately \$1 billion of premium equivalents would be lost. Mr. Johnson explained that loss of volume would result in unabsorbed overhead, reduced ability to obtain provider discounts, and lost profit on the individual health business. Mr. Femal then inquired whether the Deutsche Banc analysis assumes that premium growth would not offset the loss of volume to some extent. Mr. Johnson replied that it would be difficult for him to believe that premium growth would offset the loss in volume very quickly. He acknowledged that his firm's analysis assumed only a five-year impact. This assumption is somewhat arbitrary, because it is impossible to know how adeptly the company could respond to the problems that would arise. It is possible that the impact would last longer.

Ms. Lipton asked Mr. Johnson whether this methodology is comparable to other analyses performed with respect to the Blue Cross and Blue Shield service marks. Mr. Johnson explained that his firm started with an analysis prepared by Empire Blue Cross & Blue Shield, New York's Blue Plan, as the format for their own analysis. Deutsche Banc then asked BCBSUW management to review the format and provide the necessary raw data. Mr. Johnson explained that this type of analysis is an art, not a science, because one is constructing the analysis from hypothetical circumstances. Mr. Harrison added that Empire's analysis was constructed internally by Empire's management team, whereas Deutsche Banc's analysis was more simplistic in its

approach because it was constructed from the information available to them as outsiders to BCBSUW.

Mr. Johnson proceeded to provide a brief overview of information added to the conversion resource book since presentation of the last draft. Section 3 was revised to include information on the Empire conversion plan. The Empire conversion plan has many more “shareholder-friendly” provisions than the BCBSUW conversion plan. The New York Attorney General is seeking to make the conversion plan even more shareholder friendly. Mr. Nepple noted that, contrary to what OCI staff and Deutsche Banc representatives had thought earlier, the Empire conversion plan has not yet been approved by the BCBSA. Mr. Harrison added that the Empire conversion plan has elements at odds with the BCBSA Board of Director’s resolution concerning what would be approved in Empire’s conversion plan.

Mr. Johnson continued with his description of changes to the conversion resource book. Sections 1 through 8 were largely the same as the version presented at the last meeting, excepting inclusion of Empire information. He acknowledged that he had not taken the committee through section 7, which contains a primer on the initial public offering (“IPO”) process. Mr. Johnson introduced sections 10 through 12 as a new format for analyses previously discussed by the committee, and these sections were briefly reviewed.

Discussion turned to the draft appraisal committee report prepared by OCI staff and Deutsche Banc based on the concerns and directions of the committee in the course of its meetings. Mr. Ruch noted that a finalized version of the conversion resources book will be attached as an exhibit to the final appraisal committee report. Mr. Ruch noted the committee’s approval of an outline for their report. The OCI staff and Deutsche Banc prepared the draft in the general format of the approved outline. The “Introduction” and “Committee Meetings” sections give the historical background of the committee’s appointment and the statutory basis for its existence and its work. The “Executive Summary” reaches an overall conclusion with respect to the Blue Cross conversion plan. The “Valuation Issues” section follows the committee’s working list of issues. This is followed by a “Recommendations” section with suggested changes to or conditions as part of the approval of the conversion plan. The “Acknowledgement” section concludes the report with room for the signatures of the committee members. Mr. Ruch noted that the committee members had been provided with a draft of the report on Monday evening, so they could review the draft in advance of this meeting.

Mr. Ruch asked the committee members how they wished to structure their conversation about the report. Mr. Femal noted that, while the committee members read the draft report individually, this was the first time that they would be discussing it among themselves. The open meetings law was strictly observed by the committee members. Therefore, there could be no discussions between committee members between meetings. That being the case, Mr. Femal suggested that Mr. Johnson lead the committee through the report, so that the committee members would have the opportunity to bring up any questions or concerns.

Ms. Lipton agreed with Mr. Femal, stating that the committee had to be sure that it is satisfied that the effect of the BCBSA requirements are mitigated with respect to their impact of the valuation of United Heartland Group’s (“UHG”) common stock. Mr. Femal agreed, indicating that the conversion proceeds are intended for the public benefit, and that the committee must be certain that the Foundation’s beneficiaries do receive the full, fair, and reasonable value of BCBSUW.

Mr. Blumer said that the draft report does appear to have captured the issues raised by the committee, and to have been responsive to those concerns. It was essential that the committee page through the report together, so that each committee member may finally share their impressions with the others.

Mr. Femal opened discussion on the "Introduction" section with the comment that he had conducted his own deliberations less with an eye to the interests of policyholders, and more as to how to constructively maximize the amount that would be realized by the Foundation. He did not conduct his deliberations with any willful indifference to BCBSUW policyholders, but he simply did not see a clear relationship between the committee's mission and any effect that its work would have on policyholders, although the policyholders could have an effect on the value of BCBSUW. Mr. Femal explained that he did not believe that a study of the conversion plan's impact on policyholders was within the scope of the committee's mission.

Mr. Nepple noted that the policyholders would not be recipients of any funds directly as a result of the conversion, though they might enjoy whatever advantages accrue to the public at large from the ultimate application of those funds.

Mr. Blumer indicated that the interests of policyholders had been critical to OCI's review of BCBSUW's Application for Conversion. Mr. Ruch agreed, but asked that if the committee members believed that there was anything in the conversion plan that was adverse to policyholders, this meeting was an appropriate forum for airing such concerns.

Ms. Lipton observed that the committee was tacitly obliged to make assumptions regarding the value of BCBSUW's membership in the BCBSA, and the value of its license to use the Blue Cross and Blue Shield service marks.

After additional discussion, the committee decided that each member would re-read the "Introduction" and "Executive Summary" sections of the draft report during the overnight recess and come back with any specific wording changes.

Mr. Blumer observed that there are many people who believe that the committee will provide a definitive fixed-dollar value or range of values that should be the amount that is received in the public interest as a result of this conversion. Mr. Blumer noted that the committee had discussed this possibility at length in previous meetings, and had resolved that they could not do this. Mr. Johnson, recalling those debates, added that any effort to quantify how much the Foundation might realize several months in advance of an initial liquidity event and a few years in advance of its sale of its final UHG share would be uninformative as to the value that will or would ultimately be realized. Valuation is as of a specific date in time. Mr. Johnson said that the real question is whether the conversion plan was prudently structured, so as to enable the Foundation to realize the full, fair, and reasonable value of BCBSUW.

Mr. Nepple asked whether Mr. Blumer was directing staff to insert language into the report that would note the matter had been debated, and explain the basis for the committee's conclusion. Mr. Blumer responded that OCI staff should insert language in the appraisal committee report that is consistent with the committee's discussion.

Discussion proceeded to Issue #1 of the "Valuation Issues" section of the report. Mr. Johnson noted that the one instance of a company using its authorization of blank check preferred stock was the Coventry Group, which is not a Blue Plan. Issue #1, subsections B and C, address the possibility of UHG, or its successor, issuing shares to the detriment of the Foundation. Dilution of value prior to the establishment of a market value for UHG and before the Foundation has had the opportunity to effect an orderly sale of its shares should clearly be avoided.

The committee concluded that transferring 100% of the outstanding shares of UHG to the Foundation would, in fact, constitute 100% of the value of BCBSUW.

Mr. Femal asked why the recommendations were not included in the body of the report. Mr. Johnson and Mr. Junior explained that, while some recommendations are responsive to only one issue, many more are responsive to several at once. In constructing the report, some effort was expended in that direction, but in the course of drafting the language and organizing the format, the approach of stating recommendations in the "Valuation Issues" section was simply impractical.

Discussion proceeded to Issue #2, which related to the matter of the BCBSA – mandated divestiture schedule, which requires the Foundation to meet certain targets for reduction of its ownership interest in UHG, or its successor in the event of a merger. Mr. Johnson noted that he had spoken at length to the committee in previous meetings on the deleterious effect that the divestiture schedule could have on the Foundation's ability to realize full, fair and reasonable value. The draft recommendations address the desirability of an immediate post-conversion liquidity event that would take the Foundation over its first divestiture hurdle. He noted that another recommendation provides for an extension of the divestiture schedule in narrow circumstances that are in keeping with those delineated in the RightChoice example.

Mr. Femal asked for anyone's recollection of the September 30, 2001, deadline in the divestiture schedule specified in the filed Application for Conversion, and how this would play into the recommendations suggested to mitigate the divestiture schedule. Mr. Johnson replied that the draft report's recommendation is worded in such a way as to supercede that specific date in the conversion plan.

The committee proceeded to the section for Issue #3, concerning shareholder rights. The draft report proposes changes to improve valuation of the common stock through improvements to corporate governance. The report concludes that the shareholders of UHG could be given greater governance rights without apparently exceeding the BCBSA guidelines.

Mr. Femal observed that the Foundation's voting rights are severely restricted in any case by the Voting Trust and Divestiture Agreement. If the Foundation itself will not directly be able to exercise the improved shareholder rights, he wondered whether the beneficiaries of the Foundation would likely receive any greater value for the Foundation's shares, in consequence of these improvements. Mr. Johnson responded in the affirmative, that, generally speaking, if shareholders were given additional governance rights, they would likely utilize them. This, in turn, should have a positive influence on the value of the UHG stock, and thus the sole asset of the Foundation. The Foundation should benefit from additional governance rights accorded shareholders, even if the Foundation cannot itself exercise all of these additional governance rights.

Mr. Femal noted that there were ownership limitations, whereby retail investors were limited to less than 5% of shares outstanding and institutional investors to less than 10% of shares outstanding. In view of these limitations, Mr. Femal asked how the shareholders would exercise these rights and achieve any impact on UHG corporate activity.

Mr. Johnson responded that the question is not about the influence of any one shareholder, but the influence of shareholders as a group. Having some shareholder-aligned directors on UHG board and permitting the Foundation to have observation rights at board meetings should permit fair hearing on strategic possibilities that may favorably impact the valuation of UHG's common shares.

Mr. Blumer said that he was trying to reconcile the BCBSA requirements with the need to establish a structure in which shareholders may have some means to encourage their interests.

Mr. Femal asked whether there was any way for Deutsche Banc to estimate the impact on the valuation of BCBSUW that results from BCBSA restrictions. Mr. Johnson responded that, although one could argue how, theoretically, BCBSA restrictions reduce value, right now, Blue Plans are trading at higher earnings multiples than independent managed care companies.

Ms. Lipton inquired whether the Blue Plan franchise is protective of valuation. Mr. Johnson replied that even buy-side investors in the publicly traded Blue Plans could not define the value of the franchise. Ms. Lipton described situations of stock issues that involved two classes of shares, with one class having more restrictive provisions on the exercise of corporate governance than the other. She noted that, in such situations, the less restricted class trades at a premium. Ms. Lipton suggested that, in addressing governance issues, the committee could propose structural recommendations that could enable the UHG stock to be eligible for some form of takeover premium.

Mr. Johnson wrapped up the discussion of Issue #3 by stating that one may not demonstrate that the market today is discounting Blue Plans relative to other managed care companies. However, by fine-tuning some governance measures in the Application, one may enhance the prospect of a fair hearing, from the shareholders' point of view, on strategic issues at the board level.

Mr. Johnson introduced Issue #4 as concerning the intangible value of the Blue Cross and Blue Shield service marks. He explained that there is not any one correct way to value the BCBSA license that allows use of these logos. Deutsche Banc customized the Empire Blue Cross & Blue Shield methodology using data provided by BCBSUW. One cannot create BCBSUW as a stock company without BCBSA membership; it is simply too integral to the company's business. It is in the interest of the Wisconsin public for those working on this project to cooperate with the BCBSA to address its reasonable concerns while insisting on fair shareholder representation.

Mr. Blumer called attention to the language of the draft report that described how the Foundation lacked most of the ownership rights customarily possessed by shareholders in the United States, but that many of these provisions were required by the BCBSA. Mr. Johnson indicated that the committee had the advantage of precedent transactions to guide them. Mr. Blumer observed that there seems to be some recognition by the BCBSA that each Blue Plan has unique features and concerns. The BCBSA seems to have shown some willingness to exercise flexibility, provided that its standards and commitments are not jeopardized.

The committee concluded that, based upon the information it had reviewed concerning the value of the Blue Cross service mark to BCBSUW, the maintenance of the Blue Cross service mark is an integral piece to the future well-being of the company.

The committee proceeded to Issue #5. Mr. Johnson mentioned that the matter of past transactions between Blue Cross and its affiliates had been addressed exhaustively in past meetings. Mr. Femal inquired as to whether the \$70 million loan from Blue Cross to UWS had been factored in to any recommendations. Mr. Johnson replied that there are any number of means to arrange orderly repayment if UHG were to be a stand-alone company. Under a merger with UWS, however, the debt would likely be extinguished, with additional consideration (presumably UWS stock) issued in its stead. Mr. Femal asked why the committee did not think that \$70 million, being such a sizable number, should, in some fashion, be recognized within the scope of its recommendations. Mr. Nepple said that the OCI oversight provisions will ensure a proper review of the value of the loan in a merger situation. Mr. Johnson confirmed that the value of the loan would be addressed in any merger transaction.

Mr. Femal recessed the committee at 2:55 p.m.

Mr. Femal reconvened the meeting at 3:16 p.m.

The committee discussed Issue #6, concerning the alternatives for monetizing the Foundation's shares in UHG. Mr. Johnson noted that there was nothing in the Application for Conversion that specified a definite means to achieve liquidity. The recommendations derived from this area of concern are intended to get the Foundation over the first hurdle of the divestiture schedule.

The section of the draft report for Issue #7 related to background information and regular updates on the financial performance of the health insurance and managed care sector, so the committee accorded this section of the text only a brief review. The section of the draft report for Issue #8 made reference to the "Recommendations" section, and did not engender discussion.

The committee turned its attention to the "Recommendations" section of the draft appraisal committee report. Mr. Femal asked that the "Recommendations" section be revised to make clear and specific reference to the body of the appraisal committee report and the conversion resource book, because the recommendations have a context and a frame of reference.

Mr. Femal inquired as to whether the recommendations represent suggested changes to the conversion plan filed with the Office of the Commissioner of Insurance. Mr. Junior noted that, for the most part, this was the case. However, certain recommendations serve as specific affirmations of the plan as filed. Mr. Femal suggested that recommendations that affirm the existing provisions of the conversion plan should be worded so that this is distinctly evident.

In reference to recommendation #1, Mr. Femal requested an explanation on why this measure should not be regarded as duplicative of OCI's usual regulatory review authority. Mr. Nepple noted that the Commissioner of Insurance has no regulatory authority to review the stock issuance of holding companies that are not insurers. In addition, the holding company laws permit the Commissioner to protect policyholders, but not to protect shareholders. The Foundation would have the status of a shareholder in such review as the Commissioner may otherwise have authority to conduct without the recommended extension of authority. Mr. Ruch added that the extension of OCI's authority would likely sunset when the UHG stock has achieved an adequate float in the public equity market or some form of final sale of UHG has occurred, whichever occurred sooner.

There ensued a discussion of whether policyholders' interests would conflict with the Foundation's interests as a stockholder. Mr. Nepple responded that, normally, financial health and good reputation would be regarded as being of mutual interest to shareholders and policyholders alike. In any event, an insurer must operate in accordance with the insurance laws. The Foundation takes the stock given it subject to all the requirements of the insurance laws.

Mr. Johnson introduced recommendation #2 as being intended to mitigate the burdens of the divestiture requirements on the Foundation. Section 2(i) of this recommendation provides for automatic extensions to the divestiture schedule in certain narrow circumstances that mirror provisions approved by the BCBSA for the RightChoice conversion. Mr. Blumer sought and obtained confirmation from Mr. Johnson that the RightChoice conversion plan provided for extensions when, under certain situations, an action of the company makes it impossible for the Foundation to conduct a public offering necessary to meet a deadline.

Mr. Johnson noted that the construction of recommendation #2 is intended to provide UHG with options. UHG could remain a stand-alone company, or complete a merger with UWS. As a result, UHG would have limited flexibility with respect to the timing of the conversion. The recommendation is worded to allow the company to proceed with conversion any time during the six-month period after the Commissioner approves the Application.

Discussion turned to the issue of what level of public float would assure the liquidity and investor interest necessary for orderly future sales of UHG stock by the Foundation. Mr. Johnson noted that the current public market capitalization of UWS (i.e., the float), excluding the value of shares held by BCBSUW, is about \$30 to \$35 million. One would want equity analyst research coverage and market making interest in the stock. Deutsche Banc believes that, ideally, a company having the size of a combined UHG and UWS should have a minimum float of between \$75 million and \$100 million.

Mr. Blumer mentioned that it was his understanding that institutional investors often have thresholds of interest based on float, capitalization, and dividend rates. Mr. Blumer asked Mr. Johnson what relationship the volume of suggested float should have to the overall capitalization of the company. Mr. Johnson responded that a range of between 25% to 35% of capitalization is fairly normal for initial public offerings. An initial public offering of \$75 million is actually at the low end of this range if one presupposes a merger of United Heartland Group, Inc. and United Wisconsin Services, Inc. before the offering.

Mr. Johnson related that it is possible for small companies with very high growth rates to complete smaller offerings, but that is only done successfully when there is an expectation that the float will increase rapidly through share price appreciation. UHG is not a "dot.com" company that the market expects will grow rapidly. Conversely, there have been initial public offerings of 100% of the initial capitalization, but that usually involves issuance at a discount. In addition, institutional investors like to know that stock will be available for future purchases so that they can build their positions.

Mr. Johnson discussed the advantages of having UHG and the Foundation issuing shares simultaneously. First, it aligns the interests of UHG and the Foundation. Management will then more likely commit to meetings throughout the country with potential investors, and will more likely make a good faith effort to obtain equity analyst research coverage from firms other than the underwriters. Second, it allows the company to raise additional primary capital. During Deutsche Banc's due diligence discussions, management repeatedly stated the usefulness of additional capital. Capital could be applied to transactions with other Blue Plans, the creation of joint ventures and provide flexibility in the pursuit of strategic initiatives generally.

Mr. Johnson indicated that the Foundation might be under some compulsion to participate in an initial public offering if afforded the opportunity, depending on Wisconsin foundation law, but stressed that it is still preferable for the company to participate and raise primary capital.

Mr. Blumer asked for clarification on the timing of the follow-on offering under (2)(ii)(B). Mr. Johnson responded that, as the recommendation stands now, the follow-on offering must be structured to follow conversion. Mr. Harrison added that a packaged sequence of transactions is quite usual in demutualizations.

Mr. Femal announced that the committee would reconvene in the same location at 9:00 a.m. on the following day, and the meeting was recessed at 4:07 p.m.

The meeting resumed at 9:06 a.m. on Thursday, February 10, 2000, with the following persons in attendance:

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

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

Representatives of Deutsche Banc Alex. Brown: Thomas W. Johnson and Giles E. Harrison

Other members of the public present: Ben Adams, Stephen E. Bablitch, Sybil Better, Joseph C. Branch, Thomas J. Fonfara, L. Jane Hamblen, Gail L. Hanson, Wade M. Williams, and Jeanne Wittig

Mark Femal, the committee's chairman, opened with a discussion of procedural issues. After discussion, the committee decided that, when the members completed their work today, they would adopt the report subject to the changes resolved upon at today's session.

Mr. Johnson was recognized for the purpose of conducting the committee through the recommendations. Mr. Johnson directed the committee's attention to Recommendation #2, which lays out various options concerning the relative participation of UHG, or its successor, and the Foundation in any initial public offering and follow-on offering, the minimum public float before and after the stock issuance, and the size of the offering. Discussion ensued on the merits of requiring the company to participate in the raising of primary capital.

After discussion, the committee members decided to complete their review on the entire document and then make conclusive decisions, rather than making decisions piecemeal. The committee also decided to skip recommendation #3 for the moment, and proceed through recommendations #4 through #6.

Mr. Johnson noted that recommendation #4 relates to providing sufficient funds for the Foundation's maintenance prior to the initial public offering or follow-on offering. The Foundation must have seated its board and retained competent advisors if its board is to be able to decide whether or not to participate in such an offering.

Mr. Johnson explained that recommendation #5 would permit OCI to retain appropriate professional advisors (such as an investment banking firm) to assist OCI in the evaluation of mergers and public offerings until the public float is adequate to assure sufficient liquidity, equity analyst research coverage, and investor interest for orderly sales by the Foundation. Depending on the circumstances, an actuary might also have to be retained if there are questions about the relative adequacy of loss reserves between two prospective merger partners. There was no specific determination that an actuary would be necessary in the review of a merger between UHG and UWS.

Mr. Johnson described the provisions of recommendation #6. Recommendation #6 would prohibit the issuance of equity options on United Heartland Group, Inc. and United Wisconsin Services, Inc. common stock to the officers, directors, and employees of UHG, Blue Cross & Blue Shield United of Wisconsin, UWS, or any affiliates of these entities. This prohibition applies either in anticipation of the conversion or for 365 days after the date on which UHG shall become a publicly traded company. There are also restrictions proposed to prevent certain compensation packages being triggered as a consequence of a merger between UHG and UWS. There is an exception for a director who is scheduled to join the UWS board in May 2000 to receive 3,000 shares under option, which is in line with customary procedures.

Mr. Femal, in reference to the issuance of options "in anticipation of the Conversion", asked when the clock would start running under that definition. Mr. Johnson replied that about one-third of all shares of UWS now under option were granted in January 2000. Of the 1.6 million shares under option to senior management, defined as consisting of Messrs. Hefty, Hanson, Bablitch, Siewert,

and Hartert, 648,800 shares were granted under option this last January, at a strike price of \$4.3125 per share (which was the market price on the day the options were priced).

Mr. Femal inquired as to whether the option awards of January 2000 were normal. Mr. Johnson said that the grants were much larger than historical norms. What is normal is the timing of the grants, which have customarily taken place in January in recent years. Mr. Johnson also said that UWS has recently changed its overall approach to executive compensation, reducing the cash component and increasing the stock option component, in response to work completed by UWS' compensation consultants.

Ms. Lipton asked if there had been any re-pricing of previously issued options awards. Mr. Johnson responded that there has been no re-pricing of which he is aware. The options awards are 10 to 12 years in duration.

Ms. Lipton inquired as to whether these options are dilutive. Mr. Johnson replied that the older option awards are at strike prices well above book value and so exercise would be accretive to book value per share. The most recent options grants, however, would be dilutive to book value per share if exercised today as the strike price is below book value, and there are 10 years to run on these.

Mr. Femal asked the Deutsche Banc representatives whether, from their experience, the numbers of shares under option are normal in number and amount. Mr. Johnson said that it is not out of the ordinary for management to receive options.

Mr. Harrison directed the committee to page 39 of section 5 in the conversion resource book. The ratio of 16% of shares under option versus total shares issued and outstanding is overstated because 1,000,000 of the shares under option were issued to persons who are no longer associated with UWS. Most of the options held by these outsiders are at strike prices substantially above the current price. This chart, however, does not reflect the January 2000 options awards.

Mr. Femal asked whether there is any problem, perceived or real, with respect to the option grants in January 2000. Mr. Johnson noted that Wall Street looks at fully diluted earnings per share.

Mr. Femal asked whether the number of shares under option now outstanding would create any problem or diminution of value for the Public Health Foundation. Mr. Johnson responded that he did not see that this would, in itself, present a problem from the perspective of the investment community. Institutional investors will see management as very much aligned with their interests. Mr. Johnson commented that there certainly is incentive for management to achieve an increase in the stock price.

Mr. Femal reiterated his question, once again asking if this were a perceived or real problem. Mr. Johnson stated that the problem was more one of perception, as it stands, rather than reality.

Mr. Blumer asked about the effect that a merger would have on the exercise rights of the options. Mr. Johnson referred to footnote #11 of the draft appraisal committee report. OCI and Deutsche Banc were informed that officers, directors, and employees are being asked to sign a waiver to acknowledge that a merger with UWS would not constitute an acceleration event under their options awards. Mr. Blumer disclosed that it was his understanding that persons holding options that are no longer affiliated with UWS are unlikely to sign waivers, but that their option holdings are at a strike price substantially above the current stock price.

Ms. Lipton suggested that the committee consider a prohibition on the re-pricing of options. Mr. Harrison offered that the current wording of recommendation #6 provided that there could be no change in the terms of an options package. Mr. Johnson added that a merger between UHG and UWS should trigger none of the change in control agreements.

Mr. Femal asked Ms. Lipton and Mr. Blumer whether the appraisal committee's report to Commissioner O'Connell should comment on the January 2000 options awards, and provide guidance on an appropriate response.

Mr. Johnson offered that he did not think that the option grants were granted specifically in anticipation of the conversion, in part because management doesn't know what will happen to the stock price. The awards were made at the customary time and with a strike price at the prevailing stock price. The option awards will give management the incentive to work on improving the company's stock price performance. Mr. Nepple asked the committee if their report should be revised to include Mr. Johnson's comments. Mr. Blumer suggested that the committee comment on the principles surrounding the question, and not comment on the specific number or strike price of options.

Mr. Harrison stated that, in general, management's interests are aligned with those of the Foundation's through the UWS options, but that these interests would diverge should UHG pursue an IPO. Mr. Johnson interjected that in a merger between UWS and UHG, the interests of management would be aligned against those of the Foundation in setting a share exchange ratio in a merger between UHG and UWS. After the merger, provided there was a prompt follow-on initial public offering, management's interests would realign with the Foundation.

Mr. Femal recessed the committee at 9:50 a.m.

Mr. Femal reconvened the meeting at 10:10 a.m.

Mr. Johnson introduced recommendation #3, explaining that the intent of recommendation #3 was to modify governance and, to a lesser extent, anti-takeover provisions. The intent is to follow RightChoice, and in some cases, to go a little further, while ensuring that the organization remains committed to the principles of the BCBSA.

Mr. Harrison described how the Foundation's articles of incorporation, as proposed, could only be amended, before or after the conversion, with the approval of the board of BCBSUW. Section (3)(i) is intended to provide discretionary authority that is more in line with other foundations resulting from Blue Plan conversions.

Mr. Femal proposed that the wording of section (3)(iv) in the "Recommendations" be modified to reflect the committee's intention that the Foundation be permitted to direct the trustee of the voting trust in all decisions regarding change of control of UHG, or its successor, except in the event of a merger with UWS, to the extent of its then-current shareholdings. It is not the committee's intent to propose that the Foundation should have "veto" rights (although in the early years when the Foundation is the only shareholder or the majority shareholder, the effect will be the same).

Mr. Johnson broadly described the proposals encompassed in recommendation #3. The suggestion is that the Foundation should have the right to demand an unlimited number of registrations, subject to certain conditions, so that the Foundation may sell as many shares as it wants, subject to what the market will bear. In keeping with all other Blue Plan conversions, the UHG, or its successor, should pay the expenses of registration, while the Foundation pays its own legal expenses, as well as the commissions and discounts on the shares it sells. The

recommendation provides for an independent board for the Foundation, free of influence from UHG or other interested parties.

Mr. Blumer asked for an explanation of board meeting observation rights. Mr. Johnson and Mr. Harrison responded that observation rights are much as the rights of the public attendees at this meeting. The Foundation may send some representatives to sit and listen, but not to speak or vote.

There was a discussion of the mechanisms, whereby public shareholders could gain representation on the board of UHG (after the Foundation had sold some of its UHG shares), so long as the self-perpetuating majority was maintained as required by BCBSA requirements. The presence of some shareholder-aligned directors was seen as additive to value. This was followed by a discussion of different options to permit shareholders some opportunity to remove directors for gross misconduct.

Ms. Lipton asked that the appraisal committee report be modified to clearly indicate that the committee had debated the possibility of arriving at a fixed-dollar value or range of values, but rather elected to focus on the sounder course of evaluating the structure of the transaction. The committee unanimously agreed to include this information in the Executive Summary.

Mr. Femal indicated that the appraisal committee report should not suggest unlimited and perpetual oversight on the part of OCI over UHG, or its successor, in excess of that otherwise provided by law. The oversight measures were intended to provide reasonable and temporary protection for the Foundation's interests until an adequate float is achieved in the public marketplace.

The committee unanimously resolved that the minutes should reflect its sense that Deutsche Banc should be continued on this conversion review until its completion, so that the expenses of OCI oversight are kept reasonable. The committee believes that a change in firms would lead to unnecessary expense simply for the successor firm to educate itself about Blue Cross and the background of this conversion transaction.

Mr. Femal asked whether there was any merit in recommending that UHG common stock pay a dividend as a means of aiding the valuation. Mr. Johnson suggested that what was necessary for UWS in 1991 might or might not be the case this year, and that the question of an initial dividend should be reviewed in connection with the initial public offering or the follow-on offering, as the case may be, at the time of the offering. Mr. Blumer affirmed this approach to the dividend question.

Mr. Blumer proposed that the committee vote on recommendations #1, #4, #5, and #6 simultaneously. The rest of the committee concurred.

Mr. Femal proposed that section (6)(i) be revised to read, "from the date of this report". In the same spirit, Mr. Blumer proposed that the report be revised to reflect committee discussion of the January 2000 options grants. Mr. Femal suggested that the commissioner review the question of the January 2000 options grants.

Mr. Blumer moved that the committee adopt recommendations #1, #4, #5, and #6, as modified by the changes proposed by the committee's members. This motion was seconded by Ms. Lipton, and carried unanimously.

After discussion, the committee adopted Mr. Blumer's proposal to permit an extension of up to one year on the timing of the conversion, based on the date of the commissioner's final decision or a related order.

Mr. Blumer asked Ms. Lipton for her opinion on a desirable minimum float. Ms. Lipton responded that the range of float recommended by Deutsche Banc was well in line with the expectations of institutional investors. After debate, the committee resolved that the minimum recommended float after an initial public offering or follow-on offering be \$75 million, but that this could be reduced to no less than \$50 million with the consent of the commissioner. The minimum recommended size for an initial public offering or follow-on offering was also set at \$75 million, but that this, too, could be reduced with the consent of the commissioner, but in no event should it be less than \$50 million.

After discussion, Ms. Lipton moved that the committee recommend that, in conducting an initial public offering or follow-on offering, UHG be required to issue new common shares up to the minimum level required of the offering, but that such amount be reduced by the amount that the Foundation, in its discretion, may wish to offer. In the event of a \$75 million offering, for example, the Foundation could decline participation, in which case UHG would be obliged to issue \$75 million; otherwise, the Foundation could agree to supply all of the shares of the offering up to \$75 million or such greater amount as the lead managing underwriter permits.

Ms. Lipton moved that the committee adopt recommendation #2, as modified by the changes proposed by the committee's members. This motion was seconded by Mr. Blumer, and carried unanimously.

After discussion, Mr. Blumer moved that the committee adopt recommendation #3, solely with respect to the section captioned "Foundation", with certain technical changes to clarify the intentions of the committee. This motion was seconded by Ms. Lipton, and carried unanimously.

The committee discussed various options related to the composition of the UHG board of directors. Mr. Harrison advised the committee that the Foundation would never be able to participate in the nomination or election of directors. Nonetheless, the sense of the committee was that the presence of shareholder-aligned directors working alongside the self-perpetuating directors would be advantageous to the valuation of UHG's common stock.

The committee unanimously agreed that the percentage of Independent directors on UHG's Board (with "Independent" as defined by the BCBSA) should be retained at 80% as proposed in the Application, however, a mechanism should be established (that is approved by the Commissioner) that provides for the nomination and election of truly independent directors for the remaining 20% of Board until such time as the Foundation holds less than 20% of UHG stock.

Mr. Blumer moved that the committee adopt recommendation #3 in its entirety, as modified by the changes proposed by the committee's members. This motion was seconded by Ms. Lipton, and carried unanimously.

Mr. Blumer moved that the committee adopt the appraisal committee report, as amended. It was further moved that OCI staff and Deutsche Banc representatives be authorized to make technical and typographical corrections in accordance with the resolutions of the committee. This motion was seconded by Mr. Femal, and carried unanimously.

The next meeting of the Appraisal Committee was set for Monday, February 14, 2000. The purpose of the meeting will be to approve minutes of meetings and for the committee members to

sign the final and adopted version of the Appraisal Committee Report. OCI would see to the distribution of public notice once a time and location on that day has been set.

Mr. Femal thanked OCI and Deutsche Banc for their assistance, and the public attendees for their interest in the work of the committee.

The meeting was adjourned by the unanimous consent of its members at 12:28 p.m.