

STATE OF WISCONSIN
BEFORE THE OFFICE OF THE COMMISSIONER OF INSURANCE

In the Matter of:

Proposed Acquisition of Control of
Physicians Insurance Company of Wisconsin, Inc., by
American Physicians Capital, Inc. and
American Physicians Assurance Corporation

Case No. 04-C29283

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OF INSURANCE

APPLICANTS' BRIEF IN SUPPORT OF REQUESTED DISCOVERY

Preliminary Statement

American Physicians Assurance Corporation and American Physicians Capital, Inc. ("Applicants") are attaching draft discovery requests to this Brief, as Exhibits 1, 2 and 3. These requests are directed to Physicians Insurance Company of Wisconsin ("PIC"). In submitting these requests for the Commissioner's review, the Applicants do not concede or agree that PIC is entitled to participate in these proceedings as a party. For the reasons set forth in Applicants' Brief dated June 6, 2005, the Applicants do not believe that PIC qualifies as a party under the applicable standards. Because that issue is still pending, however, the Applicants have drafted the attached discovery requests in the event that the Commissioner permits PIC to intervene as a party.

Moreover, the Applicants do not believe that any discovery in this matter is appropriate or necessary, beyond that conducted by the Commissioner's Staff as part of its own independent review of the Form A filing. Based on the statements made by PIC's representatives in correspondence to the Commissioner's office, and at the prehearing conference, it is apparent that PIC wants to use discovery as part of its apparent effort to stall the transaction as long as possible, and to make it as expensive as possible for the parties. Therefore, the Applicants want to make clear to the Commissioner that by submitting the attached discovery requests, they do

not concede in any way that discovery in this proceeding is appropriate. Rather, the requests are submitted on the assumptions that the Commissioner will permit some discovery, and that Applicants are entitled to as much discovery from PIC as PIC obtains from the Applicants.

The Applicants have proposed discovery on issues that have been raised by PIC in their pleadings or public statements opposing the proposed transaction. Some of the arguments raised by PIC have nothing to do with the standards governing this proceeding as set forth in Wis. Stats. §611.72. The Commissioner, in reviewing the proposed discovery, may well define and narrow the issues that are in dispute. To the extent the Commissioner takes such an action, some of the proposed requests will be irrelevant. Given that the Applicants do not know the final outcome of any such rulings, the Applicants have submitted discovery on issues that they would otherwise consider irrelevant under §611.72.

Applicants do not agree that the history and purpose of PIC are relevant considerations. But Applicants do believe that if they are to be examined then the history must be brought up to the present. First, this will enable the Commissioner to judge whether the management and Board have been consistent in “history” and “purpose” and what PIC’s past and current behavior says about its current view of its “purpose”. Second, it will demonstrate PIC’s continuous operation as to a stock company.

Finally, the Commissioner has also advised that he intends to consider some additional factors at the hearing (Transcript of prehearing conference, pp. 28-30.)¹ The majority of the

¹ Even a broad reading of Wis. Stats. § 611.72(3)(d) requires the conclusion that this section is triggered only when the acquiring party has plans to make “material change[s] to [the domestic insurers] business or corporate structure or management.” No such change is proposed. Indeed it disclaimed by Applicants. Thus, the history and purpose of PIC cannot be tied to this section by the Commissioner’s positioning of this issue in the issues list distributed on May 31st.

proposed discovery requests are directed to these additional factors identified by the Commissioner at the prehearing conference.

To assist the Commissioner's review of the discovery proposed by the Applicants, the discovery requests are collected in this Brief into the following broad categories:

1. The transferability of the shares of PIC and the effect of the proposed plan on the history and purpose of PIC Wisconsin;
2. The issue of "control" of PIC as a result of the proposed transaction; and
3. The basis for the statements asserted by PIC in their pleadings and public statements opposing the proposed transaction.

Each of these categories is described in further detail below.

TRANSFERABILITY OF THE STOCK OF PIC

In the prehearing conference, the Commissioner provided a "punch list" of the items that the Commissioner intends to review in connection with these proceedings. That list contains the following statement:

This includes an evaluation of the effect of the proposed plan on the history and purpose of PIC of Wisconsin, including the extent to which the stock is or was intended or expected to be transferable and the contribution of PIC of Wisconsin to the Wisconsin insurance marketplace.

Transcript, pp. 28-29. The Commissioner elaborated on the "transferability" issue:

Not having been here at the time that these entities were formed, and especially PIC, I think it's very important for the record to be clear that despite the fact that there's been some relatively informal ability to transfer or sell stock, I think it's important for this record to at least clarify that those transfers were appropriate and that this potential transfer is appropriate as well. There is history to the manner in which this entity was formed, the purpose for which it was formed and at the end of the day, I think I'm going to want to know a pretty good answer to what the bigger picture was sometime back in order for us to assess what the market may be like in the future.

Transcript, p. 30.

The Applicants were not involved in the formation of PIC. Therefore, to obtain information responsive to the Commissioner's request, it is necessary to obtain this information from PIC. The Applicants believe that the evidence will show that when PIC was formed, it was intentionally formed as a stock company, rather than a mutual insurance company. The Applicants also believe that they are entitled to inquire whether the founders of PIC considered alternate business structures, such as a mutual insurance company, or forming a subsidiary of the Wisconsin Medical Society. The Applicants seek this information in Document Request # 1; Interrogatory # 1 and 2, Request for Admit #1-3. This is directly relevant to the issue identified by the Commissioner.

If the stock of PIC is not transferable, as some apparently claim, then it has no value, and there should not have been any transfers permitted by PIC. If PIC has allowed such transfers historically, this provides strong evidence that the shares are just like any other shares issued in the State of Wisconsin – they are transferable. To obtain information on this issue, the Applicants are requesting information on the stock transfers that have been authorized and/or recognized by PIC, the documents created regarding those transfers, and the current composition of the shareholder base to compare it to the original shareholders. (Document Requests # 2 and #7).

Moreover, if the shares were not transferable and had no value, PIC would not be able to use the shares as a means of compensating its officers and directors. To obtain this information, the Applicants have requested information on the compensation plans of PIC that are based on stock (Document Requests #6 and #7, Interrogatories #3 and #4; Requests to Admit #4 and #5). To establish that PIC has treated the shares as having value associated with transfers (something

that would not exist in a mutual insurance company), the Applicants have requested information that will show that PIC has redeemed/repurchased the shares issued to insiders and that it has done so based on the book value of the company, or some other measure. (Document Request #7, Request to Admit #5, and Interrogatories #3 and #4.) In fact, the Applicants wish to confirm that at the same time PIC has been agitating regarding this proposed transaction and claiming that the shares cannot be transferred, it has been rewarding insiders by redeeming their shares at book value. The Commissioner should consider this evidence when evaluating PIC's demonstrably false claim that the shares can not be transferred and thus have no value.

PIC is believed to have generated a number of documents over the years, arguing to its shareholders that it is trying to create liquidity for the shareholders and addressing the potential transfer of its shares. These documents were likely generated during the following events in PIC's history: (1) the 1994 Redemption Offering by PIC; (2) the 1998 Redemption Offering, (3) the Shareholder Redemption and Exchange Plan presented in 2003, and (4) the Shareholder Value Plan presented in 2004. The Applicants are requesting these documents in order to determine whether PIC has made representations to its shareholders over the years that would be relevant to the Commissioner's determination of this issue. (Document Requests # 3-5). It is believed that PIC has repeatedly addressed itself to its shareholders, as any other stock corporation would, by offering mechanisms for shareholders to transfer their shares and extract their original investment in a company.

In addition, the Applicants believe that PIC regularly makes statements to its shareholders that it is developing plans to promote liquidity and/or to bring value to its shareholders. Such statements appear in Annual Reports, and are likely in mission statements, strategic plans of PIC, and histories of PIC that it has prepared. The Applicants seek these

documents to confirm that these kinds of representations were made so that they may also be considered by the Commissioner. (Document Requests #8-15). PIC may also have documents that show that it has been involved in discussions with third parties regarding share transfers and how the shares should be valued upon transfer. The Applicants seek this information to further confirm PIC's historical position in light of the Commissioner's request. (Document Requests #8-15, #25).

Finally, PIC has advanced the position that its "mission" is to serve only Wisconsin policyholders and that PIC is more like a mutual company than a stock company. Of course, if PIC was a mutual company, there would be a unity of interest between its shareholders and its policyholders. PIC made the conscious decision in approximately 1990 to allow health care providers to purchase professional liability insurance from PIC even though they were not shareholders of PIC. Currently, it is believed that more than 50% of the policyholders are not shareholders of PIC, and that more than 50% of the policyholders are not Wisconsin residents. The Applicants have drafted discovery requests to elicit evidence on this point to submit these facts to the Commissioner. (Requests to Admit #6-10; Document Requests # 2, 16 and 23).

ISSUE OF CONTROL

As stated at the prehearing conference, the Applicants believe that as the result of PIC's adoption of a poison pill (euphemistically called a "Shareholders Rights Plan"), PIC has made it impossible for the Applicants to obtain actual control over the operations of PIC or its Board of Directors without full Board approval. To support this point, the Applicants seek discovery to show that when the shareholders care about an issue, they vote on it, meaning that the amount of stock to be owned by APA will not be a controlling interest. (Document Request #19). The Applicants also seek the documentation regarding the creation of the "Rights Plan" which are

likely to confirm that this was the exact result intended by PIC when it adopted the plan. (Document Request #18). Amendments to the Articles of Incorporation and the Bylaws of PIC from its origin will be relevant to both the transferability issue and to the issue of control. (Document Request #17)

DISCOVERY FOCUSED ON THE ISSUES RAISED BY PIC

The final category of discovery sought by the Applicants pertains to issues that have been raised by PIC in opposition to the proposed transaction. For example, the Requests to Admit seek to confirm whether PIC is actually contesting that each of the standards set forth in Wis. Stats. § 611.72 is satisfied. (Requests to Admit #11-18.) If PIC is contesting any of these issues, then it should be required to respond to interrogatories that request the basis for its position, the witnesses it intends to rely upon in support of its position, and to identify the documents it intends to use on each issue. (Interrogatories # 5-18; Document Request # 20-27). If PIC admits that it is not contesting any issue, then the Applicants do not require any discovery regarding it.

PIC is attempting to divert the Commissioner's attention from the statutory standards by advancing some arguments in its Request for Admission as Party, that are irrelevant. For example, PIC's Request for Admission states that there are "serious questions about Petitioner's history of acquisitions and dispositions of companies." The Applicants do not believe this issue is even remotely relevant to these proceedings. No one can seriously contend that APA is interested in making this investment in PIC so that it can turn around and somehow then reduce market share or convince PIC management or its Board to exit the Wisconsin marketplace! In its Form A, the Applicants agreed that there would be no material change in the business operations of PIC without Commissioner approval – even assuming that the Applicants had control over this issue. This is a red herring designed for days of distraction, not attention to the statutory criteria.

If, however, the Commissioner believes it is somehow relevant to consider APA's history with regard to other States, then APA is entitled to show that (1) PIC also has a history of entering and exiting markets, and (2) PIC left many of those markets for the same reasons that ultimately drove APA's decision to exit some markets (like Florida). The Applicants seek this information in Document Request # 21 and Interrogatory # 19.

Similarly, PIC has argued that it is entitled to review information regarding APA's loss reserves. Once again, this information is not remotely relevant to these proceedings, as APA is purchasing only a minority of the outstanding shares of PIC. A shareholder's solvency is not relevant to PIC's solvency, particularly when Wisconsin law regulates the circumstances under which any domestic insurer can dividend money to its shareholders. PIC has not historically paid shareholder dividends, and the Applicants' Form A once again commits that it will not change PIC's business practices without prior approval of the Commissioner. Therefore, whether APA is over-reserved or under-reserved is not relevant to these proceedings. If, however, the Commissioner permits PIC to start combing through APA's loss reserves, then APA is entitled to the same information from PIC to demonstrate (1) the assumptions underlying its loss reserves are reasonable and are frequently the same assumptions used by PIC, and (2) in many cases, APA's loss ratio and performance equals or exceeds that of PIC. This information is addressed in Document Request # 20.

The Applicants have also included requests for documents exchanged with Wisconsin Medical Society regarding the proposed transaction. In addition, the Applicants seek documentation regarding PIC's efforts to strong-arm the Wisconsin Medical Society into supporting its position in this proceeding through negotiations regarding the financial terms of the continuing relationship between the parties. (Document Request #24). This information is

relevant to potential impeachment of witnesses, as well as making this proceeding transparent to the shareholders.

Finally, the Applicants seek production of the documents that PIC intends to use as exhibits in this matter, and their expert information. These will ultimately have to be produced if PIC is a party in any event.

SUMMARY OF REQUESTS

As detailed in the foregoing analysis, the proposed discovery requests break down as follows:

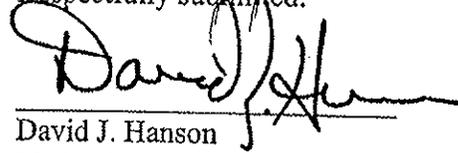
Issue	Interrogatory	Document Request	Request to Admit
Transferability of PIC stock	1-4	1-16, 25	1-11
Control	7	17-19	18
Issues raised by PIC	5, 6, 8-21	20-27	12-17

Conclusion

If the Commissioner permits discovery in this matter, it should be permitted on the core issues that have been identified by the Commissioner under the statute. But if broad discovery is to be permitted on issues not yet narrowed then APA is entitled to correspondingly broad discovery.

Dated this 8th day of June, 2005

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