



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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DATE: December 16, 2004
TO: Roger A. Peterson
FROM: Steven J. Junior
SUBJECT: Acquisition of Control of Unity Health Plans Insurance Corporation by University Health Care, Inc. (Case No. 04-C29300)

DESCRIPTION OF THE TRANSACTION

Overview

On October 1, 2004, University Health Care, Inc. filed a plan to acquire Unity Health Plans Insurance Corporation under the terms of purchase options in certain Joint Venture Agreements including, among others, University Health Care, Inc., Community Health Systems, LLC and Blue Cross and Blue Shield of Wisconsin. Currently, Unity Health Plans Insurance Corporation is an indirect wholly-owned subsidiary of Wellpoint, Inc.

United Wisconsin Services, Inc., then a subsidiary of Blue Cross, acquired HMO of Wisconsin Insurance Corporation on November 1, 1994, through a cash purchase of 100% of the stock of HMO-W, Inc. This acquisition was structured so that, simultaneous with the acquisition, HMO of Wisconsin Insurance Corporation assumed the benefit and provider contracts of U-Care HMO, Inc. U-Care HMO, Inc. was a HMO controlled by University Health Care, Inc. that was incorporated on April 14, 1988 and commenced business on January 1, 1989. As part of the overall purchase and sale arrangement, Blue Cross entered into two separate joint venture agreements dated October 31, 1994, one with University Health Care, Inc., among other parties, and another with HMO of Wisconsin Insurance Corporation.

The joint venture agreement between Blue Cross and University Health Care, Inc. was superseded by another joint venture agreement dated September 30, 1999. Business developments led to the execution of a joint venture agreement between Blue Cross and Community Health Systems, LLC on October 25, 1999. These joint venture agreements include options exercisable by University Health Care, Inc. and Community Health Systems, LLC to collectively acquire all of Unity's assets. Generally, the options provide for dismantling the joint ventures and returning the parties to their positions prior to entering the joint ventures. However, the parties' circumstances and relationships have changed since the joint venture agreements were entered into, and, consequently, the effect of the options has also changed. University Health Care, Inc. controls both options due to its control of Community Health Systems, LLC and the simultaneous exercise of both options results in University Health Care, Inc.'s complete acquisition of Unity, intact as a going concern.

On June 3, 2004, University Health Care, Inc. informed Blue Cross that it intended to exercise its option to acquire Unity's business, principally, its benefit and provider contracts, and likewise, as Community Health Systems, LLC's controlling member, that Community Health Systems, LLC would exercise its option to acquire all of Unity's common stock. University Health Care, Inc. would like the acquisition to be accomplished at a single closing so that there is no division of the Unity stock ownership from control of the Unity book of business. This would require Blue Cross' consent to a waiver of a provision in the Blue Cross/ Community Health Systems, LLC joint venture agreement that prohibits assignment of the stock option. However, even if Blue Cross refuses to grant the waiver, University Health Care, Inc. and Community Health Systems, LLC can exercise their options in two separate closings and University Health Care, Inc. will effectively control Unity intact as a going concern.

It is anticipated that the aggregate purchase price that will be paid to Blue Cross and its immediate parent to acquire Unity and settle other outstanding obligations ancillary to participation in the joint ventures could approximate \$45,100,000. The individual components of this price are as follows:

Estimated Net Worth of Unity as of December 31, 2004	\$36,500,000
Goodwill Payment	500,000
Buy Out of Blue Cross' Minority Interest in Community Health Systems, LLC	3,600,000
Redemption of Term Note issued to Blue Cross by Health Professionals of Wisconsin, Inc., a subsidiary of University Health Care, Inc.	3,000,000
Redemption of Blue Cross' Preferred Stock in Health Professionals of Wisconsin, Inc.	<u>1,500,000</u>
Total	<u>\$45,100,000</u>

The actual purchase price could vary from the foregoing estimate. The net worth of Unity as of December 31, 2004 could differ from the estimate. The buy out of Blue Cross' minority interest in Community Health Systems, LLC may or may not happen at a price that could differ from the foregoing figure.

Neither University Health Care, Inc. nor Community Health Systems, LLC have the direct resources to exercise their options. The University of Wisconsin Hospitals and Clinics Authority will contribute 60% of the necessary funds and the University of Wisconsin Medical Foundation, Inc. will contribute the remaining 40% of the necessary funds.

Scope of Wisconsin's Regulatory Concern

Section 611.72, Wis. Stat., requires the Office of the Commissioner of Insurance to approve a plan for acquisition of control if it finds, after a hearing, that the plan meets the standards under that statute.

The holding company system of the proposed acquirer (hereinafter also, "University Group") presently includes no insurers. The following entities are members of the University Group's holding company system:

1. University of Wisconsin Hospital and Clinics Authority
2. University of Wisconsin Medical Foundation, Inc.
3. University of Wisconsin Medical School
4. University Health Care, Inc.
5. Community Health Systems, LLC
6. Health Professionals of Wisconsin, Inc.

The current succession of control of Unity Health Plans Insurance Corporation is as follows:

1. Wellpoint, Inc. (Delaware)
2. Crossroads Acquisition Corp. (Delaware)
3. Blue Cross and Blue Shield of Wisconsin (Wisconsin)
4. HMO-W, Inc. (Wisconsin)

Immediately following the proposed acquisition of control, Unity Health Plans Insurance Corporation will become a direct, wholly owned subsidiary of University Health Care, Inc.

OBSERVATIONS BASED ON REVIEW OF DOCUMENTS AND ON INQUIRIES

Format and Informational Sufficiency of the Form A

The Form A filing was prepared in a format that complies with s. Ins 40.02, Wis. Adm. Code. The information contained in the filing and in the supplementary information obtained by OCI in connection with review of this filing is sufficient for the OCI to make a decision concerning the proposed plan.

Legality and Fairness of the Proposed Plan

My review of the Form A included a review of the following agreements:

1. Second Amended and Restated Joint Venture Agreement as of September 30, 1999 among Unity Health Plans Insurance Corporation, Blue Cross and Blue Shield United of Wisconsin, United Wisconsin Services, Inc., University Health Care, Inc., University Community Clinics, Inc. (f/k/a Health Professionals, Inc.) and Health Professionals of Wisconsin, Inc.
2. Amended and Restated Joint Venture Agreement as of October 31, 1994 by and among Blue Cross & Blue Shield United of Wisconsin, United Wisconsin Services, Inc., University Health Care, Inc., U-Care HMO, Inc., Health Professionals, Inc.
3. Amended and Restated Joint Venture Agreement as of October 25, 1999 by and among Unity Health Plans Insurance Corporation, Blue Cross & Blue Shield United of Wisconsin, United Wisconsin Services, Inc. and Community Health Systems, LLC

4. Agreement of Merger and Joint Venture dated October 11, 1994 by and among United Wisconsin Services, Inc., UWS Acquisition Corporation, Blue Cross & Blue Shield United of Wisconsin, HMO-W, Incorporated and HMO of Wisconsin Insurance Corporation

This review of the Form A and the component agreements of the proposed plan, with due consideration to supplementary information filed in response to examiner inquiries, discloses no basis for denial of the application on a point of law.

I can find no basis on which the proposed acquisition, as disclosed in the Form A and its supplementary filings, should not be regarded as complying with the standards under s. 611.72, Statutes.

Satisfaction of Licensing Requirements Maintained

Execution of the transactions disclosed in the Form A according to the plan indicated would have no effect on the ability of Unity Health Plans Insurance Corporation or any other insurer to maintain their existing licenses to write the lines of insurance for which they are presently licensed.

Effect on Competition within the Wisconsin Insurance Marketplace

In 2003, direct premium volume for all categories of insurance business for which data is available was as follows:

Type of Insurer	Direct Premiums Written
Life and Health Companies	\$11,262,380,085
Property and Casualty Companies	7,397,437,534
Health Maintenance Organizations	4,324,943,329
Blue Plan	648,367,869
Fraternal Benefit Societies	710,493,676
Hospital, Medical & Dental Indemnity Companies	389,243,282
Title Insurers	175,962,747
Limited Service Health Organizations	36,461,573
Miscellaneous*	Not Available
Surplus Lines Insurers	<u>208,389,043</u>
Total	<u>\$25,153,679,138</u>

- * Miscellaneous insurers consist of gift annuity corporations, warranty plans, motor clubs, viatical settlement companies, and continuing care retirement communities.

The distribution of accident and health insurance premiums in Wisconsin during 2003 was as follows:

Type of Insurer	Direct Premiums Written
Health Maintenance Organizations	\$4,324,943,329
Life and Health Companies	2,810,529,836
Blue Plan	648,367,869
Hospital, Medical & Dental Indemnity Companies	389,243,282
Property and Casualty Companies:	
13 – Group Accident and Health	125,672,509
14 – Credit Accident and Health	11,711,511
15.1 – Collectively Renewable A&H	144
15.2 – Non-Cancelable A&H	8,121
15.3 – Guaranteed Renewable A&H	51,814,097
15.4 – Non-Renewable for Stated Reasons Only	40,894,603
15.5 – Other Accident Only	1,530,350
15.6 – All Other A&H	3,218,384
15.7 – Federal Employees Health Benefits Program	<u>0</u>
Subtotal – P&C A&H Premiums	269,075,766
Fraternal Benefit Societies	41,059,882
Limited Service Health Organizations	<u>36,461,573</u>
Total	<u>\$8,485,455,490</u>

Unity is currently a member of the holding company system under the ultimate control of Wellpoint, Inc. During 2003, the Wellpoint Group had the largest market share of Wisconsin's accident and health insurance market of any insurance holding company system operating in the state. Anthem, Inc. and WellPoint Health Networks, Inc. completed their merger on November 30, 2004. Anthem, Inc. was the surviving corporation, but was renamed Wellpoint, Inc.

Relevant market share information for the Wellpoint Group in 2003 was as follows:

Wellpoint Group	DPW in WI	Market Share
Anthem Life Insurance Company	\$1,850	0.000%
Anthem Insurance Companies, Inc.	0	0.000%
Blue Cross & Blue Shield United of WI	\$648,367,869	7.674%
CompCare Health Services Insurance Corp.	386,403,379	4.573%
Healthy Alliance Life Insurance Company	0	0.000%
OneNation Insurance Company	0	0.000%
Trigon Health and Life Insurance Company	0	0.000%
UNICARE Life & Health Insurance Co.	11,357,190	0.134%
United Heartland Life Insurance Company	0	0.000%
United Wisconsin Insurance Company	28,746,885	0.340%
Unity Health Plans Insurance Corp.	232,831,714	2.756%
Valley Health Plan, Inc.	<u>81,943,980</u>	<u>0.970%</u>
Total Wellpoint Market Share	<u>\$1,389,652,867</u>	<u>16.447%</u>

This analysis of accident and health market share is qualified by a lack of information on the volume and distribution of premium equivalents under administrative services only programs. There is also a lack of information on the volume and distribution of the various distinct products offered within Wisconsin's accident and health insurance marketplace. For example, a hospitalization indemnity policy with a fixed-dollar daily benefit is not the equivalent of the coverage available with membership in a health maintenance organization.

University Health Care, Inc. does not own any insurance companies at this time. Accordingly, this transaction will not create a monopoly or substantially lessen competition in any type or line of business in Wisconsin.

Future Plans after the Change in Control

University Health Care, Inc. has stated its intention to continue the business and operations of Unity as presently conducted in large part. University Health Care, Inc. has expressed an interest in increasing provider reimbursement levels for itself. There have been discussions concerning a change to the process by which Unity's employees acquire office supplies. University Health Care, Inc. intends to maintain Unity's home office in Sauk City, Wisconsin.

Because Wellpoint, Inc. will no longer have any economic interest in Unity following the proposed acquisition of control, the officers and directors will be replaced. It is anticipated that the following individuals will compose the board of directors and management of Unity after the change in control.

It is anticipated that the board of directors will be composed of the following five individuals:

<i>Name and Residence</i>	<i>Principal Occupation</i>
Gary E. Eiler Madison, Wisconsin	Chief Financial Officer University of Wisconsin Hospital and Clinics Authority
James M. Roberts Madison, Wisconsin	Senior Vice President and General Counsel University of Wisconsin Hospital and Clinics Authority
David E. Entwistle Middleton, Wisconsin	Senior Vice President and Chief Operating Officer University of Wisconsin Hospital and Clinics Authority
Peter H. Christman Madison, Wisconsin	Executive Vice President University of Wisconsin Medical Foundation, Inc.
Susan M. Pelatzke Madison, Wisconsin	Vice President of Quality and Care Management University of Wisconsin Medical Foundation, Inc.

It is anticipated that the officers of the company will be as follows:

Name	Office
Andrew T. Fabian	President and Chief Executive Officer
Gail M. Midlikowski	Vice President
Nancy N. Sielaff	Secretary
Edward T. Breunig	Treasurer

Financial Soundness of Prospective Affiliates

Unity Health Plans Insurance Corporation was incorporated on October 31, 1983, as HMO of Wisconsin, Inc., and commenced business on January 1, 1984. The company converted to a stock insurance corporation under Chapter 611 on April 1, 1987, simultaneously changing its name to HMO of Wisconsin Insurance Corporation. Under the plan of conversion, a holding company, HMO-W, Inc., was formed to hold the stock of the converted corporation. United Wisconsin Services, Inc. acquired HMO of Wisconsin Insurance Corporation on November 1, 1994, through a cash purchase of 100% of the stock of HMO-W, Inc. At the same time that United Wisconsin Services, Inc. acquired the company, Unity assumed the benefit and provider contracts of U-Care HMO, Inc. The plan changed its name to Unity Health Plans Insurance Corporation effective April 1, 1995. As of December 31, 2003, Unity reported assets of \$56,423,849, liabilities of \$30,916,880, policyholders' surplus of \$25,506,969, and direct premiums written of \$232,831,714.

University Health Care, Inc. is a Wisconsin-domiciled non-stock, not-for-profit corporation that is controlled by three members: University of Wisconsin Hospitals and Clinics Authority; University of Wisconsin Medical Foundation, Inc.; and the University of Wisconsin Medical School.

The University of Wisconsin Hospital and Clinics Authority (hereinafter also, "UW Hospital") is an academic medical center operating an acute care hospital with 470 available beds, numerous specialty clinics, and four ambulatory facilities providing comprehensive care to patients, education programs, research, and community service primarily to residents of southern Wisconsin. Prior to June 29, 1996, the UW Hospital was a unit of the University of Wisconsin – Madison. From and after June 29, 1996, UW Hospital was restructured as a public authority created by Chapter 233 of the Wisconsin Statutes. An Affiliation Agreement requires UW Hospital to continue to support the educational, research, and clinical activities of the University of Wisconsin, including the University of Wisconsin Medical School and the University of Wisconsin Schools of Nursing and Pharmacy. As of June 30, 2003, UW Hospital reported assets of \$568,615,000, liabilities of \$260,452,000, net assets of \$308,163,000, and an increase in net assets of \$25,005,000.

The University of Wisconsin Medical Foundation, Inc. (hereinafter also, "UW Medical Foundation") is a Wisconsin-domiciled non-stock, not-for-profit corporation that was formed on January 1, 1996, by organizing 14 separate Departmental Practice Plan Associations of the University of Wisconsin Medical School into one entity. The organization, operation, and distributions of the UW Medical Foundation are governed by an agreement with the Board of Regents of the University of Wisconsin System. The UW Medical Foundation was formed for the purposes of: (1) providing education to medical students, practicing physicians, health care providers and personnel, patients and the general public; (2) supporting medical research in the field of clinical medicine; and (3) promoting the delivery of patient care. Medical care is provided primarily in southern Wisconsin. The UW Medical Foundation operates in support of the

University of Wisconsin – Madison, including the University of Wisconsin Medical School. It also provides support to, and receives support from, the University of Wisconsin Hospital and Clinics Authority. As of June 30, 2004, the UW Medical Foundation reported assets of \$211,179,873, liabilities of \$118,782,161, net assets of \$92,397,712, and an increase in net assets of \$18,390,020.

The University of Wisconsin Medical School is a unit of the University of Wisconsin – Madison and is governed by the University of Wisconsin Board of Regents.

University Health Care, Inc. is a Wisconsin-domiciled non-stock, not-for-profit corporation organized to promote medical education, research and public service by the University of Wisconsin Medical School and its faculty, the University of Wisconsin Medical Foundation, Inc., and the University of Wisconsin Hospital and Clinics Authority. University Health Care, Inc. represents its members in external outreach, such as the formation of outreach clinics and the development of clinical programs. In addition, University Health Care, Inc. enters into managed care contracts on behalf of the University of Wisconsin Medical Foundation, Inc. and the University of Wisconsin Hospital and Clinics Authority. As of June 30, 2004, on a stand-alone basis, University Health Care, Inc. reported assets of \$10,785,904, liabilities of \$9,690,083, net assets of \$1,095,821, and a decrease in net assets from January 1, 2004 of \$(39,508).

University Health Care, Inc. controls two entities, Community Health Systems, LLC and Health Professionals of Wisconsin, Inc.

Community Health Systems, LLC is a Wisconsin-domiciled limited liability company that holds an interest in a joint venture agreement with Unity and retains the right to reacquire certain assets of Unity, including 100% of its common stock. University Health Care, Inc. holds a controlling member interest in Community Health Systems, LLC and an 81.12% economic interest. Blue Cross holds the remaining 18.88% economic interest, which it acquired through a loan default by Community Physicians Network. Community Health Systems, LLC formerly represented rural hospitals and physicians in the area served by Unity, but it currently has no business activities. As of June 30, 2004, Community Health Systems, LLC reported assets and members' equity of \$8,000. Distributions to members for the six months ended June 30, 2004 amounted to \$1,053,914.

Health Professionals of Wisconsin, Inc. (hereinafter, "HPW") is a taxable corporation that holds and rents real property. HPW owns medical clinic buildings in Middleton, Fitchburg, Cottage Grove and Horicon. These properties are rented by the University of Wisconsin Hospital and Clinics Authority or the University of Wisconsin Medical Foundation, Inc. As of June 30, 2004, on a stand-alone basis, HPW reported assets of \$4,564,911, liabilities of \$5,286,302, restricted net assets of \$2,169,715, unrestricted net assets of \$(2,891,107), and a decrease in net assets from January 1, 2004 of \$(7,349).

The financial condition of University Health Care, Inc., individually, and its holding company system taken as a whole, are unlikely to jeopardize the financial stability of Unity Health Plans Insurance Corporation, or to prejudice the interests of its Wisconsin policyholders.

Change in Control

Completion of the transactions proposed in the Form A will result in a change in control for Unity Health Plans Insurance Corporation. The plan would result in the sale of 100% of the outstanding capital stock of Unity Health Plans Insurance Corporation to either University Health Care, Inc. or Community Health Systems, LLC

Competence and Integrity of Prospective Management

University Health Care, Inc. provided copies of biographical reports for the prospective members of the board and management of Unity Health Plans Insurance Corporation. Review of the composition of the prospective board and management of Unity Health Plans Insurance Corporation discloses no basis for disapproval of the Form A.

Summary of Observations

1. The Form A filing was prepared in a format that complies with s. Ins 40.02, Wis. Adm. Code. The information contained in the Form A filing and its supplements are sufficient to the transaction.
2. The plan would not violate the law or be contrary to the interests of Unity Health Plans Insurance Corporation or its policyholders.
3. After the acquisition of control, Unity Health Plans Insurance Corporation will not experience a change that would cause it to become unable to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed.
4. It is evident that this transaction will not create a monopoly or substantially lessen competition in any type or line of insurance in Wisconsin.
5. The financial condition of University Health Care, Inc., individually, and its holding company system taken as a whole, are unlikely to jeopardize the financial stability of Unity Health Plans Insurance Corporation, or to prejudice the interests of its Wisconsin policyholders.
6. The plan results in a change in control for Unity Health Plans Insurance Corporation. There are no plans or proposals to liquidate the domestic stock insurance corporation, Unity Health Plans Insurance Corporation, to sell its assets (other than investment portfolio transactions in the ordinary course of business), or to consolidate or merge it with any person. The anticipated business, corporate structure, and management following the acquisition has been described in the Form A and its supplements. The plan does not appear to be adverse to Unity Health Plans Insurance Corporation, or its policyholders, or to conflict with the public interest.
7. The competence and integrity of the persons who would control the operation of Unity Health Plans Insurance Corporation are such that it is in the interest of their respective policyholders and of the public to permit the proposed plan.

RECOMMENDATION

I recommend that the plan for the acquisition of control of Unity Health Plans Insurance Corporation by University Health Care, Inc. be approved, subject to the following findings of fact:

1. It should be a finding of fact that each of University of Wisconsin Hospitals and Clinics Authority, University of Wisconsin Medical Foundation, Inc., and the University of Wisconsin Medical School, as members in the succession of control of University Health Care, Inc., will be affiliates of Unity Health Plans Insurance Corporation following its acquisition by University Health Care, Inc. and must meet the requirements applicable to affiliates of insurance corporations that are domiciled in the State of Wisconsin.
2. This decision specifically should note that the plan of acquisition approved does not allow University Health Care, Inc. or its members to employ proceeds of the conversion of Blue Cross & Blue Shield United of Wisconsin maintained in the public trust by the University of Wisconsin Medical School nor general purpose revenue from the State of Wisconsin to purchase or operate Unity Health Plans Insurance Corporation.
3. Approval of the plan of acquisition does not include approval of any dividend payment or any portion of the plan that may contemplate payment of a dividend. Any future dividend request must be filed in accordance with Chapter 617 of the Wisconsin Statutes. University Health Care, Inc. should be advised that the Office of the Commissioner of Insurance would look very closely at any initial dividend request. The Office of the Commissioner of Insurance anticipates that no such request will be filed until new ownership and management have at least a calendar year track record demonstrating financial and operational performance.