

BCBS CLASS 1 CONTESTED CASE AD. HEARING, 11/29/99
OFFICE OF THE COMMISSIONER OF INSURANCE
STATE OF WISCONSIN

1

In the Matter of Application for Conversion of
Blue Cross & Blue Shield United of Wisconsin,

Petitioner. Case No. 99-C26038

CLASS 1 CONTESTED CASE
ADMINISTRATIVE HEARING

Monday, November 29, 1999
10:00 a.m.

at

ITALIAN COMMUNITY CENTER
631 East Chicago Street
Milwaukee, Wisconsin

BEFORE:

Ms. Connie L. O'Connell, Commissioner
Mr. Fred Nepple, General Counsel
Mr. Steven J. Junior, Senior Insurance Examiner

Reported by Debra A. Wisniewski, CRR/RMR/CSR
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1 A P P E A R A N C E S:

2 FOLEY & LARDNER, by
3 Mr. Joseph C. Branch
4 777 East Wisconsin Avenue
5 Milwaukee, Wisconsin 53202
6 Appeared on behalf of the Petitioner.

7 ALSO PRESENT:
8 Mr. Stephen E. Bablitch, Petitioner.
9 Mr. Thomas M. Rose

10 I N D E X

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TRANSCRIPT OF PROCEEDINGS

1
2 THE COMMISSIONER: Good morning. I'm
3 Connie O'Connell, Commissioner of Insurance,
4 presiding over Case No. 99-C26038 concerning Blue
5 Cross & Blue Shield United of Wisconsin's
6 application for conversion. The purpose of the
7 application for conversion is to permit Blue Cross &
8 Blue Shield United of Wisconsin to convert from a
9 nonprofit service insurance corporation to a stock
10 insurance corporation in accordance with Sections
11 613.75 and 611.76, Wisconsin Statutes.

12 This hearing is being held as a Class 1
13 contested case hearing in accordance with Chapter
14 227 of the statutes and INS 5.39(2) of the Wisconsin
15 Administrative Code.

16 On November 19th, 1999, three motions to
17 intervene in this matter were received by this
18 office. As agreed during the prehearing status
19 conference on November 24th, I had made a ruling
20 based upon the briefs that were received on November
21 26th. I ruled just prior to the commencement of
22 this hearing as agreed to by the moving parties and
23 Blue Cross Blue Shield United of Wisconsin. I'd
24 like to take a few minutes to discuss this decision.

25 For the record, I note that the -- there
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1 is attendance by each of the moving parties this
2 morning. The proposed conversion of Blue Cross Blue
3 Shield United of Wisconsin is a matter of
4 significant public interest. The Office of
5 Commissioner of Insurance is committed to a
6 thorough, informed, and public review of this plan.
7 In order to conduct such a review, considerable
8 input from the public and advice from experts is
9 necessary.

10 It is my responsibility with broad public
11 input to balance the diverse interests and make a
12 determination of whether the proposed plan is
13 contrary to the public interest. I've scheduled a
14 public hearing today that will continue tomorrow in
15 Stevens Point to allow any organization or
16 individual to express views -- their views and
17 concerns regarding the application. This is only
18 one way that our office is used to involve the
19 public and interested organizations in this process.

20 In addition, I have met with many
21 individuals and organizations, received and reviewed
22 volumes of written material, and made the documents
23 related to the application available to the public
24 through our office and published on our Internet Web
25 site.

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1 In addition to the public hearing and
2 review, I've scheduled the Class 1 contested case
3 hearing for Blue Cross Blue Shield United of
4 Wisconsin to make its case for its conversion
5 application. Three organizations which participated
6 in the public review process also filed motions to
7 intervene in the Class 1 contested case hearing.
8 These organizations are the University of Wisconsin
9 Medical School, the Medical College of Wisconsin,
10 and the coalition representing ABC for Health,
11 Wisconsin AARP, and the Wisconsin Coalition for
12 Advocacy.

13 Each of these organizations has valuable
14 input to offer in this process. The two medical
15 schools can offer insight into how the original plan
16 proposed by Blue Cross would operate. They also
17 have unique insights into health issues of the
18 citizens of the state. In addition, the Coalition
19 has conducted research not only on Blue Cross Blue
20 Shield United of Wisconsin but on conversions in
21 other states, they've assembled experts, and offered
22 important insight into many of the issues that are
23 central to the consideration of this proposal.

24 However, access to information and
25 expertise are not the standard for granting standing
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1 to parties in an administrative hearing. To have
2 standing, the petitioners must meet a two-part test.
3 They must demonstrate the decision of the agency
4 causes injury to their interest and that the
5 interest they are asserting is recognized by law.

6 The potential injury asserted by these
7 parties is no different from potential injury to any
8 member of the general public caused by the agency
9 action or inaction. To allow standing in the
10 instant case would establish a precedent for the
11 agency to admit multiple parties in future
12 proceedings each with a specific interest, which is
13 one among many to be considered in determining the
14 public interest. Therefore, I have denied their
15 motions to intervene.

16 Fortunately, OCI has broad discretion to
17 structure the review process to maximize
18 participation by organizations such as those
19 represented by the petitioners. I will use this
20 discretion to ensure each of the organizations
21 seeking party status has a full opportunity to
22 participate in this proceeding, including, if
23 appropriate, to offer expert testimony at a
24 continuation of today's hearing, to pose questions
25 to the applicant, and to discuss the pending

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1 application with the investment banking firm
2 retained by the office.

3 Therefore, although I cannot under the
4 law grant the petitioner's status as parties, I can
5 grant them similar ability to participate in this
6 process. Today's hearing will be continued. Any
7 such further proceeding will be added to the record.
8 OCI intends to assure that this application receives
9 a complete and public review. OCI has no intention
10 of allowing any consideration, including the
11 applicant's express desire to complete the approval
12 process by year end, to supersede that full and fair
13 review.

14 Now today's hearing is being held at the
15 Italian Community Center in Milwaukee, Wisconsin at
16 10 a.m. on November 29th, 1999. The proceedings are
17 being transcribed by Gramann Reporting.

18 Will the petitioner please state for the
19 record by whom you are represented.

20 MR. BRANCH: Yes. The appearances, my
21 name is Joseph Branch from the law firm of Foley &
22 Lardner. With me at counsel table is Attorney
23 Thomas Rose from Foley & Lardner representing the
24 petitioner. Also representing the petitioner is
25 Mr. Steven E. Bablitch, vice president and general
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1 counsel of the petitioner.

2 THE COMMISSIONER: Thank you. The issues
3 for today's hearing as described in the notice of
4 hearing are as follows. Conversion of Blue Cross
5 Blue Shield United of Wisconsin from a nonprofit
6 service corporation to a stock insurance
7 corporation. Whether or not under Sections 611.76
8 and 613.75 of Wisconsin Statutes the plan of
9 conversion violates the law or is contrary to the
10 interests of the policyholders of Blue Cross & Blue
11 Shield United of Wisconsin or the public. In the
12 Class 1 contested case hearing, the fair play
13 provisions of Chapter 227 apply. This means that
14 all testimony taken will be made under oath and
15 subject to cross examination that may reasonably be
16 required for a full and true disclosure of the
17 facts.

18 Mr. Branch, do you have any preliminary
19 matters or questions that need to be addressed at
20 this time?

21 MR. BRANCH: Nothing at this time, Madam
22 Commissioner.

23 THE COMMISSIONER: At this time I'll
24 introduce for the record Exhibit H as offered by
25 Blue Cross. Exhibit H is a list of exhibits offered
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1 and received by Blue Cross as of the beginning of
2 this hearing.

3 Mr. Branch, would you like to give a
4 brief opening statement?

5 MR. BRANCH: No, Your Honor -- Madam
6 Commissioner. Our first witness will provide an
7 overview of this matter.

8 THE COMMISSIONER: Okay. Please begin
9 your case.

10 MR. BRANCH: I'd like to call Mr. Thomas
11 R. Hefty.

12 THOMAS R. HEFTY, called as a witness
13 herein, having been first duly sworn on oath, was
14 examined and testified as follows:

15 DIRECT EXAMINATION

16 BY MR. BRANCH:

17 Q Mr. Hefty, do you have a statement you'd care to
18 make in this matter?

19 A Yes, I do. May I proceed? And good morning to
20 Commissioner O'Connell and to the members of the
21 public with us. My name is Thomas R. Hefty and I'm
22 the president, chief executive officer and chairman
23 of the board of Blue Cross & Blue Shield United of
24 Wisconsin, and as the chief executive, I would like
25 to introduce the plan of conversion, the process by
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1 which we arrived at the plan, and the business
2 reasons for its consideration.

3 Let me start by giving you a brief
4 background of Blue Plans nationally. Back in 1990,
5 there were 71 independent Blue plans. Today there
6 are 50 independent plans across the United States.
7 These plans are all members of a national
8 coordinating body and trade association known as the
9 Blue Cross Blue Shield Association. The association
10 licenses the name and the mark to the individual
11 Blue plans, including Wisconsin. The licensing
12 agreements require each individual plan to maintain
13 minimum capital and surplus, minimum liquidity
14 levels, acceptable customer service levels,
15 participation in certain national initiatives, and
16 finally to adhere to specific ownership limitations.

17 Until 1994, these rules prevented Blue
18 plans from organizing as shareholder-owned entities.
19 In that year, the association changed this
20 requirement in response to competitive forces at
21 play in the changing health insurance market. Since
22 this restriction was removed, a number of other
23 plans have converted, including Blue plans in
24 California, Georgia, and Virginia. Blue plans in
25 Colorado, New York, and Missouri are also in the
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1 process of converting or changing their structure.

2 Conversion provides a number of
3 advantages to Blue plans. Using the marketable
4 stock to make acquisitions helps to build economies
5 of scale and thereby drive down costs. The issuance
6 of stock also helps to generate capital which can be
7 used for investment in new products, systems,
8 networks, and the medical information management
9 required to deliver high quality, competitive
10 service.

11 Now that I've spoken about the changing
12 national trends, I'd like to say a few words about
13 Wisconsin. Blue Cross was founded in 1939 under the
14 name Associated Hospital Service. We changed our
15 name in 1979 in conjunction with a merger between
16 Associated Hospital Service and an entity known as
17 Surgical Care-Blue Shield. From that day forward,
18 we have been known as Blue Cross & Blue Shield
19 United of Wisconsin.

20 The Wisconsin market is also changing.
21 Today our competitors are largely national plans and
22 local tax-exempt sponsored HMOs. Although we
23 compete on a level playing field, Blue Cross differs
24 from other health insurers doing business in
25 Wisconsin in two important ways. One, Blue Cross is
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1 a tax paying, Wisconsin-headquartered health insurer
2 providing insurance services and benefits to over
3 700,000 people in the State of Wisconsin. We are
4 responsive to local customer needs. We will hear
5 from Penny Siewert, our senior vice president, who
6 will be addressing the community service aspect of
7 Blue Cross's commitment to local needs. Because we
8 are a Wisconsin-based health insurer, we're
9 fortunate to employ over 1800 Wisconsin residents in
10 more than ten different communities.

11 The second way in which Blue Cross is
12 different from other competing health insurers is
13 its organizational structure. Because Blue Cross
14 cannot issue tax-exempt bonds and cannot issue stock
15 in our current corporate form, we do not have the
16 same access to capital markets as do most
17 competitors. This limits the ability of Blue Cross
18 to grow.

19 In response to these concerns of the
20 changing market, the board of directors of Blue
21 Cross appointed the special committee on December
22 9th, 1998. You will hear Professor James Hickman, a
23 member of that special committee, testify today.
24 That committee was asked to investigate the
25 structuring options available to Blue Cross and to
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1 make a recommendation to the full board.

2 On June 2nd, 1999, the special committee
3 made that report to the full board of directors.
4 The special committee found that Blue Cross's
5 inability to access capital markets resulted in a
6 lack of flexibility to acquire, merge, or affiliate.
7 These deficiencies made Blue Cross vulnerable to
8 larger and better capitalized competitors. Without
9 a reorganization, Blue Cross would be left with
10 limited options to raise capital and to finance our
11 growth.

12 After extensive discussion, the full
13 board adopted the findings of the special committee
14 on June 2nd, 1999 and passed a resolution to
15 undertake a plan of conversion on that same day and
16 that plan is now before you.

17 Now I'd like to quickly describe some of
18 the significant aspects of the plan of conversion.
19 Under the plan, Blue Cross will convert from a
20 service insurance corporation to a stock insurance
21 corporation without any interruption in its
22 corporate existence. This really amounts to nothing
23 more than a change in the corporate form of Blue
24 Cross. As a result, the conversion will not cause
25 any interruption in coverage for Blue Cross

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1 policyholders. The plan of conversion does not
2 contemplate any change in the terms, rates, or
3 premiums of health insurance for policyholders.

4 Two additional new entities will be
5 created under the plan of conversion. The first of
6 those entities, which has yet to be organized, is a
7 holding company to be known as United Heartland
8 Group. Once this holding company is created, 100
9 percent of the converted Blue Cross entity will be
10 owned by the holding company, United Heartland
11 Group.

12 The second of those entities, a
13 foundation, has already been organized. The
14 foundation is called the Blue Cross & Blue Shield
15 United of Wisconsin Public Health Foundation. Just
16 as the holding company will own 100 percent of the
17 issued stock of the converted Blue Cross, the
18 foundation will in turn own 100 percent of the stock
19 of the holding company. The net effect of these two
20 transactions will be that the foundation will
21 receive 100 percent of the equity value of the
22 converted Blue Cross entity.

23 The plan of conversion provides for the
24 foundation to serve the health care interests of the
25 people of the State of Wisconsin. To this end, it

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1 will be the mission of the foundation to support
2 public health initiatives through the University of
3 Wisconsin Medical School and the Medical College of
4 Wisconsin, two institutions trusted by the State for
5 nearly a century to not only educate its medical
6 professionals but also provide needed research in
7 the rapidly changing fields of medical technology
8 and to provide community outreach on a statewide
9 basis, collaborating together and with others to
10 serve the public. You will hear Medical College of
11 Wisconsin President E. Michael Bolger and UW-Medical
12 School Dean Phil Farrell presenting testimony
13 regarding the involvement of the two medical schools
14 in the plan of conversion.

15 In order to fund this public health
16 mission, the foundation will liquidate most of the
17 stock issued to it through arms-length transactions
18 in the five years following the conversion. You
19 will hear Mark Orloff, Deputy Legal Counsel for the
20 Blue Cross Blue Shield Association, testify that
21 this five-year time frame is a requirement that
22 grows out of the association licensing restrictions
23 that I mentioned earlier. It is the Blue Cross
24 boards's expectation that by the liquidation of the
25 stock on the free market, the foundation will

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1 realize the fair and reasonable value of Blue Cross
2 as of the date of the conversion.

3 In order to help ensure that the
4 foundations realizes the fair and reasonable value
5 of the Blue Cross stock, nine individuals
6 unaffiliated with Blue Cross have been selected to
7 the board of directors to govern the foundation.
8 You will hear foundation board member John Daniels
9 testify that each of these directors owes a
10 fiduciary duty to the foundation to ensure that this
11 objective is met. These individuals represent a
12 diverse cross-section of the Wisconsin community and
13 each one individually brings a wealth of knowledge
14 and experience in public service to the foundation.

15 In summation, two comments. The Blue
16 Cross board of directors thoroughly researched and
17 deliberated over the plan of conversion and
18 concluded that the conversion was in the best
19 interest of Blue Cross & Blue Shield United of
20 Wisconsin. It is in the best interest of Blue Cross
21 to convert in order to enable the company to access
22 capital markets and to compete more effectively.

23 Finally, as our board said, Blue Cross is
24 doing the right thing in the right way by turning
25 the full equity value of the company over to the
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1 foundation, which will in turn fund programs
2 promoting public health initiatives developed
3 through the medical schools, which we believe will
4 serve the interests of the public.

5 I'd like to thank you and your staff for
6 the opportunity to present this opening statement
7 today. By promoting the financial stability of Blue
8 Cross through this conversion, our goal is to
9 provide a stronger and more competitive Blue Cross
10 in the State of Wisconsin. Therefore, I ask for
11 your approval of this conversion plan.

12 THE COMMISSIONER: Mr. Hefty, you
13 indicated that some of the reasons for converting.
14 Can you address the timing for this request? Why
15 are you requesting conversion at this time?

16 THE WITNESS: The market both locally and
17 nationally continues to change rapidly and we've
18 seen new competitors in our market here. I
19 mentioned today, they're principally national
20 competitors or tax-exempt sponsored competitors.
21 And the consolidation in the health care world is
22 going on rapidly. I mentioned the drop in the
23 number of Blue Cross plans nationally, and any
24 lengthy delay of that process takes Wisconsin out of
25 that changing marketplace and so we think that the
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1 timing is consistent with the changes going on both
2 locally and nationally.

3 THE COMMISSIONER: How would you view
4 conversion impacting Blue Cross in the long term,
5 what is your vision for the company five years from
6 now, ten years from now?

7 THE WITNESS: Our goal is to continue to
8 grow the business in Wisconsin, serving
9 policyholders here, and we hope participating in the
10 national consolidation of Blue plans. There are a
11 number of other plans that are smaller than the
12 Wisconsin plan and we would hope to participate as a
13 first mover, if you will, in the consolidation
14 that's going on nationally.

15 THE COMMISSIONER: You also mentioned the
16 association -- the Blue Cross national association
17 licensing restrictions. Are there takeover
18 provisions in your plan that are not required by the
19 Blue Cross Blue Shield national association?

20 THE WITNESS: No, and we did look at that
21 issue in the sense of maintaining control in
22 Wisconsin, but such restrictions would impact the
23 value of the company that will be obtained by the
24 foundation for the public health of Wisconsin, and
25 so on balance, other than those restrictions

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1 required by the national association, there are none
2 in the plan.

3 THE COMMISSIONER: How would you see the
4 conversion affecting the Wisconsin insurance market
5 as a whole, the health insurance marketplace?

6 THE WITNESS: I think it will make it
7 more competitive. It will equalize, if you will,
8 the access to capital between ourselves, the
9 tax-exempt sponsored plans, and the much larger
10 national plans, and so I think the marketplace will
11 benefit by that competition.

12 THE COMMISSIONER: Thank you.

13 MR. BRANCH: Thank you, Mr. Hefty.

14 As our next witness, we would like to
15 call Professor James Hickman to the stand.

16 JAMES C. HICKMAN, called as a witness
17 herein, having been first duly sworn on oath, was
18 examined and testified as follows:

19 E X A M I N A T I O N

20 BY MR. BRANCH:

21 Q Professor, could you state your name, current place
22 of employment, and any relevant employment history.
23 A My names is James C. Hickman. I am an Emeritus
24 professor of business and statistics at the
25 University of Wisconsin-Madison and I served as dean
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1 of the School of Business between 1985 and 1990. I
2 also serve on the boards of several companies and
3 organizations, including the Board of Pensions of
4 the Presbyterian Church, U.S.A, and the Century
5 Investment Management Company.

6 Q What is your association with Blue Cross?

7 A I have been a director of Blue Cross Blue Shield
8 United of Wisconsin since December of 1986, and in
9 December of 1998, approximately one year ago, I was
10 appointed to serve as a member of a special
11 committee established by the board of directors to
12 examine corporate structuring alternatives for Blue
13 Cross.

14 Q Are you knowledgeable about Blue Cross's
15 consideration of the proposed conversion?

16 A Yes. Since my appointment to the special committee,
17 I am directly involved in the examination of the
18 proposed conversion of Blue Cross from a service
19 insurance corporation to a stock insurance
20 corporation. As a member of that special committee,
21 I am very knowledgeable of the extensive analysis
22 conducted by Blue Cross in reaching its decision to
23 convert to a stock insurance company.

24 Q Why are you testifying here today, Doctor?

25 A I am testifying on behalf of Blue Cross and
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1 especially the members of the committee to briefly
2 discuss the role and findings of the special
3 committee with respect to the proposed conversion.

4 Q Can you give us an overview of the work done by that
5 committee?

6 A Yes. The special committee was established on
7 December 9th of 1998 at a meeting of the board of
8 directors of Blue Cross. At that meeting, the board
9 of directors approved the creation of an independent
10 special committee to investigate structuring
11 alternatives available to Blue Cross. In addition
12 to myself, the board of directors selected Ms. Janet
13 Steiger, Mr. Michael Joyce, and Dr. Ken Viste to
14 serve on the special committee.

15 In mid-January, the special committee set
16 out to fulfill its mission of investigating
17 alternatives to the current legal and corporate
18 structure of Blue Cross and to ultimately present
19 its findings, conclusions, and recommendations to
20 the full board of directors by July 1 of 1999. The
21 primary responsibility of the special committee was
22 to examine objectively a broad range of
23 reorganization alternatives available to Blue Cross
24 and, as one of our members stated, "to try to do the
25 right thing and to do it in the right way, and that
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1 is to do it in the right both for the future of the
2 company and for the many stakeholders in the
3 organization.

4 The special committee convened on six
5 separate occasions over a five-month period in its
6 work of investigating these alternatives and to
7 develop a plan of conversion for Blue Cross. To
8 assist in that extensive examination, the special
9 committee early on retained legal -- retained
10 counsel to advise the members on structuring
11 alternatives and on issues relevant to the
12 conversion. The special committee retained the law
13 firm of Foley & Lardner to provide legal counsel and
14 the investment firm of Donaldson, Lufkin & Jenrette
15 to provide banking and financial advice. Both firms
16 have been and continue to be actively involved in
17 assisting and advising the committee and the Blue
18 Cross board on various issues relating to the
19 proposed conversion.

20 Q What were the major considerations of the special
21 committee?

22 A Well, several considerations very heavily influenced
23 the examination conducted by the special committee.
24 The first and foremost was to adhere to our
25 fiduciary duties and develop a corporate strategy
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1 that advanced and protected the interest of Blue
2 Cross, its policyholders, and the citizens of
3 Wisconsin.

4 Another significant consideration of the
5 special committee was to develop alternatives that
6 were consistent with the corporate mission of Blue
7 Cross as well as the short-term and long-term
8 corporate goals.

9 The special committee also considered the
10 relative strengths of existing and alternative
11 corporate structures in adapting to and surviving in
12 today's competitive health care environment.

13 Q Can you summarize the issues examined by the special
14 committee?

15 A Well, given the depth and breadth of the issues
16 examined by the special committee, it's probably
17 impossible to summarize in any short time that I
18 have here today all of those issues, but the
19 materials reviewed by the special committee that are
20 contained in the application for conversion at Tabs
21 18 through 23 of Exhibit A-1 contain some of this
22 material. Nevertheless, I will highlight briefly
23 some of the major issues examined during our
24 five-month review.

25 As previously mentioned, the special
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1 committee was charged with examining strategic
2 alternatives available to Blue Cross. Over the
3 course of our review, the special committee examined
4 three principal alternatives. The first was to
5 convert to a mutual insurance company; the second
6 alternative was to convert to a stock insurance
7 company; and the final alternative was to continue
8 with the current status.

9 For each alternative, we identified and
10 considered the various interests that would be
11 affected, including the potential impact, if any, of
12 a conversion on the policyholders and employees of
13 Blue Cross. We also examined recent national trends
14 in the delivery of health care and in the managed
15 care and health insurance industries. The
16 conversion and consolidation of certain other Blue
17 plans and other insurance carriers were analyzed
18 because of their possible impact of these actions on
19 the future success of Blue Cross.

20 After weighing all of this information
21 and the issues presented to the special committee,
22 it became overwhelmingly clear that converting to a
23 stock insurance corporation would best serve the
24 long-term interests of Blue Cross and its
25 policyholders.

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1 Thus, the special committee focused its
2 review on the actual conversion process and
3 discussed subsequent corporate reorganizations that
4 would possibly follow conversion to a stock
5 insurance corporation, including a possible merger
6 with United Wisconsin Services, Incorporated.

7 Q Did the special committee address issues related to
8 the creation and operation of the proposed
9 foundation?

10 A Yes, indeed. The special committee devoted a
11 considerable amount of time concentrating on the
12 creation and endowment of a foundation to promote
13 and improve public health in the State of Wisconsin.
14 Recognizing the historical background of Blue Cross,
15 the special committee reviewed the conversion as a
16 tremendous opportunity to contribute to the
17 well-being of the citizens of Wisconsin. In this
18 same spirit, the special committee recommended
19 placing the full value of Blue Cross into a public
20 health foundation.

21 Q What funding alternatives did the special committee
22 consider?

23 A Well, the special committee devised or discussed
24 three funding alternatives to distribute the value
25 of Blue Cross. The three alternatives included,
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1 first, establishing the first school of public
2 health in the State of Wisconsin; two, establishing
3 a foundation that would be directly responsible for
4 distributing funds and grants; or, three,
5 establishing a foundation that would utilize the
6 University of Wisconsin Medical School and the
7 Medical College of Wisconsin as the principal
8 organizations to carry out programs of education,
9 research and service to advance public health in
10 Wisconsin.

11 Q Why did the special committee select the alternative
12 it did?

13 A In examining the three alternatives, the special
14 committee realized that startup and ongoing
15 administrative costs inherent in the first two
16 alternatives could be -- could significantly --
17 could be significantly minimized by utilizing the
18 existing structure of Wisconsin's two medical
19 schools. Furthermore, the special committee
20 concluded that utilizing the expertise and knowledge
21 of the medical schools would maximize the use of the
22 proceeds for the broadest range of public health
23 needs and would ultimately benefit the greatest
24 number of citizens in the State of Wisconsin.

25 Q Did the special committee issue and submit formal
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1 findings?

2 A Yes, it did. On May the 17th, 1999, the special
3 committee adopted formal findings, conclusions and
4 recommendations and a resolution recommending the
5 conversion of Blue Cross & Blue Shield United of
6 Wisconsin from a service insurance corporation to a
7 stock insurance company. On June the 2nd of 1999,
8 the special committee presented its findings to the
9 board of directors who unanimously approved the
10 resolution adopting the plan of conversion of Blue
11 Cross.

12 Q Do you believe the proposed conversion is contrary
13 to the interests of Blue Cross policyholders or the
14 public?

15 A I do not. Given the amount of time and resources
16 dedicated by the special committee in conducting its
17 extensive review of the proposed conversion, I am
18 confident that the special committee and the board
19 of directors reached the best conclusion. Having
20 carefully examined the issues before us for more
21 than five months, I am also convinced that the
22 conversion of Blue Cross is not contrary to the best
23 interest of its policyholders or the citizens of
24 Wisconsin and, in fact, is necessary to ensure the
25 continual success and strength of the company well
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1 into the next century.

2 MR. BRANCH: Thank you, Professor
3 Hickman. We have no further questions of this
4 witness, Madam Commissioner.

5 THE COMMISSIONER: When you considered
6 the potential alternatives to distribute the
7 foundation resources, you indicated you looked at
8 the school of public -- establishing a school of
9 public health, a separate foundation to distribute
10 grants, and then the medical schools. Did you
11 consider any other alternatives in terms of non --
12 existing nonprofit organizations that would have had
13 some of the same economies in terms of not having to
14 set up a new structure but they could have
15 distributed the grants?

16 THE WITNESS: The answer is yes. In the
17 opinion of the special committee, after careful
18 consideration, the two medical schools have a long
19 history in the order of a century, they have the
20 organization of existing foundations, they already
21 engaged in action programs, and every day they make
22 decisions about setting priorities in health care.
23 We felt that the best interests of the conversion
24 would be served by using these existing structures
25 and this existing expertise. We knew of no other
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1 organization in the state -- in our state that had
2 such a long history and did the kind of action that
3 we wanted to promote.

4 THE COMMISSIONER: Was there any concern
5 on the part of the special committee members that
6 perhaps the medical schools may have too narrow of a
7 focus in terms of health issues?

8 THE WITNESS: The answer is yes. We were
9 concerned with the fact that apparently they are in
10 the southern half of the state and therefore we went
11 to great lengths to discuss the ways that this
12 program might have an impact across the entire
13 state. As you are probably aware, at the direction
14 of the board of directors, the two medical schools
15 conducted a rather remarkable program of eliciting
16 opinions and ideas from throughout the state on the
17 public health needs of the state. We felt that that
18 alone contributed considerably to our understanding
19 and the understanding of the two schools with
20 respect to those needs.

21 THE COMMISSIONER: Can you address what
22 provisions in the plan provide for accountability
23 from the medical schools to the Blue Cross board of
24 directors and to the public?

25 THE WITNESS: Right. The issue of
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1 accountability, of course, is answered by the usual
2 kind of provisions for reporting, but the key point
3 is that it is the citizens of Wisconsin to whom they
4 are responsible, not just the board of Blue Cross
5 Blue Shield or to the foundation board that will be
6 created, and by their public reports and the fact
7 that both are already responsible to the public.
8 The ultimate guarantee is that public
9 accountability, although you will find the document
10 provisions requiring periodic reports to the
11 organizations that you named.

12 THE COMMISSIONER: Do you anticipate then
13 that the Blue Cross board itself would play an
14 active role in monitoring and providing that
15 accountability or would it be largely through then
16 the public reports and that type of accountability?

17 THE WITNESS: I would not expect the Blue
18 Cross Blue Shield board to be active in the sense of
19 making specific allocations or in directing that
20 allocations of this activity go in various purpose
21 -- to very specific purposes. In fact, one of our
22 goals is to use existing expertise rather than
23 substituting the opinions of those of us trained, in
24 my case, in mathematics, in other cases, in law or
25 administration on public health issues. We would
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1 anticipate that those issues best be handled by
2 people who have spent their lives in public health.
3 Although the issue of broad accountability will rest
4 with both the board of the foundation and, in a
5 certain sense, to the -- for a short time to the
6 board of Blue Cross Blue Shield, ultimately the
7 responsibility is to the people of this state and we
8 believe that these two agencies have that expertise
9 that is lacking in many of us trained in other ways.

10 THE COMMISSIONER: Thank you.

11 MR. BRANCH: Thank you, Professor
12 Hickman. Our next witness is T. Michael Bolger, the
13 president of the Medical College of Wisconsin.

14 T. MICHAEL BOLGER, called as a witness
15 herein, having been first duly sworn on oath, was
16 examined and testified as follows:

17 E X A M I N A T I O N

18 BY MR. BRANCH:

19 Q Would you please state your occupation, please.

20 A I am currently the president and chief executive
21 officer of the Medical College of Wisconsin. A

22 Q Why are you testifying here today?

23 A The Medical College of Wisconsin is the proposed
24 recipient of one-half of the proceeds of the
25 conversion of Blue Cross & Blue Shield United of
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1 Wisconsin.

2 Q How does the Medical College plan to utilize the
3 proceeds of the conversion to benefit the citizens
4 of Wisconsin?

5 A The Medical College will utilize the proceeds of the
6 conversion to advance our commitment to community
7 collaborations that promote health in Wisconsin and
8 to address the needs of underserved communities and
9 groups throughout the state. To establish and
10 advance these collaborations, the Medical College
11 will be seeking proposals from a wide variety of
12 community organizations who wish to serve as
13 partners on public health initiatives. As projects
14 are identified and funded, community organizations
15 will be responsible for directing and managing the
16 project's activities with participation from the
17 Medical College. Approximately \$12 million of the
18 initial funds received by the Medical College will
19 be used to cover beginning expenditures to implement
20 the plan as rapidly as possible. The remainder of
21 the funds will be placed in a permanent endowment.
22 This endowment will provide ongoing financial
23 support for the health programs established and set
24 forth in the plan.

25 Q Does the plan include any specific provisions to
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1 promote the general health and welfare of the
2 citizens of Wisconsin?

3 A Yes. Under our initial plan, approximately 35 to 45
4 percent of the annual endowment income will be used
5 to create and support Wisconsin's first Institute
6 for Public and Community Health. The primary
7 purpose of this institute will be to collaborate
8 with communities and various organizations,
9 agencies, and groups to further public health
10 throughout Wisconsin.

11 To achieve this mission, the institute
12 will initially promote three primary areas. The
13 first area will promote prevention and wellness
14 programs focused primarily on cancer, cardiovascular
15 disease, child and adolescent health, and women's
16 health issues. The second area will address broad
17 health-related issues in Wisconsin covering a wide
18 spectrum of topics such as improving access to
19 health care, addressing the lack of health care
20 providers, improving patient education, and
21 addressing environmental health problems present in
22 the state. The third area will concentrate on
23 health services research aimed at identifying health
24 risks, medical effectiveness, and patient care
25 outcomes and assisting communities and public health

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1 officials in effectively addressing the needs of
2 Wisconsin citizens.

3 Q Will any of the funds be utilized to support medical
4 research?

5 A Yes. Again, our initial plan estimates that 35 to
6 45 percent of the annual endowment will support a
7 program entitled "Research for a Healthier
8 Tomorrow." This program is intended to support
9 research into the prevention and possible cures for
10 major causes of death and disability among Wisconsin
11 residents such as cardiovascular disease, cancer,
12 stroke, and Alzheimer's disease. We also anticipate
13 expanding geographical access to clinical trials
14 across the street and expanding research
15 collaborations with other health care providers and
16 research institutions in Wisconsin.

17 Q Will any of the funds be utilized to promote health
18 education in Wisconsin?

19 A Yes. We initially anticipate utilizing 10 to 20
20 percent of the annual endowment to fund a program
21 entitled "Education and Leadership for Public
22 Health." This program will be designed to advance
23 four primary health education objectives. The first
24 objective is to support educational outreach by
25 expanding distance learning and teleconferencing and
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1 health training in rural and medically underserved
2 areas. A second objective is to promote consumer
3 outreach by expanding access to health information
4 through computer Web sites and civic programs. A
5 third goal is to establish a Masters of Public
6 Health thereby expanding our current program to
7 include non-physicians to assist local public health
8 departments, state agencies, and other organizations
9 in addressing the health concerns of our citizens.
10 A final goal of this program is to create more
11 student scholarships that require the recipient to
12 practice in a medically underserved urban or rural
13 area in Wisconsin.

14 Q How will the Medical College provide oversight of
15 its current plan and future funding initiatives?

16 A The Medical College of Wisconsin will provide
17 stewardship for the endowment by appointing
18 qualified citizens to serve on two external advisory
19 boards, one for the Institute for Public and
20 Community Health and an Endowment Fund Commission to
21 review adherence to the plan and to monitor fiscal
22 expenditures. The external advisory board for the
23 Institute for Public and Community Health will
24 consist of 8 to 12 members chosen statewide. This
25 board will be responsible for setting the strategic
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1 priorities of the institute. Members will be
2 selected based upon their interest and expertise in
3 public and community health, prevention/wellness,
4 health care advocacy, and health services research.

5 The external Endowment Fund Commission
6 will have seven members representing a broad cross-
7 section of individuals statewide who have an
8 interest in promoting public health in Wisconsin.
9 It should be noted that members of the Medical
10 College's board of trustees will not be allowed to
11 serve on this commission.

12 Q Will the Medical College provide annual reports
13 regarding the use of the funds from the endowment?

14 A Yes. The Medical College will issue annual
15 stewardship reports to the Blue Cross & Blue Shield
16 Public Health Foundation, the Blue Cross & Blue
17 Shield United of Wisconsin board of directors, the
18 Wisconsin Office of the Commissioner of Insurance,
19 and to interested members of the public. These
20 reports will outline endowment income and project
21 expenditures and will identify progress and
22 challenges in meeting program objectives. Every
23 fifth year the stewardship report will be expanded
24 to provide a detailed assessment of program
25 initiatives, including expanded data on communities

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1 impacted, collaborations developed, and multi-year
2 accomplishments resulting from the proceeds received
3 from the foundation.

4 Q Do you believe that the Medical College of Wisconsin
5 and the University of Wisconsin Medical School are
6 appropriate parties to utilize the conversion funds?

7 A Yes, I do. Wisconsin's two medical schools are
8 appropriate stewards of the Blue Cross Foundation's
9 endowment for numerous reasons. By their nature,
10 both medical schools are forward looking and are
11 aware of the public health needs of the State of
12 Wisconsin. They focus not only on today's health
13 concerns but also on tomorrow's health needs. The
14 two medical schools are, in essence, public trusts
15 and possess the requisite infrastructure to support
16 public health programs, to efficiently administer
17 the funds, to wisely invest and account for the
18 funds, and to effectively use such funds in
19 collaboration with community organizations to
20 improve the quality of health for all the people of
21 Wisconsin.

22 Furthermore, both medical schools are
23 comprehensive and well equipped to address the
24 state's additional public health needs.

25 Finally, both medical schools have a
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1 history of statewide collaborations and partnerships
2 with civic and health care organizations to enable
3 them to benefit the greatest number of citizens in
4 our state.

5 Q Have the two medical schools collaborated in
6 developing their respective plans?

7 A Yes. The two medical schools have worked together
8 to avoid duplication in our plans and to maximize
9 the use of the proceeds for the broadest range of
10 public health needs. By coordinating our plans, we
11 can help to ensure that the endowment has a
12 tremendous impact on improving the health of our
13 citizens. The endowment will also serve to
14 challenge the two medical schools to aggressively
15 move forward and lead our state in public health
16 improvement strategies. This challenge frankly is
17 one the Medical College of Wisconsin looks forward
18 to accepting.

19 MR. BRANCH: Thank you, President Bolger.
20 I have no further questions at this time.

21 THE COMMISSIONER: How would the Medical
22 College make sure that the resources that are
23 provided from the foundation do not supplant
24 existing resources?

25 THE WITNESS: What we have done is we
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1 have created a -- we are, first of all, going to
2 separate the account for the endowment income so
3 that it will always be open to public scrutiny and
4 to the scrutiny of our endowment commission and also
5 to your office, so we'll always have separate
6 accounting.

7 If -- a careful reading of our plan,
8 which we adhere to in obtaining the funds, indicates
9 that the funds will be used primarily in areas that
10 we no longer -- that we do not currently spend a
11 great deal of time, mainly in prevention, wellness
12 and other factors that we have identified in the
13 plan. We feel that these monies are appropriate not
14 to supplement or supplant existing programs because
15 we can find funding sources elsewhere like at the
16 Federal Government for some of our research and
17 other things, but that these funds can be used to
18 expand our reach into the communities that we
19 currently serve in a way that we couldn't otherwise
20 do and that is primarily working in collaboration
21 with other agencies, working in collaboration with
22 organizations for which funding is simply not
23 available.

24 And our plan is going to be open, it's
25 going to be -- every year we will file a stewardship
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1 report, every year we will have the priorities set
2 by the advisory board to the institute, and every
3 fifth year the two medical schools will collaborate
4 together to do a reassessment of the public health
5 needs in the State of Wisconsin. It is our
6 intention to continue to collaborate as we have
7 always done in the past.

8 THE COMMISSIONER: Can you explain the
9 mechanics? If I was an organization that wished to
10 apply for resources --

11 THE WITNESS: Yes.

12 THE COMMISSIONER: -- what would I do,
13 what would the process be or at least as far as you
14 know at this point?

15 THE WITNESS: Yeah, at this point in time
16 what we plan to do is, first of all, recruit a
17 director for this institute that we are forming.
18 The director, and in conjunction with the board of
19 the institute, will set the strategic priorities of
20 the institute and then will seek application for
21 proposals from organizations. Let me just give you
22 an example. Let's assume that an organization in
23 town determines that immunization of children is a
24 very high priority for public health needs in an
25 urban setting, just as an example. That

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1 organization will make application. If the board
2 and the director of the institute determine that
3 that is one of the strategic priorities of the
4 institute at that particular point in time, then
5 funds would be made available to that organization
6 in order for that organization in cooperation with
7 the Medical College to conduct immunizations.
8 That's the type of procedure that we see being
9 followed.

10 THE COMMISSIONER: What other kinds of
11 organizations would you anticipate applying for
12 these resources?

13 THE WITNESS: Well, we would think
14 there's almost an infinite number of those in the
15 State of Wisconsin, Madam Commissioner, and that's
16 really why I have come to the conclusion that the
17 two medical schools are very apt recipients of these
18 funds because what we do every day is we have to
19 make strategic decisions in terms of priorities and
20 how funds are used to best address the health needs
21 of the state, so I would anticipate that a variety
22 of organizations from small community-based
23 organizations to large organizations such as the
24 American Cancer Society, the American Heart
25 Association and others down to grass-roots
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1 organizations in Ladysmith, Wisconsin would want to
2 participate, and we would welcome that and seek
3 their applications.

4 THE COMMISSIONER: And would the -- the
5 applications then, it would be the Institute for
6 Public and Community Health then that would make the
7 decision on those applications?

8 THE WITNESS: Yes.

9 THE COMMISSIONER: What criteria will you
10 use for appointing the members of that institute?

11 THE WITNESS: Well, as we said in our
12 testimony, the criteria would be statewide and it
13 would be individuals who have an interest in public
14 advocacy, an interest in prevention, an interest in
15 wellness, an interest in public health, or an
16 interest in health services research. We would try
17 to get as broad a representation on that board as we
18 possibly could.

19 THE COMMISSIONER: And it would be the
20 board of the Medical College that would make the
21 appointments then to the -- this board?

22 THE WITNESS: Yes. Yes. And that, as
23 you know, is a public board. The governor appoints
24 one-third of our board, the county executive for the
25 County of Milwaukee appoints two members, and the
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1 rest are selected from the community at large, and
2 it's a fiduciary responsibility. We have no
3 shareholders, we are a 501(c)(3) foundation
4 ourselves, that's why I said we're a public trust,
5 and the trustees of the board of the Medical College
6 of Wisconsin have the duties to carry out their
7 duties in a fiduciary capacity for the people of the
8 state.

9 THE COMMISSIONER: You mentioned in your
10 testimony that there would be an initial outlay to
11 get the program up and running?

12 THE WITNESS: Yes.

13 THE COMMISSIONER: What again is the
14 amount that's going to be spent in terms of start-up
15 resources?

16 THE WITNESS: We anticipate we would like
17 to spend approximately \$12 million in achieving the
18 startup initially to get the programs off and
19 running, and the reason for that is Blue Cross Blue
20 Shield board made it very clear to us that they
21 would like to get this program moving quickly so
22 that the impact of these monies can be felt in the
23 state almost immediately, and in order to do that,
24 we need an initial outlay of funds to work with
25 these community organizations and to begin to get

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1 the programs underway and then once the programs are
2 underway, the endowment income will be used to
3 support those programs for the future and additional
4 programs as the needs change. We expect to do an
5 assessment every five years as to what the needs are
6 and we have the infrastructure already in place to
7 do that as we did this last time around when
8 Dr. Farrell and I traveled the state to determine
9 what the needs were.

10 THE COMMISSIONER: Thank you.

11 THE WITNESS: Thank you.

12 MR. BRANCH: Thank you. For our next
13 witness, I'd like to call Dr. Phillip Farrell, the
14 dean of the University of Wisconsin Medical School.

15 PHILLIP FARRELL, called as a witness
16 herein, having been first duly sworn on oath, was
17 examined and testified as follows:

18 E X A M I N A T I O N

19 BY MR. BRANCH:

20 Q Dr. Farrell, could you please state your occupation,
21 please.

22 A Yes. I'm the dean of the University of Wisconsin
23 Medical School.

24 Q Why are you testifying here today?

25 A The Medical School is the proposed recipient of half
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1 of the proceeds of the conversion.

2 Q How would you describe the impact that the state's
3 two medical schools have on the quality of health
4 care in Wisconsin?

5 A Wisconsin ranks third nationally in the quality of
6 its health care. UW Medical School and the Medical
7 College of Wisconsin are among the reasons why we
8 have that ranking. Between us, we educate two-
9 thirds of the physicians who practice in this state.
10 We also continue to educate them about the latest
11 technology, medicines, prevention and rehabilitation
12 regimens. As we speak, we are testing treatments
13 that seem to kill cancer cells, tumors -- cancerous
14 tumors, and we are unlocking the key to why
15 Alzheimer's victims' memories cease to function.
16 Beyond that, we are placing students and residents
17 in more than 100 locations throughout the state to
18 learn and work with local physicians and hope that
19 they will return to practice in communities where
20 health care professionals are scarce and we have
21 demonstrated a special commitment to bringing health
22 care resources into rural areas through our area
23 health education system, or AHEC. We partner with
24 groups that range from Native American tribes to the
25 South Madison Health Care Center to bring services

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1 to the underserved populations of the state. As an
2 example, we operate a clinic in a supermarket here
3 in Milwaukee.

4 Q Are there any institutional perspectives that make
5 the UW Medical School a worthy recipient of the
6 conversion funds?

7 A Yes. We have a statewide focus and a global view of
8 the health needs of Wisconsin. Because of this, we
9 are uniquely qualified to be stewards of the funds
10 we're slated to receive. In fact, our statewide
11 faculty are positioned throughout Wisconsin to
12 identify and serve as advocates for local needs.

13 Q Did the medical schools solicit the public's input
14 as to how the conversion funds should be spent?

15 A Yes. As part of a comprehensive health assessment,
16 which included nine public listening sessions,
17 e-mail, and regular mail submittals, a phone comment
18 line, and a sample survey conducted by St. Norbert
19 College, we heard from the people of the state.
20 Most who communicated with us had special interests.
21 They had a spouse they were caring for who has
22 Alzheimer's disease, a mother with breast cancer,
23 and many other concerns. They wanted money to
24 support better health education, more information
25 about osteoporosis prevention, more attention to
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1 good nutrition, and more education for public health
2 professionals. No one area dominated the input. In
3 need, many areas cut across specific clinical lines
4 to talk about prevention, access, public health, and
5 safety. What we learned from what they said is that
6 regardless of our national ranking, the health needs
7 of our state are still great.

8 Q How do the medical schools plan on addressing these
9 needs?

10 A The two schools have created plans to act as
11 frameworks through which to address these needs.
12 Both plans are responsible and responsive. They
13 continue to evolve and take shape through the input
14 we receive daily from our faculty, from the public,
15 and from those who seek support for a particular
16 health concern. We expect that these hearings will
17 further guide our plans.

18 Q Could you generally describe the plan, please.

19 A The UW plan maintains most of the fund as an
20 endowment. The major focus of our plan is on
21 prevention, working with our faculty, the health
22 care community and community groups toward that end.
23 Because we are deeply committed to improving health
24 in our rural and urban communities, we will create a
25 fund to enhance our community and rural health

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1 partnerships with community-based groups. Through
2 an annual competition guided by an advisory
3 committee of university and community
4 representatives, we will distribute approximately 10
5 percent of the proceeds directly to groups that want
6 to work with us on community health needs. Access
7 will be assured through statewide announcements to
8 community organizations. Advocacy groups with
9 greater needs will be able to access additional
10 funding in either the underserved funds or research
11 funds categories. One example of such a partnership
12 is our Alzheimer's institute, which is creating
13 special diagnostic programs around the state in
14 rural communities like Rhinelander.

15 Q Does the plan include any provision to address the
16 needs of the underserved and rural populations in
17 Wisconsin?

18 A Yes. At least 10 to 20 percent of the funds will be
19 specifically dedicated to addressing the needs of
20 underserved urban and rural populations. Targeted
21 projects include expanding programs with the state's
22 Indian Nations and development of a Milwaukee Center
23 for Urban Population Health, which will link with
24 other urban sites.

25 Q What proportion of the endowment would be spent on
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1 preventive medicine?

2 A Approximately 40 to 60 percent of the endowment will
3 be spent on prevention in the priority areas
4 identified by our public process. We know that good
5 science makes good health. Virtually every major
6 health care advance in the last century can be
7 traced to a search, and while federal and private
8 funding is readily available for research related to
9 cures, it is almost nonexistent for prevention and
10 population education. The fund therefore will be a
11 catalyst for prevention initiatives.

12 Responding to our assessment, we will
13 specifically target women's health, cancer,
14 cardiovascular diseases and aging and other neuro-
15 degenerative disorders such as Alzheimer's disease.
16 We will fund research and outreach projects that
17 involve our faculty and provide opportunities to
18 partner with statewide advocacy groups and local
19 health care providers.

20 Q Will any of the funds be spent on public health
21 education?

22 A Yes. We will respond to the many comments we
23 receive about the need for better public health
24 education. Our school addressed this by proposing
25 to consolidate and focus existing public health

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1 programs, incorporating a multi-disciplinary
2 approach as we do so. We will expand our course
3 offerings, develop an institute where the existing
4 public health workforce can receive training, and
5 offer new degrees to those interested in pursuing
6 public health careers. Twenty to 30 percent of the
7 funds will be used for public health education.

8 Q Does the plan include any reporting or reassessment
9 processes?

10 A Yes. Our intent is to provide annual reports about
11 how the funds were spent. Once every five years, we
12 will reassess public needs in a similar manner to
13 what we did last summer. Following that assessment,
14 we will provide a report that indicates how we will
15 modify our plans for the future.

16 Q How, if at all, will oversight of the plan be
17 conducted?

18 A Oversight will be provided by a newly reconstituted
19 Medical School advisory board, comprising
20 distinguished citizens from around the state,
21 including representation from key organizations such
22 as the Department of Health and Family Services,
23 minority communities and health advocacy groups.

24 Q Beyond what you have already described, how would
25 you characterize the specificity of the plan at this
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1 time?

2 A The projects we propose are ideas. They take time,
3 coordination, and money to develop. Once we know
4 the funds are forthcoming, we will begin to identify
5 more specific uses for the funds. Our assumption is
6 that we will receive no money until we clearly
7 identify exactly what we will spend the monies for.
8 This is a process that we are quite familiar with.
9 I hope the Commissioner will accept our plan not as
10 a blueprint but more of an artist's rendering of
11 what we will build if we're given the opportunity to
12 move to the next step in the process.

13 Q Once the specifics of the plan are identified, will
14 the UW Medical School commit to spending the funds
15 according to those specifics?

16 A Yes. Yearly we receive some \$160 million of public
17 research funds for which we are accountable.
18 Elaborate procedures are in place to ensure fiscal
19 and operational responsibility. Indeed, as a state
20 institution, all of our operating funds are public
21 and we are accountable for their use.

22 Q Does of the UW Medical School plan to use any
23 portion of the endowment to build a new Medical
24 School building?

25 A No. While a new Medical School is a strategic
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1 objective of our institution, the public has clearly
2 stated that they do not want the conversion dollars
3 to be used for construction of buildings.

4 Q Will any portion of the endowment be used to enhance
5 programming?

6 A Yes. We will use the conversion funds to either
7 expand programs, such as our Alzheimer's screening
8 program, or to create new initiatives that further
9 address, identify needs, and create a margin of
10 excellence. We will also use the conversion funds
11 to leverage outside dollars. Many programs we have
12 today use a combination of medical school, local,
13 and philanthropic resources.

14 Q Will the medical schools use the conversion funds to
15 address every purpose identified at the listening
16 sessions that were held?

17 A No, it is simply not possible to provide funds for
18 all of the good purposes identified by our
19 assessment. Citizens spoke eloquently of the need
20 for items which ranged from handicap toilets to a
21 comprehensive strategy against bio-terrorism.
22 Others have suggested that the funds should pay for
23 health care for uninsured individuals, but these
24 things are not directly within the purview of the
25 schools' missions.

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1 Q Is the reach of the UW Medical School limited to its
2 campus?

3 A No. Our campus is the State of Wisconsin. We have
4 more than 100 clinical sites and preceptorships
5 throughout the state. We are a unique resource
6 within the state, omnipresent and global in our
7 thinking. Our mission, articulated 150 years ago,
8 is to serve the people of Wisconsin as their medical
9 resource. These funds represent an unprecedented
10 opportunity to bring resources to areas that need
11 them the most. We also have the ability to leverage
12 dollars with private and other public funds thereby
13 increasing their impact.

14 Q Lastly, Doctor, do you feel that the UW Medical
15 School is a worthy recipient of the conversion
16 funds?

17 A Yes. Our existing resources and our record of
18 accomplishments stand as testimony to our ability to
19 act as responsible stewards and we are confident
20 that our plan will maximize the impact of the Blue
21 Cross & Blue Shield conversion funds on the long-
22 term health of our citizens.

23 On behalf of the University of Wisconsin,
24 I would like to thank Blue Cross and Blue Shield and
25 commend them for their thoughtful consideration of
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1 how to best impact the health of the state's
2 citizenry.

3 MR. BRANCH: Thank you, Doctor. I have
4 no further questions at this time, Madam
5 Commissioner.

6 THE COMMISSIONER: Thank you. As I
7 mentioned earlier, we met with many individuals and
8 organizations in our office, received a fair amount
9 of written correspondence as well, and one of the
10 themes within the written correspondence from
11 individuals representing local public health
12 agencies is that they're generally complimentary of
13 the medical schools in terms of meeting the missions
14 of the schools, but I'll paraphrase one of the
15 letters that we received. An R.N. from Madison
16 indicated that she was questioning whether or not
17 the medical schools could effectively speak to the
18 public health issues, that her discussion was that
19 physicians focus on population medicine, secondary
20 and tertiary care for individuals who have access to
21 health care, but local public health agencies on the
22 other hand focus on what she would define as
23 population health, that they intervene through
24 policy development, intervention by private
25 providers as well as direct service provision, so

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1 the distinction was made between the missions of the
2 medical schools and what this individual would view
3 as the role of local public health agencies.

4 You indicated that there were some needs
5 that were presented to you that weren't consistent
6 with the missions of the medical schools and
7 therefore would not be a part of the expenditure of
8 the foundation resources. How do you respond to
9 this type of concern that we've received?

10 THE WITNESS: I'm happy to respond.
11 Traditionally, the focus of the medical profession
12 has been on intervention, no question about that.
13 However, in the last decade or so, a more balanced
14 approach has been developed at both the UW Medical
15 School and the Medical College of Wisconsin,
16 balancing intervention with prevention, and
17 increased emphasis on population health through
18 community-based activities. And, in fact, we've
19 developed in the last decade UW Medical School a
20 large faculty concerned with population health,
21 concern with research related to population in
22 public health and also with education. We have
23 assembled a faculty large enough to create through
24 reorganization a virtual school of public health on
25 the Madison campus and serving the Wisconsin idea,
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1 that is, the boundaries of the state will be the
2 boundaries of this program, and so even though there
3 may be a basis for concern in relationship to the
4 traditional approach of medical schools, it's not
5 the case from what's developed during the last
6 decade.

7 THE COMMISSIONER: In terms of any local
8 agencies or local community organizations, again,
9 what would the mechanics be for them to apply for
10 resources from the UW Medical School?

11 THE WITNESS: Well, as stated in the
12 plan, we wish to have an annual competition, and we
13 will announce on a statewide basis to community
14 organizations advertising in the local newspapers
15 this annual competition. There will be a request
16 for proposals, criteria for reviewing these
17 proposals will be stated at the time of the
18 announcement, and then the proposals will be
19 reviewed on an annual basis with an advisory
20 committee chaired by the dean of the Medical School
21 responsible for making the funding decisions, and
22 this is described in some detail in the plan as part
23 of the description on page 36.

24 THE COMMISSIONER: And who would
25 establish the criteria then for the applicants?

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1 THE WITNESS: The advisory committee.

2 THE COMMISSIONER: And who would appoint
3 the advisory committee?

4 THE WITNESS: Appointed by UW Madison, by
5 the chancellor and the dean of the Medical School,
6 and some of the members are described in the plan,
7 including representatives from government health
8 agencies and voluntary health organizations, but
9 this group would finalize the criteria that are
10 referred to tentatively on page 36 before the first
11 request for proposals.

12 THE COMMISSIONER: And you think one of
13 the elements in the plan was that the minimum
14 granted, it at one juncture was \$50,000. Is that
15 still a minimum grant amount allocation that you're
16 looking at?

17 THE WITNESS: Yes. We believe in order
18 to have high impact, far-reaching results, to
19 develop innovative programs that impact effectively
20 on communities that this amount is appropriate, and
21 we base that also on our experience with programs
22 that we've established around the state. As an
23 example, our Wisconsin Alzheimer's Institute, our
24 cancer center have a statewide collaborative
25 programs, partnerships, and this is the type of

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1 money that it takes in order to have impact.

2 THE COMMISSIONER: And would
3 organizations then be expected to put up an equal
4 \$50,000 amount in order to be eligible for the
5 grant?

6 THE WITNESS: That's correct.

7 THE COMMISSIONER: And have you looked at
8 what types of organizations would have the financial
9 capacity to put up that amount as opposed to perhaps
10 some of the local community organizations that --
11 I'm just wondering what ability some of those
12 smaller local community organizations would have to
13 raise that type of resources for a match?

14 THE WITNESS: Yes, I understand that
15 question. We know that many of the organizations
16 that we've worked with in the past would not have
17 difficulty in having such an amount of money
18 available for programs that would extend over a
19 period of time, perhaps a year or two or three, so
20 we've worked with many groups that have that
21 ability. We think the matching provision will
22 enhance the partnerships.

23 However, we also know that some small
24 community organizations either singly or in
25 coalitions will be in a similar situation, and we've
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1 had a great deal of experience with matching funds
2 approaches working with the State of Wisconsin and
3 other organizations and we know this is a very
4 effective way to create partnerships.

5 THE COMMISSIONER: And what amount of
6 resources have you dedicated for start-up funds and
7 have you looked at whether or not a smaller start-up
8 allocation which would allow you to build the
9 endowment for the future, how did you weigh the pros
10 and cons between that?

11 THE WITNESS: Well, we've requested an
12 initial allocation of \$20 million as I think what
13 you referred to as start-up. We've requested that
14 after careful analysis because we believe very
15 strongly that we wish to catalize the development of
16 these programs in creating the new paradigm of
17 public health for the State of Wisconsin including
18 prevention through research, public health
19 education, and we would like to begin the fund for
20 communities, the Enhancing Community of Rural Health
21 Fund immediately, and so that's why we've requested
22 the \$20 million and we have indicated explicitly
23 that the remainder would be placed in an endowment
24 serving generations to come.

25 THE COMMISSIONER: Thank you.

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1 MR. BRANCH: Thank you, Dr. Farrell.

2 Next we'd like to call Mr. John Daniels.

3 JOHN DANIELS, called as a witness herein,
4 having been first duly sworn on oath, was examined
5 and testified as follows:

6 E X A M I N A T I O N

7 BY MR. BRANCH:

8 Q Mr. Daniels, could you please give us your current
9 employment position and background.

10 A My name is John Daniels, Jr. I'm a partner at
11 Quarles & Brady where I'm a member of the management
12 committee. I am presently national president of the
13 American College of Real Estate Lawyers and a
14 director of the Ralph Evinrude Foundation. I am
15 involved in a number of local entities which are
16 designed to enhance urban life.

17 Q Why are you testifying here today?

18 A I'm testifying today because I have been asked and
19 I've agreed to be a member of the board of directors
20 of Blue Cross & Blue Shield United of Wisconsin
21 Public Health Foundation, Inc.

22 Q Can you give us an overview of the goals and
23 organizational structure of the proposed foundation?

24 A Yes, I can. The issue of public health in the State
25 of Wisconsin is of course an important one to all of
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1 us. The health and general welfare of the citizens
2 of Wisconsin is a crucial factor in maintaining the
3 health of the state. With the increasing costs of
4 medical care and the shortage of funds available for
5 research and development, there is an increasing
6 need to identify areas of need within the state in
7 order to best focus and effectively utilize these
8 funds. Blue Cross & Blue Shield United of Wisconsin
9 Public Health Foundation was organized to address
10 that need.

11 The general purpose of the foundation is
12 set forth in the articles of incorporation. The
13 foundation is organized and will be operated
14 exclusively to promote the general health, welfare,
15 and common good of the residents of the State of
16 Wisconsin through its support of public health
17 initiatives which have been described here today
18 both by the University of Wisconsin Medical School
19 and the Medical College of Wisconsin.

20 Q Why are the medical schools involved?

21 A A degree of public dialogue has been focused on the
22 involvement of the two medical schools, and I
23 believe these organizations are uniquely qualified
24 to provide the insight and guidance as to the best
25 and most appropriate use of the foundation's funds.

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1 These schools are the only two educational
2 institutions in our state that offer courses
3 designed to award the Doctor of Medicine degree and
4 other medical degrees.

5 Moreover, both of these institutions are
6 nationally recognized and they share values and have
7 a unity of purpose in their balanced fourfold
8 mission of education, research, care, and community
9 services. These missions are reflected in the plan
10 which has been previously discussed here today and
11 identified as "Advancing the Health of Wisconsin's
12 Population."

13 Further, since these schools already have
14 existing, effective infrastructures in place to
15 carry out the purpose of the fund -- of the
16 foundation, valuable funds that should and can be
17 allocated to furthering the general health, welfare,
18 and common good of the residents of our state are
19 not being expended in the creation or administration
20 of a new infrastructure.

21 Q Can you explain how the foundation will be managed?

22 A The foundation was originally organized October 21st
23 of 1999. It was created, as you know, as a not-for-
24 profit, nonstock corporation under Wisconsin
25 Statutes. The foundation was created with three
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1 initial directors in order to facilitate its
2 incorporation and the filing various documents with
3 the Service. Once the conversion is approved, these
4 three directors will resign and a nine member board
5 of directors will replace them.

6 Q Have the board members been selected?

7 A Yes, directors have been selected and identified
8 publicly. In addition to myself, the foundation
9 board will include Ben Brancel, Howard Fuller, David
10 Meisner, Louise Trubek, Kathy Hudson, George Stiel,
11 Robert Froelke, and Tom Lyon. These individuals
12 represent a very diverse cross-section of the State
13 of Wisconsin and our community and each individually
14 brings a wealth of knowledge and experience in
15 public service to the foundation.

16 Q What will the board of directors do?

17 A The board, once installed, will have principally two
18 main objectives. First, the board will oversee the
19 liquidation of United Heartland Group, Inc., stock
20 held by the foundation. Second, the board will
21 oversee the dissemination of funds which will result
22 from the liquidation of stock in United Heartland
23 Group, Inc.

24 Q What, if any, legal duties to the foundation members
25 -- what legal duties do the foundation members have
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1 to the foundation?

2 A In order to ensure the foundation directors act in
3 the foundation's best interest, each board member is
4 subject to three fiduciary duties that are required
5 in fact by law: the duty of care, obedience, and
6 loyalty. In very simple terms, directors are
7 required to act in the same manner as an ordinarily
8 prudent person would act in a like position under
9 similar circumstances. Directors must also give
10 their undivided allegiance to the foundation when
11 making decisions that affect the foundation and be
12 faithful to the mission of the foundation acting in
13 a manner that is consistent with the foundation's
14 goals and purposes which have been previously
15 outlined.

16 Q Switching to another subject now, is there anything
17 significant concerning the structure of the
18 foundation?

19 A Yes, Mr. Branch. The foundation is in fact
20 structured as a tax-exempt entity under the Code.

21 Q Is that a reference to the Internal Revenue Code?

22 A Yes, it is.

23 Q Why is that important?

24 A The reason that's important is that the tax-exempt
25 structure was selected in part to maximize the funds
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1 which would be ultimately available to be
2 distributed to the two medical schools. Had the
3 foundation been structured differently, return on
4 investments, including the sale of the United
5 Heartland Group, Inc.'s stock could be subject to an
6 additional 2 percent tax that is not applicable to
7 entities such as the foundation.

8 Because the foundation is exempt, it is
9 subject to certain limitations under the Internal
10 Revenue Code regarding its operations, which will
11 ensure that the foundation's activities are
12 conducted on the terms which are fair and
13 reasonable. For example, a tax-exempt organization
14 is prohibited from allowing any part of its net
15 earnings to inure to the benefit of any private
16 individual. Further, all transactions and
17 activities entered into by tax-exempt organizations
18 must be on commercially reasonable terms and provide
19 the foundation with no less than fair value for the
20 goods or services provided by the foundation.

21 In short, all tax-exempt organizations
22 must conduct themselves in a manner that furthers
23 their exempt mission and does not unduly benefit
24 private individuals or entities.

25 I want to point out particularly that the
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1 reporting obligations concerning the foundation's
2 operations which flow from the foundation's status
3 as a tax-exempt entity will be particularly
4 beneficial to the public. The foundation is
5 required to make filings with the Service concerning
6 its operations which are open to public inspection.
7 As a result, the public will have access to review
8 the foundation's operations.

9 Q Will the foundation continue indefinitely?

10 A It's not contemplated the foundation will continue
11 in perpetuity. As discussed by other witnesses in
12 this proceeding, the plan of conversion contemplates
13 that the foundation will divest itself of United
14 Heartland Group, Inc.'s stock over a period of
15 approximately five years and that proceeds from the
16 sale of such stock will be used to carry out the
17 public health initiatives which have been identified
18 both for the University of Wisconsin Medical School
19 and the Medical College of Wisconsin. Once the
20 foundation determines that it no longer has a
21 necessary or practical need to remain in legal
22 existence or when the funds have been completely
23 distributed, the foundation will in fact terminate
24 its existence.

25 Q Do you believe the conversion will be contrary to
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1 the interests of Blue Cross policyholders or the
2 public?

3 A Yes, I do. The Foundation's role in the plan of
4 conversion is clearly beneficial to the public of
5 the State of Wisconsin. I've agreed to serve as a
6 director because I believe that the foundation will
7 advance the public health interests of the state.
8 Given the mission of the foundation, the involvement
9 of the two fine medical schools, and the clear
10 benefit to the citizens of the State of Wisconsin, I
11 would urge the commissioner to approve the Blue
12 Cross plan of conversion and to allow the foundation
13 to be endowed.

14 Q So it's your testimony, Mr. Daniels, that the -- you
15 believe the conversion will not be contrary to the
16 interest of the policyholders or the public --

17 A I very strongly --

18 Q -- is that correct?

19 A -- do not believe it would be contrary to the
20 interest of policyholders.

21 MR. BRANCH: Thank you very much. I have
22 no further questions at this time, Madam
23 Commissioner.

24 THE COMMISSIONER: You indicated that
25 there would be a limited life for the foundation
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1 board. During that time frame, what degree of
2 oversight would the foundation board have over the
3 medical schools in the use of the foundation
4 resources?

5 THE WITNESS: It's my understanding that
6 plans have been developed which have been described
7 as organic documents. It would be my contemplation
8 that those plans would have to be administered with
9 what has been previously submitted to the
10 Commissioner and that there would be appropriate
11 oversight.

12 THE COMMISSIONER: And how would you
13 anticipate that the foundation itself would go out
14 obtaining expertise necessary to sell the common
15 stock of United Hartland Group?

16 THE WITNESS: Madam Commissioner, I think
17 that's an excellent question, and it would be my
18 contemplation that given the diversity of the
19 directors of the foundation, many of whom who have
20 experience in various business aspects, that we
21 would rely upon the expertise of those persons, but,
22 more importantly, that we would seek professional
23 advice from persons who are fully experienced and
24 competent in maximizing and monetizing the value of
25 the assets of the foundation for the public

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1 interest.

2 THE COMMISSIONER: Thank you.

3 MR. BRANCH: Thank you. Our next

4 witness, I'd like to call Mr. David Platter.

5 DAVID PLATTER, called as a witness
6 herein, having been first duly sworn on oath, was
7 examined and testified as follows:

8 E X A M I N A T I O N

9 BY MR. BRANCH:

10 Q Mr. Platter, can you describe for you us your
11 current occupation, please.

12 A Yes. My name is David Platter and I'm a managing
13 director at the investment banking firm of
14 Donaldson, Lufkin & Jenrette, or DLJ as I'll refer
15 to it. DLJ is a New York based, full service
16 investment banking firm providing a wide range of
17 capital raising and merger and acquisition advisory
18 services to clients in a broad range of industries.

19 Q Describe DLJ's experience in the Blue Cross Blue
20 Shield sector, please.

21 A DLJ is a leading advisor to Blue Cross Blue Shield
22 organizations as well as other health insurance and
23 managed care companies. In addition to working with
24 Blue Cross & Blue Shield United of Wisconsin, or
25 Blue Cross as I'll refer to it, DLJ has been
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1

1 involved in advisory capacities for other Blue plans
2 directly involved in acquisitions, restructurings or
3 conversions, as well as working for the relevant
4 state insurance commissioners in those situations.

5 Q What is your association with Blue Cross Blue Shield
6 United of Wisconsin?

7 A DLJ was retained by a special committee of the board
8 of directors of Blue Cross, which I'll refer to as
9 the special committee, in February 1999 with respect
10 to strategic financial matters, including advising
11 on issues related to a possible conversion of the
12 company from a service insurance corporation to a
13 shareholder-owned corporation.

14 Q Please describe your work on behalf of the special
15 committee.

16 A Our work for the special committee has included a
17 discussion of the rationale for conversion to a
18 shareholder-owned corporation, an overview of
19 comparable or precedent conversion transactions
20 involving our Blue plans, and a review of the
21 alternatives for completing such a transaction. The
22 initial phase of our assignment from the special
23 committee addressed the issue of strategic
24 alternatives for Blue Cross. The alternatives we
25 discussed included maintaining the status quo,
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1 converting to a mutual insurance company, and
2 converting to a shareholder-owned corporation. Our
3 team from DLJ met frequently with the special
4 committee and management to present our findings and
5 to discuss the advantages and disadvantages of each
6 of these alternatives.

7 Q What impact would the proposed conversion have on
8 the company's policyholders?

9 A The special committee asked DLJ to address this
10 issue in particular detail. To address this
11 question properly, it is important to reflect upon
12 Blue Cross's current situation and how the company's
13 organizational structure impacts its ability to
14 address the significant changes that are occurring
15 today in the managed health care industry.

16 Compared to the majority of managed
17 health care companies, Blue Cross is a relatively
18 small industry participant with limited financial
19 resources. Blue Cross's access to additional
20 capital is limited by its current organizational
21 structure. This significantly reduces the company's
22 ability to undertake strategic and operational
23 initiatives such as bolstering statutory capital
24 reserves, funding infrastructure initiatives to
25 improve administrative efficiencies, and increase

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1 the depth and breath of services to its
2 policyholders, and pursuing strategic merger and
3 acquisition opportunities.

4 We believe that the company's lack of
5 access to capital markets limits its stand-alone,
6 long-term prospects for success. To address these
7 issues and others, we believe that converting to a
8 shareholder-owned corporation will better position
9 Blue Cross as an organization to continue to provide
10 reliable health care insurance to its insured
11 members in the future.

12 Q How will the proposed conversion accomplish this?

13 A Once converted to a shareholder-owned corporation,
14 Blue Cross will be able to access the capital
15 markets more efficiently. With access to the
16 capital markets, Blue Cross will be able to increase
17 operational efficiencies through infrastructure
18 investments, fund growth and, where appropriate,
19 effect mergers or acquisitions. From a capital
20 raising perspective, by operating as a service
21 insurance corporation, Blue Cross is at a
22 significant disadvantage relative to its
23 shareholder-owned peers since its options for
24 raising equity capital are essentially nonexistent.
25 If the company seeks to raise debt capital, its
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1 capital options are limited to the issuance of
2 surplus notes.

3 In contrast, over the last eight years,
4 Blue Cross's shareholder-owned competitors have
5 raised in excess of 7.3 billion in debt and equity
6 capital from the public capital markets.

7 As a shareholder-owned corporation, Blue
8 Cross will also be able to effect a merger with
9 United Wisconsin Services, Inc., or UWZ as I'll
10 refer to it, or other shareholder-owned managed care
11 entities. Through such a transaction, Blue Cross
12 would be able to achieve greater size in much less
13 time than would be required to grow the company
14 internally. In recent years, the managed care
15 environment has favored managed care providers with
16 greater size and scope as evidenced by the migration
17 of customers from smaller plans with limited
18 offerings to larger plans with broader coverage
19 options.

20 Q Who will receive the value of the company once the
21 proposed conversion is completed?

22 A One of the principal concerns of the special
23 committee regarding the conversion was the question
24 of what party or parties would receive the value of
25 the converted Blue Cross entity. There is also the
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1 question as to what form and amount, if any, of the
2 value of the new company granted to a third-party
3 entity. The alternatives we reviewed in regard to
4 this question included contributing a defined value
5 to a foundation in the form of cash or contributing
6 the full equity value of the company to a foundation
7 in the form of stock.

8 It is the belief of the special
9 committee, Blue Cross management, and DLJ that a
10 contribution of the full equity value of Blue Cross
11 in the form of 100 percent of the capital stock of
12 the converted Blue Cross entity to a charitable
13 foundation or the Foundation is the most
14 straightforward solution. Currently, Blue Cross
15 cannot undertake a defined value contribution since
16 it does not have sufficient excess cash reserves to
17 contribute a meaningful amount of cash to a
18 foundation. Moreover, by contributing 100 percent
19 of the capital stock, there is no question that the
20 foundation is receiving 100 percent of the value of
21 the company.

22 Q Has this alternative been implemented elsewhere?

23 A Yes. In our review of precedent conversion
24 transactions, including Blue Cross of California,
25 Blue Cross & Blue Shield of Missouri, and Empire
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1 Blue Cross & Blue Shield, the entity receiving value
2 or being proposed to receive value was or is one or
3 more charitable foundations. However, it is
4 important to note that the foundation contributions
5 made in connection with the conversions of the
6 California and Missouri Blue plans resulted from
7 negotiated settlements reached after their
8 conversions and were not proposed concurrently with
9 the conversion as is the case with Blue Cross'
10 proposed transaction here. In fact, unlike the
11 other completed transactions and the proposed
12 conversion of Blue Cross of Missouri, Blue Cross &
13 Blue Shield United of Wisconsin is the only one of
14 these plans which started a conversion process with
15 a proposal to give all of the value of the company
16 to a foundation. Furthermore, unlike Blue Cross of
17 California, which was exempt from state taxes until
18 the point of conversion, Blue Cross & Blue Shield
19 United of Wisconsin reached its decision to fund the
20 foundation with its full value despite the fact that
21 it has paid state income taxes since 1972 and has
22 been fully taxable for more than a decade.
23 Q What can you tell us about the value of Blue Cross?
24 A The question of what Blue Cross is worth is, in many
25 ways, irrelevant to this transaction. This is
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1 because no matter what that value is, the foundation
2 will be receiving all of it. By contributing 100
3 percent of its capital stock to the foundation, the
4 foundation will have a claim on any and all aspects
5 of value attributable to Blue Cross. Despite this
6 fact however, we developed a preliminary indication
7 of value -- of the value of Blue Cross as part of
8 our analysis and evaluation of the conversion
9 process.

10 The value being received by the
11 foundation consists of two components. First, the
12 equity value of Blue Cross as a stand-alone
13 business; and, second, the value of Blue Cross's
14 significant equity interests in UWZ, which is
15 approximately 46 percent, and American Medical
16 Security Group, or AMZ, which is approximately 38
17 percent. Of the two components, the easiest to
18 value are Blue Cross's investment in UWZ and AMZ,
19 which can be easily determined by stock market
20 prices. The most difficult component to value is
21 the equity value of Blue Cross on a stand-alone
22 basis, which can only be valued definitively through
23 either an outright sale of the company or through an
24 offering of the company's shares to the public.
25 However, by looking at relative valuations for
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1 comparable companies, an approximate valuation can
2 be imputed for Blue Cross on a stand-alone basis.
3 For the benefit of the special committee, we
4 completed a preliminary valuation of Blue Cross
5 using two traditional valuation of methodologies.
6 First, a comparable public companies analysis; and
7 second, a comparable merger and acquisitions
8 acquisition transactions analysis. Based on the
9 results of our preliminary analysis, the value of
10 Blue Cross on a stand-alone basis, combined with the
11 value of its investments in UWZ and AMZ, implies a
12 potential range of values from about 146 million to
13 600 million.

14 It should be noted that the value of the
15 Blue Cross & Blue Shield names and marks is
16 reflected in the preliminary range of values for
17 Blue Cross. While the company derives meaningful
18 value from being able to market its plans under the
19 Blue marks, this goodwill value is embedded in the
20 premium revenues and earnings achieved by the
21 company that ultimately comprise its overall equity
22 value. It should also be noted that since the time
23 of preliminary evaluation analysis that I
24 referenced, valuations of publicly traded managed
25 care companies have declined significantly.

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1 Q How will the foundation realize this value?

2 A In a conversion scenario in which all of the stock
3 of Blue Cross has contributed to the foundation, the
4 special committee asked DLJ to discuss the
5 alternatives for achieving the liquidity necessary
6 for the foundation to complete its charitable
7 mission. Post-conversion, Blue Cross will be a
8 privately held, shareholder-owned corporation and,
9 consequently, it will not be immediately possible
10 for the foundation to sell shares of Blue Cross to
11 third-party investors to raise cash. We discussed
12 with the special committee two liquidity
13 alternatives available to the foundation, including
14 first an initial public offering of common stock, or
15 IPO, and a second merger or acquisition transaction.

16 In assessing the potential for an IPO,
17 several factors must be considered including the
18 size of the company, the market environment for
19 similar publicly traded companies, and the proposed
20 use of proceeds. In our opinion, the IPO option
21 does not currently represent a valid liquidity
22 alternative to the foundation due both to the small
23 size of Blue Cross relative to its publicly traded
24 peers and the current adverse market environment for
25 health insurance managed care companies.

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1 Blue Cross could also provide liquidity
2 to the foundation through a merger or acquisition
3 transaction with a publicly traded company such as
4 UWZ. Under this scenario, Blue Cross's shares would
5 be exchanged either for cash or shares of the
6 publicly traded partner. If shares were received as
7 consideration, the foundation would be able to gain
8 liquidity either by periodically selling a smaller
9 number of shares in the market or by completing a
10 single larger underwritten public offering of the
11 shares received. A merger transaction could also
12 potentially enhance the equity value of the new
13 combined entity as it would result in greater scale
14 and scope of operations. By having ownership in a
15 larger merged entity, the foundation could
16 potentially realize a greater premium in the
17 ultimate sale of its shares, either in a piecemeal
18 fashion to the market or in larger blocks through an
19 underwritten public offering.

20 MR. BRANCH: Thank you, Mr. Platter. I
21 have no further questions at this time.

22 THE COMMISSIONER: Can you comment in
23 more detail on the current marketplace for health
24 insurance stock and then what you would see over the
25 five-year divestiture period?

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1 THE WITNESS: It's very difficult to
2 speculate what may happen over the -- over five
3 years. What I can say as to my comments that the
4 market for health care stocks as traded off since we
5 did our analysis, we did our preliminary evaluation
6 work for the special committee in May and the market
7 on a stock value basis is off 25 to 30 percent since
8 then. Markets go up and markets go down. I really
9 don't think I can speculate what's going to happen
10 over the next five years. There is -- I think it's
11 covered in the press a number of issues surrounding
12 the health care industry right now which are
13 bantered about and will perhaps have their impact
14 on the value of the stocks as we go forward.

15 THE COMMISSIONER: Blue Cross has
16 announced an estimate for the ultimate conversion
17 proceeds of 250 million. Do you know how that
18 figure was arrived at and are you comfortable with
19 that estimate?

20 THE WITNESS: To answer the question,
21 again, I want to underscore the comment I made that
22 values in some ways are irrelevant and I think it's
23 an important point to drive home which is that all
24 the values being given to the foundation, whether
25 that value is a small number or a big number or the
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1 \$250 million. Again, the \$250 million number that
2 was put forward is an estimate of a range done in
3 May that considers factors such as where comparable
4 public companies were trading at the time, both
5 large and small publicly traded health care
6 companies, and also takes a look at merger and
7 acquisition transactions for other health care
8 companies and the values that have been obtained in
9 the sales of those companies, so I make reference a
10 moment ago to a range of values from 146- to \$600
11 million of value, that's a very wide range, that
12 encapsulates the top and the bottom of the various
13 methodologies we undertook back in May. \$250
14 million as of May was a comfortable middle range of
15 the types of value and work that we had done at that
16 time.

17 THE COMMISSIONER: So the 250 just
18 reflects the mid-point of the two numbers, there's
19 -- is there anything else that went into that
20 equation?

21 THE WITNESS: It was not a precise mid-
22 point. Rather, it was an estimation at that point
23 in time if one were to look at the value and the
24 different methodologies we had examined. Roughly,
25 what the enterprise, the combination of the value
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1 they held in AMZ and UWZ stock and the value of Blue
2 Cross on a stand-alone basis might add up to it.

3 THE COMMISSIONER: And you indicated that
4 -- when you gave the 25 percent, what was the 25
5 percent number again?

6 THE WITNESS: I'm sorry.

7 THE COMMISSIONER: Preliminary analysis
8 in May conducted and something has dropped 25
9 percent since then.

10 THE WITNESS: Oh, yes. I made reference
11 to the fact that the stock market for an index of
12 health care companies, if you looked at where that
13 index was, say, in May versus where it is now, the
14 index is off about 25 to 30 percent in rough terms.

15 THE COMMISSIONER: Thank you.

16 MR. BRANCH: Thank you, Mr. Platter. Our
17 next witness is Miss Gail Hanson.

18 GAIL HANSON, called as a witness herein,
19 having been first duly sworn on oath, was examined
20 and testified as follows:

21 E X A M I N A T I O N

22 BY MR. BRANCH:

23 Q Could you please state your name and position with
24 Blue Cross Blue Shield United of Wisconsin.

25 A My name is Gail Hanson, I am the chief financial
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1 officer, vice president, and treasurer for Blue
2 Cross & Blue Shield United of Wisconsin.

3 Q What do your work responsibilities include?

4 A My responsibilities include oversight of all the
5 financial, investment, and tax matters of Blue
6 Cross.

7 Q Can you give us a brief overview of Blue Cross's
8 financial history.

9 A Blue Cross & Blue Shield United of Wisconsin has
10 historically enjoyed a reputation as a financially
11 sound insurance company. Blue Cross has been
12 subject to state income taxes since 1972 and has
13 been a fully taxable entity for more than a decade.
14 When taking into account income taxes, business
15 taxes, and ownership taxes together from 1987
16 through 1998, Blue Cross has paid in excess of \$72
17 million in taxes.

18 On January 1, 1987, which coincides with
19 the date Blue Cross became subject to federal income
20 tax, our total assets measured approximately \$196
21 million and our total reserves and unassigned funds,
22 which for a service insurer is the equivalent of
23 surplus, approximated \$56 million. In comparison,
24 our most recent quarterly financial statements show
25 that as of September 30, 1999, Blue Cross had total
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1 admitted assets of over \$243 million and total
2 reserves and unassigned funds exceeding \$122
3 million, which is more than double our total
4 reserves and unassigned funds from just over a
5 decade ago.

6 Q Have you been involved in reviewing the financial
7 implications associated with the proposed conversion
8 of Blue Cross?

9 A Yes. I have been actively involved in the proposed
10 conversion of Blue Cross and am knowledgeable of the
11 financial implications and benefits associated with
12 the proposed conversion. Based on the above
13 figures, which demonstrate our overall financial
14 strength, it is apparent that the purpose of the
15 conversion is not to rescue Blue Cross from
16 financial turmoil but rather to ensure its continued
17 financial strength in today's rapidly changing
18 health care market.

19 Q Can you describe that current health care market?

20 A In recent years, there has been a significant market
21 consolidation in the managed care industry.
22 According to reports prepared by our investment
23 banking firm, Donaldson, Lufkin & Jenrette, the
24 nation's top ten managed care firms have increased
25 their market share from approximately 43 percent in
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1 1995 to over 51 percent in 1998. During this same
2 period, total enrollment in the top ten managed care
3 firms increased from 50.9 million enrollees to 76.6
4 million enrollees. Furthermore, recent surveys
5 indicate that over one-third of employers
6 anticipated moving to health plans with larger
7 provider networks in 1998. As a result, Blue Cross,
8 like other relatively smaller carriers, is being
9 gradually squeezed out of the health care market by
10 larger and better capitalized companies despite its
11 current financial strength.

12 Q Given these market trends, is Blue Cross
13 disadvantaged by its current organizational
14 structure?

15 A Yes. In the last decade, increased demands for
16 lower costs, high quality health care products and
17 services have driven the need to attract investment
18 capital into the managed care industry. This influx
19 of capital has subsequently fueled a massive
20 restructuring of the health care system.
21 Unfortunately, the current corporate and legal
22 structure of Blue Cross has severely limited its
23 ability to take advantage of these market trends.
24 For example, Blue Cross is unable to be a first
25 mover during market consolidation and is restricted
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1 in its ability to pursue strategic mergers and
2 acquisitions. Instead, we are forced to be reactive
3 rather than proactive in this rapidly changing
4 market resulting in adverse positioning for
5 long-term growth. As a result, the current
6 structure of Blue Cross could be viewed as actually
7 limiting its ability to best serve its interests and
8 the interests of its policyholders.

9 Also, as I previously mentioned, a
10 significant disadvantage of the current corporate
11 structure of Blue Cross is the limited ability to
12 effectuate -- to effectively raise capital and
13 directly access capital markets. Instead, Blue
14 Cross must rely on its interests in United Wisconsin
15 Services, Inc. and American Medical Security Group,
16 Inc. to provide indirect access to capital markets.
17 As a result, Blue Cross cannot generate the
18 acquisition capital necessary to benefit from the
19 dramatic consolidation trends that are sweeping
20 through the managed care industry. Limited access
21 to capital also impairs our ability to fund major
22 technology and infrastructure improvements which
23 again put us at a disadvantage with our largest
24 competitors. It follows that Blue Cross, like many
25 smaller insurers, may have difficulty competing on a
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1 financial basis with our larger, better capitalized
2 competitors.

3 Q How can Blue Cross generate needed capital?

4 A Without access to capital markets, Blue Cross is
5 left with very limited and often undesirable
6 alternatives to generate additional capital. One
7 option for generating capital is to incur debt,
8 which can negatively impact our insurance ratings
9 and must ultimately be repaid by Blue Cross.

10 A second option is to raise premium rates
11 for our policyholders. This second alternative is
12 often viewed as detrimental to our policyholders and
13 would likely result in a loss of business for Blue
14 Cross. By converting to a stock insurance company,
15 Blue Cross can no longer be forced to rely almost
16 exclusively on increased premiums or debt to
17 generate additional capital.

18 Q What are the advantages to converting to a stock
19 insurance corporation?

20 A There are financial advantages to converting Blue
21 Cross to a stock insurance corporation. In fact, a
22 number of the disadvantages I previously mentioned
23 will be significantly reduced or eliminated if Blue
24 Cross is allowed to convert to a stock insurance
25 corporation. For example, the converted corporate
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1 structure would provide Blue Cross with a greater
2 opportunity and flexibility to raise capital to fund
3 future growth by providing direct access to capital
4 markets.

5 By gaining direct access to capital
6 markets, we would be in a better position to fund
7 necessary infrastructure and technology improvements
8 and enhance the quality of services provided to our
9 policyholders. Likewise, company growth and an
10 increase in market share would improve negotiating
11 strength and maximize economies of scale.
12 Ultimately, these benefits would be passed on and
13 enjoyed by existing and future policyholders of Blue
14 Cross.

15 Finally, a conversion to a stock
16 insurance corporation would provide Blue Cross with
17 the corporate structure necessary to merge with
18 United Wisconsin Services thus preserving inter-
19 company relationships and economies of scale between
20 these entities. A subsequent merger would also help
21 to clarify investment community confusion with
22 respect to the structure, operations, and strategies
23 of the two companies, which could translate into
24 increased stock values.

25 Q What would be the impact, if any, of a merger on the
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1 stock of a post-conversion Blue Cross?

2 A The foundation created pursuant to the proposed
3 conversion will hold all of the stock of the newly
4 created stock holding company following the
5 conversion. In the event of a merger between Blue
6 Cross and United Wisconsin Services, the foundation
7 would receive its -- as consideration for its
8 shares, stock in the surviving entity or some
9 combination of stock and cash. Thus, the foundation
10 could substantially benefit if the value of the
11 stock of the combined entity increases following a
12 merger.

13 Q From a financial perspective, is the proposed
14 conversion contrary to the interests of
15 policyholders or the public?

16 A Financially, the proposed conversion is not contrary
17 to the best interests of our policyholders or the
18 public. In fact, we have reached a crossroads in
19 the health insurance industry where a path of
20 complacency and status quo could actually prove to
21 be detrimental to the long-run interests of Blue
22 Cross and its policyholders. To avoid this result,
23 we have chosen a path of innovation to provide Blue
24 Cross with the structure necessary to remain
25 financially secure and to continue to provide

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1 quality health-related services to the people of
2 Wisconsin.

3 MR. BRANCH: Thank you, Miss Hanson. I
4 have no further questions at this time.

5 THE COMMISSIONER: The quarterly
6 statement for Blue Cross as of September 30th, 1999
7 indicated a statutory net worth of 122 million.
8 This number compares to the 198 million as of
9 December 31st, 1998. Could you explain the factors
10 that have contributed to the decline?

11 THE WITNESS: The decline is largely
12 accounted for in the evaluation of Blue Cross's
13 investments and United Wisconsin Services and
14 American Medical Security. The stock price of both
15 of those companies had declined during that period.

16 THE COMMISSIONER: Thank you.

17 MR. BRANCH: Thank you, Miss Hanson. I
18 next would like to call Mr. Mark Orloff.

19 MARK A. ORLOFF, called as a witness
20 herein, having been first duly sworn on oath, was
21 examined and testified as follows:

22 E X A M I N A T I O N

23 BY MR. BRANCH:

24 Q Could you please again restate your name and
25 position with the Blue Cross & Blue Shield
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1 association?

2 A My name is Mark Orloff and I'm the vice president
3 and deputy general counsel and assistant corporate
4 secretary of the Blue Cross & Blue Shield
5 Association, which I'll refer to here as the
6 Association.

7 Q Can you explain your work duties, please.

8 A Sure. My primary duties include providing advice
9 and counsel to the Association's senior management,
10 board, and board committees as well as overseeing
11 the delivery of legal services within and to the
12 Association. In these capacities, I have gained a
13 detailed knowledge of the Association licensing
14 rules, including those relating to the conversion of
15 a Blue plan to an investor-owned company.

16 Q What is the purpose of your testimony here today?

17 A I've been asked to focus on the requirements of the
18 association as they apply to shareholder-owned
19 structures, such as Blue Cross Blue Shield United of
20 Wisconsin's plan of conversion and its use of a
21 foundation.

22 Q Please give us an overview of the association and
23 its relationship with Blue Cross companies?

24 A Sure. The Blue Cross & Blue Shield Association is
25 the national coordinating body and trade association
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1 for the 50 independent Blue Cross & Blue Shield
2 plans around the country. The association itself
3 owns the Blue Cross & Blue Shield names and marks,
4 which I'll refer to here as the Blue marks. As a
5 result, it is necessary for Blue Cross & Blue Shield
6 United of Wisconsin and the other independent Blue
7 plans to license the use of the Blue marks from the
8 Association. Nobody can use those marks or
9 participate in the Blue system of plans without
10 holding a formal license agreement with the
11 Association.

12 Q Can Blue plans be organized as shareholder-owned
13 organizations?

14 A Since 1994, Blue plans have had the option of
15 converting to a shareholder-owned organization.

16 Q Have any Blue plans done so?

17 A Yes, three plans have already done so. WellPoint
18 Health Networks, the Blue Cross licensee in
19 California, Trigon Blue Cross & Blue Shield in
20 Virginia and Georgia Blue Cross & Blue Shield.
21 There are also proposed pending conversions in New
22 York City of St. Louis to restructure the respective
23 local Blue plans.

24 Q Are you familiar with the Wisconsin Blue Plan's
25 conversion proposal?

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1 A Yes. In August of this year, the Wisconsin Blue
2 Plan, Blue Cross & Blue Shield United of Wisconsin,
3 petitioned the association for relicensure in
4 connection with its plan of conversion. Such an
5 application for relicensure is required under the
6 Association rules because the conversion will result
7 in a change of control. Absent approval from the
8 Association, implementing the plan of conversion
9 before you would be cause for the Association to
10 terminate the Wisconsin plan's license to use the
11 Blue marks.

12 Q Was the petition approved by the Association?

13 A The board of directors of the Association, which is
14 comprised of all of the CEOs of the independent Blue
15 plans, approved the Wisconsin plan's proposed
16 reorganization structure reflected in its plan of
17 conversion subject to a number of conditions. These
18 are the same basic conditions that have been
19 required in all similar Blue plan conversions
20 involving a foundation.

21 Q Could you explain those conditions, please?

22 A In general, the conditions that attach to approval
23 by the Association of a proposed conversion to a
24 shareholder-owned entity and which are applicable to
25 the plan of conversion of Blue Cross & Blue Shield
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1 United of Wisconsin can be summarized as follows.

2 First, the plan will have to remain in
3 full compliance with all Association rules, except
4 the rules that would preclude or otherwise preclude
5 the foundation from owning more than 20 percent of
6 the equity or 5 percent of the voting control of a
7 plan. These rules include charter provisions, which
8 in the Association's judgment adequately preclude
9 other parties from obtaining more than 5 percent
10 control and other protections against unwanted
11 takeover efforts.

12 Second, the foundation is allowed to
13 initially hold 100 percent of the plan's stock, but
14 is required to reduce its ownership to 80 percent of
15 such stock within the initial year of ownership and
16 must subsequently sell down its shares so that
17 within five years it is under the BCBSA Association
18 licensure minimums.

19 Third, the foundation will not have any
20 involvement in the nomination process for plan
21 directors and its voting power over the plan shall
22 be consigned to a voting trust that in the
23 Association's judgment provides adequate assurance
24 the foundation will not influence or control the
25 plan.

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1 Fourth, the foundation's board will be
2 impartially and independently selected and be free
3 from any concentration of special interest involving
4 the state or local government.

5 Fifth, the foundation will be the only
6 holder of 5 percent or more of the plan's voter
7 stock. Absent these conditions, Blue Cross & Blue
8 Shield United of Wisconsin would not be allowed to
9 continue to use the Blue marks if it converted to a
10 shareholder-owned company.

11 Q Can you explain why these conditions are imposed on
12 converting plans?

13 A Yes. There is a core set of interests that the
14 Association seeks to protect in all of its licensure
15 rules, including those that apply when a licensee
16 such as Blue Cross & Blue Shield United of Wisconsin
17 converts to a stock company. The Association's
18 license agreements, while they contain many
19 technical details, embody at least five fundamental
20 commitments that are shared among all Blue Cross &
21 Blue Shield plans and form these core interests.

22 First, there is a commitment to the
23 integrated national network of Blue Cross & Blue
24 Shield plans. Subscribers with Blue Cross & Blue
25 Shield cards in their wallets can go anywhere in the
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1 country, present that card to providers and take
2 advantage of the networks and discounts that the
3 Blue Cross & Blue Shield plans in that locality have
4 negotiated. This is a great advantage to
5 subscribers and an important selling tool in the
6 competitive marketplace. Other national programs
7 that knit all the plans together include a national
8 network of HMOs, called HMO Blue USA. The
9 Association and its member plans also serve
10 collectively over 40 percent of the federal
11 workforce. Commitment to participation in the
12 national network is a fundamental value embodied in
13 the license agreement and shared by all plans.
14 Control or domination of a plan with another entity
15 with other missions and goals could compromise this
16 objective.

17 Second, a commitment to excellence in
18 service and financial stability that is enforced
19 through minimum standards that all plans must
20 exceed.

21 Third, a commitment to independence.
22 Through the licensure rules and requirements, all
23 plans are committed to independence; namely, freedom
24 from the influence or domination of any single
25 entity or group that might serve a special interest

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1 distinct from the interest of the plans, its
2 members, and the Blue marks.

3 Fourth, a commitment to maintaining a
4 local focus and presence in the service area within
5 which the plan operates using the Blue marks.

6 Fifth, a commitment to promoting and
7 enhancing the value of the shared Blue brands in
8 common ways. This is achieved through a variety of
9 service mark use regulations and other rules which
10 govern how the licensed names and marks may be used.

11 In the context of Blue plan conversions,
12 the Association has sought to balance the need to
13 protect these five commitments and the need of plans
14 to become shareholder-owned enterprises when it is
15 either desirable or necessary to do so.

16 Q Do the Association's licensing rules address the
17 possibility of a single entity gaining control of a
18 Blue plan?

19 A Yes. As mentioned above, the Association's
20 licensure rules were changed to allow plans to
21 become shareholder-owned organizations but to put in
22 place a set of particular rules that would apply to
23 such plans. These rules have many technical
24 nuances, but in basic form, they are designed to
25 prevent a single entity or group of entities acting

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1 in concert from gaining control of an individual
2 plan and retaining the right to use the Blue marks.

3 Q How do the rules accomplish this?

4 A Protections were put in place to assure that, one,
5 if a plan that had converted to a stock company
6 structure fell under the influence of a single group
7 or entity, it would no longer have the right to use
8 the Blue marks; and two, investor-owned plans had
9 strong -- have to have strong charter provisions
10 against a third party that might seek to gain
11 control of the plan and thereby force a loss of its
12 Blue Cross and Blue Shield license. Thus, if a
13 single entity or group of entities acting in concert
14 acquire 5 percent or more of the voting control or
15 20 percent of the equity of a shareholder-owned Blue
16 plan, that company's license to use the Blue marks
17 automatically terminates unless a conditional waiver
18 is granted by the Association.

19 There are also a series of rules designed
20 to prevent any one entity from gaining control of a
21 plan board and there are requirements that certain
22 provisions be placed in the shareholder-owned plan's
23 charter to assure that it is protected from third
24 parties causing an involuntary termination of its
25 Blue license.

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1 Q Are you familiar with the fact that formation of a
2 foundation is proposed by the Wisconsin plan?

3 A Yes.

4 Q Is the proposed foundation consistent with the
5 Association's rules regarding control by a single
6 entity?

7 A The Association recognizes that a necessary element
8 of some conversion, which is evident in the plan of
9 conversion before you, Madam Commissioner, is the
10 creation of a foundation that at least initially
11 possesses all or much of the plan's stock. Because
12 of the unique nature of these foundations, the
13 Association may grant waivers to the 5 percent and
14 20 percent rules subject to certain conditions which
15 I discussed previously and are applicable to Blue
16 Cross & Blue Shield United of Wisconsin's plan of
17 conversion as well as the conversion of other plans
18 where a foundation owning plan stock is proposed.
19 These conditions are intended to assure that
20 although a foundation has excessive stock ownership,
21 it will not act in a way that threatens the
22 independence of the plan and that it will, over a
23 reasonable period of time, reduce its ownership and
24 voting power to the license minimums. The
25 conditions put in place a group of protections that,
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1 when taken as a whole, provide the Association and
2 its members adequate assurances that their interests
3 will not be compromised.

4 The Association understands that the
5 conditions imposed on the Wisconsin plan's
6 conversion reduce the flexibility of the plan and
7 the foundation in some circumstances. However,
8 these conditions in the Association's view are
9 necessary to achieve and promote the five core
10 values that are shared among all Blue Cross & Blue
11 Shield plans and at the same time protect the value
12 and integrity of the Blue marks.

13 Q Lastly, Mr. Orloff, what effect would the Wisconsin
14 plan's noncompliance, failure to comply with the
15 Association's conditions have in connection with its
16 conversion?

17 A The Association board has approved the proposed
18 conversion subject to continuing satisfaction of the
19 conditions I just referred to. Noncompliance with
20 these conditions would result in a loss of the right
21 to use the Blue marks, but we believe the Blue marks
22 have great value in the marketplace and form a
23 significant part of the value of any plan using
24 them. Jeopardizing the ability to use such marks in
25 turn puts at risk the corresponding value that the
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1 Blue marks contribute to the company.

2 MR. BRANCH: Thank you, Mr. Orloff. I
3 have no further questions of this witness.

4 THE COMMISSIONER: At the present time,
5 the market for health insurance stock is very poor.
6 If Blue Cross were to request an extension of their
7 divestiture plan, recognizing that -- the market
8 conditions, would that request be entertained and
9 what criteria would you use then to consider that
10 request?

11 THE WITNESS: Currently, in the proposal,
12 there is no opportunity for such a request. I
13 believe that our board would consider such a request
14 and would consider now outlining the criteria that
15 would be used in entertaining such a request. I
16 can't give you the specifics. I think it would, you
17 know, relate to the market conditions and the
18 economic necessity at the time that might justify a
19 at least brief extension of the sell-down period.

20 THE COMMISSIONER: Thank you.

21 MR. BRANCH: Thank you. Madam
22 Commissioner, I have just one additional witness --

23 THE COMMISSIONER: Yes.

24 MR. BRANCH: -- which would take no more
25 than 10 or 15 minutes. Whatever your pleasure is.

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1 THE COMMISSIONER: First of all, what I'd
2 like to do is just acknowledge all of the
3 individuals that have arrived here for the
4 informational hearing. We appreciate your being
5 here. We do have one remaining witness for the
6 Class 1 contested case hearing and then closing
7 remarks, so we will begin the public hearing
8 briefly. We appreciate your patience, and in
9 between the Class 1 contested case hearing, we'll
10 have a break real briefly again just to modify the
11 setup.

12 For those of you who are waiting to
13 testify at the informational hearing, rest assured,
14 you will not be subject to cross examination from
15 two different entities. This is a slightly
16 different process that we have right now. So we
17 appreciate your patience and we just need to finish
18 up real quickly with the contested case hearing.
19 Thank you.

20 MR. BRANCH: Thank you, Madam
21 Commissioner. I call Miss Penny Siewert.

22 PENNY SIEWERT, called as a witness
23 herein, having been first duly sworn on oath, was
24 examined and testified as follows:

25 E X A M I N A T I O N

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1 BY MR. BRANCH:

2 Q Could you state again your name and position with
3 Blue Cross Blue Shield United of Wisconsin.

4 A My name is Penny Siewert and I am the senior vice
5 president of Blue Cross Blue Shield United of
6 Wisconsin.

7 Q Could you explain your job duties at Blue Cross.

8 A As senior vice president, I'm responsible for all
9 all Blue Cross group and individual products, direct
10 Blue Cross marketing strategy, and coordinate all
11 regional offices.

12 Q Can you please explain Blue Cross's marketing
13 strategy and operations and how these will be
14 impacted by the plan of conversion?

15 A Generally, Blue Cross marketing strategy is to
16 appeal to a wide spectrum of consumers and to offer
17 a correspondingly wide array of insurance and
18 administrative services products. This strategy
19 will not change as a result of the conversion to
20 shareholder-owned status.

21 Specifically, Blue Cross offers insurance
22 products to group and individual policyholders. Our
23 group products include preferred provider
24 organization, point-of-service, traditional fee-for-
25 service, dental and pharmacy benefit plans. Blue
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1 Cross also offers administrative services to large
2 groups who desire to self fund their employee
3 benefit plans. Individual products include Personal
4 Choice, health insurance for individuals who are not
5 covered by a group health plan, Medicare supplement
6 plans, short-term or temporary coverage, coverage
7 designed for children ages 1 through 17, and a long-
8 term care product. In addition, Blue Cross
9 contracts with the Health Care Financing
10 Administration to provide coverage to Medicare
11 beneficiaries through the Medicare Plus Choice
12 program.

13 Blue Cross's wholly owned subsidiary,
14 United Government Services, LLC, primarily processes
15 Medicare claims pursuant to a contract between the
16 Health Care Financing Administration and Blue Cross.

17 Q Does Blue Cross plan to terminate any of these
18 services after the proposed conversion?

19 A Blue Cross does not intend on terminating any lines
20 of business as a result of the conversion.

21 Independent of the decision to convert, Blue Cross
22 has decided to put less emphasis on expanding its
23 administrative services only line of business and
24 more emphasis on growing its insured lines. As
25 always, changes in the product mix may occur in the
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1 future as necessary to respond to consumer demand,
2 straight and federal law, and market indications.

3 Q Are any service changes planned as a result of the
4 proposed conversion?

5 A Blue Cross is dedicated and will continue to be
6 dedicated to maintaining a presence throughout the
7 state in order to more effectively serve the needs
8 of our policyholders. Blue Cross corporate
9 headquarters is currently located in downtown
10 Milwaukee at 401 West Michigan Street. As
11 previously announced, Blue Cross is in the process
12 of consolidating its downtown Milwaukee operations
13 into the 401 West Michigan Street corporate
14 headquarters site, a 200,000 square foot office
15 building. Blue Cross also has previously announced
16 an expansion of operations at its sales and service
17 offices in Ashland, Wisconsin.

18 To date, Blue Cross has 12 sales and
19 service offices located throughout the state,
20 including five primary regional service center
21 offices. Our regional service centers are located
22 in Milwaukee, Eau Claire, Stevens Point, Fond du
23 Lac, and Evansville. These offices are dedicated to
24 service to policyholders throughout the state.
25 Customer service, sales, underwriting, enrollment,
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1 claims, and provider contracting departments are
2 located in each service center to ensure that each
3 policyholder's needs can be met by Blue Cross
4 employees who understand the needs of the community.

5 Our Oshkosh office is the primary service
6 center for Blue Cross individual product
7 policyholders.

8 Blue Cross also has sales and service
9 offices throughout the state in the following
10 cities: Ashland, Platteville, Sauk City, Oshkosh,
11 Pewaukee, Brookfield and Monona. United Government
12 Services processes Medicare claims for 11 offices
13 located in six states. There are no plans to
14 terminate or reduce services in any region as a
15 result of the conversion.

16 Q Are any marketing changes being proposed?

17 A Blue Cross currently uses independent agents and
18 sales employees to market all its group and
19 individual products, except Value Plus and Medicare
20 Blue. These two products are sold nearly
21 exclusively by Blue Cross employees. Blue Cross
22 also intends to add the Internet as a marketing
23 channel in the near future. Although usage of
24 independent agencies can fluctuate over time, there
25 are no plans to alter present distribution channels

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1 as a result of the conversion. Any future changes
2 in distribution channels would be the result of
3 routine and ongoing business marketing strategy.

4 Q Are any rate changes contemplated?

5 A Blue Cross recognizes that rising health care costs
6 are a major concern for our policyholders and that
7 policyholders may be wondering whether conversion
8 will impact their rates. As a shareholder-owned
9 corporation, Blue Cross will face the same market
10 forces which place pressure on rates as we currently
11 face as a service insurance corporation. Market
12 forces such as medical inflation and rising
13 administrative costs affect service insurance
14 corporations and shareholder-owned entities
15 similarly.

16 The advantage of a conversion is that
17 Blue Cross will be able to look to additional
18 alternatives to combat market forces. Although
19 market forces will continue to affect premium rates,
20 the plan of conversion does not contemplate rate
21 increases and there are no plans to do so as a
22 result of the conversion.

23 Q Does Blue Cross participate in any community
24 outreach programs and will this participation
25 continue after the proposed conversion?

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1 A Blue Cross is committed to community outreach. This
2 commitment to the communities we serve will continue
3 into the future regardless of whether Blue Cross is
4 a shareholder-owned or service insurance
5 corporation.

6 Q Can you explain Blue Cross's charitable activities
7 in greater detail, please?

8 A Blue Cross has contributed to various charitable,
9 educational, and health organizations which benefit
10 the people of Wisconsin. For example, Blue Cross
11 contributed over \$60,000 in 1999 and has contributed
12 over \$225,000 since 1995 to the Trigger Lock program
13 of the Child Safe Foundation, a nonprofit foundation
14 formed by the State Medical Society to promote
15 injury intervention and safety among Wisconsin
16 children. Blue Cross has helped to fund over 20,000
17 Trigger Lock distributions to gun owners throughout
18 the state. Blue Cross also sponsors the annual
19 Nurse of the Year award presented by the Wisconsin
20 League for Nursing. This year Blue Cross
21 contributed \$30,000 to this program honoring
22 Wisconsin's outstanding nurses.

23 Given our leadership in the health
24 industry, Blue Cross also sponsors anti-smoking
25 campaigns, which improve the overall wellness of
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1 Wisconsin citizens. We are proud of our
2 participation in the American Cancer Society's
3 Freshstart Smoking Cessation program, the Smoke-Free
4 Class of 2000, and Teens Against Tobacco Use. This
5 year alone, Blue Cross has contributed \$55,000 to
6 these important programs.

7 Aside from these major campaigns, Blue
8 Cross supports various organizations that serve the
9 state, including Milwaukee Public Television,
10 African World Festival, and the Coalition of
11 Wisconsin Aging Groups.

12 Furthering the corporation's commitment
13 to giving, members of the Blue Cross executive staff
14 are actively involved in public interest
15 organizations. For example, I am the president of
16 the board of trustees for the LaFarge Lifelong
17 Learning Institute, an organization devoted to the
18 educational advancement of older adults. I am also
19 on the board of the American Lung Association of
20 Wisconsin and am a board member of the National
21 American Lung Association's marketing initiative,
22 Marketing Response Systems.

23 Altogether, the Blue Cross executives
24 serve on over 20 community organization boards. Our
25 executive commitment to public service will continue
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1 regardless of whether Blue Cross is a shareholder-
2 owned or not-for-profit organization.

3 Q In your opinion, will the proposed conversion be
4 contrary to the interests of the Blue Cross
5 policyholders or the public?

6 A No. As I have explained, there will be no
7 detrimental impact to Blue Cross policyholders as a
8 result of the conversion. The conversion of Blue
9 Cross to a shareholder-owned corporation will be a
10 seamless event for our policyholders. There will be
11 no disruption of service, no subscriber will lose
12 coverage as a result of the conversion, and there
13 will be no actions required by the policyholders to
14 continue coverage. There are no anticipated changes
15 in health care benefits as a result of the
16 conversion. Blue Cross will continue to meet the
17 reasonable expectations of our policyholders if the
18 conversion is approved.

19 Q I have just one final question. Will there be any
20 benefits to policyholders or the public as a result
21 of this conversion?

22 A Blue Cross anticipates that the conversion will do
23 more than just allow us to maintain the status quo.
24 If the conversion is approved, we will strengthen
25 our ability to develop products and take advantage
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1 of emerging technology to the benefit of our
2 policyholders.

3 With increased access to capital, Blue
4 Cross would be able to underwrite a broader product
5 array. For example, although Blue Cross currently
6 offers a long-term care product, Blue Cross would be
7 able to devote more resources to educating consumers
8 about this emerging product. As a result of
9 increased access to capital, Blue Cross would be
10 able to fully underwrite and expand marketing
11 efforts for this product to Wisconsin consumers.

12 With increased access to capital, Blue
13 Cross would also be able to take advantage of the
14 increasing opportunities in the world of competitive
15 technology. Blue Cross could take advantage of the
16 vast resources of available through the Internet,
17 including providing policyholders greater access to
18 information regarding our products and benefits.
19 Greater access to information invariably results in
20 better service and increased consumer satisfaction.

21 With increased access to capital, Blue
22 Cross would be able to increase its competitive
23 strength. With a greater market share, we can
24 provide additional job opportunities, achieve
25 greater administrative efficiency, and strengthen
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1 our ability to hold the line on ever increasing
2 health care costs.

3 To summarize, Blue Cross products and
4 operations will not change as a result of the
5 conversion; Blue Cross charitable activities and
6 commitment to the communities we serve will
7 continue; policyholders can be assured that coverage
8 will continue unaffected; and as a result of the
9 conversion, we will be able to provide even better
10 service to our policyholders. Accordingly, if the
11 conversion is approved, there will be no detrimental
12 effect to the contractual rights of our
13 policyholders nor any detrimental effect to the
14 reasonable expectations of our policyholders.

15 MR. BRANCH: Thank you, Miss Siewert. I
16 have no further questions.

17 THE COMMISSIONER: You mentioned a number
18 of the major charitable campaigns that Blue Cross is
19 involved in. Do you know the range of annual
20 contributions for the last few years that would be a
21 total number as opposed to the major campaigns?

22 THE WITNESS: I don't have that offhand,
23 but we could submit it to you in writing.

24 THE COMMISSIONER: Okay. Thank you.

25 MR. BRANCH: Thank you. Your Honor --
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1 or, Madam Commissioner, this concludes our direct
2 testimony in this matter. We would appreciate the
3 opportunity for a brief summation by counsel.

4 MR. BABLITCH: Thank you, Madam
5 Commissioner. The Wisconsin Insurance Code
6 specifically permits a Chapter 613 service as
7 insurance corporation to convert to a shareholder-
8 owned insurance corporation. The ultimate
9 touchstone which must guide you in your decision and
10 through these proceedings in ruling on Blue Cross's
11 application is the simple and straightforward legal
12 standard set forth in Section 611.76(7). That is,
13 the Commissioner must determine based upon the
14 record before her whether the conversion of Blue
15 Cross violates the law or is contrary to the
16 interests of its policyholders or the public. If
17 the conversion of Blue Cross would do neither, then
18 the Commissioner shall approve the application for
19 conversion.

20 I submit that the record before you today
21 clearly demonstrates that Blue Cross has met the
22 statutory test and therefore the application for
23 conversion must be granted.

24 The first step in the conversion process
25 is for the board of directors of the converting
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1 entity to pass a resolution indicating that the
2 conversion is in the best interest of the
3 policyholders. The Blue Cross board of directors
4 passed such a resolution and adopted a plan of
5 conversion on June 2nd, 1999. The resolution and
6 the plan were submitted to the Commissioner as a
7 part of the Blue Cross application for conversion.

8 As Mr. Hickman testified today, the Blue
9 Cross board passed this resolution and adopted a
10 plan of conversion only as the result of a careful
11 and deliberative process during which it carefully
12 evaluated the company's strengths and limitations in
13 light of the highly competitive market in health
14 care financing today. The board's decision was
15 reached by drawing extensively upon their collective
16 wisdom, their years of business experience, their
17 knowledge of the insurance industry, and the company
18 in particular. The board's resolution represents
19 nothing short of its very best business judgment on
20 how best to position the company for future growth
21 and stability.

22 In determining whether the proposed
23 conversion is contrary to the interests of the
24 policyholders and the public, the Commissioner must
25 determine whether the reorganization would be

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1 detrimental to the safety and soundness of the
2 insurer or the contractual rights and reasonable
3 expectations of its current policyholders.

4 As our filings and testimony have
5 established, there will be no disruption in service
6 or an interruption of coverage for our
7 policyholders. There will be no changes in premium
8 rates, coverage, marketing, or customer service as a
9 result of the conversion. From a policyholder's
10 perspective, the conversion will be invisible.

11 On the other hand, over time, greater
12 access to capital will permit the company to expand
13 and enhance policyholders' service and product
14 lines, ultimately benefiting our customers.

15 The testimony of Gail Hanson and David
16 Platter evidenced how the conversion will enhance
17 the strength, financial safety, and competitiveness
18 of Blue Cross by providing it with access to capital
19 markets and allowing for greater growth potential.
20 All of this will help ensure that the contractual
21 rights and reasonable expectations of policyholders
22 will continue to be met in the decades ahead.

23 As a part of the conversion process, we
24 must show, and we have shown, that the conversion
25 will not be contrary to the interests of the public.

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1 The public is served by having a wide variety of
2 choices in the health insurance market. Since 1939,
3 Blue Cross & Blue Shield has been providing health
4 coverage for thousands of Wisconsin citizens. The
5 Blue Cross & Blue shield trademarks are one of the
6 most recognized and trusted symbols in the health
7 insurance field. It is certainly in the public
8 interest to ensure the continued financial strength
9 of the state's largest health insurer. As you have
10 seen in our testimony and in our filings, a
11 conversion allows the company to maintain financial
12 strength in the face of changing market conditions.

13 However, the most visible and immediate
14 tangible benefit to the public is the creation of
15 the public health foundation. It is unprecedented
16 for a Blue Cross plan to propose at the beginning of
17 a conversion to endow a charitable foundation with
18 100 percent of the value of the company. Only after
19 much negotiations and lawsuits have other Blue Cross
20 plans made this kind of commitment.

21 Immediately following the conclusion of
22 this Class 1 proceeding is a hearing pursuant to
23 Section 611.76 of the Insurance Code in which
24 interested persons and the public are invited to
25 comment on the proposed conversion. The citizens of
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1 Wisconsin have received notice of the proceedings
2 today and tomorrow so that all interested persons
3 may have the opportunity to share their views with
4 the Commissioner. Indeed, Blue Cross wants to hear
5 from a broad spectrum of citizens, and that is why
6 we took out ads reprinting the notice of these
7 hearings in approximately 245 Wisconsin newspapers,
8 representing a combined total circulation of
9 approximately 1.9 million readers.

10 In these next two days, you will likely
11 hear many different ideas on how best to use the
12 proceeds of the conversion. It is important to keep
13 in mind during this process that, but for the
14 conversion, there is no foundation, and without a
15 foundation, there is no debate on the best use of
16 the money. While the foundation proceeds represent
17 a large sum of money, it is not limitless. In the
18 field of public health as in other fields there are
19 bound to be a wide variety of ideas on what is the
20 best way in which to provide the greatest good with
21 a limited amount of money. The Blue Cross & Blue
22 Shield proposal sets forth a plan that is based on
23 reason and research and which represents a thorough
24 and careful analysis of how to meet the public
25 health care needs of this state.

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1 In conclusion, the guiding language of
2 the statute is clear, and I quote, "The Commissioner
3 shall approve the plan of conversion unless she
4 finds that the plan violates the law or is contrary
5 to the interests of the policyholders or the
6 public." There is nothing in this record to
7 suggest or even hint that the Blue Cross & Blue
8 Shield plan of conversion violates the law or is
9 contrary to the interests of the policyholders or
10 the public.

11 For these reasons and based on the entire
12 record before you, we respectfully ask that you
13 approve the Blue Cross plan of conversion as
14 submitted. Thank you.

15 THE COMMISSIONER: Thank you,
16 Mr. Bablitch. The contested case hearing as I
17 indicated earlier will be continued and the record
18 held open. The hearing record will remain open to
19 permit me to consider the testimony received, both
20 oral and written from the informational hearings and
21 those submitted to our office. The informational
22 public hearings are scheduled to follow the
23 contested case hearing today and to continue
24 tomorrow in Stevens Point at the University of
25 Wisconsin-Stevens Point campus.

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1 The contested case record will also be
2 held open pending the recommendation of the
3 appraisal committee and the OCI staff
4 recommendation. After receipt of the appraisal
5 committee's recommendation and the OCI staff
6 recommendation, there will be an opportunity to
7 comment for a period of time yet to be determined
8 prior to the rendering of a decision on the Blue
9 Cross Blue Shield United of Wisconsin's application
10 for conversion.

11 I would also note the appraisal committee
12 report and OCI staff memoranda will be made
13 available to the public once they are received. The
14 report and memoranda will also be placed on the OCI
15 Web site.

16 We will be taking a short break before
17 convening the informational hearing. It is now
18 12:25. We will convene the informational hearing in
19 about ten minutes. Thank you.

20 (Whereupon, the Class 1 Contested Case
21 hearing was concluded at 12:25 p.m.)
22
23
24
25

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