

0001

1

OFFICE OF THE COMMISSIONER OF INSURANCE

2

STATE OF WISCONSIN

3

4

In the Matter of Application
for Conversion of Blue Cross & Case No. 99-C26038
Blue Shield United of Wisconsin

6

7

8

CLASS I CONTESTED CASE HEARING

9

10

11

12

13

14

15

Proceedings had and evidence taken before
Connie L. Connell, Commissioner of Insurance, on the
25th day of February, 2000, at the Holiday Inn, 3871
East Washington Avenue, Madison, Wisconsin, commencing
at 10:56 a.m.

16

APPEARANCES:

17

18

19

20

State of Wisconsin
Office of the Commissioner of Insurance
121 East Wilson Street
P.O. Box 7873
Madison, Wisconsin, 53707-7873
by MR. FRED NEPPLE, General Counsel

21

22

23

24

25

Blue Cross & Blue Shield United of Wisconsin
401 West Michigan Street
Milwaukee, Wisconsin, 53203
by MR. STEPHEN E. BABLITCH, on behalf of Blue Cross.
Foley & Lardner
777 East Wisconsin Avenue
Milwaukee, Wisconsin, 53202
by MR. JOSEPH C. BRANCH, MR. BARTHOLOMEW F. REUTER and
MR. THOMAS M. ROSE, on behalf of Blue Cross.

0002

1 APPEARANCES: Cont'd
2 Advocacy & Benefits Counseling for Health
3 152 West Johnson Street, Suite 206
4 Madison, Wisconsin, 53703-2213
5 by MR. WADE M. WILLIAMS, on behalf of ABC for Health,
6 Wisconsin AARP, and Wisconsin Coalition for Advocacy.

7 Quarles & Brady
8 411 East Wisconsin Avenue
9 Milwaukee, Wisconsin, 53202
10 by MS. VALERIE L. BAILEY-RIHN, on behalf of Medical
11 College of Wisconsin.

12 University of Wisconsin-Madison
13 361 Bascom Hall
14 500 Lincoln Drive
15 Madison, Wisconsin, 53706-1380
16 by MS. HELEN H. MADSEN, on behalf of UW-Madison Medical
17 School.

I N D E X

12	WITNESS	EXAMINATION	PAGE
13	GAIL HANSON	By Mr. Williams	7
14			
15	THOMAS W. JOHNSON	By Mr. Williams	37
16		By Ms. Bailey-Rihn	56
17		By Mr. Bablitch	58

E X H I B I T S

18	EXHIBIT NO.:	MARKED	ID'ED	OFF'RD
19	B-15 12-13-99 document signed by Cowan and McLoughlin	--	--	65
20	B-16 Series of letters	--	--	65
21	J-1 Misc. intercompany transactions	20	19	65

22 (The original exhibits were retained by Commissioner
23 O'Connell.)
24 (The original transcript was sent to Commissioner
25 O'Connell.)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

P R O C E E D I N G S

COMMISSIONER O'CONNELL: On my watch it is now 10:56, and we will commence the contested Class I case hearing. It's still morning. Good morning. I'm Connie O'Connell, Commissioner of Insurance presiding over Case No. 99 dash C26038 concerning Blue Cross and Blue Shield United of Wisconsin's application for conversion.

The purpose of the application for conversion is to permit Blue Cross and Blue Shield United of Wisconsin to convert from a nonprofit service insurance corporation to a stock insurance corporation in accordance with Section 613.75 and 611.76 Wisconsin Statutes.

This hearing is being held as a Class I contested case hearing in accordance with Chapter 227 of the statutes and INS 5.39 sub two of the Wisconsin Administrative Code.

This is a continuance of the contested case hearing that commenced on November 29, 1999. Today's hearing is being held at the Holiday Inn, Madison, Wisconsin, on February 25th, 2000.

Will the participants please state for the record the name of your organization and who you represent.

0004

1

MR. BABLITCH: Blue Cross/Blue Shield

2

United of Wisconsin appears by its general counsel

3

Stephen Bablitch and outside counsel from Foley &

4

Lardner, Joe Branch, Tom Rose and Bob Reuter.

5

MS. BAILEY-RIHN: Movant, the Medical

6

College of Wisconsin appears by its counsel

7

Quarles & Brady, Valerie L. Bailey-Kihn.

8

MS. MADSEN: Movant UW Medical School

9

appears by its counsel Helen Madsen.

10

MR. WILLIAMS: Movant ABC for Health, AARP,

11

Wisconsin Coalition for Advocacy, Wade Williams

12

appearing on behalf of ABC for Health.

13

COMMISSIONER O'CONNELL: The order for

14

today's hearing as previously described is as

15

follows: Representatives for ABC for Health,

16

Wisconsin AARP and Wisconsin Coalition for

17

Advocacy will call its witnesses.

18

I will refer to these groups collectively as

19

the Coalition. For the purposes of today, the

20

witnesses are first Miss Gail Hanson of Blue Cross

21

and Blue Shield United of Wisconsin and then

22

Mr. Tom Johnson of Deutsche Bank.

23

Following the Coalition's questions, the

24

Medical College of Wisconsin may ask questions of

25

Ms. Hanson or Mr. Johnson to the extent permitted

1 in my order.

2 The University of Wisconsin-Madison School
3 of Medicine will follow the Medical College of
4 Wisconsin. Blue Cross and Blue Shield United of
5 Wisconsin may then be cross -- may then
6 cross-examine the witness on a limited basis.

7 Blue Cross/Blue Shield United Wisconsin will
8 be limited to the line of questioning raised by
9 the Coalition. Redirect of witnesses will be
10 allowed on a very limited basis.

11 The sequencing of questioning,
12 cross-examination or redirect will be followed
13 with each witness called by any of the movants. I
14 or Mr. Nepple may ask questions of witnesses at
15 any time.

16 As I said previously, I will govern this
17 hearing to exclude or limit a line of inquiry or
18 testimony that repeats what has -- what was or
19 could have been offered at the public hearing.

20 That relates to areas that are already fully
21 developed in the record of the proceeding that is
22 argumentative or that relates to proprietary or
23 trade secret material that is more appropriately
24 dealt with by the office directly.

25 The scope of questioning will be limited to

1 the scope identified in the prehearing
2 memorandum. I will also limit questioning to
3 ensure that the hearing proceeds on a timely
4 basis.

5 The hearing today is scheduled to conclude
6 at noon. You should plan your questioning so as
7 to conclude at that time. Mr. Williams, please
8 call the first witness Miss Gail Hanson to the
9 witness stand.

10 MR. BABLITCH: Your Honor, just for the
11 record -- or Madam Commissioner, I would object
12 for the record to limit -- limiting full cross-
13 exam -- examination rights to Blue Cross/Blue
14 Shield United of Wisconsin. I think we should
15 have those full cross-examination rights provided
16 for under 227.45. I note your decision, but I
17 want to preserve my record.

18 COMMISSIONER O'CONNELL: Well, I will use
19 my discretion simply to control the hearing.

20 MR. BABLITCH: Thank you.

21 COMMISSIONER O'CONNELL: Mr. Williams?

22 MR. WILLIAMS: The Coalition would call
23 Miss Gail Hanson.

24 GAIL HANSON, called as a witness herein by
25 the Coalition, after having been first duly sworn,

0007

1 was examined and testified as follows:

2 COMMISSIONER O'CONNELL: Mr. Williams, you
3 may begin your questioning.

4 DIRECT EXAMINATION

5 BY MR. WILLIAMS:

6 Q Good morning, Ms. Hanson.

7 A Good morning.

8 Q Ms. Hanson, what are your current positions within
9 the Blue Cross system?

10 A I currently am the vice president, treasurer and
11 chief financial officer of Blue Cross and Blue
12 Shield United Wisconsin, United Wisconsin
13 Services, and I hold the position of treasurer for
14 a variety of the subsidiaries of United Wisconsin
15 Services.

16 Q Your position is at Blue Cross/Blue Shield
17 itself?

18 A Yes, I am -- I am vice president, treasurer and
19 chief financial officer for Blue Cross and Blue
20 Shield United Wisconsin.

21 Q Oh, I thought you said UWS. What are your
22 positions at UWS?

23 A I am vice president, treasurer and chief financial
24 officer for United Wisconsin Services.

25 Q And how long have you been employed by Blue

0008

1 Cross/Blue Shield United of Wisconsin?

2 A I've been employed by Blue Cross for -- since
3 August of 1986 or by one of its subsidiaries
4 since -- since July of 1994 -- I'm sorry, 1984.

5 Q Could you just briefly describe how your positions
6 have -- have changed since 1986?

7 A In 1986 my title was assistant vice president and
8 treasurer, and I was responsible for audit and
9 payroll, cash receipts, taxes, investments, and
10 during that time the positions have evolved. I
11 have been responsible for audit at certain periods
12 not others.

13 I currently am responsible for the audit
14 department. I'm no longer responsible for the
15 payroll function. As treasurer I was responsible
16 for the capital-raising activities of United
17 Wisconsin Services, but as chief financial officer
18 of Blue Cross and Blue Shield United Wisconsin I
19 have responsibility of all those former -- except
20 for the payroll department -- with the former
21 responsibilities as well as for the overall
22 financial reporting of the operation.

23 Q Miss Hanson, who owns the assets of Blue
24 Cross/Blue Shield United of Wisconsin?

25 A The assets of Blue Cross and Blue Shield United

0009

1 Wisconsin are owned by Blue Cross and Blue Shield
2 United of Wisconsin.

3 Q Who owns the company?

4 A The company is a nonstock company, so there are no
5 shareholders.

6 Q Well, if -- if no one -- If Blue Cross doesn't
7 have any shareholders, who is supposed to benefit
8 from the activities of Blue Cross/Blue Shield?

9 A That's not a question that I have specific
10 knowledge of.

11 Q So in making your decisions as chief financial
12 officer, treasurer and vice president, whose
13 interests are you trying to -- to serve?

14 A We have a number of constituencies, the
15 policyholders. Policyholders have Blue Cross
16 policies. We have constituencies that include our
17 employees, our -- The groups which are the
18 employers, the fire insurance, but we don't have a
19 single shareholder.

20 Q Are you familiar with the doctrines of charitable
21 trust and cy pres?

22 A No, I am not.

23 Q So in your position as chief financial officer of
24 Blue Cross/Blue Shield United Wisconsin and your
25 high-level positions in the affiliates, you're not

0010

1 aware of -- of how those assets are supposed to be
2 managed to the benefit of the public?

3 MR. BABLITCH: Is that a question?

4 MR. WILLIAMS: Is that --

5 MR. BABLITCH: I object. That's not a
6 question.

7 BY MR. WILLIAMS:

8 Q Is that correct?

9 MR. BABLITCH: It's a statement.

10 BY MR. WILLIAMS:

11 Q Well, I'll rephrase it. Are you the CFO and
12 treasurer of the state's largest nonprofit
13 insurer?

14 A I'm the chair -- I'm in -- I am the chief
15 financial officer of Blue Cross and Blue Shield
16 United Wisconsin.

17 Q And are you aware of -- Am I correct in
18 understanding that you're not aware of what the
19 doctrines of charitable trust and cy pres?

20 A I've heard the terms. I'm not an attorney. I do
21 not specifically know the tenets of those
22 doctrines that you state.

23 Q If I were to state that -- that the purpose of the
24 charitable trust doctrine or the definition of a
25 charitable trust doctrine was that assets that are

0011

1 held in charitable trust by a nonprofit are
2 supposed to be managed in furtherance of the
3 public interest, what would be your response to
4 that in terms of how your management has aligned
5 itself with those interests?

6 MR. BABLITCH: I'd object.

7 MS. BAILEY-RIHN: Objection, foundation.

8 MR. BABLITCH: There's no foundation. It's
9 a hypothetical question. The witness doesn't know
10 the answer, asked and answered.

11 COMMISSIONER O'CONNELL: The objection is
12 sustained.

13 MR. WILLIAMS: Okay.

14 BY MR. WILLIAMS:

15 Q We'll just let that go. Could you please describe
16 the compensation packages for Blue Cross/Blue
17 Shield United Wisconsin officers and directors who
18 hold positions in affiliates -- would you --
19 beginning with Tom Hefty?

20 MR. BABLITCH: I'm going to object. That's
21 already in the record, as I understand it, from
22 the Badger Project resource book.

23 COMMISSIONER O'CONNELL: I'll allow her to
24 answer.

25 THE WITNESS: I'm -- I'm generally

0012

1 familiar with the compensation package. I,
2 however, do not determine that nor do I currently
3 report that in my function. I can indicate that
4 individuals are paid by one company or another.

5 Tom Hefty is paid by United Wisconsin
6 Services. He does not receive additional
7 compensation from Blue Cross. Officers are paid
8 by one company or another. They do not receive
9 compensation from multiple companies in our
10 organization.

11 BY MR. WILLIAMS:

12 Q Could you describe the general nature of the
13 compensation package for someone like Tom Hefty?

14 A Compensation includes several components. It
15 would include salary. There would be short-term
16 cash incentives, long-term cash incentives. There
17 could be stock options for someone of the level of
18 Mr. Hefty.

19 Q What are short-term cash incentives?

20 A Yes.

21 Q What are those?

22 A There's a profit-sharing plan covering all of our
23 employees that goes from the chairman of the
24 organization down to every individual who's
25 employed by the organization.

0013

1 Q And the long-term cash incentive?

2 A The long-term cash incentive actually has been in
3 place during -- during the time period that does
4 no longer exist. Stock options are a long-term
5 incentive.

6 COMMISSIONER O'CONNELL: Mr. Williams,
7 where are you going with this line? Mr. Williams,
8 where are you going with this line of questioning?

9 MR. WILLIAMS: Where I'm going is getting
10 at how Blue Cross/Blue Shield system has been
11 managed in terms of promoting the public interest
12 which would be relevant to the threshold issue in
13 the consideration of a conversion application
14 which is whether or not the conversion is in the
15 best interests of the public or the shareholders
16 or the policyholders. Excuse me.

17 COMMISSIONER O'CONNELL: All right. Please
18 continue, but we need to address your questions to
19 this witness as a factual -- in a factual nature
20 not inquiring legal conclusions.

21 BY MR. WILLIAMS:

22 Q Ms. Hanson, what does your compensation package
23 currently consist of?

24 A My compensation package currently consists of cash
25 compensation which is a base salary. It consists

0014

1 of participation in the company's profit-sharing
2 plan, participation in the company's management
3 incentive plan. It consists of stock options.
4 There is a pension plan, a 401-K plan and other
5 executive benefits.

6 Q And these -- these compensation types are paid by
7 the for-profit affiliates and not by Blue
8 Cross/Blue Shield?

9 A My compensation is paid by -- by United Wisconsin
10 Services.

11 Q Were UW -- Excuse me. Were UWS managers who are
12 also Blue Cross/Blue Shield managers recently
13 granted stock options?

14 A There's a regular grant of stock options for UWS
15 officers.

16 Q Could you describe that process?

17 A The -- The process is actually undertaken by the
18 management under committee of the board to which I
19 am neither staff nor participant.

20 Q The management review committee, is that a
21 subcommittee of the board?

22 A It is.

23 Q Who's on that board or who's -- Excuse me. Who's
24 on that subcommittee?

25 A It's -- It's comprised of several of our

0015

1 directors, and at this point in time I -- I'm not
2 sure I'm going to get the names correct so I
3 would -- That information should be on record.

4 Q Okay. What was the value or what -- What was the
5 most recent description of the stock option
6 grants?

7 A There was a grant done in January.

8 Q Mm-hmm. Could you describe that grant?

9 A The grants are issued at market value as of the
10 date of the grant.

11 Q Mm-hmm. Do you know what quantity of stock
12 options were granted in January?

13 A I know approximately my grant --

14 Q Okay.

15 A -- which is 120,000 shares -- options on 120,000
16 shares.

17 Q So how -- How would you take advantage of those
18 stock options?

19 A The stock options have value. Presuming that the
20 share price of United Wisconsin Services
21 increases, the value is the difference between the
22 market price at date of grant and the price --
23 price at the exercise date. The options vest over
24 four years, and so they're of no value until they
25 are vested and then exerciseable.

0016

1 Q Okay. What -- could you compare the -- the
2 recent -- Well, let's start with the January
3 stock option grant. Could you compare those to
4 last year's stock option grants?

5 A Personally I'm in a different position than I was
6 last year, so my -- my grant is higher than it was
7 last year, and I'm not very conversant with what
8 grant was given to my predecessor last year.

9 Q Who was your predecessor last year?

10 A My predecessor was C. Edward Morty (phonetic).

11 Q Just so I can get a picture of -- of what your
12 stock options are, what -- what are they worth?

13 MR. BABLITCH: You know, I'm going to
14 object on the following grounds: I don't see the
15 relevancy of where this is going. It may be of
16 interest to you, but I don't see how this pertains
17 to the conversion.

18 COMMISSIONER O'CONNELL: Mr. Williams, can
19 you -- can you address how these questions are
20 relevant?

21 MR. WILLIAMS: Yes, Commissioner. The
22 compensation packages of the various overlapping
23 officers and board members I think are relevant in
24 terms of -- of showing how the conflicting
25 interests between the nonprofit and the for-profit

0017

1 could impact -- I could use the word could --
2 could have an impact on the decision to convert
3 and whether or not it's in the best interests of
4 the public.

5 COMMISSIONER O'CONNELL: I will allow the
6 questions.

7 BY MR. WILLIAMS:

8 Q So, Ms. Hanson, what is the value of your most
9 recent grant of stock options?

10 A I don't know the value of my recent stock
11 options. They are there are formulas had can be
12 run, actuals, operating pricing formulas that can
13 be run on options. I have not run those on my
14 options.

15 Q So it's some sort of discounting net present value
16 kind of thing?

17 A Option pricing model.

18 Q Okay. It's -- Just like a ballpark. Could you
19 come up a ballpark?

20 A A person --

21 MR. BABLITCH: I object. That -- She's
22 answered the question. I don't think the witness
23 should engage in guessing.

24 COMMISSIONER O'CONNELL: Objection
25 sustained.

0018

1 BY MR. WILLIAMS:

2 Q And did you say that you weren't aware of what the
3 recent stock option grants were to other officers?

4 A I believe that information has been provided to
5 the OCI as part of the record.

6 MR. WILLIAMS: Okay. I wasn't aware of
7 that the appraisal committee was advised what the
8 most recent options were.

9 MR. NEPPLE: I believe that is included in
10 the material that was attached to the appraisal
11 committee report.

12 MR. WILLIAMS: Oh. I thought there was
13 something on top of the 945,000.

14 MR. NEPPLE: I think there was a schedule
15 that's included in the conversion resource book,
16 and I see Tom Johnson nodding his head off the
17 record here, so I seem to be right.

18 MR. WILLIAMS: Okay. So all the recent
19 stock option grants are in the resource file?

20 MR. NEPPLE: Yes. I think there's one
21 qualification that -- but Mr. Johnson did get into
22 that.

23 BY MR. WILLIAMS:

24 Q Ms. Hanson, what's your proposed position in the
25 new for-profit company system?

0019

1 A That has not yet been determined.

2 Q Has there been a proposal?

3 A I -- I'm not aware of a proposal. Let me -- in
4 the -- an application I'm assuming that I will
5 have a similar position as I currently have. The
6 question I'm -- I'm raising is if there's a merger
7 between the two -- between companies for how the
8 liquidity of that will occur. That is not
9 specifically addressed in the plan of conversion.
10 By the way the plan of conversion is drafted, my
11 position, I believe would be unchanged.

12 Q Are you -- Are you aware of whether or not the
13 management review subcommittee has considered
14 other candidates for any of the positions that
15 would -- that would be filled after the
16 conversion?

17 A I'm not aware that they have.

18 Q Do you anticipate an increase in salary or other
19 compensation in your new position?

20 A What new position are you referring to?

21 Q Well, I'm referring to your new position in the
22 for-profit converted entity, whether it's the same
23 or the title I guess?

24 A No, I'm expecting to be similarly compensated.

25 Q Ms. Hanson, I'd like now to just to go over some

0020

1 of the -- the past intercompany transactions made
2 between Blue Cross/Blue Shield and its for-profit
3 affiliates and I have some -- some of those listed
4 which were taken from Mr. Bablitch's letter of
5 January 4th, so if I could give you this printout
6 and we can maybe go over some of them, would that
7 be okay?

8 MR. BABLITCH: Shouldn't we get it marked?

9 COMMISSIONER O'CONNELL: We'll get that.
10 We'll go off the record to mark that exhibit.

11 (Discussion off the record.)

12 COMMISSIONER O'CONNELL: Now that we're
13 back on the record I should note that because we
14 started the Class I case hearing a half an hour
15 late, we will continue until 12:30, but,
16 Mr. Williams, it's to your advantage to arrange
17 your witnesses within that time frame.

18 MR. WILLIAMS: Yes, ma'am.

19 (Discussion off the record.)

20 (Exhibit J-1 was marked for
21 identification.)

22 COMMISSIONER O'CONNELL: We're back on the
23 record. Mr. Williams, can you please continue
24 with your questions.

25 MR. WILLIAMS: Yes, ma'am.

0021

1 BY MR. WILLIAMS:

2 Q Ms. Hanson?

3 A I don't have the materials.

4 MR. BABLITCH: The witness doesn't have the
5 exhibit.

6 MS. BAILEY-RIHN: We have an extra. We
7 have a copy that we can --

8 MR. NEPPLE: Thank you.

9 MR. WILLIAMS: Thank you.

10 BY MR. WILLIAMS:

11 Q Miss Hanson, directing your attention to the
12 attachments which are entitled Blue Cross/Blue
13 Shield United Wisconsin historical transactions
14 among affiliates, 1991 and '93 through 1999.

15 MR. BABLITCH: Excuse me, is there an
16 exhibit number for this?

17 MR. WILLIAMS: J-1.

18 MR. BABLITCH: Thank you.

19 BY MR. WILLIAMS:

20 Q Miss Hanson, could you -- could you pick one of
21 these transactions and describe to me how it
22 promoted the public interest? Any one.

23 MR. BABLITCH: I object. What relevance
24 does that have?

25 MR. WILLIAMS: I just talked about the

0022

1 relevance a little while ago.

2 COMMISSIONER O'CONNELL: I'll allow the
3 question.

4 MR. BABLITCH: Wait a second. Let me
5 clarify my objection. These are transactions that
6 occurred between United Wisconsin Services and
7 Blue Cross/Blue Shield United of Wisconsin.

8 I'd like to hear how the public interest
9 folds into a discussion of -- of these
10 transactions. If for no other reason then I'd
11 like to preserve my record because that's not the
12 statutory test on any of these transactions.

13 MR. WILLIAMS: What is the statutory test
14 on these transactions?

15 MR. BABLITCH: I'm not a witness,
16 Mr. Williams.

17 COMMISSIONER O'CONNELL: Excuse me,
18 Mr. Williams, would you like to explain why that
19 question is relevant?

20 MR. WILLIAMS: Yes, ma'am. Similar to my
21 questioning about the compensation packages I
22 think the public will be interested or -- or your
23 decision will be better informed if you were to
24 hear how Blue Cross/Blue Shield has conducted
25 itself regarding intercompany service agreements

0023

1 and transfers of businesses in terms of how those
2 motives relate to their decision to convert to a
3 for-profit entity which you're considering right
4 now.

5 COMMISSIONER O'CONNELL: And could you
6 please restate the question for me.

7 MR. WILLIAMS: Yes, ma'am. I'm asking
8 Ms. Hanson to pick one of these transactions and
9 describe how it promoted the public interest.

10 MS. BAILEY-RIHN: Your Honor or,
11 Commissioner, I'm going to object on foundation.
12 I'm not sure that -- perhaps she has, but I
13 haven't heard anything that Ms. Hanson has any
14 knowledge of the transactions or was involved in
15 them or has knowledge of how they benefit the
16 public.

17 MR. WILLIAMS: Okay.

18 MR. BABLITCH: You know, all of these
19 transactions have been filed with the
20 Commissioner's office and either approved
21 specifically or not disapproved. There is no
22 statutory test of what is in the public interest
23 on these, so if you want to ask that question, how
24 can you -- I mean, there's just no foundation for
25 the question to even be asked.

1 COMMISSIONER O'CONNELL: Let me consider
2 the objections for a moment.

3 MR. WILLIAMS: Yes, ma'am.

4 COMMISSIONER O'CONNELL: Mr. Williams,
5 you've asked the witness to speculate as to the --
6 whether or not the transactions are a public
7 purpose. That is an inappropriate question for
8 this witness.

9 If you would rephrase the question to ask
10 what benefit the transaction has had for Blue
11 Cross/Blue Shield, that would be an appropriate
12 question for this witness.

13 MR. WILLIAMS: Yes, ma'am.

14 COMMISSIONER O'CONNELL: And you should
15 identify which transaction in particular you're
16 interested in.

17 MR. WILLIAMS: Okay. Thank you.

18 BY MR. WILLIAMS:

19 Q Miss Hanson, do you have knowledge of the
20 transactions that are listed in this document?

21 A Some of them, yes.

22 Q Okay. Can you -- Well, these pages aren't
23 numbered. Is your document numbered?

24 A No, sir.

25 Q On the very first page of the document if you

0025

1 direct your attention to the second transaction
2 that's listed there --

3 A Yes.

4 Q -- are you familiar with that transaction?

5 COMMISSIONER O'CONNELL: Could you name the
6 transaction, Mr. Williams?

7 BY MR. WILLIAMS:

8 Q Amendment to the insurance agreement between Blue
9 Cross/Blue Shield United Wisconsin and United
10 Wisconsin Insurance Company.

11 A That transaction was done in '91, '93?

12 Q Mm-hmm.

13 A I can read what it says and I'm vaguely
14 familiar -- familiar with what the transaction is.

15 Q Okay.

16 A But I'm not going to be able to recall a lot of
17 details.

18 Q Okay. I'm not sure I'm interested in a whole lot
19 of detail. Could you -- Do you recall how this
20 transaction was fair and reasonable to the
21 interests of the Blue Cross/Blue Shield nonprofit?

22 A When we do these transactions, our gauge is that
23 it needs to be fair and reasonable to each
24 insurance company, so these transactions involve
25 an insurance company and an affiliate.

1 This one in particular involves Blue Cross
2 and Blue Shield United Wisconsin and United
3 Wisconsin Insurance Company, and it relates to a
4 reinsurance agreement that --

5 Our goal in this is to see that each
6 insurance company is -- the transaction is fair
7 and reasonable to each insurance company.

8 Q Do you recall any details about the financial
9 impact on Blue Cross/Blue Shield of this
10 transaction?

11 A Not from this brief description I have here.

12 Q Maybe we should move to a more recent transaction.
13 Miss Hanson, directing your attention to the --
14 from the pages in the back --

15 COMMISSIONER O'CONNELL: Could you indicate
16 the year? They're in chronological order.

17 MR. WILLIAMS: 1999.

18 BY MR. WILLIAMS:

19 Q It's of the fifth page in from the back. It's
20 titled -- entitled guarantees for Blue Cross
21 Association licensing.

22 A Yes.

23 Q Do you recall any -- Do you recall the purpose of
24 this transaction?

25 A Yes, I do.

1 Q Could you describe, please, how this transaction
2 was fair and reasonable to the interests of a
3 nonprofit.

4 A This transaction involves use of the Blue Cross
5 license by certain of the subsidiaries. I believe
6 it's by Compcare and by United Wisconsin. Let me
7 just see. This is by Compcare. I'm not certain
8 if it's by another government services as well,
9 but I'll discuss Compcare which I believe is
10 quoted in the description.

11 Q Mm-hmm.

12 A Compcare has the ability to -- gained the ability
13 to use the Blue Cross license. Blue Cross has a
14 requirement to use its best efforts to license
15 product to maintain the Blue Cross mark and shield
16 which is of value to the Blue Cross plan which is
17 what we believe is the nonprofit you were
18 referring to.

19 The extension of that to Compcare is not
20 only in Compcare's interests because it utilizes
21 the mark but also Blue Cross as far as continuing
22 to maintain its status in the Blue Cross
23 Association with regard to best effort statutes,
24 so it's to Blue Cross's benefit that Compcare is
25 licensed under -- with the Blue Cross mark and

1 shield.

2 This transaction in particular requires that
3 Blue Cross guarantees the -- certain transactions
4 at -- for Compcare as a sublicense of Blue Cross
5 for which Compcare will pay Blue Cross a fee, so
6 the transaction was established to be fair to Blue
7 Cross.

8 It's -- so it's a benefit to Compcare's
9 license. Compcare is also an insurer to its
10 benefit that is licensed, and the economic
11 transaction is that Compcare pay -- pays a fee for
12 Blue Cross/Blue Shield granting the mark that
13 provides for this transaction.

14 Q Who decided that fee?

15 A That fee was established by us in conjunction with
16 negotiations with Mr. Cauhill (phonetic) of the
17 Office of Commissioner of Insurance.

18 Q Okay. Thank you. Do you have any estimate of
19 what the financial effect on Blue Cross's cash
20 flow would be based on that intercompany
21 agreement?

22 A I don't recall the dollar amount that will be
23 exchanged between the parties.

24 Q So you're the chief financial officer of Blue
25 Cross --

1 COMMISSIONER O'CONNELL: It's been asked
2 and answered, Mr. Williams.

3 BY MR. WILLIAMS:

4 Q Ms. Hanson, with regard to the \$70,000,000 loan by
5 Blue Cross/Blue Shield to United Wisconsin
6 Services which is in the record, how does --
7 Could you describe how that decision to loan UWS
8 \$70,000,000 promoted the interests of Blue
9 Cross/Blue Shield?

10 A Are you referring to a specific transaction to
11 which I should refer?

12 Q No. These aren't page numbered, so it's kind of
13 hard to refer to, but are you familiar with the
14 \$70,000,000 loan?

15 A Yes, I am.

16 Q Could you describe, please, how that loan promoted
17 the interests of Blue Cross/Blue Shield United
18 Wisconsin?

19 A Blue Cross and Blue Shield receives interest on
20 the loan at a stated interest rate, so it's not an
21 interest-free loan. Blue Cross does receive
22 income for that loan. Blue Cross is of --
23 currently 46 percent owner of United Wisconsin
24 Services.

25 It's to its benefit that United Wisconsin

1 Services does well because Blue Cross has a
2 substantial stock interest in United Wisconsin
3 Services. Every dollar value of increase in
4 the -- in the stock of the United Wisconsin
5 Services increases Blue Cross's value by
6 approximately eight million dollars.

7 Q Okay. What is the -- What is the status of that
8 loan right now?

9 A That loan currently has a term of -- I believe it
10 matures in April of 2001. April 30, 2001.

11 Q Was that loan repayment due date -- for lack of a
12 better word -- was that extended?

13 A It was.

14 Q Do you know why?

15 A United Wisconsin Services requested an extension
16 from Blue Cross. The extension was granted.

17 Q Who at United Wisconsin Services requested who at
18 Blue Cross/Blue Shield to grant that extension?

19 A The board -- the boards of -- or the committee of
20 the united -- of Blue Cross has to approve the
21 extension and they did. That extension then also
22 has to be approved by the Office of Commissioner
23 of Insurance.

24 United Wisconsin Services wasn't in a
25 position to repay the cash at that point in time.

0031

1 They wanted to extend the note versus going
2 outside to a third party to get outside financing.

3 Q So the board of UWS requested the board of Blue
4 Cross/Blue Shield to grant the extension or a
5 subcommittee?

6 A The management of United Wisconsin Services
7 requests of the -- the finance committee of Blue
8 Cross to approve the extension.

9 Q How has the \$70,000,000 been used by UWS?

10 A The \$70,000,000 originally was used to acquire
11 American Medical Security Back in 1996 when United
12 Wisconsin Services and American Medical Security
13 were -- were merged back then prior to a spinoff
14 that occurred in 1998.

15 Q And how was it in the interests of Blue Cross and
16 Blue Shield for that transaction to happen I
17 guess?

18 A I'd like to separate the -- the loan from the
19 transaction. The transaction to buy out American
20 Medical Security was determined by the board of
21 United Wisconsin Services to be in the financial
22 best interests of the United Wisconsin Services
23 and its shareholders -- Blue Cross being one of
24 those. Blue Cross lent money at that point in
25 time to facilitate that purchase.

0032

1 Q Was that -- Was that \$70,000,000 used as a -- as
2 collateral somehow?

3 A It was paid to the shareholders -- the then
4 shareholders of American Medical Security to buy
5 out their interest.

6 Q Okay. And could you tell me, please, how the
7 extension of that loan repayment date promoted the
8 interests of the public beneficiaries of Blue
9 Cross/Blue Shield?

10 A The -- the existence of the loan -- The fact that
11 it pays interest and it's to an affiliate in which
12 Blue Cross owns significant stock is in the best
13 interests of both Blue Cross and United Wisconsin
14 Services. The extension of the loan is just
15 continuation of that economic best interest.

16 Q If the conversion application that Blue Cross has
17 submitted to OCI is approved, how will that
18 \$70,000,000 loan be accounted for?

19 A The \$70,000,000 loan is -- is an obligation to an
20 insurance company which is a legal entity which
21 that obligation will not go away in the
22 conversion, so there really is no change in
23 accounting with the conversion.

24 Q Okay. Ms. Hanson, with regard to the share
25 prices, United Wisconsin Services and American

0033

1 Medical Security, are you aware -- or could you
2 describe how the performance of those share prices
3 has been over, say, the past year?

4 A They go up. They go down. I mean, it just -- It
5 depends upon any point in time.

6 Q Mm-hmm.

7 A They have gone up in the recent -- in the recent
8 past, but I can't tell you the 52-week high and
9 low. I don't have that committed to memory, but
10 it is public information.

11 Q Right.

12 COMMISSIONER O'CONNELL: Mr. Williams, I
13 just want to note that it is 11:45. We do have
14 one other witness and the other movants will have
15 an opportunity to question as well as Blue Cross
16 having an opportunity for redirect. You might
17 want to conclude this witness within the next 10
18 minutes or so --

19 MR. WILLIAMS: Right.

20 COMMISSIONER O'CONNELL: -- just to make
21 sure that we have enough time for our additional
22 witness and other questions.

23 MR. WILLIAMS: Yes, ma'am. I'm almost
24 finished.

25 BY MR. WILLIAMS:

1 Q Would it be fair to say, Ms. Hanson, that the
2 share prices of -- of AMZ has fallen from about 15
3 to \$20 a share down to four to \$6.00 per share or
4 so since last summer -- I mean roughly?

5 MR. BABLITCH: You know, I'm going to
6 object just -- If she doesn't know the answer,
7 which I think she's already stated it fluctuates,
8 it's public information. There's no foundation to
9 show that she does know how it fell, and what
10 difference does it make?

11 COMMISSIONER O'CONNELL: I will allow the
12 question to the extent that Ms. Hanson has that
13 knowledge.

14 THE WITNESS: That range appears
15 reasonable.

16 BY MR. WILLIAMS:

17 Q Okay. Do you know -- Do you know why the share
18 price of AMZ has fallen so much?

19 A My best -- I don't want to say guess, but if -- if
20 I believe what I read from the best mail lists
21 it's because the earnings. They have not had --
22 They've had losses during that period of time.

23 Q Could you just summarize why AMZ has suffered
24 losses?

25 A Their underwriting losses were higher than they

0036

1 questions have been asked.

2 MR. WILLIAMS: Okay. That's all for Miss
3 Hanson. Thank you, Miss Hanson.

4 COMMISSIONER O'CONNELL: Ms. Bailey-Rihn,
5 do you have any questions for Miss Hanson?

6 MS. BAILEY-RIHN: No, Commissioner.

7 COMMISSIONER O'CONNELL: Miss Madsen?

8 MS. MADSEN: I do not.

9 COMMISSIONER O'CONNELL: Are there any
10 questions on redirect, Mr. Bablitch?

11 MR. BABLITCH: No.

12 COMMISSIONER O'CONNELL: You may call your
13 next witness.

14 MR. WILLIAMS: Could we take a five-minute
15 recess?

16 COMMISSIONER O'CONNELL: Sure. We still
17 need to conclude by 12:30, however, but we can go
18 off. We will recess for five minutes.

19 MR. WILLIAMS: Okay.

20 (A recess was taken.)

21 COMMISSIONER O'CONNELL: Five minutes
22 having expired we will go back on the record.
23 Mr. Williams, you may call your next witness.

24 MR. WILLIAMS: Commissioner, I would call
25 Mr. Tom Johnson.

0037

1 THOMAS W. JOHNSON, called as a witness
2 herein by the Coalition, after having been first
3 duly sworn, was examined and testified as follows:

4 COMMISSIONER O'CONNELL: Okay,
5 Mr. Williams, you may begin your questioning.

6 MR. WILLIAMS: Thank you.

7 DIRECT EXAMINATION

8 BY MR. WILLIAMS:

9 Q Morning, Mr. Johnson.

10 A Morning.

11 Q Mr. Johnson, have you been involved in analyzing
12 other Blue plan conversions?

13 A Yes, I have.

14 Q Could you name those?

15 A Yes. The transaction between Columbia -- the
16 proposed transaction between Columbia HCA and Blue
17 Cross/Blue Shield Mutual of Ohio -- that
18 transaction is not consummated -- the proposed
19 merger between Blue Cross/Blue Shield of New
20 Jersey and Blue Cross/Blue Shield of Delaware --
21 that transaction was also terminated -- the
22 transaction between Blue Cross/Blue Shield of
23 national capitol area and Blue Cross/Blue Shield
24 of Maryland.

25 Q Okay. Thank you. Are you aware of any other Blue

0038

1 plan conversions in which no net present value was
2 estimated for the converted Blue?

3 A I'm sorry, would you restate that?

4 Q With regard to valuation are you aware of any
5 other plans or proposed conversions in which a
6 dollar estimate of the value of the converting
7 entity was not obtained?

8 A Not to my knowledge.

9 Q Was -- Was a dollar estimate arrived at regarding
10 the Wisconsin plan by your firm?

11 A Not by our firm, no.

12 Q Why not?

13 A Stating a dollar value in today's terms is not
14 particularly relevant to any outcome that is to be
15 determined in the future.

16 Q If a liquidity event to be overseen by OCI were to
17 occur within, say, six months, would a valuation
18 be performed then?

19 A I don't know.

20 Q Would you recommend --

21 A Depends if you're requested.

22 Q Pardon?

23 A Depends if it's requested.

24 Q As an expert in analyzing these transactions,
25 would you recommend that a valuation be done?

0039

1 A I wouldn't say it would not be inappropriate that
2 a valuation be requested if the OCI were in this
3 case to want one.

4 Q How is the Commissioner supposed to get a handle
5 on this deal if she doesn't really have at least a
6 guess of what the dollar values are going to be
7 regarding what the foundation receives?

8 A I'm not sure I understand what -- what you want
9 with that question.

10 Q I understand that their president has come up with
11 a -- you know, some proposed recommendations about
12 the structure of the deal, but wouldn't it be
13 helpful to the Commissioner if she had an idea as
14 as to how large the sum was going to be so that
15 she could, you know, take a -- take that in
16 consideration in deciding how the money would be
17 spent?

18 A How the money is to be spent has not been under
19 our purview so I don't -- I don't know that -- I
20 don't -- I can't answer the question.

21 Q What kind of expected earnings would you
22 anticipate for a merged or a stand-alone United
23 Heartland Group?

24 A I can't speak to the merged entities. That's not
25 been formally proposed, and that's not been --

0040

1 been modeled. I don't recall what the earnings
2 estimates are for the Blue Cross myself. I've
3 reviewed it, but I don't have that material at
4 hand or in my head.

5 Q So why were valuations done on other converting
6 Blues but not on this one?

7 A No other Blue plan has a total 100 percent of the
8 consideration or 100 percent of the Blue plan been
9 given to an entity.

10 Q Did you review the Donaldson, Lufkin, Jenrette
11 estimate?

12 A We reviewed their work. Yes, we did.

13 Q What was -- What was their estimate of what Blue
14 Cross was worth?

15 A I don't recall. We had a discussion with them in
16 January, and we've been focused on a lot of other
17 things since, so I don't recall anything more
18 exactly.

19 Q I think the Commissioner might remember it was
20 about 140 million, 600 million, something like
21 that?

22 A Estimate for value or the estimate for earnings?

23 Q Of value. Sorry.

24 A Okay. Value is the range you stated.

25 Q Do you have any idea why that value might have

0041

1 been so -- the range of that value might have been
2 so wide?

3 A There are many different valuation techniques that
4 one can use to value a company and it is due to
5 the number and the different valuation ranges,
6 dollars the DLJ used that generated those numbers.

7 Q In your opinion the Blue Cross proposal as amended
8 by the proposed recommendations for changes by the
9 cy pres committee, what valuation methodology
10 would you recommend?

11 A I wouldn't be able to recommend any one valuation
12 methodology. I use a number of them. I would --
13 I would use a number of valuation methodologies
14 not dissimilar to the ones used by Donaldson,
15 Lufkin, Jenrette.

16 Q So if a conversion were to occur and -- Well, if
17 a conversion were to occur within, say, six
18 months, would you recommend doing an analysis
19 similar to what DLJ did?

20 A If we were asked for a valuation, I would do
21 something not dissimilar.

22 Q Would you expect to be asked to do a valuation?

23 A I can't say that. It it would be supposition on
24 my part.

25 Q If you were reviewing a decision by an investment

0042

1 banking firm to provide advice to a Commissioner
2 of Insurance and the investment banking firm did
3 not conduct an appraisal of the converting entity,
4 how would you view that?

5 A Depends on the structure of the transaction.

6 Q Could you give me your opinion of the Donaldson,
7 Lufkin, Jenrette estimate?

8 A If I recall what was in their work as well as what
9 they said in their testimony at the previous
10 hearings, their range was as you stated, I
11 believe, approximately 140 some odd million to
12 approximately 600 million. They honed in on a
13 value somewhere in the \$250,000,000 range.

14 At that time it did not appear that that was
15 an inappropriate range given the valuation
16 methodologies nor was the range they honed in on
17 inappropriate at that point in time.

18 Q Okay. Moving away from Donaldson, Lufkin,
19 Jenrette, with regard to the proposed 100 percent
20 transfer of UHG stock to the foundation, would it
21 be possible for an entity to buy that 100 percent
22 of the UHG stock if they were already a licensed
23 Blue plan?

24 A Yes.

25 Q Would it be possible for an entity to buy that 100

0043

1 percent if the entity -- the buyer was not a Blue
2 plan but if the deal was contingent upon obtaining
3 a Blue license?

4 A It's possible. How it's possible is very
5 difficult to imagine.

6 Q So it's not likely or it would just be difficult?

7 A Under the LaCrosse rules I would suspect it would
8 be very difficult.

9 Q In terms of maximizing the value of the
10 foundation's stock, what purpose do the
11 antitakeover provisions -- the antitakeover
12 provisions serve if one or any number of Blue
13 plans could buy the new Wisconsin plan without
14 risking loss of the Blue license?

15 A Just would you go back and restate that to make
16 sure I understand, please.

17 Q Maybe we could just start with could you describe
18 the purpose of antitakeover -- takeover
19 provisions?

20 A Generally in corporate America antitakeover
21 provisions are put in place so that -- They are
22 really what we call fair pricing provisions. It's
23 so that if someone offers to buy a block of shares
24 in a company that that offer is extended on the
25 fair basis to all the shareholders not just one.

0044

1 It is designed to -- We call them
2 antitakeovers so that you can't get just a
3 majority of the stock and then you buy the
4 remainder as a second step of the transaction for
5 a discounted price because you now have control.
6 They're usually just fair pricing provisions.
7 That's what they're designed to do.

8 Q What do you mean by "fair pricing"?

9 A Fair pricing among all shareholders.

10 Q Are the antitakeover -- takeover provisions
11 relevant to this conversion deal if any other --
12 if another Blue plan could buy 100 percent of the
13 stock?

14 A Yes. They can cause a fair pricing mechanism to
15 be pushed into play here, sure.

16 Q What if two competing Blue plans were to
17 competitively bid -- bid for the 100 percent?

18 A I'm sorry?

19 Q Would the antitakeover provisions be relevant if
20 two competing Blue plans were to compete and bid
21 for the 100 percent UHG?

22 A Sure. The antitakeover provisions are not
23 specific as to one party versus another.

24 Q Okay. Just in general do you think it would be
25 better for the foundation if other potential

0045

1 buyers were able to competitively bid up the price
2 of the stock which would include a controlling
3 interest?

4 A "Other buyers" being?

5 Q Other Blue plans or individual shareholders.

6 A Are you referring to some subset of the
7 recommendations of the provisions in the plan?

8 Q No, just a general idea of -- of whether or not
9 that would be beneficial to the foundation's
10 interests if -- I mean, say, for example, other --
11 another Blue plan were to be able to competitively
12 bid up the price of the foundation's holdings
13 which would include a controlling interest but not
14 necessarily 100 percent owners?

15 A Someone can always make an offer to buy shares.
16 Someone can always do that, and they can make it
17 for a majority or a minority stake, so the -- the
18 antitakeover provisions will have effect depending
19 upon the circumstances. In this case you've
20 got -- Are you talking about the corporate
21 guidelines or the Blue Cross guidelines?

22 Q I'm not talking about any guidelines. I'm just
23 talking in general. Would it be beneficial to the
24 foundation's interests?

25 A It's beneficial when anyone can competitively bid

0046

1 for anything to the seller.

2 Q Is that why the appraisal committee attempted to
3 erase as much as of the antitakeover provisions as
4 they could?

5 A It appeared that their interests were -- were to
6 make the corporate govern as guidelines relating
7 to antitakeover less stringent meaning it will
8 allow for more instances where a takeover might
9 occur, yes, that's true.

10 Q How do you -- How do you think they did in that
11 regard?

12 A One has to look at it in -- the -- The
13 recommendations that the appraisal committee made
14 were really in the context of keeping those
15 guidelines and making them as -- as shareholder --
16 call it foundation friendly, if you will, as it
17 were, as possible within the Blue Cross
18 guidelines.

19 Q Has it been beneficial to Blue Cross -- the
20 existing Blue Cross right now -- Has it been
21 beneficial to them to have directors who are also
22 officers?

23 A I don't see that it's hurt them.

24 MR. BABLITCH: I'd object to the extent
25 that that was asked in the plural, and I think the

0047

1 record will reflect that there is one director
2 who's an officer and that's Mr. Hefty.

3 COMMISSIONER O'CONNELL: The record will
4 note that.

5 MR. BABLITCH: And he's a nonvoting officer
6 of record.

7 BY MR. WILLIAMS:

8 Q How has it been -- or has it been beneficial to
9 the nonprofit Blue Cross/Blue Shield United of
10 Wisconsin to have -- to have had overlapping
11 boards of the nonprofit with the for-profit
12 subsidiaries and affiliates?

13 A I assume you're referring to the boards of Blue
14 Cross/Blue Shield United of Wisconsin, United
15 Wisconsin Services?

16 Q Mm-hmm.

17 A There is some director overlap but not -- It's
18 not complete. There are independent directors in
19 the board structure of each company, so there is
20 independence represented on both of those boards.

21 Q Were there -- Were there conflicts of interest?

22 A How do you mean?

23 Q Were there conflicts of interest between UWS and
24 Blue Cross and Blue Shield United of Wisconsin?

25 A I think anytime you have a structure like that

1 there are likely to be conflicts of interest that
2 arise. The company has gone to great lengths to
3 make sure -- companies, plural, have gone to great
4 lengths to make sure that those conflicts of
5 interest do not come into play.

6 Q How do they neutralize those conflicts?

7 A In the past there have been discussions between
8 the two entities at the board level relating to
9 certain intercompany transactions where the
10 independent directors of each of the boards have
11 not been able to agree on the outcome.

12 Q In the review of -- your extensive review of Blue
13 Cross and Blue Shields operations, did you note
14 any troublesome areas regarding conflicts of
15 interest?

16 A No.

17 Q Did you review the fairness of any prior
18 intercompany transactions?

19 A We did not review the fairness, per se, no.

20 Q With regard to the proposed converted group of
21 Blue companies in Wisconsin, would there
22 necessarily be any financial harm to the
23 for-profit Blue Cross/Blue Shield if it were to
24 have different officers than the ones that
25 currently are in place?

0049

1 A I'm sorry, restate the first part of the
2 question. I didn't hear it.

3 Q Regarding the proposed lag of officers in the
4 for-profit, would it be harmful for those
5 officers -- for those positions to be opened up
6 and -- you know, a search committee established to
7 replace them?

8 A All I would say is anytime you have turn-over in
9 senior management positions in any company there
10 is a transition period during which the new
11 officers need to become acquainted with the
12 business and the particulars of the business.
13 That transition doesn't have to, but it can result
14 in some harm done. It doesn't necessarily have to
15 result, but it can.

16 Q Okay. So if Blue Cross officers were not
17 appointed to continuing officerships within the
18 for-profit structure, that could have financial
19 harm to -- that could have financial impact on the
20 value of the UHG stock?

21 A I guess I misunderstood your former question.
22 Were you referring to United Wisconsin or United
23 Heartland?

24 Q I was referring to United Heartland.

25 A I guess my answer would be more or less the same

0050

1 to the former question which is anytime there's
2 transition in a management position you have
3 dislocations that could occur causing some
4 temporary setback in the smooth management of the
5 company, yeah.

6 Q And that could be reflected in the price of the
7 stock?

8 A If it happens to have an impact on the company's
9 financial operations which affect its earnings,
10 maybe it could. Sometimes new management teams
11 are seen as being positive.

12 Q If officers and directors have a fiduciary duty of
13 loyalty and care to make business decisions in the
14 best interests of the company, would there be any
15 financial harm to the company if they were not
16 given stock options as incentive to make those
17 decisions?

18 A If they worked for a company that can give stock
19 options, if they have not customarily been what
20 you find in a -- an alignment issue, the issue of
21 the shareholders is not aligned with that of
22 management or said vice versa the management is
23 not necessarily given any incentive to work on
24 behalf of the shareholders and that can happen.

25 Q Even though they have -- sorry. Even though they

0051

1 have duty of loyalty?

2 A That could be. I -- I can't say. Depends on the
3 individuals.

4 Q In your opinion how -- how well has Blue
5 Cross/Blue Shield done with respect to overlapping
6 boards in terms of conflict of interests?

7 MR. BABLITCH: I'm going to object. First
8 of all, there's been no foundation laid as to
9 qualifications which I'll discuss in my
10 cross-examination, but, second of all, as I
11 understand Mr. Johnson's role it's not necessarily
12 to get into areas like this.

13 As I understand it, Deutsche Bank was hired
14 to apprise the committee on valuation issues and
15 the like as reflected in the minutes of the
16 committee's meetings and the final report, so it
17 seems to me that we're getting a bit attenuated
18 here in terms of what the question is and the
19 foundation for Mr. Johnson's testimony.

20 COMMISSIONER O'CONNELL: At this juncture I
21 will allow the question to the extent that
22 Mr. Johnson is able to respond.

23 THE WITNESS: Would you rephrase the
24 question or restate the question, please.

25 BY MR. WILLIAMS:

0052

1 Q Sure. In your opinion how well have the potential
2 conflicts of interest between the interests of the
3 for-profits and the nonprofits with their
4 overlapping boards -- How well have they done in
5 neutralizing those conflicts?

6 A In the instances where we reviewed transactions
7 between the companies, it appeared that the
8 companies went out of their way to document the
9 transactions to make sure they were at arm's
10 length. They then brought the transactions before
11 the OCI for their specific approval or
12 nondisapproval. They actually have gone to great
13 lengths -- lengths that I've not seen in other
14 circumstances where the -- with this kind of
15 situation. I think they've done very well at
16 that.

17 Q Why do you think they went to extra lengths?

18 A I can't say other than they perhaps knew that
19 there were the overlapping boards and they wanted
20 to make it clear that outside vendors were
21 available, that they were at arm's length, they
22 were market rate transactions, that all the
23 transactions were fair between the two entities.

24 COMMISSIONER O'CONNELL: Now I'll note that
25 it is now 12:20. We do need to give an

0053

1 opportunity to the other movants to question the
2 witness as well as limited questions on behalf of
3 the applicants, so you will need to wind up your
4 questions.

5 BY MR. WILLIAMS:

6 Q Mr. Johnson, would there be any harm to Blue Cross
7 and Blue Shield financially if the foundation
8 that's been proposed were to be established with a
9 board that's independent of Blue Cross/Blue Shield
10 or United Heartland Group and with the ability to
11 make spending decisions on public health
12 initiatives that have -- that has ongoing input
13 from the public?

14 A That's a compound question. Can you break it down
15 in pieces, please.

16 Q Would there be any harm to the financial interests
17 of the converted entity if the proposed foundation
18 were independent of the control of the converted
19 entity?

20 A No.

21 Q Would there be any harm to the converted entity if
22 the proposed foundation were to have freedom in
23 deciding how to spend the proceeds?

24 A The spending has not been in our purview. We've
25 not reviewed that issue.

0054

1 Q Would you anticipate there was any threat?

2 COMMISSIONER O'CONNELL: The question's
3 been asked and answered.

4 BY MR. WILLIAMS:

5 Q You haven't looked at it?

6 A (Shakes head.)

7 Q Mr. Johnson, I realize that -- that you analyzed
8 the conversion as proposed by Blue Cross/Blue
9 Shield. Can you think of any other alternatives
10 that Blue Cross and Blue Shield might have pursued
11 other than conversion?

12 A To achieve what goal?

13 Q Raising money.

14 A As a nonpublic, nonstock entity, it is very
15 difficult for Blue Cross to raise money from
16 outside sources. They are limited at this point
17 to debt funds that they might borrow from banking
18 institutions or from the public markets if they
19 were allowed to do that -- go that extent.

20 Q Why -- Why do you think that isn't a suitable
21 alternative?

22 A I didn't say it wasn't a suitable alternative
23 other than lenders typically look at the
24 underlying capital of a company when it's
25 borrowing money, and if there isn't enough capital

0055

1 in that underlying entity, then lenders won't
2 lend. It's called collateral.

3 Q Why do you think Blue Cross/Blue Shield needs to
4 convert right now?

5 A I don't know that it needs to convert.

6 Q And in Blue Cross's proposal they retained
7 basically complete control of the foundation. Why
8 do you think they proposed that?

9 A We didn't ask that question.

10 Q Is that something you dealt with in your analysis?

11 A Well, I think we dealt with it in terms of some of
12 the analyses we did looking at corporate
13 structural organization and some of the corporate
14 governance issues that the appraisal committee
15 asked us to review. The -- The appraisal
16 committee has made recommendations pertaining to
17 that.

18 Q You mentioned before the other conversion deals
19 that you've been involved in, some of which
20 weren't completed, but are you aware of any other
21 conversions in which the proceeds were
22 automatically distributed to a certain beneficiary
23 other than a public health foundation?

24 A If one looks at the Trigon which is the Virginia
25 Blue Cross/Blue Shield plan when it converted, it

0056

1 was also a mutual company at the same time being a
2 nonfor-profit, a reasonably hybrid structure.

3 They had an obligation to distribute the
4 ownership of that company to the mutual
5 policyholders which they did.

6 Q Right.

7 A They in addition made a contribution to a charity
8 in the State of Virginia.

9 COMMISSIONER O'CONNELL: Mr. Williams, you
10 have time for one final question.

11 BY MR. WILLIAMS:

12 Q But would you say in this respect is the Wisconsin
13 plan unprecedented in having predesignated the
14 med. schools as recipients?

15 A That's not an issue we were asked to look into or
16 respond to.

17 Q Okay. But you're not aware --

18 COMMISSIONER O'CONNELL: I believe he's
19 answered that question, and that was your final
20 question. Ms. Bailey-Rihn, do you have any
21 questions for this witness?

22 MS. BAILEY-RIHN: I have one, Commissioner.

23 CROSS-EXAMINATION

24 BY MS. BAILEY-RIHN:

25 Q Sir, for your work for the appraisal committee,

0057

1 did it encompass in any way a determination
2 whether or not Blue Cross/Blue Shield should
3 convert?

4 A No, that was not in the scope of our work.

5 MS. BAILEY-RIHN: Thank you. No questions.

6 COMMISSIONER O'CONNELL: Ms. Madsen?

7 MS. MADSEN: No questions.

8 COMMISSIONER O'CONNELL: Mr. Bablitch?

9 MR. BABLITCH: I have a few questions.

10 First, with respect to qualifications, and I guess
11 I would turn to you in -- I'm stipulating or
12 willing to stipulate to the qualifications of
13 Mr. Johnson.

14 I assume that in the argument somewhere as
15 part of the RFP process Deutsche Bank submitted to
16 the commissioner's office their expertise and
17 based upon a competitive process Deutsche Bank was
18 chosen, so to the extent that those documents
19 exist, I would stipulate to his qualifications as
20 an expert witness in the areas that have been
21 inquired into with respect to the appraisal
22 committee work and advising the Commissioner. If
23 that stipulation is acceptable, I won't need to
24 ask Mr. Johnson to tell us all about his
25 qualifications.

0058

1 COMMISSIONER O'CONNELL: Mr. Williams, do
2 you have any comments on that? Will you accept
3 that stipulation?

4 MR. WILLIAMS: Yeah, I think Mr. Johnson's
5 qualifications are well-known. I don't have an
6 objection.

7 COMMISSIONER O'CONNELL: That stipulation
8 is accepted by the movants. Thank you.

9 CROSS-EXAMINATION

10 BY MR. BABLITCH:

11 Q I just have a few areas of inquiry that have been
12 gone into on direct examination and just in terms
13 of asking those questions I'd -- Naturally,
14 there's a few foundation questions. Mr. Johnson,
15 you were hired by the Commissioner's office, the
16 Office of Insurance Commissioner to conduct a
17 review of the Blue Cross proposed conversion in
18 this state; is that correct?

19 A That's correct.

20 Q And so you were hired by the Commissioner's office
21 as a independent and objective party to make this
22 examination?

23 A That is correct.

24 Q And you have conducted that examination I take it?

25 A As far as we were asked to examine certain issues,

0059

1 yes, we have.

2 Q And as a part of that process, did you develop a
3 work plan?

4 A Yes, we did.

5 Q Did you consult with the appraisal committee that
6 was appointed by the Commissioner?

7 A Yes, we did.

8 Q Did you assist the appraisal committee in the
9 committee coming to their conclusions which was
10 evidenced in their final report dated
11 February 15th, 2000?

12 A Yes, we did.

13 Q And as a part of that were you given specific
14 instructions and questions by the appraisal
15 committee to delve into certain areas relative to
16 the conversion?

17 A Yes, we were.

18 Q Did one of those areas encompass a question
19 pertaining to whether or not 100 percent of the --
20 of the converted entity would, in fact, constitute
21 100 percent value of the Blue Cross company?

22 A We were.

23 Q And did you determine a conclusion?

24 A The work we did concluded that in our review that
25 100 percent of the company being contributed to

0060

1 the charity, that 100 percent of the stock was, in
2 fact, 100 percent of the company.

3 Q And that conclusion was, therefore, transmitted to
4 the appraisal committee?

5 A Yes, it was.

6 Q And to your knowledge was that included in the
7 appraisal committee report?

8 A Yes, it was.

9 Q And, therefore, adopted by the appraisal
10 committee?

11 A Yes, it was.

12 Q I'd like to ask you a few questions now about
13 prior transactions that you have been asked by
14 Mr. Williams. Were you also as a part of your
15 duties and assignments asked to conduct an
16 evaluation and review of prior transactions
17 between United Wisconsin Services and Blue
18 Cross/Blue Shield United of Wisconsin?

19 A We were.

20 Q Can you describe generally and briefly what that
21 consisted of -- what that review consisted of?

22 A Yes. There was a -- We started with a -- a list
23 of transactions that I believe was referenced
24 earlier in this hearing, and we looked at a number
25 of those transactions as well as certain other

0061

1 transactions that came to our attention upon
2 talking to the company, and we looked at
3 transactions broken down into -- into three
4 different categories, those that occurred prior to
5 1991 in particular October 24th of 1991 and those
6 that took place after that date. We broke those
7 into two pieces, those that -- that were
8 transactions intracompany meaning within Blue
9 Cross/Blue Shield United itself or within United
10 Wisconsin itself.

11 Those were one category, and then the other
12 category were ones that crossed over the corporate
13 boundaries between United Wisconsin and Blue
14 Cross/Blue Shield United.

15 Q Did you -- In conducting that review did you
16 undertake an evaluation as to whether or not Blue
17 Cross/Blue Shield United of Wisconsin was in any
18 way financially hubbed by the transfer of those
19 companies?

20 A Our review was to look at essentially those
21 transactions and determine and examine whether any
22 issues there that led to -- I'll call it any
23 leakage of value of those transactions out of Blue
24 Cross into United Wisconsin.

25 Q And did you also determine whether or not there

1 was any value received by Blue Cross through its
2 investment in an ongoing relationship with United
3 Wisconsin Services?

4 A Yes, we did look into that issue.

5 Q Do you recall what your conclusions were, if any?

6 A Our conclusions of an analysis that was referenced
7 in the -- in the appraisal committee's report and
8 is included in or -- our materials was that in --
9 in the aggregate in the transactions that took
10 place between Blue Cross/Blue Shield, United
11 Wisconsin Services that there was a net benefit of
12 approximately \$117,000,000 to Blue Cross in
13 aggregate interest in those transactions.

14 Q Did you have an opportunity to review all of the
15 minutes of the appraisal committee for the
16 conversion?

17 A Yes, we did.

18 Q Did you have an opportunity to correct or -- if
19 necessary, any of the minutes?

20 A We were given that opportunity.

21 Q And I take it now you've reviewed all of those
22 minutes?

23 A I believe we have except perhaps maybe the last
24 meeting for the whole prior event, yes.

25 Q And to the extent that you're quoted or para-

0063

1 phrased in those minutes, I take it since you've
2 had an opportunity to correct you would conclude
3 that your statements in those minutes are
4 accurate?

5 A Yes, I would.

6 MR. WILLIAMS: Excuse me, Commissioner.
7 What is the purpose of asking all these questions
8 if -- if all this information is already in the
9 public record?

10 COMMISSIONER O'CONNELL: Mr. Bablitch?

11 MR. BABLITCH: Foundation questions to show
12 that as we go through this process that the
13 minutes will become a part of the record, that
14 Mr. Johnson is quoted extensively throughout the
15 minutes.

16 I want the record to reflect that he's had a
17 chance to review and correct them if necessary and
18 he hasn't, and I take it that since the record
19 should be correct, I want to make sure that it is.

20 COMMISSIONER O'CONNELL: I will allow the
21 question, however, I should note we have gone past
22 12:30, but in fairness to the applicant we do need
23 to allow additional time for questions, but could
24 we move through it as quickly as possible?

25 BY MR. BABLITCH:

0064

1 Q And have you reviewed the final report of the
2 appraisal committee for the conversion of Blue
3 Cross/Blue Shield?

4 A Yes, we have.

5 Q Did you have any part in making any of the
6 recommendations that follow on at the conclusion
7 of that report?

8 A We had -- Based on the material that we provided
9 to the appraisal committee and some of the -- the
10 issues that arose in discussion we had some -- we
11 did have some role in the creation of those
12 recommendations, yes.

13 Q And the purpose of those recommendations was to
14 make sure that the foundation can be reasonably
15 assured to realize the full, fair and reasonable
16 value of the 100 percent Blue Cross?

17 A That is the goal of the recommendations.

18 Q Are there any recommendations -- And I take it
19 these -- these recommendations are offered to the
20 Commissioner as potential conditions for the
21 conversion if that should occur or don't you know?

22 A I don't recall specifically, but I believe that
23 would be correct.

24 Q And the conditions that are incorporated in this
25 document, are they designed to make sure that

1 there is reasonable, full and fair value?

2 A I'm sorry, as to what?

3 Q The recommendations. You've read them, correct?

4 A Yes, I have.

5 Q And they are designed, I take it, to make sure
6 that the full and reasonable value is -- to the
7 foundation is obtained?

8 A That is the goal.

9 Q Can you give me any examples of conditions that
10 could be imposed that would do the opposite?

11 A I suppose I could. I'm not sure it's appropriate
12 and necessary, but I could.

13 Q Well, that's my question. In other words, are
14 there -- Are there things that could be done that
15 would have the opposite effect of realizing full
16 and fair value?

17 A Sure. The Commissioner could decide, if she
18 wanted to, not to adopt the recommendations of the
19 committee and let the corporate governance issues
20 revert to those that were proposed by the company
21 personally.

22 MR. BABLITCH: Nothing further.

23 COMMISSIONER O'CONNELL: Thank you. Have
24 all exhibits been offered that are --

25 MR. BABLITCH: I would offer Exhibits B-15

1 and B-16.

2 MR. WILLIAMS: I would offer Exhibit J-1 I
3 think it was.

4 COMMISSIONER O'CONNELL: Thank you. You're
5 done. Okay. This hearing will be continued on
6 March 10th from nine a.m. until four p.m.

7 The March 10th hearing will be held at the
8 same location as today which is the Holiday Inn,
9 3841 East Washington Avenue, Madison, Wisconsin.

10 The hearing record will remain open to
11 permit me to consider the testimony received.
12 This hearing is now in recess until March 10th at
13 nine a.m. and the time presently is 12:39.

14 (The hearing adjourned at 12:39 p.m.)

15

16

17

18

19

20

21

22

23

24

25

1

2 STATE OF WISCONSIN)

) SS:

3 COUNTY OF MILWAUKEE)

4 I, KELLY L. PIERCE, a Registered
 5 Professional Reporter, with the firm of Halma-Jilek
 6 Reporting, Inc., 225 East Michigan Avenue, Suite 404,
 7 Milwaukee, Wisconsin, 53202, do hereby certify that I
 8 reported the foregoing proceedings had on February 25,
 9 2000, and that the same is true and correct in
 10 accordance with my original machine shorthand notes
 11 taken at said time and place.

12

13

14

15

16

Kelly L. Pierce

17

Registered Professional Reporter

18

19

Dated this 3rd day of March, 2000

20

Milwaukee, Wisconsin

21

22

23

24

25