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

December 9, 1999
Conference Rm. 6 of the Lake Terrace State Office Building
121 East Wilson Street
Madison, Wisconsin

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

OCI staff members present: Guenther Ruch, Fred Nepple, Julie Walsh, and Steven Junior

Representatives of Deutsche Banc Alex. Brown: Thomas W. Johnson, Giles E. Harrison, and Kenneth M. Trujillo

Other members of the public present: Stephen E. Bablitch, L. Jane Hamblen, Gail L. Hanson, Brian S. Kaas, Christie Voss, and Wade M. Williams

Prior to the meeting, each Appraisal Committee member, OCI staff member, and public attendee received a packet of documents, including a draft agenda, draft minutes for the meeting of November 24, 1999, and a letter from Blue Cross & Blue Shield United of Wisconsin to OCI dated December 7, 1999.

The Appraisal Committee meeting commenced shortly after 9:00 a.m.

Discussion began with a review of the proposed minutes of the November 24, 1999, meeting. Mark Femal noted that the members of the Appraisal Committee had no opportunity to review the draft minutes, because they had just received them this morning. After brief discussion, it was unanimously agreed that the committee members would contact Guenther Ruch no later than the afternoon of Friday, December 10, 1999, concerning their view upon the minutes. OCI staff would poll the committee members concerning any proposed changes. If no changes were suggested by the afternoon of Friday, December 10, 1999, the minutes would be considered adopted and will be posted to OCI's website.

Mark Femal introduced the agenda for today's meeting, and asked if anyone on the committee had any changes to suggest. The committee approved the agenda by consensus.

Discussion turned to the recent hearings in the matter of the Application for Conversion of Blue Cross & Blue Shield United of Wisconsin (Case No. 99-C26038) that were held in Milwaukee on Monday, November 29, 1999, and in Stevens Point on Tuesday, November 30, 1999. Patricia Lipton asked OCI staff for information on comments made at the hearings that related to valuation issues. Steven Junior stated that the amount of testimony in the public and informational hearings related to valuation matters was relatively limited, but there were portions of both hearings, particularly in the Class 1 Contested Case Administrative Hearing, that would certainly be of interest. Steven Junior offered to send the committee members copies of those portions of the transcripts that related to testimony on valuation matters. Guenther Ruch stated that it would be OCI's intention to provide the committee members and the public a complete copy of the transcripts on OCI's web site. Fred Nepple interjected that OCI was not yet in a position to distribute copies of the transcript due to copyright issues. After some discussion, Steven Junior stated that he would distribute the hearing transcripts to the committee members with written suggestions on testimony that very specifically and directly concerns valuation matters, once the copyright issues noted by Fred Nepple had been resolved.

Mark Femal recognized the representatives of Deutsche Banc Alex. Brown, to discuss their impressions on each item of the list entitled, "Issues Concerning Valuation for the Appraisal Committee for the Conversion of Blue Cross & Blue Shield United of Wisconsin (Case No. 99-C26038)." This list is the working list of issues that the Appraisal Committee has chosen for its consideration. It was decided that the investment bankers should take each issue in turn, and the members of the Appraisal Committee would ask questions or make comments as they chose. Mr. Johnson of Deutsche Banc lead the discussion. He cited Issue #1 as follows:

> "Will the public health foundation's ownership of 100% of the issued and outstanding common stock of United Heartland Group, Inc. constitute the full value of Blue Cross & Blue Shield United of Wisconsin? Factors that the Appraisal Committee should consider in its deliberations on this question include:
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> a. While the public health foundation will receive all 10,000,000 of the issued and outstanding common shares of United Heartland Group, Inc. that are issued initially, United Heartland Group, Inc. is authorized to issue up to 50,000,000 common shares.
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> b. The effect that the issuance of additional shares by United Heartland Group, Inc. may have on values realized by the public health foundation on the sale of its shares.
>
> c. The effect that the purpose for the issuance of additional shares by United Heartland Group, Inc. may have on the valuation of common shares owned by the public health foundation."

Mr. Johnson expressed the view that ownership of 100% of a company's stock is generally regarded as ownership of 100% of that company's value. The matter of past intercompany transactions was raised pertaining to their impact on the value of Blue Cross. Mr. Johnson indicated his firm would conduct a review of historical information related to transactions with affiliates to assure that full ownership constituted full value.

Mr. Johnson indicated that the proposed number of authorized shares exceeds the initial number issued and outstanding is quite normal, and not in itself any cause for concern. When a corporation needs to raise additional capital to grow or support the balance sheet, it must be able to act quickly. Giles Harrison of Deutsche Banc noted that the proposal provided for blank check preferred stock, and that authorization of this type of preferred stock was common. Mr. Harrison continued that his firm would prepare additional information on the options that blank check preferred stock afford a corporation.

Mr. Johnson resumed discussion, commenting that the effect that the issuance of additional shares has upon the existing shareholders depends upon the context in which they are issued and the purposes to which capital raised in the issuance is applied. Purposes that are accretive to earnings benefit all shareholders, while activities that are dilutive to earnings, or perceived as dilutive to earnings, diminish value for existing shareholders.

Mr. Johnson then referred to Issue #2 in general terms. Issue #2 reads in full as follows:

> "The plan of conversion filed with this Office requires the charitable public health foundation to reduce its holdings in United Heartland Group, Inc. on a divestiture schedule. The foundation's ownership percentage must decline to less than 80% by September 30, 2001; less than 50% within 3 years of closing, or December 31, 2002 if the closing occurs on its intended date; and less than 20% within 5

> years of closing, or December 31, 2004. What impact can the divestiture schedule be expected to have on the public health foundation's efforts to realize a fair and reasonable amount in exchange for its common stock? How do the divestiture requirements compare with those of other Blue Plan conversions?"

Mr. Johnson informed the Appraisal Committee that his team is in the process of gathering data on divestiture schedules applied in other Blue Plan conversions. As a general rule, anyone selling shares under compulsion is at a disadvantage. However, the disadvantage in such cases can be mitigated by the corporation's operational success and management assistance. Increased liquidity in the later phases of the divestiture may also substantially mitigate the disadvantage.

Mark Femal asked how a sale of shares by United Heartland Group, or, in the event of a merger, by a successor, for its own account during the same period as the foundation's divestiture would affect the amount that the foundation would realize.

Mr. Johnson responded that the interests of the foundation require that the capital needs of the stock corporation should usually come before the capital raising efforts of the foundation. Failure to permit the insurance holding company timely access to needed capital could impair the value of the foundation's remaining stock. This impairment would likely outweigh any immediate advantage that might be obtained from selling a portion of its holdings more quickly.

Randy Blumer noted that a cooperative relationship between the management of the stock holding company and the board of the public health foundation would prove important to the success of both organizations. Mr. Johnson affirmed this point of view, but stated that the rights of the foundation to demand registration for the sale of its shares was something that would be closely studied by the investment banking team. Randy Blumer suggested that a review of comparable Blue Plan conversions would aid in understanding the way in which registration rights should be constructed and applied in Wisconsin.

Mr. Johnson agreed, noting that the Wellpoint example in California offered an example of piggyback registration rights, whereby Wellpoint and its nonprofit shareholders sold stock simultaneously. Giles Harrison explained that Wellpoint had gone so far as to sell convertible debt, which was then used to repurchase shares from the California Health Care Foundation.

For the committee's clarification, Guenther Ruch noted that the nonprofit owners of Wellpoint had to work within a divestiture schedule, and inquired whether previous Blue Plan conversions offered any pattern of the impact that an overhang could have on stock prices realized by nonprofit foundations.

Mr. Johnson responded by reiterating that a gradual increase in liquidity can mitigate the effects of overhang at the beginning of the process. Institutional investors want to know they can get out after getting in. Because the initial offering of Wellpoint was fairly large, the effect of overhang was mitigated. In the instance of Trigon, the immediate and broad distribution of shares among policyholders bypassed the overhang issue altogether. When a divestiture schedule is in place, hedge funds will short shares into the marketplace and cover on the offering. The Deutsche Bank team will review whether more flexibility in the divestiture schedule would be desirable.

Mr. Johnson then referred to Issue #3, which reads as follows:

> "What effect do the provisions contained in the Application, including the requirements of the BlueCross BlueShield Association, pertaining to control or change in control have on the value of the common stock donated to the public

health foundation and to the public interest? Factors that the Appraisal Committee should consider in its deliberations on this question include:

a. Under the United Heartland Group's articles of incorporation, shareholders have no right to remove any director or the whole board unless the director or the entire board is convicted of a felony or found liable for gross negligence or willful misconduct in a matter of substantial importance to the corporation, where such adjudication is no longer subject to direct appeal. Even then, the holders of 75% of the issued and outstanding common shares must vote in the affirmative to remove the director or offending board. Consideration should be given to how such governance provisions compare to other health insurance companies in general, and to other converted Blue Plans in particular.

b. Under Article IV of the United Heartland Group's articles of incorporation, each director has immunity for breach of fiduciary duty on any votes for or against any proposal or course of action that, in his judgement, would breach any requirement of the BlueCross BlueShield Association or lead to the termination of any license issued by that organization. In the Voting Trust and Divestiture Agreement, the public health foundation is required to assert in the recitals that the Blue Cross and Blue Shield licenses will contribute substantially to the United Heartland Group's value and its future prospects.

c. Under the Voting Trust and Divestiture Agreement, the public health foundation is not permitted to solicit or encourage any inquiries or proposals relating to the sale of any of the stock holding company's common shares until any such proposal is approved by the stock holding company's board of directors.

d. Section 11 of the Registration Rights Agreement allows the stock holding company to negotiate for the sale of all or part of the public health foundation's share holdings through a private placement.

e. Section 4 of the Registration Rights Agreement allows the stock holding company to match the price per share negotiated in a private placement.

f. The proposed public health foundation has no preemptive or preferential rights to purchase or subscribe to the stock holding company's common or preferred shares.

g. The effect that ownership by an Employee Stock Ownership Plan or other employee benefit plan would have on the valuation of United Heartland Group, Inc.

h. The effect of ownership limitations applicable to retail and institutional investors of one share short of 5% and one share short of 10%, respectively, would have on the valuation of United Heartland Group, Inc."

Mr. Johnson responded to each factor in turn. The Deutsche Bank team will contact the BlueCross BlueShield Association to understand the concerns with respect to change in control. Generally, if a company is seen as takeover-proof, it will trade at a discount. Deutsche Bank will get back to the committee with information on how the proposed structure of corporate governance compares to corporations generally, and to other converted Blue Plans in particular. The proposed private placement registration rights will be studied. The existence of a right of first refusal may cause outsiders to bid less aggressively. The lack of preferential purchase rights is unimportant, since the public health foundation's drive will be to sell, not to buy. The team would check on the existence and form of ESOPs at the other converted Blue Plans. ESOPs are often a good way for companies to give employees a sense of participation, incentive to work, and pride of ownership. The probable effect of the ownership limitations will be studied.

Issue #4 reads as follows: "What is the value of the Blue Cross and Blue Shield service marks as an intangible asset?" Mr. Johnson stated that the value of the Blue Cross and Blue Shield trademarks varies from plan to plan based upon the public perceptions cultivated by each plan through its manner of operation.

Mr. Johnson then referred to Issue #5, which reads as follows:

> "What effect, if any, can past and present transactions among Blue Cross & Blue Shield United of Wisconsin and its affiliates be expected to have on the valuation of United Heartland Group, Inc.? Factors that the Appraisal Committee should consider in its deliberations on this question include:

a. The value of the subsidiaries Blue Cross & Blue Shield United of Wisconsin transferred to United Wisconsin Services, Inc. in relation to the consideration it received.

b. The consideration Blue Cross received in exchange for the return of all of the cash dividends it received from United Wisconsin Services, Inc. prior to March 31, 1995.

c. In 1992, many Blue Cross employees were transferred to United Wisconsin Services, Inc., and Blue Cross began to reimburse United Wisconsin Services, Inc. for the use of employees.

d. The consideration Blue Cross received for its provision of credit guarantees for its subsidiaries and for its $70 million loan to United Wisconsin Services, Inc.

e. The investment Blue Cross has made in subsidiaries and affiliates through capital contributions.

f. The impact of existing service, management, cost allocation, and other written agreements among members of Blue Cross' holding company system on the valuation of United Heartland Group, Inc.

g. The impact that the existence of shareholders with a significant percentage of ownership in United Wisconsin Services, Inc. and American Medical Security, Inc., if any, could have on the valuation of United Heartland Group, Inc."

Randy Blumer noted that the list of factors under Issues #3 and #5 should not be regarded as all-inclusive.

Mr. Johnson said that the Deutsche Bank team would take guidance from the Appraisal Committee and OCI on what specific matters to look at. Mr. Johnson stated that it does not appear on its face that the public shareholders of the downstream subsidiaries received any benefit in excess of that justified by the pro rata share of their ownership in the downstream subsidiaries.

Mr. Johnson indicated that most transactions among affiliates require regulatory review, and that regulators typically do a decent job of reviewing such matters.

Mark Femal raised the issue that Blue Cross made a $70 million loan to United Wisconsin Services, and that it extended credit guaranties to various subsidiaries. For the committee's information, Fred Nepple noted that the BlueCross BlueShield Association requires credit guaranties in order for downstream subsidiaries to use the Blue Cross and Blue Shield service marks.

Randy Blumer emphasized that the Appraisal Committee is only interested in a review of material transactions and relationships, not every day-to-day transaction.

Mr. Johnson stated that dissecting past transactions exhaustively would not be particularly useful. What is now is what there is. A backward look does not help in thinking about the foundation's efforts to achieve liquidity now, and to achieve fair and reasonable value for what it owns. If a merger occurs between United Heartland Group and United Wisconsin Services, the service agreements will be rendered meaningless. From the vantage point of the public health foundation, they will constitute internal cost allocations among units of the same corporation. One must take care not to get lost in details.

Mr. Johnson then referred to Issue #6, which reads as follows:

> "How would each of the various principal alternatives for monetizing the public health foundation's stake in United Heartland Group, Inc. impact valuation? What effect does the existence of two publicly traded corporations within the holding company system, namely United Wisconsin Services, Inc. and American Medical Security, Inc., have upon the valuation of United Heartland Group, Inc.?"

Mr. Johnson emphasized the importance of issue #6. The specifics of each alternative do matter with respect to the ultimate outcome. Mr. Johnson stated that his team would be looking at the proposal's various monetization alternatives and provide comment on their potential impact.

Mark Femal raised the issue of the public health foundation's lack of cash under the proposed conversion plan. Steven Junior responded that United Heartland Group would pay the public health foundation a $2,000,000 dividend. The funds would originate from an extraordinary dividend from Blue Cross. This $2,000,000 should serve to prevent compulsive sales from desperation.

Mark Femal raised the issue of the medical schools' plan to make a combined $32 million in initial outlays prior to accumulating funds for endowment. In response, Guenther Ruch stated that the $32 million in question is intended for outlays on programs, not organizational expenses. Mr. Johnson said that the public health foundation would likely see this $32 million as a capital need, alongside the financing requirements of the United Heartland Group's businesses. Patricia Lipton indicated that, in connection with evaluating alternatives for converting the foundation's stock to cash, the committee should look at the medical schools' capital needs with respect to the first phase of their public health initiatives. Mr. Johnson said that the foundation should think of the appropriate size for its initial share offering. Mark Femal asked OCI staff to obtain clarification as to timing, expectations, and the true capital needs of the program initiatives. Fred Nepple advised the committee that the specific purposes for which the conversion funds are to be disbursed are not within the committee's mission. Randy Blumer agreed, stating that the divestiture schedule, not the programs themselves, should be of concern to the Appraisal Committee. Mr. Johnson indicated that it is important to understand the needs of the beneficiaries in managing the company's needs.

Discussion turned to Issue #7, which reads as follows: "What are the conditions of the marketplace for health insurance equities in general, and the valuations being accorded to previously converted Blue Plans in particular?"

Mr. Johnson provided copies of certain charts and graphs to the committee members and most of those present. Mr. Johnson, assisted from time to time by Giles Harrison, highlighted various facts on market conditions for managed care companies in the recent past and at present. The range of market capitalizations, enterprise values, and membership valuations were discussed. Profit margins and growth tracks embedded in the business and membership are critical factors in the valuations that investors accord managed care companies.

Mr. Johnson described the range of price to book value relationships and price earnings ratios. Market participants anticipate earnings in evaluating companies. It was noted that United Wisconsin Services, at 24.5 times estimated 2000 earnings per share, has the highest price/earnings ratio of any managed care company. In part, this is due to anticipated acquisition premium. Takeover speculation always has a positive impact on share prices. The median price to book multiple among managed care companies is 1.3, a level that is within the usual range historically. United Wisconsin Services and American Medical Security, Blue Cross' publicly traded affiliates, have price to book multiples of 1.6 and 0.4, respectively. Brief mention was made of cash flow multiples and value per member.

Mr. Johnson noted that stocks in the managed care sector were 20% to 30% higher only 6 months ago. People had very good expectations for growth. Since then, however, litigation and legislative changes have very adversely affected valuations for these companies, although Blue Plans have not been hurt quite as much as other managed care companies.

Mr. Johnson turned the committee's attention to a series of charts that summarize the market performance of Blue Plans, other managed care companies, the property & casualty insurance sector, and the Standard & Poor's 500 index. Historically, publicly traded Blue Plans have outperformed the S&P 500 and the other two insurance indexes. However, circumstances have caused recent experience to recede toward the S&P 500, though it is not all of the way there yet. At the present time, non-Blues managed care companies are struggling to stay even. Earlier, they had been able to cherry-pick the healthier subsets of the population. With their current market penetration, however, such companies mirror the overall health status of their respective communities. It was in connection with the review of the performance charts that Mr. Johnson noted that the Donaldson, Lufkin, & Jenrette analysis of Blue Cross' value, upon which public discussion had been based, was performed just prior to this sector's recent peak, and the market has changed since that time.

The meeting was adjourned for a break shortly before 11:00 a.m. The Appraisal Committee reconvened at 11:17 a.m.

Resuming the course of discussion prior to the break, Guenther Ruch asked if we have seen the bottom in the market for managed care companies. Mr. Johnson replied that one can never call a stock market bottom until it has passed. The managed care industry can expect to face legislative challenges going into an election year. Legislation is changing business fundamentals. If the companies do not have the ability to raise rates, we have not hit the bottom. There is a broadening of exposure to mandated benefits.

Mark Femal requested an assessment of where American Medical Security, United Wisconsin Services, and Blue Cross & Blue Shield United of Wisconsin stand relative to the Wisconsin marketplace. Mr. Johnson confirmed that this would be done.

Randy Blumer stated that a distinction exists between the issues facing managed care companies in Wisconsin and the Nation generally. Mr. Johnson agreed that features distinguishing the Wisconsin marketplace had to be taken into account.

Mr. Johnson indicated his understanding that the Appraisal Committee would not seek a concrete value number. The stock to be held by the public health foundation will have a value that is equal to what is actually achieved when it is achieved.

Mark Femal referred to the testimony of David Platter, a managing director with Donaldson, Lufkin, & Jenrette, at the November 29 hearing in Milwaukee. A range of valuation had been provided. Mr. Fremal opined that the public might desire a fixed value to be placed on the stock to be held by the public health foundation.

Randy Blumer responded that numerous alternatives for the foundation's realization of value are presented in the conversion plan, thus making any fixed valuation of little or no value.

Patricia Lipton indicated that it was her understanding that the investment bankers at Deutsche Bank would study the issues originating from the committee and from their own review, and prepare a summary of structural issues and recommendations. Mr. Johnson confirmed that this had been his understanding. Mr. Johnson said it must be remembered that a successful result will depend not on each and every detail of the plan taken in isolation, but rather, how the details together form the whole picture.

Mark Femal revisited the concept of the committee arriving at a fixed valuation. Mr. Femal inquired of his fellow committee members and the representatives of Deutsche Bank whether or not, if a fixed value cannot be concluded, a range of fair value should be provided in the Appraisal Committee's report.

Randy Blumer said that he did not believe the Appraisal Committee's report should contain a specific valuation, but that the report would include comments and recommendations concerning the plan.

Patricia Lipton said that if any specific dollar valuation figures would be provided, they would have to be expressed in the form of a range, not as a fixed point. The report should focus on making comments and recommendations on the integrity of the process proposed to realize value for the foundation.

Mr. Johnson said that valuation is as of a specific date in time. The value appropriate at one time may be too high or too low at some point in the future. A valuation could be done for the Appraisal Committee, but the achievement of a higher or lower number than appraised at the time of the conversion would not validate that fair and reasonable value was ultimately received. Deutsche Bank has experience in providing analysis and comment on the propriety of the procedures employed during public offerings, and could prepare such an analysis if the Appraisal Committee considered it necessary.

Mr. Johnson went on to discuss a lack of clarity in the Application for Conversion on the future relationships between American Medical Security, United Wisconsin Services, and Blue Cross. Will United Wisconsin Services be taken private prior to merger? Will a merger proceed with the result of a publicly traded stub? These alternatives have a real impact on value, and the Deutsche Bank team will seek clarification on this issue. A decision to merge United Heartland Group and United Wisconsin Services, and leave a publicly traded stub outstanding means that United Heartland Group will be made public, not taken public.

Committee chairman Mark Femal asked Mr. Johnson if there were any issues or comments that he had for the committee in response to Issue #8. Issue #8 reads, "Are there any restrictions that should be imposed or removed to improve the likelihood that a fair and reasonable value is realized by the public health foundation in exchange for its shares?" Mr. Johnson indicated that more study was needed before he would be prepared to comment.

Led by Mark Femal, discussion turned to courses of action and specific work assignments. After an exchange of ideas, the committee established the following:

a. The members of the committee would inform Guenther Ruch, or secondarily, Steven Junior, of any changes to the minutes of November 24, 1999. If there were no changes suggested by the afternoon of Friday, December 10, 1999, the minutes would be posted to OCI's website.
b. Guenther Ruch would prepare a general format for the Appraisal Committee's eventual report so that it can be evaluated at the next meeting.
c. The Deutsche Banc Alex. Brown investment banking team would prepare a work plan in consultation with OCI and make initial contacts with Blue Cross management and Blue Cross' investment banking team from Donaldson, Lufkin, & Jenrette.
d. Steven Junior would work with the committee members to establish times available for future meetings of the committee.
e. Steven Junior would review the requests of the committee at the November 5, 1999, meeting, and report back, fulfilling any remaining requests, if possible.
f. Steven Junior would distribute the hearing transcripts to the committee members with written suggestions on testimony that concerns valuation matters, once the copyright issues noted by Fred Nepple had been resolved.
g. Steven Junior would modify the Appraisal Committee's working list of issues to include consideration of blank check preferred stock, the option of a merger between United Heartland Group, Inc. and United Wisconsin Services, Inc., and reword issue #8 to more clearly reflect the committee's mission. These changes would be made in consultation with Randy Blumer, and distributed to the committee's members early next week.

The next meeting of the Appraisal Committee was set for Friday, December 17, 1999, from 9:00 a.m. to 12:00 p.m. (Noon).

Mark Femal inquired of the committee and OCI staff as to any other business. Randy Blumer made the motion to adjourn, which was seconded by Patricia Lipton and carried unanimously. The committee adjourned at 11:52 a.m.