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CLIENT/MATTER NUMBER
016125-0107

January 16, 2001

VIA HAND DELIVERY

Commissioner Connie L. O'Connell
Office of the Commissioner of Insurance
121 East Wilson Street
P.O. Box 7873
Madison, WI 53707-7873

Re: Blue Cross Conversion – Compliance with Order

Dear Commissioner O'Connell:

This letter documents the compliance of Blue Cross & Blue Shield United of Wisconsin ("BCBSUW") with the terms and conditions of the Commissioner's Order, dated March 28, 2000, and based thereon BCBSUW seeks to obtain the Commissioner's final approval to proceed with the conversion. As indicated in detail, BCBSUW has now complied with each and every requirement in the Commissioner's Order.

It is our preference to complete the review and approval process by January 28, 2001, in order to accommodate a proxy mailing by such date for the exchange transaction between United Wisconsin Services, Inc. ("UWS") and the Wisconsin United for Health Foundation, Inc. ("Foundation"), through its wholly-owned holding company. Since the SEC has indicated that it will not be reviewing the S-4 filing of UWS for the exchange transaction, OCI's approval is the principal remaining condition to be satisfied prior to effecting the proxy mailing. The timing for the proxy mailing will allow BCBSUW to rely on third quarter financials and satisfy the conversion deadline under your Order. Delay in your review and approval could jeopardize completing the exchange transaction by the March 28, 2001 deadline imposed by you. BCBSUW believes it is in the public's interest to complete this transaction as described in the S-4 and fund the Foundation.

Although OCI was already in the process of reviewing the S-4 which contains the formal Exchange Agreement and the various Conversion Application documents, as revised to comply with your Order, we understand that OCI requests a written explanation of BCBSUW's compliance with the Order. Accordingly, this letter outlines BCBSUW's compliance with the

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requirements identified in the three distinct sub-sections of the Order, namely, Foundation Governance, Accountability for Distribution of Funds, and Conversion Process.

I. Foundation Governance

On January 10, 2001, I submitted to OCI Amended and Restated Articles of Incorporation and Amended and Restated Bylaws for the Foundation (formerly known as the Blue Cross & Blue Shield United of Wisconsin Public Health Foundation, Inc.). Copies of such revised documents are enclosed, including black-lined copies which illustrate the changes from the originally filed documents (with one additional revision that is noted below in Item 5). Compliance with the terms and conditions of the Order regarding "Foundation Governance" is noted as follows:

1. Order §§ 1(1), (2), (3), (4), (6), and (7). BCBSUW has complied with the requirements of these provisions in the Order. See Amended and Restated Bylaws, Article III, which addresses the Commissioner's authority to appoint the initial Foundation Directors, to fill vacancies in accordance with the exact requirements of the Order, and to establish the terms of the Directors.
2. Order § 1(5): *Conversion Funds Distribution*. BCBSUW has complied with the requirements of this provision in the Order. See Amended and Restated Bylaws, Article III, Section 10, which incorporates the exact requirements of the Order.
3. Order § 1(8): *Open Meetings and Records Required*. BCBSUW has complied with the requirements of this provision in the Order. See Amended and Restated Bylaws, Article III, Section 6(d), which requires the Foundation to conduct itself in compliance with Wisconsin public meeting and public record laws.
4. Order § 1(9): *Audits, Reports and Examination*. BCBSUW has complied with the requirements of this provision in the Order. See Amended and Restated Bylaws, Article V, which incorporates the requirements in the Order.
5. Order § 1(10): *Accountability for Distribution of Funds*. BCBSUW has complied with the requirements of this provision in the Order. See Amended and Restated Bylaws, Article III, Section 1, which limits the authority of the Foundation board in compliance with this provision of the Order. (Note that this represents an additional change from the documents submitted on January 10, 2001.)
6. Order § 1(11): *Name*. BCBSUW has complied with the requirements of this provision in the Order. In accordance with OCI's approval of the name change of the Foundation, Article I of the Amended and Restated Articles of Incorporation and the Amended and Restated Bylaws reflect the change of name of the Foundation to "Wisconsin United for Health Foundation, Inc."
7. Order § 1(12): *Amendment of Articles*. BCBSUW has complied with the requirements of this provision in the Order. See Amended and Restated Articles of Incorporation, Article VII, and Amended and Restated Bylaws, Article IX, which incorporates the requirements of the Order.
8. Order § 1(13): *Board Removal*. BCBSUW has complied with the requirements of this provision in the Order. See Amended and Restated Bylaws, Article III, Section 4, which incorporates the requirements of the Order.

II. Accountability for Distribution of Funds

I understand that representatives from the Medical College of Wisconsin and the UW Medical School, respectively, have been working directly with OCI to draft the governing documents for the Public and Community Health Oversight and Advisory Committees ("PCHOAC") in order to satisfy the requirements of the Order. BCBSUW recognizes OCI's desire that the operation of each PCHOAC be completely independent of BCBSUW, and BCBSUW has consequently taken no role in the drafting process. However, since the Order contemplates such documents being filed, we have again contacted each medical school and requested that they immediately file the governing documents.

III. Conversion Process

I have enclosed original and black-lined versions of the following Conversion Application documents, as amended to comply with the terms and conditions of the Order: (1) Cobalt Corporation Articles of Incorporation ("Cobalt Articles"), (2) Cobalt Corporation Bylaws ("Cobalt Bylaws"), (3) the Registration Rights Agreement, and (4) the Voting Trust and Divestiture Agreement ("Voting Trust"). Compliance with the terms and conditions of the Order regarding the "Conversion Process" is noted as follows:

1. Order § 3(1): *Mechanism to Ensure Adequate Short Term Liquidity for the Foundation and/or Meet BlueCross BlueShield Association Requirements.* BCBSUW has complied with the requirements of this provision in the Order. See Voting Trust, Article I, sections (r) and (bb), which amend the definitions of the terms "Five Year Divestiture Deadline" and "Three Year Divestiture Deadline" in compliance with the requirements of the Order. The term "Blackout Period" has also been modified in the Registration Rights Agreement not to exceed 120 days (see Section 6 in the Registration Rights Agreement).
2. Order § 3(2): *Tighter Governance Structure to Better Align Interests Between the Foundation and UHG.*
 - a) *Foundation change in control rights.* BCBSUW has complied with the requirements of this provision in the Order. See Section 4.03(c) in the Voting Trust, which already satisfied this requirement in the Order.
 - b) *Foundation right to join litigation.* BCBSUW has complied with the requirements of this provision in the Order. See Section 5.06 in the Voting Trust, which has been amended to incorporate the requirements of the Order.
 - c) *Foundation demand rights.* BCBSUW has complied with the requirements of this provision in the Order. Various sections of the Registration Rights Agreement have been modified to satisfy the requirements of the Order. The definition of the term "Effective Period" has been revised to commence as of the closing date. Section 2 of the Registration Rights Agreement has been modified to incorporate the requirements with respect to demand registrations. Section 3 of the Registration Rights Agreement has been modified to incorporate the requirements with respect to piggy-back rights. Section 6 of the Registration Rights Agreement has been modified to

address a black-out period not to exceed 120 days. Last, Section 9 has been modified to satisfy the requirements with respect to registration-related expenses.

- d) *Foundation observation rights.* BCBSUW has complied with the requirements of this provision in the Order. See new Section 5.07 in the Voting Trust, which has been incorporated into the Voting Trust to satisfy the requirements of the Order. Concerning observation rights, the Foundation, through an authorized representative, has specifically been granted the right to attend and observe all Cobalt Corporation board meetings, including any executive sessions. As to consultation rights, Cobalt Corporation must consult with the Foundation prior to soliciting any change of control proposal (other than a combination with UWS) or in the event Cobalt Corporation receives any change of control proposals. In each case, these rights will remain in place for so long as the Foundation beneficially owns 20% or more of Cobalt Corporation's capital stock.
- e) *Independent stockholders elect directors.* BCBSUW has complied with the requirements of this provision in the Order. Regarding the reduction of the Independent directors (as defined in the Cobalt Articles) on the Cobalt Corporation board from 80% to 50%, see Cobalt Articles, Article III, Section 4, which has been modified to satisfy the Order by reducing the initial 80% to 50% in proportion to the decrease in stock beneficially owned by the Foundation. With respect to a mechanism "that provides an effective and reasonable means for the nomination and election by non-foundation stockholders of truly independent directors," a number of observations are relevant. First, as part of the exchange transaction incident with the conversion, the slate of directors of Cobalt Corporation post-conversion is subject to shareholder approval. Of the nine contemplated directors for Cobalt Corporation post-conversion (as identified in the S-4 previously submitted to OCI), three are wholly independent from BCBSUW and currently represent the public shareholders of UWS. To proceed with the exchange transaction and the conversion, the transaction must be approved by the highest vote required under Wisconsin law for a similar transaction – the affirmative vote of (i) 80% of the outstanding shares of UWS common stock, and (ii) 66 2/3% of the outstanding shares of UWS common stock which are not owned by BCBSUW. Accordingly, the entire Cobalt Corporation Board post-conversion, which will be comprised of 6 "Independent directors" (as defined in the Cobalt Articles) and three directors who are "independent" as contemplated in the Order, is subject to approval by a majority of the non-BCBSUW public shareholders as part of the approval for the exchange transaction. Second, Section 3.04 of the Cobalt Bylaws already contains a customary provision for public companies which allows for nomination of director candidates by shareholders. Third, the Voting Trust has been amended (see Voting Trust, Section 4.03(d)) to include a mirror voting provision which, in the event certain director seats are eligible for non-Independent directors at a particular election, requires the trustee of the Foundation's shares to vote its shares in the same manner and for the same director candidates as voted for by the non-Foundation shareholders.
- f) *Removal of Director.* BCBSUW has complied with the requirements of this provision in the Order. See Cobalt Articles, Article III, Section 7, which has been modified to satisfy the requirements of the Order.

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- g) *Commissioner's approval required for amendment of articles or by-laws.* BCBSUW has complied with the requirements of this provision in the Order. See Article VI, Section 2, and Article X of the Cobalt Articles; and Article X of the Cobalt Bylaws, each of which incorporates the requirements of the Order.
- h) *Limited purchase rights.* BCBSUW has complied with the requirements of this provision in the Order. See Section 2(b) of the Registration Rights Agreement, which has been modified to incorporate the requirements of the Order.

3. Order § 3(3): *Functional Foundation Required.*

- a) *Requirement of funding the Foundation.* BCBSUW has complied with the requirements of this provision in the Order. Under the terms of the Exchange Agreement described in detail in the S-4, the Foundation will receive \$500,000 (through its holding company) in order to fund its operating expenses. BCBSUW believes such an amount is sufficient to satisfy the needs of the Foundation on a going forward basis.
- b) *Foundation must be operational prior to the conversion.* BCBSUW has complied with the requirements of this provision in the Order. The Foundation currently exists and is operating. The Articles of Incorporation are on file with the Wisconsin Department of Financial Institutions, initial organizational meetings were held, and the Internal Revenue Service has granted the Foundation standing as a 501(c)(4) tax-exempt entity. Although BCBSUW respected and acknowledged OCI's desires regarding the Foundation's independence from BCBSUW, in response to OCI's specific request, BCBSUW has actively been in contact with Ben Brancel (chair of the Foundation board) to schedule an initial meeting of the Foundation directors appointed by the Commissioner. The initial meeting of new Board will be held on February 13, 2001, at which time the initial Foundation board will approve the new Foundation charter documents reflecting the changes required by the Commissioner's Order and, in effect, will commence the new terms for the directors appointed by the Commissioner.

4. Order § 3(4): *Right of OCI to Retain External Professional Services in Conduct of Oversight.*

BCBSUW has complied with the requirements of this provision in the Order. OCI has retained the investment banking services of Deutsche Banc Alex.Brown, and BCBSUW has already confirmed its obligation to reimburse OCI for the expense related to Deutsche Banc's services.

5. Order § 3(5): *Limitation on Compensation to Officers, Directors, and Employees.*

BCBSUW has complied with the requirements of this provision in the Order. Since the entry of the Order, no options have been awarded to directors, officers or employees unless approval from OCI was granted.

6. Order § 3(6): *Regulatory Oversight to Prevent Potential Equity Dilution Post-Conversion.*

The requirements in this portion of the Order address OCI's continued oversight and do not require any affirmative action by BCBSUW prior to conversion based upon the structure of the Exchange Agreement as set forth in the S-4.

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7. Order § 3(7): *Manner of Conversion.*

- a) *Conversion options.* BCBSUW has complied with the requirements of this provision in the Order. BCBSUW has chosen to convert contemporaneously with an exchange transaction between the Foundation (through its wholly-owned subsidiary) and UWS, which in substance and economic effect is the equivalent of a merger transaction. The transaction is described in detail in the S-4 which was filed with the SEC on December 22, 2000, and which was provided to OCI on December 28, 2000.
- b) *Results required.* BCBSUW has complied with the requirements of this provision in the Order. As a result of the exchange transaction, the Foundation will beneficially own 77.5% of the issued and outstanding capital stock of Cobalt Corporation. Thus, the 80% threshold required in the Order will be satisfied.

The exchange transaction also will result in a public float that satisfies the requirements of the Order. The Order is silent with respect to a definition for the term "public float" and concerning when the public float would be measured (other than the phrase "result in"). The non-BCBSUW shareholders of UWS currently hold 9,098,865 shares of issued and outstanding UWS common stock, which represents the public float. Given such public ownership and the language of the Order, a number of salient observations are germane to satisfaction of the public float requirement.

Since stock prices for publicly traded companies obviously fluctuate upwards and downwards over time (for example, there have been wide swings in the stock prices for publicly trade companies within the healthcare sector of the market within the past year), we have assumed you perceptively did not intend to measure the public float at one specific point in time. As to timing of the public float calculation, the Order only requires the conversion transaction to "result in a public float" of \$75 million, or \$50 million if approved by the Commissioner. Such language can obviously be interpreted broadly to ascertain when the public float should be measured, and we believe the volatility of the market and the greater interest of funding the Foundation dictate a broader view of this timing element than just to view it at a single point in time. To limit the public float analysis to immediately following the close of the exchange transaction may not allow the market sufficient time to fully reflect the value of the combined BCBSUW and UWS operations.

At various points in the past year's trading activity of UWS stock, the public float has satisfied the \$75 million threshold. For example, based upon the highest trading price for UWS shares in the past 52 weeks of \$8.25 per share, the \$75 million public float requirement was satisfied (i.e., \$75,065,636). We recognize, however, that based upon recent trading, we would not meet that mark. Accordingly, we are requesting you to approve the \$50 million threshold as contemplated in your Order, if necessary.

Summary

The foregoing demonstrates that BCBSUW has complied with the terms and conditions set forth in the Commissioner's Order, and we look forward to the prompt issuance of the

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Commissioner's approval in order to proceed with the exchange transaction. Accordingly, we appreciate OCI's prompt review of the S-4 and the revised Conversion Application documents in order to meet the January 28, 2001 proxy mailing deadline. As we have said earlier in this letter, BCBSUW believes it is in the public's interest to complete this transaction as described in the S-4 and fund the Foundation for the ultimate benefit of Wisconsin's citizens and the furtherance of public health initiatives in this State.

Sincerely,

Joseph C. Branch

Enc.

cc: Stephen E. Bablitch, Blue Cross & Blue Shield United of Wisconsin
Randy Blumer, OCI
Guenther Ruch, OCI
Fred Nepple, OCI
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Thomas M. Rose