

In the Matter of
Proposed Acquisition of Control of
Physicians Insurance Company of
Wisconsin, Inc. by
American Physicians Capital, Inc. and
American Physicians Assurance
Corporation

MEMORANDUM OF PHYSICIANS
INSURANCE COMPANY OF
WISCONSIN, INC. ("PIC") IN SUPPORT
OF ITS REQUEST TO BE ADMITTED AS
A PARTY

Case No. 04-C29283

INTRODUCTION

The Physician's Insurance Company of Wisconsin, Inc. ("PIC") was formed in 1986 to provide quality, stable, and affordable medical malpractice insurance to Wisconsin physicians and medical providers. Due to more frequent and rapidly growing damage awards in medical malpractice cases, insurers continually withdrew from this market throughout the 1970s and early 1980s, significantly reducing the availability of medical malpractice coverage. As a result, rates for this type of insurance had increased exponentially, and medical providers and patients ultimately were paying the price.

The Wisconsin market for medical malpractice insurance and health care provider protection has significantly improved since 1986, and PIC has played a primary role in this improvement. Today, PIC provides approximately 40 percent of the professional medical malpractice insurance in Wisconsin, and Wisconsin is one of only six states in the country with a relatively healthy environment for health care providers. Many other states are in "crisis." The Wisconsin market has come a long way since PIC was founded, and PIC has played a significant role in bringing stability to this crucial segment. As a corollary, any would-be suitor has a heavy burden to demonstrate to this Commission that its tendered acquisition will not jeopardize or harm that which PIC has worked so hard to accomplish.

Pursuant to section 611.72, Wis. Stat., American Physicians Capital, Inc., and American Physicians Assurance Corporation (collectively, “APC”), seek the approval of the Wisconsin Commissioner of Insurance (“OCI”) of a Form A which would allow APC to purchase at least 4,450 shares of PIC’s outstanding common stock, the company’s only voting shares. The Form A would place a controlling block of approximately 24 percent of PIC’s common stock in APC. APC also would occupy at least one seat on PIC’s board of directors, and perhaps more.

Surprisingly, after first stating to this Commission that it took no position on PIC’s request to be made a party (*see* APC Letter to the OCI, dated October 26, 2004), APC now argues that PIC should not be granted party status. Even more surprisingly, APC contends that PIC has no “substantial interest” that may be affected if the OCI approves the Form A and allows PIC to acquire control of the company.

APC’s position is preposterous. PIC’s ownership (as well as its insureds) are the “target” of APC’s Form A application to acquire a “controlling” (24 percent) interest. PIC has a right to participate as a party and be heard on the statutory criteria that must be applied by this Commission. That is because, if approved, the transaction would irrevocably alter PIC. Make no mistake — this Form A amounts to nothing less than a proposed hostile takeover. And, if APC’s recent business activity is any indication of how it intends to exercise control over PIC, APC’s substantial stake in the company and presence on PIC’s board of directors could jeopardize the quality of service PIC has provided to Wisconsin policyholders for nearly twenty years. Indeed, the Applicants’ Initial Brief in Opposition to Party Status for Physicians’ Insurance Company of Wisconsin, Inc. (hereinafter, “APC’s Initial Brief”) contains a stunning admission on behalf of APC that strongly suggests this is exactly what will happen: “...the fact that insurance companies and their agents often act contrary to the interests of their policyholders

and insureds is the entire reason for much of the regulation relating to insurance companies administered by the Commissioner of Insurance.” APC’s Initial Brief, p. 3.

Because PIC’s substantial and legally protected interests will be affected if the Form A is approved, and because its interests are different in both kind and degree from those of the general public, PIC respectfully requests that the OCI exercise its discretion and grant PIC full party status in the proceedings that are required in this matter under section 611.72, Wis. Stat.

I. PIC MEETS THE APPLICABLE “SUBSTANTIAL INTEREST” STANDARD UNDER SECTION 227.44(2m), WIS. STAT.

A. The Correct Standard Is The “Substantial Interest” Standard Plainly Set Forth In Section 227.44(2m), Wis. Stat.

The Form A submitted by APC would result in its acquisition of control over PIC. Under the Wisconsin insurance code,

“Control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, by common management or otherwise. A person having a contract or arrangement giving that person control is deemed to be in control despite any limitations placed by law on the validity of the contract or arrangement. There is a rebuttable presumption of control if a person directly or indirectly owns, holds with the power to vote or holds proxies to vote more than 10% of the voting securities of another person, except that no person shall be presumed to control another person solely by reason of holding an official position with that person.

Wis. Stat. § 600.03(13) (emphasis added).

If OCI approves the Form A, APC’s interest in PIC would be more than double the percentage threshold that constitutes control under section 600.03(13), Wis. Stat. Practically, APC’s controlling interest also would give it the power to direct or cause the direction of PIC’s management and policies.

Because the Form A constitutes a “plan for acquisition of control,” the OCI is required by statute to hold a hearing and approve the Form A before it may be executed. Wis. Stat § 611.72(2)-(3). In most cases, the OCI holds a public hearing to fulfill its obligation under this statute. Most cases, however, are not hostile takeovers, and, in this case, the OCI decided to hold a contested case hearing. In addition, because the OCI has “substantial discretionary authority” to approve or disapprove the Form A, the contested case hearing in this situation is classified as a “Class 1” proceeding. Wis. Stat. § 227.01(3)(a).

The Wisconsin Statutes establish a “substantial interest” standard to determine whether a person who may be affected by the decision in any contested case hearing should be granted party status. Specifically, the statutes state that:

Any person whose substantial interest may be affected by the decision following the [contested case] hearing shall, upon the person’s request, be admitted as a party.

Wis. Stat. § 227.44(2m).

In its Initial Brief, APC, claiming there is a dearth of case law construing this statute, flatly concludes that “§ 227.42 applies” and argues that PIC should be required to show it has standing to commence a contested case hearing in the first instance in order to be granted party status. APC’s Initial Brief, p. 2. APC’s argument confuses statutory standing to commence an action with standing to participate in an action once it is commenced, however, and it turns section 611.72(2), Wis. Stat., on its head. Here, APC was statutorily required to file this action. Once filed, Wisconsin law absolutely requires that the Commission hold a hearing (a “Class 1” contested case hearing). Wis. Stat. § 611.72(2). Only after holding a hearing may the OCI make its decision on the proposed acquisition. *Id.* This statute requires a filing by the entity seeking approval; it does not provide for such a filing by any other entity, but that in no way affects the

question of whether any such entity has the right to participate as “a party” in the contested case. It is inherent in the nature of this statute that the target company would have standing to appear and to contest the proposed acquisition.

APC’s argument also ignores this Commission’s decision that interpreted and applied section 227.44(2m), Wis. Stat., in a contested case involving legal requirements very similar to those included in section 611.72, Wis. Stat. See *In The Matter of Application for Conversion of Blue Cross and Blue Shield United of Wisconsin, Motion To Intervene as Parties, Motions by ABC for Health, WI AARP, WI Coalition for Advocacy, Medical College of Wisconsin, and UW-Madison Medical School*, Decision on Motions To Intervene as Parties, Case No. 99-C26038, dated November 29, 1999 (hereinafter, “*Conversion of Blue Cross*”) (copy attached as Exhibit A). In *Conversion of Blue Cross*, the OCI applied a two-part test to determine whether five petitioners had a “substantial interest” necessary to participate as parties in a contested case hearing under section 227.44(2m), Wis. Stat. See *Conversion of Blue Cross*, p. 4.¹ Specifically, the OCI stated that petitioners must show: (1) they sustained or were in immediate danger of sustaining some real, immediate, and direct injury to their interest as a result of the challenged action; and (2) the interest was of a type recognized, regulated, or sought to be protected by the law applied by the agency. *Id.*²

¹ In this matter, although it was not statutorily required to do so, the OCI held a contested case hearing on the proposed conversion of an insurance service corporation to a stock corporation. Prior to the contested case, the petitioners appeared at several public hearings on the matter. In this opinion, the OCI ruled on their request to participate as parties in the contested case hearing as well.

² Ultimately, none of the five petitioners in this matter met the requirements of the two-part test, and the OCI denied their requests. *Conversion of Blue Cross*, p. 5. Granting the petitioners party status under such circumstances, the OCI concluded,

would open the door to “permit hundreds of persons appearing in an agency proceeding to cross examine witnesses, to make opening statements, and to depose witnesses, would produce a chaotic, unmanageable and interminable proceeding.” It would leave agency proceedings “vulnerable to deliberate

Applying the same two-pronged standard that the OCI applied in *Conversion of Blue Cross*, an insurance company whose controlling interest is subject to a hostile takeover attempt undoubtedly is entitled to participate as a party in the proceedings. If “substantial interest” means anything in this context, it should mean exactly that. In this context, no other person’s interests are subject to more real, immediate, and direct injury than the target company, and those interests are protected under the Wisconsin insurance code, including but not limited to section 611.72(3), Wis. Stat.

Chapter 227, Wis. Stat., requires a similar result in this case. Here, the statutes simply mandate that any person whose “substantial interest may be affected by the decision . . . shall . . . be admitted as a party.” Wis. Stat. § 227.44(2m). The statute’s silence as to what constitutes a “substantial interest” in order to be admitted as a party simply gives the OCI the discretion to determine whose interests are substantial enough to be granted party status.³

Moreover, because the target insurer’s interests are different in both kind and degree from its insureds and those of the general public, granting it party status would not set an unmanageable precedent. To the contrary, it would set a simple, logical precedent that at least one entity — the company whose controlling interest is threatened by the hostile takeover

obstruction.” This is not the process contemplated by the legislature. It is not a precedent the Office can accept.

Id. (citing *Wisconsin Environmental Decade v. PSC*, 267 N.W.2d 609 (Wis. 1978)).

³ If canons of statutory construction are of any assistance, *expressio unis est exclusio alterius* is more applicable than the canon relied upon by APC, and it supports PIC’s interpretation of the statute. Based on this canon, elements that are included in one statute but excluded from another imply that legislature intended to exclude those elements from the latter statute. In other words, if the legislature intended to require a person seeking party status to a statutorily required contested case hearing to prove that it has an independent right to bring a contested case hearing, it would have said so. It did not.

attempt — is entitled to “party status.” Thus, APC’s attempted “slippery slope” argument falls flat.⁴

B. PIC’S Interests Clearly Meet The “Substantial Interest” Standard Under Section 227.44(2m), Wis. Stat.

In his June 8, 2005 Prehearing Conference Memorandum, the Commissioner found that this was a “contested case” and identified the issues that would be considered at the hearing.

These included whether or not, under section 611.72, Wis. Stat.,

1. The plan would violate the law or be contrary to the interests of the insureds of Physicians Insurance Company of Wisconsin, a participating domestic corporation, or of the Wisconsin insureds of any participating nondomestic corporation.
2. After the acquisition of control, Physicians Insurance Company of Wisconsin would be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed.
3. The effect of the acquisition of control would be to create a monopoly or substantially to lessen competition in insurance in Wisconsin.
4. The merger is likely to jeopardize the financial stability of Physicians Insurance Company of Wisconsin or to prejudice the interests of its Wisconsin policyholders.
5. Any plans or proposals which the acquiring party has to liquidate the domestic stock insurance corporation or its parent insurance holding corporation, sell its assets, or consolidate or merge it with any person, or make any other material change in its business or corporate structure or management are fair and reasonable to policyholders of the domestic stock insurance corporation or in the public interest. This includes an evaluation of the effect of the proposed plan on the history and purpose of the Physicians Insurance Company of Wisconsin, including the extent to which its stock is or was intended or expected to be transferable and the

⁴ In addition, APC’s assertion that PIC’s request for party status is somehow a “smoke screen for its real interest — preserving management and board discretion by avoiding the presence of shareholders who know the business and could, in the future, be influential” — is false, offensive, and without any legal basis whatsoever. PIC has never avoided shareholders who “know the business.”

contribution of Physicians Insurance Company of Wisconsin to the Wisconsin insurance marketplace.

6. The competence and integrity of the persons who would control the operation of the domestic stock insurance corporation or its parent insurance holding corporation are such that it would be in the interest of the policyholders of the corporation and of the public to permit the acquisition of control.

June 8, 2005 Pre-Hearing Conference Memorandum, pp. 5-6 (emphasis added).

Respectfully, there is no way that these issues can be considered — much less “contested” — without PIC’s participation as a party. No other person or entity is in a position to present or contest evidence on these issues. No other person or entity is more directly “interested,” “affected,” or potentially “aggrieved” on these issues. No other person or entity has a greater interest regarding whether APC’s acquisition of control is likely to: (a) jeopardize PIC’s financial stability; (b) result in material harmful changes in PIC’s business or corporate structure or management; (c) affect PIC’s history or purpose; or (d) alter the makeup of the persons who control PIC’s operation in such a way that the acquisition would not be in the interest of PIC’s policyholders.

As explained in detail below, PIC is in danger of sustaining real, immediate, and direct injury to its substantial interests if the Form A is approved, and those interests are protected under the law that must be applied by the OCI. In addition, as the target company whose financial stability, structure and management, history and purpose, and makeup of controlling persons are threatened, PIC’s interests are different in both kind and degree from those of its policyholders and the general public.

1. PIC's Interests Are Substantial And Protected Under The Wisconsin Statutes

The basis for PIC's request to be admitted as a party in these proceedings relate to the unique structure, management, and history of the corporation, its business model, and the negative effect APC's hostile takeover would have on the company itself. PIC is not a publicly traded stock corporation, and its business structure was designed to further PIC's core philosophy and mission (*i.e.*, providing quality, stable, and affordable medical malpractice insurance in the Wisconsin market). Because PIC shares are not publicly traded, the company is insulated from the customary pressure to maximize shareholders' investments, which may work to the detriment of public companies' financial stability and long-term goals. In addition, because PIC shareholders and policyholders are often one and the same, PIC's conservative outlook balances their dual interest as: (a) owners of the company; and (b) physicians and medical providers insured under PIC's medical malpractice insurance policies.

In stark contrast, APC is a public insurance company domiciled in Michigan. It naturally has a primary responsibility to maximize the return on its shareholders' investments, and its financial stability fluctuates with the market. In addition, APC has no significant ties to Wisconsin or any Wisconsin-based physician or medical provider. Although a very marginal amount of APC's business comes from the Wisconsin market, the overwhelming majority of its business activities are located outside of this state in various geographic regions of the country.

PIC primarily issues medical malpractice insurance,⁵ and, as a result, it subscribes to a conservative business philosophy. The OCI has noted, and PIC agrees, that insurers heavily invested in this market must be operated in a "very conservative manner" because claims often are resolved years after policies are priced and sold. *See In the Matter of the Acquisition of Stock*

⁵ Upon their request, PIC also issues general liability and property insurance to its medical malpractice insureds.

of the St. Paul Companies, Inc., Including St. Paul Fire and Casualty Insurance Company, a Wisconsin Corporation, by Alleghany Corporation, a Delaware Corporation, and Whether the Acquisition Constitutes Acquisition of Control, Findings of Fact, Conclusions of Law, Final Decision, and Order, Case No. 88-C20269, dated April 7, 1988 (hereinafter, “*Acquisition of St. Paul*”), p. 6 (copy attached as Exhibit B).

In *Acquisition of St. Paul*, the OCI denied the Alleghany Corporation’s application for approval to acquire control over a target insurer that was heavily involved in Wisconsin’s medical malpractice market, and the issues involved in that case are strikingly similar to those at issue here. In brief, the Alleghany Corporation was a public company headquartered in New York, and it sought to acquire a 20 percent interest in the target company. After recognizing the conservative, long-term philosophy to which medical malpractice insurers must subscribe, the OCI concluded that the Alleghany Corporation’s short-term, profit maximizing interests would conflict with the interests of the target company’s policyholders:

The presence of a 20% investor whose preeminent goal is to maximize value to its shareholders will conflict with the interest of policyholders of St. Paul. The short-term benefits that may be available to Alleghany shareholders through restructuring St. Paul, divesting assets, and reducing surplus are threatening to the long-term interests of St. Paul policyholders. The risks to St. Paul policyholders are exacerbated by the volatile lines of insurance that St. Paul writes.

Id., p. 17.

From the beginning, PIC’s shareholders were motivated primarily by a shared interest in capitalizing a company that would provide quality and affordable medical malpractice coverage in their home state. These shareholders were not disinterested investors, and profit maximization was not their motivating goal or the goal of the company they capitalized. Today, approximately 43 percent of PIC’s shareholders are the same physicians and medical providers who are covered

under PIC's policies, and they are primarily interested in the quality and affordability of PIC's coverage. PIC's nonpublic corporate structure has insulated it from common pressures felt by public companies to maximize shareholder investments.

APC, on the other hand, is much like the Alleghany Corporation in *Acquisition of St. Paul*. As a public company, APC is beholden to the short-term, profit-maximizing interests of its shareholders, and it is primarily focused on the value of the company and the return on the investment of its disinterested shareholders. If the Form A is approved, APC's leverage to direct PIC's management and policies could result in PIC taking courses of action that are objectionable to the company, its diverse group of shareholders, and the core philosophy that forms the basis of PIC's success. In addition, it would expose PIC to the forces of the public market that the company was intentionally designed to avoid.

APC may argue that its involvement in the medical malpractice market in other states also requires it to subscribe to a conservative philosophy. Its actions in recent years undermine that claim, and if those actions are any indication of APC's primary motivations or the way in which it intends to exercise control over PIC, then approval of the Form A will likely jeopardize PIC's financial stability. For example, pursuant to an agreement between APC's board of directors and the Stilwell Group,⁶ owners of 8.1 percent of the APC's outstanding shares, APC's board repurchased 1,543,310 shares (15.07 percent) of its common stock in 2002 alone.⁷ APC reportedly spent a total of \$60.3 million to buy back shares of its common stock during a multi-

⁶ The Stilwell Group is comprised of two individuals, Joseph Stilwell and Spencer Schneider, and four businesses entities — (1) Stilwell Value Partners V. L.P.; (2) Stilwell Associates, L.P.; (3) Stilwell Partners, L.P.; and (4) Stilwell Value.

⁷ These figures are based on statements filed with the Securities and Exchange Commission and the Michigan Office of Financial and Insurance Services.

year period ending December 31, 2002, a period in which the company reported significant losses.

APC's unstable recent history is not limited to this stock buyback activity. For example, as recently as 18 months ago, APC replaced its senior management team. As recently as 15 months ago, APC reviewed all of its strategic options, including sale of the entire company. Since November 2003, APC has received two downgrades from A.M. Best. In addition, it recently exited the worker's compensation insurance market entirely, once a principal line of its business, and has been forced to move substantial capital to Insurance Corporation of America, an APC subsidiary. With respect to medical malpractice insurance, APC also recently exited the Nevada and Florida markets and substantially raised premium rates to all of its remaining policyholders.

Even assuming APC's acquisition of control would have no significant financial effect on PIC, the fundamental differences between these two companies, coupled with APC's controlling presence, would materially alter PIC's business and management structure. With ownership of nearly a quarter of PIC's voting shares, APC's interest would dwarf the 3.6 percent interest of PIC's next largest shareholder.⁸ By definition, the size of APC's interest would be more than double the statutory standard for control, and practically, it would give APC the power to direct PIC's management and business policy.

2. PIC's Interests Are Unique

Contrary to APC's assertions that PIC has "a mere 'generalized' interest" (APC's Initial Brief, p. 2), PIC's substantial interests in these proceedings are different in kind and degree from those of PIC's insureds and the general public. *See Conversion of Blue Cross*, p. 5 (citing

⁸ Currently, PIC has 1,190 shareholders, and the average holding of the remaining shareholders, if the transaction were allowed to proceed, would be approximately 12.5 shares.

Wisconsin Environmental Decade v. PSC, 267 N.W.2d 609). If the Form A is approved, PIC's current board of directors would be forced to operate the company and continue serving its policyholders in the wake of a hostile takeover. The company would be subject to the controlling influence of a dominant shareholder and at least one board member with whom it wants no association and whose corporate philosophy is adverse to PIC's history and core values. The fulfillment of the fiduciary duties PIC's board of directors owes to the company, all of its shareholders and its policyholders with one or more new board members imposed upon it through a hostile takeover is not a generalized interest. The strategic planning that PIC's board and management must do in the face of different and competing goals of a major publicly traded shareholder is not a generalized interest. Management's handling of the day-to-day operations of an integral component of Wisconsin's medical malpractice market while having to account to a shareholder hostile to its conservative philosophy and goals is not a generalized interest. Yet each of these concerns has an effect on the stability of PIC and, at the least, an indirect effect on PIC's policyholders. It is certain that PIC, as a corporate entity, would never be the same if the Form A is approved. Under the circumstances, PIC's substantial interests are different from any other person imaginable.

Because of its unique interest in these proceedings, granting PIC party status will not create an unmanageable precedent. Instead, it will allow one entity — the company whose controlling interest is subject to a hostile takeover — the ability to participate fully as a party in the proceedings. PIC should have that right.

II. PIC ALSO MEETS THE STANDARD FOR PARTY STATUS ARGUED BY APC

Even assuming, as argued by APC, that an interested person seeking party status in a required contested case hearing must show that it has an independent right to such a hearing in

the first instance, PIC meets the requisite standard. Under the Wisconsin Statutes, a person is entitled to a contested case hearing if he or she can establish all of the following:

- (a) A substantial interest of the person is injured in fact or threatened with injury by agency action or inaction;
- (b) There is no evidence of legislative intent that the interest is not to be protected;
- (c) The injury to the person requesting a hearing is different in kind or degree from injury to the general public caused by the agency action or inaction; and
- (d) There is a dispute of material fact.

Wis. Stat. § 227.42(1).

For many of the same reasons that justify PIC's standing for party status under the "substantial interest" standard of section 227.44(2m), Wis. Stat., PIC also has standing to bring a contested case hearing in the first instance under section 227.42(1), Wis. Stat. To reiterate, PIC's interests are substantial, and they are threatened by APC's proposed hostile takeover. The legislature clearly intended to protect PIC's interests under the Wisconsin insurance code, specifically section 611.72, Wis. Stat., and PIC's potential injury is different in both kind and degree from that of the general public.

In addition, this case involves significant disputes of material fact. Among other things, PIC disputes APC's claim that it has no intention to change or have any effect on PIC's core mission or management structure. PIC also disputes APC's claim that it has no intention of acquiring a greater interest in the company and maximizing its control.

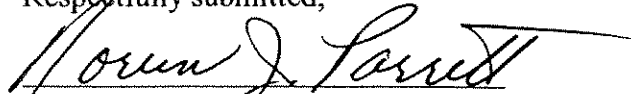
Thus, even assuming, *arguendo*, that PIC must show it has standing to bring a contested case hearing in the first instance under section 227.42(1), Wis. Stat., PIC meets the requisite standard. Accordingly, PIC should be granted party status.

CONCLUSION

PIC is threatened by a hostile takeover attempt that would irrevocably alter the fundamental nature of the company. PIC meets the standards for party status set forth in chapter 227, Wis. Stat., and its substantial interests are protected under the Wisconsin insurance code. Accordingly, the OCI should exercise its discretion and grant PIC the right to participate in these proceedings as a party.

Dated this 13th day of June, 2005.

Respectfully submitted,



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