OFFICE OF THE COMMISSIONER OF INSURANCE STATE OF WISCONSIN

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**In the Matter of the Acquisition of Control of Physicians Insurance Company of Wisconsin, Inc. by American Physicians Capital, Inc. and American Physicians Assurance Corporation ("Applicants")**

REPLY MEMORANDUM OF PHYSICIANS INSURANCE COMPANY OF WISCONSIN, INC. ("PIC") IN SUPPORT OF ITS REQUESTS FOR DISCOVERY

Case No. 04-C29283

Physicians Insurance Company of Wisconsin, Inc. ("PIC") respectfully submits this memorandum in further support of its request for discovery in this matter, and in reply to the briefs and submissions in opposition to that discovery that have been filed by the would-be acquirors, American Physicians Capital, Inc. and American Physicians Assurance Corporation (collectively, "APC"), by Dean Health Systems ("Dean"), and by The Monroe Clinic, Inc. ("Monroe").

Insofar as APC is concerned, APC's response largely concedes the relevance to this proceeding of the topics on which PIC has sought discovery. Thus, APC has agreed to provide certain discovery with respect to the transaction itself (APC Mem. at 4), with respect to current business plans (*id.*), reserves (*id.* at 7) and ratings agency presentations (*id.* at 8). APC also makes no objection to providing information with respect to the Wisconsin insurance market or its intentions relating to PIC.

Although conceding the relevance of these critical topics, APC attempts to impose a series of artificial and unjustified limitations to the discovery it will provide. *First*, although APC *itself* has sought discovery from PIC going back as far as 1986, APC claims that only its *current* conditions are relevant. *Second*, although APC is seeking to acquire control of a

Wisconsin insurance company and has filed a proceeding with this Wisconsin governmental agency, APC seeks to hide behind Michigan privileges which are not applicable in Wisconsin. *Third*, in an effort to claim falsely that PIC is seeking to engage in unwarranted and burdensome discovery, APC overstates what PIC is seeking in hopes that the Commissioner will impose such limitations on discovery that only APC's sanitized final Board documents will be produced.

Ultimately, the real issue is APC's unduly narrow and untenable position as to the discovery that is warranted in this proceeding. APC claims that it has met the requirements under Section 611.72. That will be the subject of the hearing in this matter. Under APC's view, notwithstanding that this is a *contested* proceeding, PIC should be limited to reviewing only that information which APC has chosen to make publicly available, that which it deigns to provide by way of "summaries," or "final" documents approved by APC's Board. In essence, APC proposes that PIC and the Commissioner should simply take APC at its word on all relevant matters, and have no ability to probe the *bona fides* of APC's asserted compliance with the statutory criteria through examination of any of the underlying or supporting information from which these public filings, summaries or "final" documents were created.

PIC respectfully submits that such a "you get to see only what I want you to see" approach is not appropriate. PIC believes that APC cannot make the showings required by Section 611.72. Discovery is a needed tool in the fact-finding process and should be appropriately utilized. PIC has no desire for more discovery than is necessary in this matter, but it is clearly entitled to all *necessary* discovery from APC.

Insofar as discovery with respect to the selling shareholders is concerned, APC, Dean and Monroe make a variety of arguments against the written discovery PIC is seeking.

They assert that there have been no violations of law and that the discovery cannot be relevant. Here also, they are plainly wrong, as explained in detail below.

PIC has no desire to delay any proceedings in this matter. If written discovery can be provided by July 15, PIC will thereafter expeditiously complete its oral depositions before the next pre-hearing conference.

## I. DISCOVERY NEEDED FROM APC

### A. Scope of Requests

As a threshold matter, APC takes exception to PIC's use of the term "concerning," claiming that it would result in the production of every single document in APC's possession. But this is a strawman. The purpose of this language was to ensure that APC did not take an unduly narrow interpretation of various requests by producing only the specific documents identified but not other obviously relevant documents on precisely the same topics.

In fact, PIC's use of this formulation appears to have been merited, since it is now evident that APC *does* hold an extremely narrow view of what should be produced. For instance, APC claims that only supposed "official actions of the Company" are relevant, and that any documentation that underlies such "official actions" should be out of bounds. Thus, APC requests that production be limited to "final documents prepared by management, and/or documents reflecting plans or actions presented to and approved by the Board." (APC Mem. at 3). In a similar vein, APC unreasonably seeks to constrict the relevant timeframe in an effort to avoid consideration of the tumultuous events that have plagued APC in its very recent past, including significant turnover in management, sizeable reserve and accounting adjustments, and a wholesale reevaluation of its business strategy.

PIC is willing to accept reasonable limitations on the kinds of documents that APC would be obligated to produce. But PIC expects good faith compliance with its requests, and APC's unilateral attempt to impose categorical limitations of the sort it proposes should be squarely rejected. Clearly, as APC itself recognizes, materials approved by the board or management will be critical to determining whether APC has met its burden of showing that it meets the statutory criteria. But in this regard, PIC must also be permitted to review the underlying work to probe the validity and accuracy of APC's evidence for this to be a meaningful process. Accordingly, except for its request relating to APC's reserves and actuarial analyses of those reserves, as to each of its other document requests calling for internal APC documents, PIC is willing to limit its requests to final and draft documents prepared by or for APC's senior management (*i.e.*, its CEO, CFO, or other officers) or by or for its Board of Directors.

## B. Categories of Documents

### 1. Documents Regarding the Transaction At Issue, PIC and the Wisconsin Insurance Market (PIC Document Request Nos. 27-38).

For good reason, APC appears to concede the relevance of documents exchanged between the applicants and the selling shareholders pertaining to the transaction at issue, as well as documents relating to its plans for PIC following the acquisition. (APC Mem. at 4). Such documents are obviously relevant to this proceeding.[1]

APC makes an oblique reference to the "joint interest privilege" and appears to be willing to provide only those documents exchanged prior to the execution of the Share Purchase

[1] Nor does APC at any point object to production of documents relating to the Wisconsin insurance market. They are plainly relevant as well.

Agreement in September 2004, not after. (*Id.*) This is not proper. The Share Purchase Agreement has been amended several times since then, and an additional party (Northpoint Medical Group, Ltd.) was added to the agreement. PIC is entitled to all communications, not simply those prior to the initial execution of the agreement in September.

**2. Documents Regarding APC's Business Plans (PIC Document Request Nos. 1-3, 23-26).**

As PIC previously discussed, many of the statutory criteria in Section 611.72 (*see, e.g.*, § 611.72(3), (3)(a), (3)(c) and (3)(e)) require examination into the condition, prospects and business plans of the would-be acquiror. Recognizing this fact, APC has agreed to provide "the final decisions of the Board of Directors of AP Capital, and the management presentations implementing" the "fundamental changes" described in the Form A. (APC Mem. at 4). Consistent with the position set forth above, PIC is willing to limit its requests regarding APC's business plans to all draft or final documents prepared by or for the APC Board and all draft or final documents prepared by or for APC officers on these topics. PIC has no desire, and sees no need, to obtain every single piece of paper on these topics – but PIC is clearly entitled to probe into the rationale and underlying circumstances giving rise to the changes.

APC's unilateral declaration that APC's late 2003 and early 2004 review of all strategic alternatives is wholly off limits is equally untenable. APC claims that this review is irrelevant because, after analysis, the Board of Directors concluded that the Company should remain as an independent, stand-alone entity. (APC Mem. at 4-5). But this self-serving assertion cannot be accepted without further examination. Where, as here, an applicant proposes to acquire a controlling interest in a Wisconsin insurance company, the very recent activities regarding a possible sale or merger of the applicant itself are clearly probative of the applicant's

financial health and stability and are appropriate for examination to determine whether the applicant meets the requirements of Section 611.72. Moreover, PIC is entitled to review the admittedly extensive work done in connection with this project because that work would undoubtedly contain information about APC's financial condition and other matters that are highly relevant to whether APC meets the statutory criteria with respect to *this* transaction.[2]

Equally unavailing is APC's effort to restrict the type of documents that it must provide concerning its A.M. Best ratings. (*See* PIC Document Request Nos. 2 and 3). APC's effort to limit the universe of documents concerning its A.M. Best ratings to only those sanitized documents that were actually shared with A.M. Best is inappropriate. (APC Mem. at 7). Given the importance of this issue, PIC is entitled to examine it, and PIC's proposed discovery, as limited, is necessary to conduct a meaningful review.

### 3. Documents Regarding Communications with Auditors and Accountants (PIC Document Request Nos. 4-6).

Unable to seriously contest the relevancy of documents relating to its financial condition, including communications with its internal and external auditors, APC suggests that discovery should be limited to a handful of documents of APC's own choosing in this area. (APC Mem. at 5-8). Not surprisingly, APC is unable to point to any provision of Wisconsin law that would permit such a narrow review. Instead, APC seeks to rely on *Michigan* law in an attempt to shield broad categories of plainly relevant documents relating to its financial condition. APC's effort is unavailing for a number of reasons.

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[2] APC's claims concerning confidentiality with respect to this work do not make any sense. What PIC is looking for is information about APC, not information about *other* companies. The fact that APC's own information was protected by confidentiality agreements when furnished to third parties in connection with this process obviously does not imbue *its own data* with any additional protections in this proceeding. PIC is prepared to enter into a

*First*, APC's argument fails at the outset because Wisconsin, like the majority of states, does not recognize either of the two Michigan privileges (the accountant-client and the self-evaluative audit privilege) upon which APC relies. Nor is there any reason why the Commissioner should recognize either privilege in this proceeding. As Wisconsin's Supreme Court has recently explained, when presented with competing state's laws, the decision-maker must examine "whether the contacts of one state to the facts of the case are so obviously limited and minimal that the application of that state's law constitutes officious intermeddling." *Beloit Liquidating Trust v. Grade*, 2004 WI 39, ¶ 24, 270 Wis. 2d 356, 374, 677 N.W.2d 298 (2004). Here, the central issue before the Commission concerns the effect of the proposed transaction on *Wisconsin* policyholders, thereby placing Wisconsin's interest at the forefront of this case. Conversely, *Michigan*'s interest in this case is "so obviously limited and minimal" that the application of Michigan privilege law would constitute "officious intermeddling" into Wisconsin public policy.

Accordingly, there is no reason why the Commissioner should apply the Michigan privileges relied upon by APC in this matter.[3] In any event, even if the Commissioner were to

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confidentiality agreement here, and to the extent that the data would identify potential purchasers or merger partners, the names of those entities can obviously be redacted.

[3] In *Beloit*, the Wisconsin Supreme Court articulated a second, alternative test for evaluating which state's law to apply. The second test involves examining five factors, including: (1) predictivity of results; (2) maintenance of interstate and international order; (3) simplification of the judicial task; (4) advancement of the forum's governmental interests; and (5) application of the better rule of law. *Beloit*, 270 Wis. 2d at 375, 677 N.W.2d at 307. Here, all factors counsel in favor of applying Wisconsin privilege law. Having chosen to pursue the acquisition of a Wisconsin company, and having made a filing before a Wisconsin governmental agency, APC was clearly on notice that its efforts to do so would be controlled by Wisconsin law, including Wisconsin privilege law. APC has not, and cannot, show that applying Wisconsin law here is any way detrimental to interstate order. With respect to simplifying the judicial task, the Wisconsin Supreme Court has noted that "a court's task is rarely simplified when the lawyer and judges must apply themselves to foreign [here, Michigan] law rather than forum [i.e., Wisconsin] law." *Id.* (internal citation omitted). Applying Wisconsin privilege law advances the governmental interest of Wisconsin, which has made an informed policy choice not to shield certain communications from discovery. Lastly, as noted above, the vast majority of states have not adopted the Michigan privilege laws cited by APC, rendering Wisconsin's rule "the better law," which should be applied in this proceeding.

import the Michigan privilege law cited by APC into this case, APC has clearly waived the right to assert either privilege. By seeking to enter the Wisconsin market with full knowledge of the statutory criteria of Section 611.72, and by having commenced this proceeding before the Department of Insurance, APC has squarely put into issue its financial condition, including its correspondence with its internal and external auditors.

*Second*, neither of the Michigan privileges upon which APC seeks to rely can be read as broadly as APC suggests. In particular, Michigan's self-evaluative audit privilege excludes from its scope all "documents, communications, data, reports, or other information *expressly required to be collected, developed, maintained, or reported to a regulatory agency under this act or other federal or state law.*" M.C.L.A. 500.221(13)(a) (emphasis added). Here, APC has represented that the draft reports and internal audit documents called for by PIC's requests were prepared *not* as part of some internal self-evaluative audit, but rather were prepared, *inter alia*, "as a result of Sarbanes-Oxley, to which AP Capital is subject." (APC Mem. at 6). Having conceded as much, APC cannot now be heard to argue that these documents fall within the purview of the self-evaluative audit privilege.

### 4. Documents Concerning APC's Reserves, Reserve Studies and Adjustments (PIC Document Request No. 7).

APC recognizes, as it must, that the adequacy of its reserves is a "critical factor" in evaluating its financial condition. (Form 10-K, American Physicians Capital Inc., filed Mar. 16, 2005 at 40) ("2004 10-K"). On this note, APC has disclosed that it has been forced to make adjustments to prior year reserves in 2004, 2003 and 2002. (*See id.* at 7). Most notably, APC took a significant reserve charge of *$43.4 million* for the year ended December 31, 2003 – a charge that APC's own CEO characterized as "disturbing news." Even after these significant

adjustments, APC continues to caution the public about its current reserve levels. (*See, e.g.*, 2004 10-K at 9) ("The volatility of professional liability claim frequency and severity makes the prediction of the ultimate loss very difficult. Likewise, the long time frame for professional liability claims to develop and be paid further complicates the reserving process."). This real concern about APC's reserves levels has been echoed by A.M. Best, which has highlighted "the company's historically poor operating results primarily attributed to the adverse development of loss reserves" and "remains concerned that the potential adverse development of loss reserves attributed to run-off professional liability business that was written in soft market conditions could impact operating results and risk-adjusted capitalization." (*See* A.M. Best's Company Report for American Physicians Assurance Corp. dated July 21, 2004 at 1).

The magnitude of APC's past adjustments, coupled with the continued uncertainty regarding its current reserve levels, confirms that discovery into this area is not only appropriate, but vital. Indeed, APC itself recognizes the relevancy of this topic by offering to produce a few sanitized and summary reports, but, in an effort to stave off any meaningful discovery, erects the strawman argument that responding to this request "would require the production of reams and reams of paper" concerning APC's need to strengthen its reserves. (*Id.*) As discussed above, PIC has no interest in reviewing every document in APC's possession. However, PIC is entitled to review the underlying data relating to reserve calculations to probe the validity and accuracy of APC's past and present reserve calculations. Because the adequacy of its reserves is such a "critical factor" in evaluating APC's financial condition, discovery relating to APC's reserves cannot be limited to those documents prepared by or for APC's senior management or by or for its Board of Directors (the limitation proposed by PIC for its other document requests). Rather, in a spirit of compromise and to address APC's objection to the

word "concerning," PIC requests that the Commissioner require production of documents in response to the following revised Document Request No. 7:

> All actuarial studies, reports and opinions of independent actuaries (including accounting firms) and/or Your internal actuaries relating to Your reserves and specific risks or events that have been the subject of actuarial analysis, and all workpapers related to those studies, reports or opinions.

The underlying workpapers, even though they may not have been shared with management, are integral to understanding the basis for any conclusions set forth in these critical studies.

**5. Documents Regarding Change in Auditors (PIC Document Request Nos. 8-9)**

APC has indicated that it is prepared to furnish the bidding materials relating to its decision to select BDO as its new auditor. (APC Mem. at 8). PIC is prepared to accept this limitation, subject to its right to seek additional materials if necessary.

**6. Documents Regarding APC's Internal Controls (PIC Document Request Nos. 10 and 11).**

APC acknowledges that it undertook efforts to assess its internal controls. (APC Mem. at 8). This issue is obviously relevant to APC's business condition and prospects and as such, to whether APC satisfies the statutory criteria of Section 611.72. APC asks PIC and the Commissioner to rely upon its assurances that the material weaknesses disclosed in APC's SEC filings were not a problem and had no impact on the accuracy of its financial statements. But PIC is clearly entitled to probe that self-serving assertion and the existence of other control weaknesses through discovery.

Moreover, APC seeks to improperly narrow PIC's request, which was not limited to the specific issue of Sarbanes-Oxley violations or the issues in New Mexico, but was intended to include more generally *any* control weaknesses that have been identified by APC's auditors or APC itself within the last three years. (*See* PIC Document Request No. 10). APC's offer to provide "the documentation and testing associated with the New Mexico business which was assembled during the Sarbanes testing" is insufficient because it totally avoids these broader matters. PIC is entitled to documents relating to APC's internal controls, internal audits, management letters and other matters incident to APC's audits, controls and relations with its external auditors. Those facts go directly to whether APC can satisfy its burden with respect to, *inter alia*, § 611.72 (3)(a), (3)(c) and (3)(e).

**7. Documents Regarding APC's Activities In Other Markets (PIC Document Request Nos. 18-22, 25).**

Information regarding APC's decision to exit from various markets is plainly relevant. APC does not dispute this fact, but instead improperly seeks to provide a premature argument on the merits, claiming these business decisions were warranted in light of market conditions. (*See* APC Mem. at 9-10) (noting that Florida and Nevada are "crisis states" because of the lack of effective tort reform). Of course, APC is free to present this argument to the Commissioner at the hearing, but it should not be permitted to avoid discovery solely on its own unsupported assertion. PIC should be permitted to probe APC's current assertions by examining APC's contemporaneous internal documentation of the rationale for these decisions. For similar reasons, it is no answer to claim, as APC does, that APC has already provided the financial documentation regarding the losses that it suffered in those states. PIC is not interested in "mountains of statistical data underlying the loss reserves for those states, as well as all claim

files, policy files, and communications with agents and policyholders." (APC Mem. at 9-10). PIC is merely seeking APC's internal analysis and documentation that formed the basis for its decisions to exit those markets. Such information is clearly relevant and should be produced.

Likewise, information about APC's rate increases in other states is relevant. APC claims that it will have no ability to change PIC's rate structure, but that claim is belied by its current intention to seek board representation. (*See* Form A Amd., Item 5.) APC has offered to provide "summaries" of the rate increases. In the interests of expedition of this process, PIC is prepared to accept this limitation, but reserves its rights to seek further production in the event that those summaries prove to be inadequate.

APC adopts a similarly cavalier approach to the plainly relevant requests relating to state insurance department examination reports. According to APC, "[p]rior exam reports are irrelevant to the current activities of APA, and irrelevant to these proceedings." (APC Mem. at 10.) APC does not explain why that is so, and the proposition is plainly wrong. Whether and to what extent other state departments of insurance have identified deficiencies and areas of concern is obviously important to APC's stability, fitness and character – matters that are directly relevant to whether APC meets the statutory criteria of Section 611.72. These documents should be produced.[4]

Finally, APC's claim that Document Request No. 25 (relating to APC's reduction in the number of medical malpractice policyholders) would "literally require the production of

[4] To the extent that PIC can obtain APC's state insurance department examination reports directly from publicly available sources in a timely manner, PIC will endeavor to do so. However, PIC's requested discovery includes internal final and draft documents prepared by or for APC's senior management or by or for its Board that relate to the examination reports. Given their relevance in this proceeding, these internal APC documents – which are not publicly available – should be made available for review by PIC.

each policy renewal package" (APC Mem. at 11) for each non-renewing policyholder is rhetorical hyperbole. Once again, APC's historical efforts to reduce the number of policyholders is relevant to APC's condition, prospects and business plans and therefore appropriate topics for discovery. APC's offer to provide a state by state breakdown of its policyholders is not enough – PIC is entitled to review whether APC has, as part of its business strategy, undertaken an effort to reduce the number of policyholders. PIC is prepared to limit the scope of its requests to any documents prepared by or for the Board of Directors or by or for senior management since January 1, 2002 relating to any analysis, discussion or decisions relating to reductions in the number of medical malpractice policyholders.[5]

**8. Information Relating To APC's Shareholders, Stock Repurchases and Dividends (PIC Document Request Nos. 12-17).**

APC claims that discovery relating to the shareholder agreements with the Stilwell Group and Daniel Gorman are not relevant because neither is the "applicant." But that is precisely the issue. As discussed in PIC's Opening Memorandum, the unusual arrangements with Stilwell and Gorman, as well as the actions that APC has taken in response to these powerful shareholders, raise significant questions about whether Stilwell or Gorman *should* be required to file a Form A. (*See* PIC Mem. at 6). Under Wis. Stat. § 600.03(13), control is presumed to exist when a shareholder owns more than 10% of the stock and the Commissioner may find that control exists at less than the 10% presumptive level in certain situations, including where the shareholder has multiple board seats, committee representation on all board

[5] With respect to Document Request No. 20, PIC is prepared to accept APC's offer of producing the correspondence exchanged with the Kentucky Medical Society that documents APC's loss of the endorsement of the Kentucky Medical Society.

committees and additional substantial contractual rights. The documents that PIC seeks are clearly relevant to these important questions.

APC also claims that its history of dividends payments is out of bounds based on its assurance that it has "no plan to seek to compel PIC-Wisconsin to pay dividends to its shareholders." (APC Mem. at 12). But not only is PIC entitled to examine this self-serving assertion, APC's history of moving money among its subsidiaries is relevant to its overall financial condition and health. As PIC previously explained, the parent public company, American Physicians Capital, has the power to move capital between and among its various subsidiaries. APC offers no response to PIC's request for information relating to APC's very recent activities in this regard – *i.e.*, the recent merger of one of APC's subsidiaries into APA and APC's decision to cause APA to upstream an $8 million dividend and then took $4 million and placed that in its highly tenuous Insurance Corporation of America subsidiary. This information should be produced.

## II. DISCOVERY NEEDED FROM APC AND THE SELLING SHAREHOLDERS (PIC Document Request Nos. 31-38; PIC Interrogatories 1-8; Subpoenas to be Issued).

The elements of Section 611.72 plainly require the Commissioner to consider any violations of law related to the proposed transaction. Here, there appear to have been a number of violations of law in connection with the proposed transaction, including violations of federal and state securities laws and insurance codes. APC improperly seeks to limit discovery, on behalf of itself and the selling shareholders, concerning these various violations of law. Similar objections have been made by Dean and Monroe. These efforts to restrict discovery concerning violations of law – an area that is clearly relevant under Section 611.72 – should be rejected.

*First*, APC claims that "whether the selling shareholders should have made certain filings or not is irrelevant to whether the current Form A should be approved under Wis. Stat. § 611.72 (3)." (APC Mem. at 13). This contention is echoed by Dean and Monroe, but it is wrong. On the contrary, when a required Form A is not filed, Wis. Stat. § 601.41(4) provides for various remedies "including seizure or sequestration of voting securities of an insurer owned directly or indirectly by a person who has acquired or is proposing to acquire voting securities in violation of 611.72 or ch. 617." If these shares should be seized or sequestered by the OCI as a result of violations of law by Dean and the other selling shareholders, the shares obviously could not be sold to anyone else, including the applicant here, APC. Moreover, information as to whether the selling shareholders violated these and other laws is relevant in determining whether APC violated the same or similar laws in connection with APC's participation in the same series of transactions and events.

*Second*, APC and the two selling shareholders contend that the selling shareholders were not in "control" of PIC. This argument ignores the statutory presumption of control when a shareholder owns more than 10% of the stock of PIC, *see* Wis. Stat. § 600.03(13), and ignores the fact that Dean violated the terms of its 2003 disclaimer of control when Dean formed a group in 2004 owning 24% of PIC's stock. Courts and insurance regulators have reached the conclusion that a disclaimer of control is inappropriate when a party has acquired over 20% of the stock. *See, e.g., Ex Parte: Mut. Sav. Life Ins. Co.*, 536 So.2d 1378 (Ala. 1988) (disclaimer unacceptable with 22.2% equity interest). At the very least, these are contested facts for the Commissioner to determine after a reasonable amount of discovery.

*Third,* as for Section 13(d) of the Securities Exchange Act, 15 U.S.C. 78m(d), discovery is appropriate for a number of reasons. As an initial matter, Monroe contends that it does not own 5% of the PIC stock and could not possibly have violated Section 13(d) of the Securities Exchange Act. This, too, is not correct. SEC Rule 13d-5 (b)(1) states: "When two or more persons agree to act together for the purpose of acquiring, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership, for purposes of Section 13 (d) and 13 (g) of the Act, as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such person." Thus, the entire group of selling shareholders had an SEC reporting obligation beginning with the formation of the selling group in 2004, and PIC's discovery will be focused on those facts which relate to the plan for the Applicants to buy the PIC securities owned by the selling group. In addition, each of the selling shareholders represented in Section 2.2 of the Stock Purchase Agreement that neither the execution of the agreement nor the consummation of the transactions will violate any law, regulation or restriction of any governmental agency. The requested discovery also relates to the accuracy of their own representations.

Equally flawed is APC's assertion that it has not violated Section 13(d) and Wis. Stats. § 552.03 (1). (APC Mem. at 14). In support of its assertion, APC quotes a selected portion of SEC Reg. 240.13d-1(a) to the effect that the SEC filing requirement only applies after a person has acquired beneficial ownership of an equity security. However, APC *failed* to quote SEC Rule 13d-3(b), 240.13d-3(b), which also defines "beneficial ownership" to include the following:

> (b) Any person who, directly or indirectly, creates a trust, proxy, power of attorney, pooling arrangement or any other contract,

> arrangement, or device with the purpose or effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of Section 13(d) or 13 (g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security.

Wis. Stat. 552.03 has an identical requirement concerning beneficial ownership. In addition, discovery would determine whether APC aided and abetted the selling shareholders' violations of Section 13(d), which itself is a violation of Section 13(d). *See, e.g., Wellman v. Dickinson*, 475 F. Supp. 783, 831 (S.D.N.Y. 1979, *aff'd*, 682 F. 2d. 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

Section 4.2 of the Stock Purchase Agreement requires that the selling shareholders' PIC shares be immediately delivered to APC's law firm in Michigan, which presently has possession of the stock certificates pursuant to an escrow agreement to which the selling shareholders are a party (*See* Form A Amendment No. 1, April 2005, Exhibits 2 and 3 ). APC's escrow arrangement does not meet the requirements for a pledge of securities set forth in SEC Rule 13d-3(d)(3), which provides an exemption from this Section 13(d) requirement for bona fide pledges. In addition, Section 4.1(a) of the Stock Purchase Agreement provides that the selling shareholders are obligated not to participate, directly or indirectly, in discussions with any person other than APC in connection with the sale of the stock of PIC or any rights thereto. In Section 4.1(c) of the Stock Purchase Agreement, each seller has agreed "not to, directly or indirectly, sell, transfer, tender, pledge, convert, encumber, assign or otherwise dispose of the Shares, or enter into any contract, option or other agreement to do any of the above, except to Purchaser [APC]." The escrow trust and Section 4.1 covenants were put into effect by APC *without* the OCI's approval. PIC seeks discovery relating to whether the purpose or effect of

the escrow trust and these binding covenants constitute a contract, arrangement or device for divesting the selling shareholders of their shares and preventing the vesting of beneficial ownership of such shares in anyone other than APC, which violates Section 13(d) and Wis. Stats. 552.03 and 611.72. PIC also seeks discovery to determine whether APC's agreement with Northpoint Medical Group, Ltd. dated November 30, 2004 violated SEC Rules 13d-1(e)(2) (ii) and 13d-1(f)(2), which make it illegal to increase beneficial ownership in securities prior to a required Schedule 13D having been filed.

Section 13(d) is an important provision of the Securities Exchange Act. The selling shareholders and APC have apparently ignored this provision in connection with the purchase of the PIC stock, the formation in 2004 of a group of shareholders owning 24% of the stock, and the proposed sale of that stock to APC. As Judge Milton Pollack pointed out in *SEC v. Drexel Burnham Lambert Inc.*, 837 F. Supp. 587, 607 (S.D.N.Y. 1993) (internal citations omitted): "The purpose of Section 13(d) is to alert the marketplace to large, rapid accumulations of securities which might represent a potential shift in corporate control. Section 13(d) is not a mere 'technical' reporting provision; it is, rather, the 'pivot' of a regulatory scheme that may represent 'the only way that corporations, their shareholders and others can adequately evaluate . . . the possible effects of a change in substantial holdings.'" The formation of the 24% group of PIC shareholders was an integral and necessary part of the plan to sell these securities to APC and for APC to buy the securities. The discovery from the sellers seeks to gather the information which the sellers were legally required to provide if they had properly filed their Schedule 13Ds and Wisconsin filings in accordance with the law.

*Fourth* and finally, Section 5(c) of the Securities Act of 1933, 15 U.S.C. § 77e(c) makes it illegal for the selling shareholders and their broker, Edelman & Co. Ltd, ("Edelman") to offer to sell the PIC stock and illegal for APC to offer to buy the PIC stock unless an SEC registration statement was in effect for such securities or an exemption from SEC registration is available. No SEC registration statement was filed. The burden of proof is on a party seeking an exemption from SEC registration and the exemptions are narrowly construed. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953); *SEC v. Murphy*, 626 F.2d 633, 641 (9th Cir. 1980); *McDaniel v. Compania Minera Mar de Cortez*, 528 F. Supp. 152, 160 (D. Ariz. 1981). A violation of Section 5 renders the stock purchase transaction illegal. PIC desires to conduct discovery as to whether any exemption from SEC registration was available.

In order to determine whether an exemption from SEC registration was available to the selling shareholders and to APC, it is necessary, among other things, to determine through discovery of the selling shareholders, Edelman, and the Applicants: (1) the identity, sophistication or qualifications of the offerees of the PIC securities; (2) the number of offerees; (3) the disclosure made to the offerees, including related soliciting material, and (4) whether Edelman was a statutory underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933. According to Section 2.4 of the Stock Purchase Agreement between APC and the selling shareholders, the selling shareholders are obligated to pay a "completion fee" to Edelman. The amount of the "completion fee" and the terms thereof are not disclosed in the Form A. PIC desires to determine, through discovery of the sellers, information relating to the items noted above and as to whether Edelman was receiving a normal and usual broker's commission and whether the sale of the PIC stock constituted a "brokers' transaction " as defined in Section 4(4) of the Securities Act of 1933 or SEC Rule 144(g). Any violations by the selling shareholders of

Section 13(d) and other disclosure obligations under SEC Rule 10b-5 or otherwise are also relevant as to whether an exemption from SEC registration exists.

APC has agreed to respond to PIC's Document Request Nos. 29-38 if the Commissioner so orders. (APC Mem. at 4). The foregoing discussion further demonstrates the relevance of those requests. With respect to PIC's request for interrogatories, APC states that they are willing to respond to PIC's eight interrogatories "up to the date of the Stock Purchase Agreement," presumably meaning September 17, 2004. (APC Mem. at 14-15). For purposes of clarification, the interrogatory responses should include the time period ending with the most recent amendment of the Stock Purchase Agreement which is April 11, 2005. APC's proposed modification of PIC's Interrogatory No. 7 is acceptable so long as the contacts with PIC shareholders include both solicited and unsolicited contacts. Lastly, for the reasons discussed above, PIC's discovery requests focused at the shareholder group and Edelman are appropriate.

## III. CONCLUSION

For all of the foregoing reasons and for the reasons set forth in its initial memorandum, PIC respectfully requests that discovery be permitted to go forward as set forth herein. If the documents are produced and interrogatories answered by July 15, PIC will thereafter be able to take and complete the oral depositions it needs before the next pre-hearing conference on August 30.

Dated this 22nd day of June, 2005.

Respectfully submitted,

John S. Skilton/SCW

John S. Skilton
Sarah C. Walkenhorst
Heller Ehrman White & McAuliffe LLP
One East Main Street, Suite 201
Madison, WI 53703
Ph: (608) 663-7460

Walter C. Carlson
Sidley Austin Brown & Wood LLP
Bank One Plaza
10 South Dearborn Street
Chicago, IL 60603
Ph: (312) 853-7000

Norren J. Parrett
Lafollette Godfrey & Kahn
1 East Main Street
P.O. Box 2719
Madison, WI 53701
Ph: (608) 257-3911

Attorneys for Physicians Insurance Company of Wisconsin, Inc.