

November 18, 2004

HAND DELIVERED

Steven J. Junior, Senior Insurance Examiner  
Bureau of Financial Analysis and Examinations  
Office of the Commissioner of Insurance  
125 South Webster Street, PO Box 7873  
Madison, WI 53707-7873

RE: Acquisition of Control of Unity Health Plans Insurance Corporation by University Health Care, Inc. (Case No 04-C29300)

Dear Mr. Junior:

**General Documentation Request**

1. Reference is made on page 6 of the Form A to “documents memorializing the transaction, which have not yet been finalized.”

Q.-What are these documents and what remains to be negotiated?

*A-The only document that the parties are working on, although not inherently required to be able to close, is the Purchase and Sale Agreement.*

Q-What do you currently see as the time frame for finalizing these memorializing documents?

*A- As soon as they are finalized. Please remember, as we have previously communicated to Commissioner Gomez, to the extent the parties do not reach agreement of the terms and conditions of the memorializing document, UHC and CHS are entitled and will proceed to closing on the basis on the terms and conditions of the applicable and existing agreements. Consequently, the only legal contingency from UHC's and CHS's perspective is the review and approval by the Commissioner of the Form A submission which should not be delayed pending the memorializing document.*

Q- When will you complete your finalizing by providing these documents?

*A-The parties are working diligently to finalize these documents and expect to conclude negotiations shortly.*

2. Please provide the audit opinion and accompanying notes to the University of Wisconsin Medical Foundation, Inc. Consolidated Financial Statements for 1999, 2001 and 2003.

*Please see Attachment #2.*

### **Personnel**

3. Q- Which corporations within the WellPoint holding company system function as the direct employers of those who provide services to Unity? Please describe the services that each of these corporations currently provide?

*A- To the best of our knowledge, most of the Unity Health Plan staff are payrolled and receive their W-2 under Unity's unique federal and state tax ID number.*

*Approximately 16 of the assigned staff are BCBS-Wi/WellPoint Corporation employees who report through BCBS-Wi/WellPoint supervisors and who provide services to Unity under an administrative services agreement. The administrative services agreement required legal, sales, underwriting and actuarial services to be contracted to Cobalt and its successors, BCBS-Wi and WellPoint. In addition, WellPoint has also moved the Human Resources staff into the Cobalt structure. Finance, Health Services, Information Services, Provider Relations and Operations have remained domiciled within Unity. UHC and WellPoint have previously agreed to the assignment of sales force personnel to their respective organizations. All staff personnel are in place at Unity and all steps have been completed or will be completed by December 31, 2004 for Unity to fully function as an independent organization on or before that date.*

4. Q- What are the number and location of employees that currently provide services to Unity and its policyholders?

*A-Please see a personnel list current through November 15, 2004, as provided to UHC by WellPoint and which is marked as Attachment #4.*

5. Please describe plans to provide sufficient personnel and other resources to administer Unity's probable volume of business and maintain its quality of service following the proposed change in control, including but not limited to the marketing and investment functions?

*A-Unity employees are enthusiastic about the UHC acquisition of the Health Plan and few departures have occurred and few, if any departures, are expected. The current employee complement will be sufficient to operate the Health Plan, which under WellPoint ownership, has dropped to 75,000 members. On this basis it is expected that*

*Unity's current high levels of service and quality will continue. Employees' current compensation will be maintained through the acquisition. UHC will undertake a market assessment within the first 6 months post-acquisition in order to maintain and sustain an adequate workforce. Employees have been offered a competitive fringe benefit replacement package and will be offered a 401k retirement benefit.*

*Currently Unity employs a manager for the Marketing Department and UHC intends that in 2005, Unity will hire a Director of Marketing to provide leadership in this area.*

*Unity currently contracts with Baird Investment Services to manage their investments. UHC expects to cause Unity to re-contract with Baird and has authorized Unity to hire a Senior Accountant to assist in tracking the investments and in preparing the statutory filings. As stated in response number 4, Unity is able to fully function without reliance on any WellPoint personnel or other resources.*

6. Q-Will Unity act as the employer for the people who provide the services necessary to run its day-to-day operations?

*A-YES*

7. Q-What approach is being taken on employee pension and other benefit plans?

*A- Unity will offer a 401k retirement plan. UHC expects that Crossroads Acquisition Corporation will make the 2004 contribution to the plans that it administers*

Q-Will Unity employees simply terminate their employment with Crossroads Acquisition Corp., retaining whatever benefits they earned there and then beginning with altogether new plans sponsored by University Health Care, Inc or Unity? Or are there arrangements to transfer funds accumulated on behalf of transferring employees to the new University Health Care, Inc or Unity plans?

*A- Unity employees will start in 2005 with the new Unity 401k plan for 2005 and if the employees wish to "roll over" their Crossroads accounts or other qualified retirement benefits at a future date, the Unity 401k plan will be qualified to accept such rollovers.*

8. Q-Have any written plans or assurances been made concerning staff retention, salaries and benefits, or severance packages, for the officers or employees who provide day-to-day services to Unity?

*A-The Unity Board of Directors, with WellPoint review and approval, offered 6 key employees retention bonuses for remaining within the company through December 31, 2004. UHC is proposing a retention package for the Medical Director that would*

*provide an incentive for that person to stay through the NCQA survey in the first quarter of 2005. No other retention bonus offers have been made. Discussions have occurred with key Unity employees to provide definition of any post 1/1/2005 position description changes, if any, and have received general assurances from UHC representatives.*

*Open enrollment meetings for all Unity employees were conducted at Unity on October 26 and 27, 2004, for the 2005 benefit plan year. Retirement Plan meetings are scheduled for all Unity employees at Unity on November 30 and December 2, 2004.*

9. Q-Has University Health Care, Inc., or Unity entered into any agreements with executive employees in anticipation of the acquisition of control of Unity? If so, please provide us copies of any such agreements.

*A-Other than the aforementioned retention agreements, no additional agreements have been entered into.*

#### **The Holding Company System, its Governance, and Resources**

10. For each of the following companies in the holding company system of University Health Care, Inc.:
- a. Community Health Systems, LLC
  - b. Health Professionals of Wisconsin, Inc.

Please provide the following information:

- a. For Health Professionals of Wisconsin, Inc. only, financial statements as of the most recent two fiscal year ends.

*A-Please see Attachment #10a.*

- b. Description of current purpose and activities

*(i) Health Professionals of Wisconsin, Inc. (HPW) is a taxable corporation that holds and rents real estate property. HPW owns medical clinic buildings in Middleton, Fitchburg, Cottage Grove and Horicon, Wisconsin. These properties are rented by either the University of Wisconsin Hospital and Clinics Authority or the University of Wisconsin Medical Foundation.*

*(ii) Community Health Systems, LLC (CHS) is a limited liability company that holds an interest in the Unity Joint Venture and retains a right to reacquire the HMO-W holding company assets of Unity. UHC holds a controlling member interest in CHS.*

- c. Capitalization structure, including the number of shares authorized, and issued and outstanding for each class of common and preferred stock as well as any debt issued, if any

*(i) HPW's Articles of Incorporation authorize the issuance of 15,000 shares of stock distributed as follows:*

	<i>Authorized</i>	<i>Issues</i>	<i>Outstanding</i>
<i>Common Stock (No Par)</i>	<i>13,500 Shares</i>	<i>13,500 Shares</i>	<i>13,500 Share</i>
<i>Preferred Stock</i>	<i>1,500 Shares</i>	<i>1,500 Shares</i>	<i>1,500 Shares</i>

*(ii) With regard to CHS, it is a limited liability corporation with UHC holding 81.12% of its economic interests. Cobalt, having acceded through a loan default by Community Physicians Network's, holds a 18.88% economic interest.*

11. Please provide a copy of the articles of incorporation and bylaws of University Health Care, Inc.

*A-See Attachment #11.*

12. Please provide a copy of the Affiliation Agreement requiring the University of Wisconsin Hospitals and Clinics Authority to continue to support the educational, research and clinical activities of the University of Wisconsin Medical School.

*A-See Attachment #12.*

13. Does University Health Care, Inc. have an economic interest in any subsidiaries other than Community Health Systems, LLC and Health Professionals of Wisconsin, Inc.? If so, please provide a list of such subsidiaries, together with the percentage of ownership and approximate value.

*A-No.*

14. Is it anticipated that University Health Care, Inc. or its members will contribute capital to Unity itself during 2005 or thereafter? What are the availability and sources of any additional capital that may be needed in the future?

*A-It is not anticipated that UHC or its members will contribute capital to Unity during 2005, UWHC has approximately \$175 million in unrestricted investments and cash portions of which, barring covenant obligations to bond holders, could be made*

*available to UHC. Independent of such assets, UWHC generates significant and available cash flow yearly from operations. University of Wisconsin Medical Foundation similarly has cash assets \$60.6 million and last year generated approximately \$17 million of profits.*

15. Do Unity's provider contracts contain any early termination option for the providers in the event of a change in control of Unity?

*A-No.*

16. Please describe the composition of the current Unity provider network and how this composition might change, if at all, as a result of the proposed acquisition of Unity by University Health Care, Inc.

*A-Unity currently operates two provider networks. The Dane network is limited to Dane County and UHC holds a capitated provider agreement with Unity for the majority of health services in that network. The Dane network includes Meriter Hospital, Associated Physicians and other providers. The Unity network is offered in all other counties in the Unity service area. Many community hospitals and private practice physicians are contracted with Unity. Unity also maintains networks for chiropractic and mental health services. No changes are planned for either network.*

17. What effect will the proposed transaction have on the ability of the affiliated provider networks associated with University Health Care, Inc. and its members to contract with any nonaffiliated health maintenance organization or any other health insurer that might wish to serve customers in the networks' respective service areas following the effective date of the proposed transaction?

*A-The Unity acquisition will not alter UHC's contracting strategies with non-affiliated health maintenance organizations or any other health insurers or provider networks.*

18. After the acquisition, will the form of Unity's articles of incorporation and bylaws closely follow those currently in use by Unity? If not, please file the forms of articles and bylaws that are anticipated after the change in control.

*A-In all respects, the Unity bylaws and articles of incorporation will stay the same except that would not reference any BCBS-Wi members certain actions of the Unity Board of Directors will require a super majority vote of the Board of Directors.*

*Please see Attachment #18.*

19. Will Unity file its tax return on a consolidated basis with other affiliates following its acquisition by University Health Care, Inc. or will it file on a stand-alone basis?

*A- Unity will file a stand-alone tax return*

20. What inter-company agreements are anticipated as necessary between University Health Care, Inc. and its other affiliates and Unity; for example, tax sharing agreements, investment management agreements, or management service agreements?

*A- For the past several years, Unity has delegated functions to UHC affiliated entities for medical management, behavioral health management, pharmacy management and credentialing. These are mature programs that are integrated into Unity operations and have contributed to Unity's high quality and service performance. These functions will remain delegated by Unity to UHC affiliated entities. It is expected that Unity will be filing the current delegation agreements for these functions for OCI's review on or before November 30, 2004.*

*UHC does not intend to provide investment management, or management, or tax sharing services to Unity. Unity will not be a party to any special tax sharing agreements and shall enter into its investment management agreements directly.*

Q- What time frame is anticipated as necessary to prepare and file these agreements?

*A- See above answer*

21. Is it anticipated that Unity will continue to employ the same public accounting firm and actuary that has in the immediate past? If not, who has University Health Care, Inc. contracted with to provide these services?

*A-Unity will bid out its audit to three nationally recognized audit firms consisting of KPMG ( currently auditors for UWHC , Ernst and Young ( currently auditors for UWMF) and Deloitte and Touche. Requests for Proposal will be issued in December 2004, and a selection will be made by early March 2005.*

*In the past actuarial service were provided by WellPoint corporate personnel. In 2005 these services will be provided by Actuarial & Healthcare Solutions, LLC.*

## **Business Plan**

22. Please provide a description of the types of policies the Unity currently makes available. The company's own internal descriptions of product types and customer types, that is, how the marketing department tracks the product mix, would be most helpful.

*A- See the Marketing Report marked as Attachment #22.*

23. Which types of insurance programs and services will University Health Care, Inc. direct Unity to prioritize for growth and development following the proposed change in control?

*A- HMO, POS, HSA*

24. Will University Health Care, Inc. direct Unity to expand its service area or increase its presence in any region of this State?

*A-At this time there are no anticipated business plan or service area changes contemplated. However, it should be noted that in 2004 and under BCBS/WellPoint , Unity expanded its service area to include Fond du Lac, Jefferson and Walworth Counties this year. Through the normal course of business, Unity and UHC will assess the results of that expansion.*

25. Which types of insurance programs and services will University Health Care, Inc. direct Unity to seek to reduce or terminate following the proposed change in control?

*None. However, it should be noted that UHC intends that Unity will continue its participation with Medicaid.*

26. Will University Health Care Inc. direct Unity to reduce or terminate services in any region of this State in which it is currently active?

*A- No.*

27. Does University Health Care, Inc. plan to direct Unity to purchase or sell any books of business over the next twelve months?

*A- UHC has no plans to purchase or sell any book of business in 2005.*

28. Does University Health Care, Inc. anticipate any changes to Unity's marketing practices or distribution channels?

*A- Unity's current approach to marketing practices and distribution channels is not expected to change and will rely on Unity's agency relationships and its internally employed sales force, and not employees of the WellPoint's sales force.*



29. What is planned level of capitalization for Unity following the change in control? What is the intended form of capitalization, that is, among common stock, preferred stock, surplus notes, gross paid-in and contributed surplus, and unassigned funds?

*A-Unity will initially be capitalized on January 1, 2005, at the same level it is capitalized at December 31, 2004 which is projected to have a risk based capitalization ratio of 485%.*

*Please note, that, in the first quarter of 2005 Unity will file a request with OCI to distribute certain amounts of Unity surplus in excess of RBC industry standards to UHC, in an amount approximating \$17 million which may reduce Unity's risk based capital ratio to 250%. Refer also to the attached forecasted balance sheets and risk based capitalization ratio worksheets. Unity and UHC fully understand that such a request shall be subject to OCI's thorough review and approval. Please see worksheets marked as Attachment #29 and worksheets attached in response to Question #31.*

30. What effect, if any, would the change in control have on the factors determining rate levels?

*A-None. UHC expects that its provider reimbursement agreements and actuarial risk model concerns regarding increasing health insurance premiums will continue to be the primary influences over rates. Rating methodology is not intended to change beyond that which is expected through the normal course of operations or by virtue of insurance regulation.*

31. Please provide the projected pro forma balance sheet and income statement for the first three years of Unity's operation following the proposed change in control.

*A-See attached forecasted income statements and balance sheets. Forecasted income statements were prepared by UHC staff in mid 2004 based on market and trend information. Balance sheets for Unity for December 31, 2004 and December 31, 2005 were also prepared by UHC staff based on actual results reported by Unity through September 30, 2004, Unity staff forecasts of operating results through December 31, 2004, and UHC staff projections for CY 2005.*

*Unity staff is preparing a budget for CY 2005 which will not be presented to the Unity Board until December 13, 2004, and the Unity staff has not prepared any forecasts or balance sheets beyond December 31, 2005.*

*Please see worksheets of forecasted income statements and balance sheets marked as Attachment #31.*

32. Unity currently has an arrangement to handle the indemnity portion of its point of service contracts. How will the indemnity portion of Unity's point of service contracts be addressed after the proposed change in control?

*A- Madison National Life Insurance Company will be the new carrier. The necessary filings have already been made with OCI and are currently under review by OCI Financial Examiner, Richard Hinkel.*

33. Describe University Health Care, Inc.'s plans for Unity's charitable contributions and commitment to community outreach after the change in control in comparison to past practices.

*A-Over the last two years, Unity has provided between \$115,000 - \$120,000 in corporate sponsorships and donations. UHC would expect to maintain that level over the foreseeable future. In addition as part of the UW Health, Unity will participate in many community service activities.*

34. Does University Health Care, Inc. have any plans, within the foreseeable future, to enter into discussions or negotiations with other entities concerning the purchase, sale, merger, or affiliation of Unity with such entities? Is University Health Care, Inc. aware of any entities that have an interest to acquire control or merge with Unity after the proposed change in control should the change in control be approved?

*A-In accordance with the fiduciary obligations of the Unity Board of Directors and the UHC members, discussions or negotiations with other entities concerning the purchase, sale, merger, or affiliation of Unity with such entities may occur as would be deemed in the ordinary course as proper to pursue. In particular, future partners bringing methodologies to help contain Unity operation costs and strengthen medical programs and membership bases would be pursued in the ordinary course, in each such case always subject to regulatory approval. To date, conceptual discussions have occurred with other Madison based and provider-owned HMOs, however none of the prior discussions has evolved to any point where one could conclude that any party has any intent to acquire or merge with Unity.*

#### **Source of Funds for the Proposed Acquisition of Control**

35. Please provide a legal analysis supporting the authority of University of Wisconsin Hospitals and Clinics Authority to provide University Health Care, Inc. with funds to purchase a health maintenance organization.

*A-The University of Wisconsin Hospitals and Clinics Authority (UWHCA) has the authority to provide University Health Care, Inc. (UHC), with the funds to purchase a*

*health maintenance organization Chapter § 233.03(9), Wis. Stat., grants UWHCA the power to:*

*“(9)(a) With any other person, establish, govern and participate in the operation and financing of any corporation or partnership that provides health-related services, if the articles of incorporation of any such corporation conform with par. (b) and if the corporation or partnership provides the secretary of administration, the legislative fiscal bureau and the legislative audit bureau access to examine any books, records or other documents maintained by the corporation or partnership and relating to its expenditures, revenues, operations or structure. The authority may provide administrative and financial services to any such corporation or partnership.*

*“(b) The articles of incorporation of any corporation under par. (a) shall provide that the secretary of administration, the legislative fiscal bureau and the legislative audit bureau have the access required under par. (a).”*

*UHC is a not for profit non-stock corporation organized pursuant to ch. 181 Wis. Stats. and its purpose is to promote the interests of the UWHCA, the University of Wisconsin Medical Foundation (“UWMF”), and the University of Wisconsin Medical School (“UWMS”). In that regard and in practice, UHC provides health-related services and it satisfies the other requirements of Ch. 233.03 Wis. Stats. Thus, UWHCA can and does participate in the governance, operation and financing of UHC.*

*Furthermore, ch. 181.0302 Wis. Stats., outlines the general powers of a non stock corporation and governs the corporate activities of UHC, including, among other general powers, the following:*

*“(6) INTERESTS IN OTHER ENTITIES. Purchase, receive, subscribe for or otherwise acquire, and own, hold, vote, use, sell, mortgage, lend, pledge or otherwise dispose of, and deal in and with, shares or other interests in, or obligations of, any other entity.”*

Q-Please describe the source and governance of the funds that are to be used for this purpose.

*A-Internal cash funds approved by the UWHCA Board of Directors.*

36. Please provide a copy of the resolution of the University of Wisconsin Hospitals and Clinics Board authorizing the contribution of funds to University Health Care, Inc. for the purpose of purchasing Unity.

*A-See Group Attachment #36.*

37. Please provide a legal analysis supporting the University of Wisconsin Medical School Foundation, Inc.'s authority to provide University Health Care, Inc. with funds to purchase a health maintenance organization.

*A-The UWMF is a 501(c)(3) not for profit non-stock corporation organized under ch. 181 Wis. Stats. The UWMF was created in 1996 to support the clinical practices of the of the UWMS faculty physicians, formerly the UWMS clinical group practice plans.*

*The corporation was established under the direction of the University of Wisconsin Board of Regents ("BoR") following a BoR resolution dated the May 12, 1995. On that date the BoR resolved that the UWMF was a "reasonable and necessary instrument through which these physicians and health care specialists should support their clinical care activities," and established an "Agreement Between the UW Board of Regents of the University of Wisconsin System and the University of Wisconsin Medical Foundation ("BoR Agreement")" to specify the relationship of the UWMF with the BoR.*

*The BoR Agreement outlines, among other things that the UWMF shall provide income and other support for the missions of the UWMS, and recites that the UWMF shall have certain powers to act which are consistent with its corporate purpose, including participation in subsidiary corporations. Paragraph 22, of the BoR Agreement, entitled "Subsidiary Corporations," allows UWMF's participation as a member in the UHC corporation, stating as follows:*

***"Subsidiary Corporations***

*"Using that portion of its aggregate professional income not committed to the State of Wisconsin, the Foundation may create or invest in such subsidiary corporations or other business entities as may be necessary or convenient to carry out the purposes of the Foundation as set forth in its Articles and Bylaws."*

*Furthermore, Paragraph 34 of the BoR Agreement states:*

*"The Board of Regents and the Foundation mutually recognize that, in keeping with the intent of this Agreement and the Articles of Incorporation and Bylaws incorporated into it by reference, the Foundation will be developing relationships and affiliations with hospitals, clinics, health care provider organizations, third-party payors and managed health care systems, and may, in addition, create subsidiary corporations or other business entities to further effect its essential purposes."*

*The UWMF Corporate Bylaws contain a complete list of the UWMF's corporate purposes ( Attachment 37 ) which include the effective and efficient delivery of health care to its patients, including Medicaid and Medicare patients, and to manage its relationships with payors for that care.*

*In order to effectuate these purposes, and in accordance with ch. 181.0302(6) Wis. Stats., UWMF and UHC may:*

*“Purchase, receive, subscribe for or otherwise acquire, and own, hold, vote, use, sell, mortgage, lend, pledge or otherwise dispose of, and deal in and with, shares or other interests in, or obligations of, any other entity.”*

*On this basis, UWMF has the right to invest in a subsidiary corporation for interests which meet its corporate purpose and which ultimately support the missions of the UWMS.*

Q- Please describe the source and governance of the funds that are to be used for this purpose.

*A-The source of these invested funds is the UWMF's investment accounts and reserves generated from its accumulated net revenues excess over expense, as approved by both the UWMF Board and its Finance Committee. Funds which are committed to the specific support of the UWMS are not being used to invest in UHC.*

*Please see Attachment #37.*

38. Please provide a copy of the resolution of the Board of the University of Wisconsin Medical Foundation, Inc. authorizing the contribution of funds to University Health Care, Inc. for the purpose of purchasing Unity.

*A-Please see Group Attachment #38.*

39. Of the \$45,100,000 required to effectuate the proposed change of control, how much will be contributed by each of the University of Wisconsin Hospitals and Clinics Authority and the University of Wisconsin Medical Foundation, Inc?

*A-Please see Attachment #29, in response to Question #29 for the schedule for the contribution amounts between UWHC and UWMF.*

Q-What alternative purposes or plans do these entities have for the use of these funds?

*A- Typical alternative purposes for these funds would be for capital expenditures to support the multiple missions of UWHC, UWMF and UHC.*

Q- Please describe the rationale for use of these funds as proposed rather than alternative purposes.

*A - UHC believes that acquisition of Unity will result in a positive return on investment through equitable provider reimbursement. In the past, positive returns were used to support profit as opposed to patient care. It is intended going forward that these returns will be used to support the corporate purposes of UHC's members to support the mission of the UWMS through improved teaching, research, and community service for all of Wisconsin's citizens.*

40. Are the funds that the University of Wisconsin Hospitals and Clinics Authority and the University of Wisconsin Medical Foundation, Inc. intend to provide to University Health Care, Inc. for the purpose of purchasing Unity derived from general purpose revenue or other public funding?

A- No.

41. Will the contribution of \$45,100,000 to University Health Care, Inc be an outright contribution, or does this contribution carry certain obligations beyond those implied by University Health Care, Inc.'s articles of incorporation and bylaws? If the latter is the case, please describe these obligations and provide copies of any supporting written documentation.

*A-UWHC and UWMF will capitalize UHC such that it can make the purchase. The booked investment or basis in UWHC's or UWMF's membership interest in UHC, will increase accordingly. The contributions do not carry obligations beyond those implied by UHC's articles of incorporation or bylaws.*

If you have any questions on our responses please contact Richard Seligman at 414-277-3442.

Sincerely,



Jane Barnett  
CEO University Health Care, Inc.

cc: Richard M. Seligman, Michael Best & Friedrich LLP  
Claudia Sanders, University of Wisconsin Medical Foundation  
James Roberts, University of Wisconsin Hospitals and Clinics Authority