STATE OF WISCONSIN

BEFORE THE OFFICE OF THE COMMISSIONER OF INSURANCE

2005 JUN 16 PM 12: 02

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WISCONSIN COMMISSIONER
OF INSURANCE

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 ("Applicants")

Case No. 04-C29283

Applicants' Reply Brief on Physicians Insurance Company of Wisconsin, Inc.'s Party Status

Introduction.

On June 10, 2005, Applicants filed a brief in opposition to Physician Insurance Company of Wisconsin, Inc. ("PIC-Wisconsin") motion to become a party. Arguments contained in that brief are adopted for purposes of this brief. We wish to focus on the major points advanced by PIC-Wisconsin. Under a proper reading of the statutes, PIC-Wisconsin has not sustained its burden.

Rather than addressing the law, PIC-Wisconsin spends much of its Brief trying to cast the Applicants into the role of a corporate raider seeking a "hostile" takeover, and otherwise disparaging the Applicants. This is a classic red herring. By attempting to shift the focus of these proceedings and by casting baseless aspersions at the Applicants, PIC-Wisconsin hopes that the Commissioner will ignore the legal standards and base a decision on a doomsday scenario. The Commissioner should not fall for this ploy. As the Commissioner is aware, the Applicants have committed that they do not plan to change the fundamental business operations of PIC-Wisconsin, gutting the crux of the argument advanced by PIC-Wisconsin in its request to participate as a party. The Applicants' commitment cannot be more plainly stated than it was in the Form A. Furthermore, the Commissioner can guarantee this "parade of horribles" does not happen by simply requiring the Applicants and/or PIC-Wisconsin to seek

prior approval from the Commissioner before they institute a change in PIC-Wisconsin's business operations.

Moreover, PIC-Wisconsin's Board has refused multiple offers to meet with the Applicants to judge the issue for itself, and instead adopted protective measures that mean the Applicants cannot purchase a single additional share of stock without triggering the poison pill. Therefore, its entire argument is specious when viewed in context. The Commissioner is more than capable of doing what his office does in every other case – review the application and ask any questions necessary to protect the policyholders and the public.

Motivation Does Not Equal The Type of Unique Interest Necessary To Qualify As A Party.

There is no question that PIC-Wisconsin is fighting hard to get in to this proceeding as a "party". But PIC-Wisconsin's aggressive stance on party status and its desire to be a party do not square with the statutory criteria to be applied by the Commissioner.

As used in § 227.44(2m), the words "substantial interest" and "affected by the decision..." must be given meaning. We suggest that § (2m) must be read *in pari materia* with § 227.42(1). The identical words "substantial interest" appear in § 227.42(1) and the concept of "injury" to that interest is introduced. "Injury" is similar to "affected by the decision..."

§ 227.42(1) makes clear that the "injury" must be "different in kind or degree from injury to the general public...." The Blue Cross & Blue Shield United of Wisconsin conversion case, discussed below, is evidence that the Commissioner's Office reads the statute like Applicants.

Any analysis must start from the proposition that PIC-Wisconsin is not a "policyholder." Much of the statutory scheme revolves around protecting the policyholder. Only a "policyholder" could be "injured" or "affected" by the decision — not a putative party who pretends to represent policyholders.

Will PIC-Wisconsin Be Injured By A Favorable Decision Granting The Application For Approval?

Can PIC-Wisconsin demonstrate an injury? Of course not. Policyholder injuries are a matter of public policy protection and are the focus of the inquiry in the statutes. But PIC-Wisconsin's concern for the effect on policyholders is just that: a concern. That interest cannot be the subject of a direct injury to PIC-Wisconsin since PIC-Wisconsin is not a policyholder.

PIC-Wisconsin argues that it has party status under § 611.72(3)(e), which brings into issue "the competence of integrity of those persons who would control the operation of ...its parent insurance holding corporation." But, that same Section talks about the "interest of the policyholders of the corporation and of the public", not the interest of the insurer itself.

A recent example may help illustrate this distinction. Dean Health Plan is the holder of more than 10% of the stock of PIC-Wisconsin. Dean Health Plan filed a document on April 22, 2003 entitled "Rebuttal of Control of Physicians Insurance Company of Wisconsin." That disclaimer was accepted by the Office of the Commissioner of Insurance and no hearing was held when Dean crossed the 10% threshold. Assume that Dean opposed and voted against the Shareholder Value Plan proposed by PIC-Wisconsin to its shareholders in 2003. The Plan failed to get shareholder support.

As events illustrate, Dean was not in a position to "control" the corporation because more than 80% of the shareholders voted individually or by proxy on that Shareholder Value Plan.

Moreover, was PIC-Wisconsin "injured" by having to market its Shareholder Value Plan to its shareholders, like any other stock company? Was it "injured" by having the plan defeated? PIC-Wisconsin was not "injured" in a way that is recognized under § 611.72(3). There is a great difference in management being rebuffed by its shareholders and an "injury" to the interest of the policyholders or the general public. Like every other stock corporation, PIC-Wisconsin is subject to shareholder rights and democracy. As a stock corporation it cannot complain if its shareholders exercise the rights which they have by virtue of the laws governing

stock insurance companies. To decide otherwise would be to suggest that a company somehow suffers an injury any time management or the Board of a company is rebuffed by its shareholders. To the contrary, this is not an injury, it is exactly what the legislature intended in adopting statutes applying to stock insurance companies.

Finally, PIC-Wisconsin's interest here is conjectural that is, if the application is granted PIC-Wisconsin may suffer alleged injury. So to suggest that PIC-Wisconsin has a "substantial interest" which will be "injured in fact or threatened with injury" is fanciful and purely speculative.

PIC-Wisconsin's Asserted Interests In This Proceeding Are Clearly Not Protected By The Legislature.

§ 611.72(3) represents a clear legislative compromise between a free market for securities of insurance companies on the one hand and concern for the interest of policyholders and the general public on the other. One looks in vain for language in § 611.72 which discusses entrenching management or diminishing the rights of shareholders to sell their shares or to participate in corporate governance. The focus of § 611.72 is on policyholders and the general public as a whole, which are the principal concerns of the Commissioner. What PIC-Wisconsin is attempting to do is to hijack this proceeding and turn it into a forum where it will spend any amount of time and money necessary to delay these proceedings while at the same time fostering a climate in which management will be immune from challenge. The Commissioner's staff are equipped to ask and have answered those questions which effect the policyholders and the general public in this proceeding without the assistance of PIC-Wisconsin. Many questions have been raised; from among them the Commissioner can determine what is of interest and procure evidence on those questions independent of PIC-Wisconsin's status as party.

The Blue Cross Blue Shield United of Wisconsin Conversion Case cited by PIC-Wisconsin Requires That Their Request For Intervention As A Party Be Denied.

Commissioner Connie L. O'Connell stated in *In re Application for Conversion of Blue Cross & Blue Shield United of Wisconsin* (Office of the Comm'r of Ins. November 29, 1999) (Decision on Motions To Intervene as Parties) (hereinafter, "*BCBSUW*") the test for participation in a contested case as a party is as follows:

> To have standing as a party in the contested case the petitioners must meet a two part test. They must demonstrate that the decision of the agency causes injury to their interest and the interest they are asserting is recognized by law. (*BCBSUW* at 2)

The Commissioner's Office has adopted the "injury" standard in applying the statute and has further required that a "potential injury" be different from the "potential injury" to a member of the general public. *BCBSUW* at 2. This is precisely the standard Applicants have articulated. "Affected by" is not enough.

We suggest that the Decision in the *BCBSUW* conversion case is controlling precedent and that its clear implication is that PIC-Wisconsin's request for party status must be denied. As noted above, and in our first brief, there is no evidence in § 611.72 that the legislature intended to entrench management or to limit shareholder rights or shareholder democracy. Instead, the focus is on the policyholder and the interest of the general public in competition.

Beginning at page 9, PIC-Wisconsin attempts to spell out its interests. First, it argues that its interests are substantial because "PIC-Wisconsin shares are not publicly traded", [PIC] is insulated from customary the pressure to maximize shareholders' investments...In addition, because PIC shareholders and policyholders are often one and the same[1], PIC's conservative outlook balances their dual interest...." PIC-Wisconsin asserts that "it subscribes to a conservative business philosophy...." Finally, it argues that approval of the Form A "will likely

[1] In fact, as PIC-Wisconsin finally concedes at page 10 of its Brief, less than 50% of its current shareholders are even policyholders.

jeopardize PIC-Wisconsin's financial stability." These claims assert facts which are wholly inconsistent with the Form A and, indeed, with the position of a 24% shareholder. Consider the following:

1. PIC-Wisconsin has adopted a poison pill and shark repellants. The Applicants cannot purchase additional shares without triggering those devices.
2. Following the transaction, PIC-Wisconsin will continue with the same Board of Directors, the same strategic plan, the same business philosophy, the same financials and the same management.
3. All that Applicants have asked to do is to seek one Board seat.
4. Applicants cannot obtain that Board seat unless a proposed Board Member is elected by a majority of the shareholders voting in person or by proxy for such candidate.
5. Applicants have disclaimed any intent to make material changes in the business philosophy of the company.
6. PIC-Wisconsin's philosophy continues to be directed by its Board of Directors and implemented by its management.
7. PIC-Wisconsin will not become a public company unless and until a majority of its shareholders determine that step is in the best interest of the company -- presumably with approval of the Board and management's recommendation.

PIC-Wisconsin next argues at page 12 that its interests are unique. While PIC-Wisconsin may have a unique interest it is not an interest recognized by the statute. PIC-Wisconsin's brief states as follows:

> If the Form A is approved, PIC-Wisconsin'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 the dominant shareholder and at least one Board Member with

whom it wants no association and its corporate philosophy is adverse to PIC-Wisconsin's history and core values.

This ignores the fundamental proposition that the shareholders actually own the Company and those shareholders have rights pursuant to state statute to participate in the governance of the Company. To suggest that there is something wrong with the Company being subject to the influence of its shareholders is a frightening assertion. It is certainly not one embedded in the law or recognized in § 611.72. PIC-Wisconsin's position is perhaps unique from a corporate governance standpoint but it is not unique in the sense that its asserted interest is recognized in the statutes.

The notion that APA would put $17,000,000 into an investment in this company and then behave in a way to harm its strength and stability is a matter which can be judged by the Commissioner of Insurance without PIC-Wisconsin's assistance. We now see that PIC-Wisconsin's argument is grounded on preserving the status quo and preserving current management's view of the company free from challenge or inquiry by its shareholders.

OCI Case Number 88-C20269 In Which Alleghany Corporation Sought To Acquire 20% of the Stock of Saint Paul Company, Inc. Is Not Helpful to PIC-Wisconsin.

Despite the great reliance of PIC-Wisconsin's Brief upon *In re the Acquisition of Stock of the St. Paul Companies, Inc., Including St. Paul Fire and Casualty Insurance Company, a Wisconsin Corporation, and Whether the Acquisition Constitutes Acquisition of Control*, Case No. 88-C20269, (Office of the Comm'r of Ins. April 7, 1988) (Findings of Fact, Conclusions of Law, Final Decision, and Order) (hereinafter, "*St. Paul*), the *St. Paul* case is largely and, most importantly, factually distinguishable from this case given that in *St. Paul*:

1. Buyer sought to acquire 20% of the stock of a publicly-traded, Minnesota company ("Holding Company"), "which [was a] holding company for one of the largest groups of property-liability insurance underwriters in the United States, and [was] also engaged

through subsidiaries in investment banking and insurance and reinsurance brokerage activities." *St. Paul* at 1, 2. An indirect subsidiary of this Minnesota company ("St. Paul") was the Wisconsin "domestic insurer involved in..." the proceeding before the Commissioner. *St. Paul* at 4.

2. Wisconsin was experiencing a medical malpractice insurance crisis at the time of the *St. Paul* decision as a "number of insurance companies [had] withdrawn from writing medical malpractice insurance in Wisconsin within the [previous] ten years." and St. Paul "was" one of only a few insurance companies that [were writing] medical malpractice insurance in Wisconsin...." *St. Paul* at 4.
3. Buyer, a Delaware company operating out of New York, was originally a "railroad holding company" that was depicted in the *St. Paul* case as a corporate raider that had undertaken a series of transactions in various industries, taking equity positions in companies and subsequently liquidating these positions at a profit, as well as occasionally selling the assets of these companies. *St. Paul* at 2, 6-8.
4. Buyer entered into its acquisition of Holding Company's stock planning to exploit an opportunity it perceived (1) to extract "surplus from [Holding Company's affiliated insurance companies] that [Buyer] consider[ed] 'excess,' or beyond what [was] necessary to sustain the company" and (2) to sell certain Holding Company assets. *St. Paul* at 8, 14. Buyer hoped to use this "excess" capital from Holding Company's insurance companies to make further equity investments such as "a major acquisition of an operating company." *St. Paul* at 8. The Commissioner expressed concern regarding the possibility that if Buyer were to extract surplus capital from Holding Company's insurance companies, it would cause St. Paul to "end up with dangerously high" premium to surplus and reserve to surplus ratios if a downturn were to occur in the medical malpractice market. *St. Paul* at 17.

5. The Commissioner expressed concern that "Ownership of St. Paul by a noninsurance interest...creates the potential for conflict between the long-term interests of St. Paul's policyholders and the short-term profit interests of [Buyer's] shareholders." *St. Paul* at 17. Buyer intended to invest an amount equal to 100% of its net worth in Holding Company. *St. Paul* at 16. The Commissioner found that:

> It would be at best a remarkable set of circumstances to have an *investment company* invest almost all of its assets in an insurance company and just sit back and receive such dividends as the insurance company would declare....
>
> [Buyer] cannot survive if its only income from its assets is a dividend paid by [Holding Company]. It will have to try to improve its income through active management of [Holding Company] and its subsidiaries. (*St. Paul* at 20 (emphasis added))

6. Buyer did "not rule out going beyond 20%" ownership of Holding Company, and "No significant external forces [would] compel [Buyer] to remain passive at 20%." *St. Paul* at 14, 16.

By contrast, in this matter:

1. Applicants have submitted a Form A application to acquire 24% of a Wisconsin insurance corporation whose stock cannot otherwise be acquired on a stock exchange.
2. All parties agree that Wisconsin is free of any medical malpractice crisis. As described in Exhibit C to the Form A, over two dozen companies were writing medical malpractice insurance in Wisconsin as of 2003.
3. Unlike the Buyer in *St. Paul*, American Physicians Assurance Corporation has written medical malpractice insurance since its inception 30 years ago and was incorporated and is based in a state that is adjacent to Wisconsin. Also, unlike the corporate raider Buyer in *St. Paul*, which invested in various industries seeking to profit from fluctuations

in the price of the stock of companies it took positions in, Applicants, as discussed in the Form A, have made a limited number of investments in other lines of insurance and in other states. Furthermore, Applicants are focused on the medical malpractice insurance business in the Great Lakes region. Form A at 7-11.

4. Applicants are interested in the proposed transaction for investment purposes. They believe that an ownership interest in PIC-Wisconsin would appreciate over time, adding to the value of APA's statutory financials. Such an investment in PIC-Wisconsin would be consistent with APA's goal of concentrating on the medical malpractice market in the Great Lakes region. Form A at 9, 27.

5. As stated in the Form A at 27, Applicants would not seek any material changes to the management or operations of PIC-Wisconsin without first obtaining the Commissioner's approval. *See also* Applicants' Brief in Support of Requested Discovery at 7. Unlike the corporate raider Buyer in *St. Paul*, "APA has no current plans or proposals to liquidate PIC-Wisconsin, sell its assets, merge it with any other person or make any other material change in its business or corporate structure." Form A at 27. Furthermore, "APA has no plans or proposals to change the terms of the policies offered to Wisconsin policyholders." Form A at 28.

6. Applicants have no interest in bringing about a "doomsday" scenario, as did the corporate raider Buyer in *St. Paul*, of extracting any "excess" capital of PIC-Wisconsin which was of major concern to the Commissioner in *St. Paul*. As stated in the Form A at 28, "APA understands the limitations upon companies in a holding company system to declare dividends, and will do nothing to cause PIC-Wisconsin to violate such limitations."

7. Unlike the Buyer in *St. Paul* who planned to invest 100% of its net worth in Holding Company, Applicants plan to invest much less than their net worth in PIC-Wisconsin. Also unlike the Buyer in *St. Paul* who could not "survive if its only income from its assets

is a dividend paid by [Holding Company] (*St. Paul* at 20), as stated in the Form A at 27-28, "APA's financial condition is such that it does not need funds from PIC-Wisconsin to support APA's operations, as this investment is relatively small compared to APA's asset size, and APA will not take action to jeopardize the financial stability of PIC-Wisconsin." In fact, the investment here is 2.2% of APA's statutory invested assets as of December 31, 2004 and only 1.5% of its assets on GAAP basis – a dramatic difference from the *St. Paul* case.

8. Presumably, Holding Company in *St. Paul*, did not adopt a poison pill and shark repellents as did PIC-Wisconsin to prevent future stock acquisitions. Therefore, unlike the Buyer in *St. Paul*, there are external forces preventing Applicants from purchasing additional shares of PIC-Wisconsin.

9. Additionally, Applicants note well the concern the Commissioner expressed in *St. Paul* that the "mere presence of a 20% investor will cause concern among St. Paul's reinsurers and may, therefore, limit the amount of business St. Paul [and its parent] can write." *St. Paul* at 16. Although, as noted above, the facts of this matter differ greatly from those of *St. Paul*, Applicants stated in the Form A that:

> Wisconsin physicians receive excess medical malpractice coverage from the Patients Compensation Fund. APA believes a close working relationship between the company and its reinsurers, whether commercial or government sponsored, is necessary for an efficiently run claims operation. APA currently works with similar funds in New Mexico and Indiana without difficulty. (Form A at 28).

Applicants have been writing business as a medical malpractice insurer more than 10 years longer than PIC-Wisconsin and, unlike PIC-Wisconsin, APA's parent is subject to the reporting obligations of a public-company. Applicants are ever mindful of the fiduciary responsibility they owe to policyholders and have great appreciation for the comments of the

Commissioner in *St. Paul* that the "combination of general industry cyclicality and unique emphasis on 'long-tail' lines require[a medical malpractice insurer] to be operated in a very conservative manner," (*St. Paul* at 6) which PIC-Wisconsin makes reference to in its Brief at page 9.

Most important, the party and standing issues were apparently not litigated in the *St. Paul* case, and it accordingly has no precedential value on that question.

Conclusion.

PIC-Wisconsin has not carried its burden of showing that it has a substantial interest, *i.e.* one that is recognized by statute which will be "affected" or "injured" by the decision in this matter. PIC-Wisconsin has no special claim to represent policyholder interests which are protected by the statutes and its purported injuries are conjectural and hypothetical. To the extent that the Commissioner wants to hear from Wisconsin policyholders, the Wisconsin Medical Society has requested party status without objection by any proposed party and should participate.

Respectfully submitted this 16th day of June, 2005:

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