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## FACSIMILE TRANSMISSION

**DATE:** December 7, 2004

**To:**

NAME	FAX No.	PHONE No.
Steven Junior Office of the Commissioner of Insurance	(608) 266-9935	(608) 267-4388

**FROM:** Julie M. Rusczek **PHONE:** (414) 277-3463

**SENT BY:** Julie Rusczek **EXTENSION:** 3122 **LOCATION:** 31N

**RE:** Acquisition of Control of Unity by UHC (Case No 04-C29300)  
Responses to December 3, 2004 Questions

NUMBER OF PAGES, INCLUDING COVER:	6		
CLIENT-MATTER NUMBER:	092611-0001	SENDER'S ACCOUNT NUMBER	0122

**NOTES/COMMENTS:**

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December 7, 2004

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:

Responses to your questions posed in your December 3, 2004 letter are presented in the order of your questions and comments.

1. Since University Health Care, Inc. indicates that its preparedness to close on the transaction is now imminent, please indicate who will serve as directors, officers, and the senior management team of Unity following the merger and provide biographical affidavits for each such individual.

**Response:** The Unity Board of Directors will be as follows:

- Designated by University of Wisconsin Hospital and Clinics Authority:
  - Gary Eiler
  - James Roberts
  - David Entwistle<sup>1</sup>

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<sup>1</sup> David Entwistle has been a Senior Vice President at the University of Wisconsin Hospital and Clinics since July 2000. His office is located at 600 Highland Avenue, Madison, WI 53792. Prior to joining the University of Wisconsin Hospital and Clinics, Mr. Entwistle was the Vice President of Professional Services and Joint Operations at City of Hope National Medical Center in Duarte, California from 1999 to 2000. While in this position, he concurrently served as President and CEO of Oncology Management Services, Inc., an oncology management service organization of City of Hope. Other positions at City of Hope included Director of Operations from 1998 to 1999 and Manager of Operations from 1997 to 1998. Mr. Entwistle earned a Bachelors degree in Health Sciences from Brigham Young University in 1994 and a Masters in Health Services Administration from Arizona State University in 1996. He completed a postgraduate administrative fellowship at University of Texas M.D. Anderson Cancer Center in 1997. He has no criminal convictions.

- Designated by University of Wisconsin Medical Foundation:
  - Peter Christman
  - Susan Pelatzke

Officers will be elected per the draft by-laws, upon completion of the transaction. The individuals who have been selected to fill the Officer positions, as defined in section 4.1 of the draft Unity bylaws, shall be as follows:

President – Andrew Fabian

Vice President- Gail Midlikowski

Secretary --Nancy Sielaff

Treasurer-Edward Breunig

Andrew Fabian is currently Acting CEO for Unity Health Plans and will be the CEO upon completion of the reacquisition. The other senior management is and shall remain as has previously been described in the Form A Filing.

2. In item #3 of your November 18 letter, you indicate that legal, underwriting, sales, and human resource functions are being provided by WellPoint Health Networks Inc., and its affiliates through an administrative services agreement. What arrangements have been made for the continuation or replacement of these services following the acquisition of control? Please file any agreements with WellPoint Health Networks, Inc. regarding the assignment of sales or other staff to Unity.

**Response:** WellPoint has identified 16 employees who are within their corporate structure who perform the legal, underwriting, sales and human resource functions for Unity, some physically located in Sauk City and others located elsewhere. As part of the transaction, WellPoint has requested and Unity has agreed to provide these 16 employees with “letters of offer of employment” so that Unity will continue to function seamlessly. We expect that those employees necessary to conduct Unity’s operations will accept employment.

Following the acquisition, neither BCBS-Wi nor WellPoint Health Networks, Inc. will be providing staff or services to Unity.

3. In the redacted closed session minutes of the Finance Committee of the University of Wisconsin Medical Foundation’s August 17, 2004 meeting, there was discussion that WellPoint Health Networks, Inc. changed many of Unity’s policies and procedures with the implication that the previously existing policies, procedures, and systems would be restored. This seems in contravention to Item 5 of the Form A dated September 29, 2004, which stated, “Applicant intends to continue the business and operations of Unity as presently conducted. There are no plans by Applicant to make

any material changes in the operations and business of Unity.” Please reconcile this conflicting information with a description of the changes to policies, procedures, and systems that are anticipated following the acquisition of Unity.

**Response:** WellPoint instituted certain non-material operational processes and procedures, which outsourced certain facility functions.

Sue Pelatzke and Claudia Sanders attended the UWMF Finance Committee meeting closed session on August 17, 2004. Each reports that the minutes of the Closed Session discussion on August 17<sup>th</sup> refer to a new purchasing policy established by WellPoint for Unity relating to the office supply purchasing process, which was reported on to the Finance Committee by Ms. Pelatzke. Ms. Pelatzke described that under this system WellPoint required that its “associates” (i.e., Unity employees) request any needed pens, paper clips, staples, and other supply resources through an online request system which existed separate and apart from the Unity system. The requested supplies were then delivered by an outside vendor to employees on the next business day.

Ms. Pelatzke further reported to the Committee that at the Unity staff meeting, employees complained that the process was cumbersome. Therefore, it was agreed that following the acquisition Unity would return to an internal purchasing system using current staff. This was the only process change that was considered during the UWMF Finance Committee’s discussion at that time.

The office supply process identified above was not noted in Section V of the September 29, 2004 Form A Filing as it was not thought that this change was of such a material nature as to be responsive to the inquiry.

Ms. Pelatzke also reported to the Committee that WellPoint had initiated changes to medical management protocols. Since medical management is a critical component of Unity’s business operations, it was agreed that these actions should be reviewed post acquisition.

4. In the redacted closed session minutes of the Finance Committee of the University of Wisconsin Medical Foundation’s August 17, 2004 meeting, there was discussion of an “overassessment” of \$4.7 million, which was to be applied to the purchase of Unity. Please describe what is meant by the use of the term “overassessment”?

**Response:** UWMF, as the clinical support organization for the UW Medical School Faculty, receives a pre-determined percentage of the physicians’ revenue to cover certain costs of the various operations of the organization including support of clinical, billing, and business office operations. “Overassessment” in this case represents the positive difference between UWMF’s revenue received and its budgeted expenses.

This difference for the fiscal year ending June 30, 2004, was reported at the August 17, 2004 Finance Committee meeting closed session in order to obtain approval for use of those funds for the Unity purchase, as noted in the redacted closed session minutes.

5. In the Finance Committee minutes mention is made of "excess cash in the amount of \$16.8M." What is being referred to by the term "excess cash"?

**Response:** In analyzing the Unity acquisition, UW Health calculated an estimate of the amount of funds in Unity working capital that it believed to be above the capital required by Unity. UHC fully understands OCI's responsibility with regard to the financial review of Unity.

6. Item #29 of your November 18 letter indicates that Unity intends to request an extraordinary dividend in the first quarter of 2005 to reduce Unity's risk-based capital ratio to 250%. It should be noted that risk-based capital is not an insurance industry tool for determining a target level of capital. The intended risk-based capital level suggested or being targeted is problematically low, and OCI would look very closely and might very likely not approve a dividend request until new ownership and management have posted a track record that is sufficient to evaluate their financial and operational performance.

**Response:** We fully understand that OCI would look carefully at any dividend request and as noted in question # 7 we are not expecting that such a dividend is necessary in order to fund the acquisition. If we do bring forward a request for dividend, we will ask that OCI look at the Unity capital in comparison to national and state guidelines and to Unity's historical ratios.

We also expect that most, if not all, current management continues with Unity in 2005 and beyond. UW Health personnel who have intimate knowledge of Unity operations and have been involved with Unity for years will also continue their involvement with the HMO. From a management/ownership perspective, we expect a smooth transition.

7. If a dividend were not requested and/or approved in the first quarter of 2005, will University Health Care, Inc. or its members need to adjust its proposed method of funding the acquisition of Unity?

**Response:** No, neither UHC nor its members will need to adjust its / their proposed method of funding the acquisition of Unity if a dividend is not requested or if it is not approved. UWMF, UW Health and UHC have all the corporate authorizations necessary to fund and to proceed with the acquisition of Unity.

8. The response to question 39 includes a statement that a positive return on the acquisition investment will be a result of the transaction through "equitable provider reimbursement." Does this response suggest a change in how providers will be

reimbursed? If so please provide information regarding the changes anticipated in provider reimbursement.

**Response:** University Health Care, Inc., currently receives capitation for Unity Dane members and a "fee for service" arrangement for non-Dane members. In recent years, UHC and its underlying providers, as was outlined in the Form A filing, have incurred material financial losses under Unity contracts. Consequently, what naturally should be expected under academic and non-profit provider HMO ownership is that the approach to provider reimbursement rates will be to pay at compensatory levels that appropriately cover academic provider costs and not to price provider costs simply to produce and create profits for dividend distribution to for-profit stockholders.

From a consumer impact standpoint, since UHC intends that the provider pricing approach will merely trade some portion of what was dividend profit dollars for appropriate provider reimbursement levels with the goal that Unity will otherwise achieve an appropriate bottom line, there will be no differential impact on premium levels or the financial integrity of Unity.

If you have any questions on our responses please contact me at 608-265-5555 or 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