



State of New Jersey  
DEPARTMENT OF BANKING AND INSURANCE  
DIVISION OF INSURANCE  
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STEVEN M. GOLDMAN  
*Commissioner*

October 14, 2008

John W. Campbell  
Senior Vice President, General Counsel and Secretary  
Horizon Healthcare Services, Inc.  
Three Penn Plaza East  
Newark, New Jersey 07105-2200

Re: Plan of Conversion to a Domestic Stock Insurer

Dear Mr. Campbell:

The Department of Banking and Insurance ("Department") has completed its initial review of the Plan of Conversion to a Domestic Stock Insurer ("Plan") and the accompanying documents submitted by Horizon Healthcare Services, Inc., doing business as Horizon Blue Cross Blue Shield of New Jersey ("Horizon"). A filing was received on August 15, 2008 that sets forth the proposed plan by which Horizon will convert from a nonprofit health service corporation to a stock insurance company. The Department has concluded that the Plan, and the materials delivered in connection with it, are incomplete, and the Department hereby requests that Horizon furnish the additional items described below. Following receipt and review of these items, the Department will determine whether the application is complete or requires further supplementation.

The Department notes that the business plan contained in the application to convert is confidential pursuant to N.J.S.A. 17:48E-58b. Accordingly, the findings of incompleteness regarding the business plan are contained in a separate letter. Moreover, the comparative premium rate analysis submitted with the application to convert as required by N.J.S.A. 17:48E-51b (6) has been marked confidential by Horizon. The Department and the Attorney General have not yet determined whether the comparative premium rate analysis satisfies the standards for confidential treatment set forth at N.J.S.A. 17:48E-58b. Accordingly, at this time the Department's comments regarding the insufficiency of the comparative premium rate analysis are contained in a separate letter. If a determination is made that the comparative premium rate analysis is not confidential, in whole or in part, under N.J.S.A. 17:48E-58, some or all of the contents of that letter may be released to the public.

Exhibit M indicates that the stock given to the Foundation will be significantly restricted with respect to, inter alia, voting rights, nomination of directors, and required divestiture. The Commissioner may find that the entire fair market value of Horizon is transferred to a foundation only if he determines that such restrictions are necessary and reasonable to maintaining the value of the assets of the converted insurer. To assist the Commissioner in making this determination, N.J.S.A. 17:48E-54 c (2) provides that the Commissioner may require an appraisal of the diminution in value of the stock as a result of the restrictions, which appraisal shall take into consideration the increase in value of the shares on account of any registration rights granted to the foundation in connection with shares of capital stock of the converted insurer. The Commissioner has decided to have his consultants perform such an appraisal and Horizon is directed to provide the Commissioner's consultants with all information they require for the appraisal.

Section 6.04 asks the Commissioner and the Attorney General to consult with Horizon with respect to the nature and scope of the cost of their consultants. Such consultation is not required by N.J.S.A. 17:48E-51 and 64b and should be removed from the application.

Appendix G, the Amended and Restated Certificate of Incorporation of Horizon Healthcare Services, Inc., indicates that Horizon does not intend to change its name following conversion. However, N.J.S.A. 17B:18-4 a (1) requires that the name of a domestic stock insurer contain the words "insurance company" or words of similar connotation which shall not so closely resemble that of any existing insurer or other corporation as to be likely to mislead the public. Accordingly, the legal name of the converted company must be revised and set forth in the Plan.

The indemnification provisions in Horizon's Amended and Restated Certificate of Incorporation contained in Appendix G must exclude proceedings by or in the right of Horizon, must indicate that the director, officer, employee or agent acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of Horizon. With respect to criminal proceedings, the officer, director, employee or agent must have had no reasonable cause to believe his conduct was unlawful. N.J.S.A. 14A:3-5 (2) (a) and (b).

We ask that you provide the following information to this office in hard copy (six copies) and in electronic form in accordance with the Commissioner's Order No.A08-116. The documents should be Bates-stamped and indexed sequentially in accordance with our questions. In responding to our questions, you may make reference to documents you have already submitted by citing to the specific document by title, page number and paragraph. However, please also submit a properly indexed and Bates-stamped copy of the document.

1. Please provide a general corporate history of Horizon and its affiliates, including for each entity the dates of formation and state of incorporation of each affiliate, its current federal, state, and local exempt tax status, and previous federal, state and local tax-exempt status, if different. For each related entity that has been tax-exempt at any time, please provide any letter, certificate of exemption, or other determination issued by a taxing authority. Please provide any letter, case, or other determination denying any federal, state, or local tax exemption.
2. Please explain what safeguards have been taken to assure that the persons referred to above and other affiliates of Horizon will be compensated only at fair market value after completion of the conversion.
3. Please explain if Horizon's current employment agreements with officers, senior officers, directors and salaried employees comply with the 24 month limitation in N.J.S.A. 17B:18-52 b 3.
4. Is Horizon currently taxed for federal income tax purposes pursuant to Internal Revenue Code section 833? How will conversion affect Horizon's federal, state and local tax status?
5. N.J.S.A. 17:48E-55 (b) provides that for so long as the foundation owns at least 10% of the shares of stock of the converted insurer or its parent issued to the foundation upon conversion, additional shares of capital stock of the converted insurer or its parent or other securities convertible into shares of such capital stock cannot be issued without the Commissioner's prior approval, which is to be granted only if the converted insurer demonstrates to the commissioner's sole satisfaction that the sale would not materially dilute the shares distributed to the foundation and that all shares and other securities so sold and in any sale under N.J.S.A. 17:48E-54e are priced in a manner consistent with the fair market value of the aggregate equity of the converted insurer or its parent at the time of sale. The statute goes on to state that the sale of capital stock in a firm commitment underwritten public offering is presumed to satisfy these standards as long as the capital stock is of the same class and series as the stock owned by the foundation. Explain how Exhibit D's inclusion of transactions other than firm commitment underwritten

public offerings is consistent with the statute's presumption of compliance for firm commitment underwritten public offerings only.

6. Unlike the conversion plans of other Blue Cross Blue Shield entities, this plan does not include any caps on rate increases, any commitment to remain in underserved markets, or any commitment to maintain the surplus of the converted company at a certain level. Provide Horizon's evaluation of these elements and how they might affect a finding that the plan is fair and equitable, and promotes the public interest, as required by N.J.S.A. 17:48E-52.
7. The proposed Restructuring is subject to a separate filing and approval process under N.J.S.A. 17:27A-2. It therefore should be removed from this plan in terms of approval. Is restructuring a condition of the conversion?
8. N.J.S.A. 17:48E-54e allows for a simultaneous offering of shares of authorized but unissued capital stock for cash to directors, officers and employees subject to a 5% cap on the aggregate shares of capital stock to be used by the converted insurer pursuant to the plan of conversion to be offered for purchase by directors, officers and employees and subject to the one year limitation for directors and officers at N.J.S.A. 17:48E-57. The plan contains no provisions for such offering. Is it Horizon's intent that the converted company will not be adopting stock option or grant plans for directors, officers or employees on conversion?
9. Article 2 states that the purpose of the conversion is to enable Horizon "to realize its vision of being the best health plan in New Jersey by improving [Horizon's] ability to serve its customers, strengthening its financial position and allowing it to provide competitive products and services in today's healthcare marketplace." Explain how conversion will accomplish these goals or how remaining a health service corporation prevents the achievement of these goals.
10. Details of the purpose of the conversion are set forth in Exhibit A, which refers to the following reasons for conversion: (1) to realize Horizon's vision of being the best health plan, both locally and nationally, by helping its members become and stay healthy; (2) to obtain financial flexibility needed to make significant investments to continue to provide market-leading services to members and other constituents and to position the company for flexible response to future state and national health care reform; and (3) to maintain its financial strength, particularly its Standard & Poor's rating. The Department has the following questions regarding the stated purposes of conversion and believes that the Plan of Conversion should address these questions.
  - a. How does Horizon measure whether it is the "best health plan" and how will conversion increase such measurement? Why is being the "best" consistent with Horizon's statutory mandate to provide health care services to members?
  - b. How does Horizon currently help its members become and stay healthy as stated in the plan and how does it intend to do so in the future?
  - c. Does the reference to Horizon's vision of being the best health plan nationally mean that it intends to expand operation into other states after conversion? If so, please detail such expansion plans.
  - d. What specific investments does Horizon plan to make to provide market leading services to members and other constituents? Does this refer to services already offered by competitor plans such as electronic referrals and provider ranking?
  - e. Provide detail as to how conversion will enable Horizon to respond better to state and federal health reform.

- f. Explain how conversion enhances Horizon's ability to earn and maintain ratings from Standard & Poor's and other rating agencies.
11. Appendix A states that Horizon has significantly improved the quality of health care in New Jersey through the introduction of education, prevention, wellness, and care management programs. What is the approximate annual cost to Horizon of these programs? How does Horizon measure the improvement in the quality of health care resulting from such programs? How are these programs relevant to the conversion application, i.e. how does not converting prevent or inhibit further improvements?
  12. Appendix A refers to Horizon's status as the exclusive licensee of the Blue Cross Blue Shield Association ("BCBSA") in New Jersey.
    - a. Please provide a copy of the current license agreement between Horizon and BCBSA and any addendum thereto.
    - b. Submit a copy of the "capital, ownership and operating requirements of BCBSA" that are referred to in Appendix A, including all requirements relating to converted Blue plans.
    - c. Provide a copy of the BCBSA rules, identifying those that require restrictions on stock ownership following conversion.
  13. Has Horizon notified the BCBSA of the proposed conversion? Has the BCBSA approved or otherwise commented on any aspect of the proposed conversion? Attach copies of all communications (including electronic communications) with the BCBSA regarding the proposed conversion.
  14. Provide a description of the national BlueCard system and a copy of the BCBSA's requirements regarding BlueCard.
  15. Has Horizon considered giving up its status as a licensee of the BCBSA? How would Horizon's status as exclusive licensee be affected if it were to withdraw from certain markets, such as Medicare Part D, Medicare Advantage, Medicaid managed care, or from certain regions of the state, such as southern New Jersey?
  16. Appendix A states that Horizon "must invest an estimated \$100 to \$150 million (over and above the current annual expenditure of approximately \$35 million) to develop new systems and capabilities over the course of the next five years." Please describe in detail the nature and expected timing of these investments and the precise functional improvements that would result.
  17. Page 4 of the Plan states that Horizon has been forced to limit investments in capability development to maintain financial strength and competitive pricing in the past years by spending \$35 million in 2008 versus a required investment level of twice that amount. This suggests that only an additional \$35 million per year is needed. How does this expenditure impact achievement of the goals identified above? How is the need for an additional \$35 million per year for capability development consistent with Horizon's decision to voluntarily return \$50 million to policyholders as an affordability dividend in 2005? How is the need for the additional \$35 million per year consistent with Horizon's commercial market pricing at a level that appears to be breakeven or less?
  18. What alternatives did Horizon consider other than conversion in order to generate the additional \$35 million per year needed for system capabilities? Please identify each alternative considered, by whom it was considered, and why it was rejected. For example, were surplus notes considered? Was the public offering of some or all of the shares of the health maintenance organization ("HMO") subsidiary considered?
  19. Please provide more detail on why Horizon feels that its financial strength would be jeopardized by an additional \$35 million per year investment in capability development for the next five years. Since Horizon's pricing policy has been much more aggressive than

- its competitors as evidenced by its underwriting losses in 2007 and 2008, did the company consider adjusting its pricing to allow for the required investment in capability development? Furthermore, would some of the amounts invested be considered admitted assets, and thus not directly affect Horizon's reported financial strength?
20. Page 5 of Appendix A states that hospitals, physicians and other health care professionals are expecting different types of reimbursement arrangements. What are these different arrangements? What is the factual basis for this statement? How would conversion to a stock company affect Horizon's ability to amend its reimbursement arrangements?
  21. With respect to the discussion of health care reform on page 7 of Appendix A, how does enactment of S-1557 relate to conversion? Quantify the expected additional expenses of stockholder dividends and the expenses related to operating as a publicly traded company and their impact upon Horizon's ability to satisfy the increased loss ratio requirement set by S-1557 as compared to if it remains a health service corporation.
  22. Page 8 of Appendix A states that Horizon cannot use its reserves (surplus) to meet its capability development needs. Horizon should explain why it feels that its present capital levels are necessary. Horizon's annual report for 2006 states that actuarial studies support the present surplus level. Provide these studies, and Horizon's analysis of them, if any.
  23. The plan should discuss whether that the converted company will maintain the same level of reserves as Horizon now maintains as a health service corporation. Please explain what level of surplus Horizon expects to maintain once it is converted and whether it intends to move some of its surplus to the holding company that will be created upon conversion. Is Horizon willing to maintain surplus in the converted insurance company at a certain level for a fixed period following conversion?
  24. Page 8 of Appendix A notes the importance of maintaining an A or A- rating from Standard and Poor's. On September 8, 2008 A.M. Best downgraded Horizon's Financial Strength Rating from A- (Excellent) to B++ (Good) and its Long-Term Issuer Credit Rating from a- (Strong) to bbb (Good). Please explain the impact of this downgrade and the effect of remaining a health service corporation or converting.
  25. The Department notes that for 2007 Horizon Healthcare Services, Inc. had an underwriting loss of \$60,925,466 but had net income of \$126,151,172 after taxes due to net investment gain of \$170,744,152. For the first six months of 2008, Horizon Healthcare Services, Inc. had an underwriting loss of \$42,864,063, net investment gains of \$22,532,381, resulting in a net loss of \$15,390,440 after adjusting for taxes. Why has the company been operating at a net underwriting loss for the past year and a half and does the company plan to continue to operate at this level?
  26. Page 11 of Appendix A states that conversion will have no negative impact on provider reimbursement and will not impact product offerings and pricing. If Horizon does not increase its premium rates or reduce provider reimbursements, how does it intend to reverse the net underwriting loss while absorbing any additional expenses or loss of revenue resulting from being a publicly traded stock company? The additional expenses, as mentioned elsewhere, include stockholder dividends and regulatory compliance costs associated with being a public company. The loss of revenue includes the possibility of lower investment income if levels of surplus are reduced.
  27. Horizon states on page 11 of Appendix A that implementation costs for the conversion will not be significant. What is the basis for this statement? A number of non-profit Blue Cross Blue Shield plans have converted or attempted to convert. Has Horizon obtained any information about the costs of these conversions?

28. Exhibit I to Appendix A refers to network tiering. Please elaborate on Horizon's plans to tier its provider network. Do you expect to develop products with varying cost sharing based on the network tier? How would conversion from a health service corporation to an insurance company affect your ability to do this? Would network tiering primarily affect Horizon's stock subsidiary and thus be relatively unaffected by conversion?

The items above are subject to supplementation after consultants are retained by the Department. Questions regarding the items requested in the above should be directed to me.

Very truly yours,

A handwritten signature in black ink, appearing to read "Donald Bryan". The signature is stylized and cursive, with a large initial "D" and "B".

Donald Bryan  
Director, Division of Insurance