



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

May 7, 2009

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 – Plan of Conversion

Dear Mr. Campbell:

The Department of Banking and Insurance (the "Department") has completed its review of the responses submitted by Horizon Healthcare Services, Inc., doing business as Horizon Blue Cross Blue Shield of New Jersey ("Horizon") to the Department's October 14, 2008 letter (the "October 14 letter") regarding Horizon's plan of conversion. A filing was received on August 15, 2008 that sets forth the proposed plan by which Horizon seeks to convert from a nonprofit health service corporation to a stock insurance company, and the Department's October 14 letter was issued in response to such filing. The Department has concluded that Horizon's application for conversion, and the materials delivered in connection with it, remain incomplete, and the Department hereby requests that Horizon furnish the additional items described below with respect to the plan of conversion filed in connection with the application. Following receipt and review of these items, the Department will determine whether the plan of conversion requires further supplementation.

This letter details deficiencies in the plan of conversion and the responses submitted by Horizon to the Department's October 14 letter relating thereto. These documents are public records pursuant to N.J.S.A. 17:48E-58b, and this letter is therefore considered a public document. We ask that you provide the information requested to the Department and to the Office of the Attorney General (the "Attorney General") in hard copy (six copies) and in electronic form in accordance with the Commissioner's Order No.A08-116. Additional copies should be sent to the Department's consultants, who are copied on this letter.

As a preliminary general comment, please be reminded that it is Horizon's burden to clearly and fully articulate the case for its conversion to for-profit status, including how the conversion will benefit policyholders, with sufficient substance to support a finding by the Department that the conversion would be in the public interest. We urge you to be mindful of the standards for approval for the Department and the Attorney General as well as the application requirements in preparing your responses to questions and in revising and supplementing the Petition. We have set forth below a second round of questions related to the plan of conversion.

We have set forth our specific questions addressing the responses to the Department's

October 14 letter and other outstanding plan of conversion questions. These are separated into five categories. In the first category, we identify questions that do not require further information or clarification at this time. The second category represents questions/requests that were not answered or otherwise addressed by Horizon. The third category sets forth some preliminary questions relating to employee benefits and compensation, which are being addressed separately at present, and which will be followed up with questions about anticipated changes in compensation plans. The fourth category includes questions that require additional clarification, and the fifth category consists of new questions beginning with question #29.

- I. Horizon's responses to question #20 do not require further information or clarification at this time.
- II. Horizon did not answer or otherwise respond to the 3 questions/comments in the preamble.
- III. The following 3 questions relating to employee benefits and compensation are being addressed separately at present: #2, #3, and #8. A letter seeking information about Horizon's current program was sent by Dewey & LeBoeuf to Davis Polk & Wardwell ("Davis Polk") on April 20, 2009. Additional questions including especially with respect to future plans, are included beginning with Question #35 and we anticipate further questions in the future on this subject.
- IV. Horizon's responses to the following 22 questions require additional clarification/detail as set forth below: #1, #4, #5, #6, #7, #9, #10, #11, #12, #13, #14, #15, #16, #17, #18, #19, #21, #22, #23, #24, #25, #26, #27, and #28.

For ease of review, we have aligned these follow-up questions in sequential order to the original 28 questions asked in the October 14 letter. As a result of this approach, and given input from multiple parties to this document (the Department, the Attorney General and their consultants), we recognize that there may be some questions that overlap to at least some extent. As long as Horizon fully answers the questions, responses may be cross-referenced where appropriate but only if and to the extent that Horizon clearly identifies precisely which portions of the cross-referenced response specifically respond to the question. Similarly, cross-references to documents provided in Horizon's August 15, 2008 filing must identify precisely which portions of which documents are responsive and confirm that there are not additional responsive documents.

All references to the Horizon Board of Directors should be construed to include committees of the Board, including especially but not limited to the Ad Hoc Proposal Review Committee.

Preamble 1: 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. The Department advised that such consultation is not required by N.J.S.A. 17:48E-51 or 64(b) and the request should be deleted from the application.

Preamble 2: 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. The Department advised that 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 altered and set forth in the plan of conversion.

Preamble 3: Appendix G's indemnification provisions must exclude proceedings by or in the right of Horizon, and 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. Further, with respect to criminal proceedings, the officer, director, employee or agent must have had no reasonable cause to believe his conduct was unlawful.

1. Question 1 asks for a general history of Horizon and its affiliates, and copies of all letters, certificates of exemption or other determinations issued to them by a taxing authority. Horizon's response is not fully responsive: supporting tax-exemption documentation has not been provided nor has affiliate information. Please provide and supplement.
2. Employee benefits and compensation are being addressed in a separate letter to Davis Polk.
3. Employee benefits and compensation are being addressed in a separate letter to Davis Polk.
4. See follow-up to Foundation Plan question 21.
5. This issue is being addressed separately.
6. In its response to question 6, Horizon asserts that the imposition of commitments would put Horizon at a competitive disadvantage to other insurers, negatively impact its business results, undermine its competitiveness and negatively impact the value of the shares of common stock held by the Foundation. Please provide support for this assertion, addressing specifically, with support, each type of commitment made by a BCBS entity that has converted to a for-profit entity, including, among others Empire. Also, please consider this request another opportunity for Horizon to suggest commitments.
7. The approval for any restructuring such as is described in Section 5.04 of the Plan of Conversion would be the subject of a separate filing and approval process under N.J.S.A. 17:27A-2. Please include the steps of any restructuring in the comprehensive timeline that has been requested.
8. Employee benefits and compensation are being addressed in a separate letter to Davis Polk.
9. Horizon's business case for converting, as distinguished from its business plan, must be fully described in the plan of conversion.
10. Horizon's business case for converting, as distinguished from its business plan, must be fully described in the plan of conversion. In particular, please explain why Horizon could not maintain its S&P rating as a not-for-profit.
11. This question deals with the costs incurred by Horizon to improve health care in New Jersey. Horizon identifies several programs and asserts that the costs of these programs are confidential and are included in the business plan.
 - a. What is the approximate annual aggregate cost to Horizon of all of these programs?
 - b. Horizon in its response describes a mobile mammography screening initiative that was discontinued due to funding issues. How much did that initiative cost? Will this effort be restarted after conversion?
 - c. Horizon in its response also mentions an IT initiative to integrate clinical information and apply automated evidence based guidelines. How much did this initiative cost?

12. Question 12(c) asks for a copy of the BCBSA rules. Please provide a complete copy of the rules.
13. Please refer to question 34 in the Foundation Plan follow-up letter.
14. On page 1 of Exhibit A to the Plan of Conversion, Horizon states that conversion will allow it to maintain its financial strength rating, thereby enhancing its ability to acquire and maintain large accounts. Please explain further, and please also explain how Horizon's participation in the BlueCard program affects Horizon's ability to market national accounts, and whether that will change in any way upon conversion.
15. Has Horizon considered withdrawing from certain markets or regions post-conversion? If so, please describe, and also, will the BCBSA allow another plan to service markets or regions if Horizon were to withdraw?
16. Question 16 relates to Exhibit A (titled "Overview of Purposes of Conversion"). Horizon's response is that responsive information is confidential, and therefore is only set forth in its confidential response to the confidential business plan questions. Please identify precisely which of Horizon's responses to the business plan questions specifically respond to this question. Also, as noted above, Horizon's business case for converting must be fully detailed in the plan of conversion. Accordingly, Horizon must provide a narrative that is fully responsive to this question that can be a part of the plan of conversion, and also must set forth the basis for a claim of confidentiality.
17. See 16 above. In response to Question 16, Horizon states that "risk based capital has declined considerably in 2008, both at the Company and throughout the industry." Please explain the analysis completed by Horizon to support this statement and provide supporting documentation. Please also explain what is meant by, and support, the following statement: "the outlook for both the Company and the entire industry reflected quickly growing profits and risk based capital levels."

Please describe the affordability dividend (how it is used, how it is calculated, etc.). When did the company stop pricing below the market trend? What has been the impact to rates during this time?
18. See 16 above. Please list all alternatives considered and provide investment banking and other presentations and all management / committee reports related to all alternatives considered (including reports from Horizon's advisors indicating that debt and surplus notes are not viable options).
19. Please provide supporting documentation for your response. In response to Question 19, Horizon states that the "gap already reflects assumed pricing at market levels." Please explain what is meant here by "market levels." For example, to what market and which levels is Horizon referring? How would any increase above "market levels" undermine Horizon's competitive position and adversely affect New Jersey consumers?
20. We do not require further information or clarification at this time.
21. See Business Plan follow-up questions 8 and 71. Additionally, please list and describe the governance measures in place to ensure Horizon's compliance with S-1557. Please discuss Horizon's understanding of the anticipated additional requirements post-conversion.
22. In response to question 22, Horizon states that the actuarial studies supporting its assertions in the response are confidential and have been provided in response to the confidential business plan questions. Please indicate which of Horizon's responses to the business plan questions specifically respond to this question. Please provide

actuarial data requested by the Department and the Attorney General's actuaries, including RBC documentation.

23. This question asks whether a converted company will maintain the same level of reserves as a non-profit entity. Horizon indicates it will maintain surplus in the same general range. Horizon also indicates its capital is approximately in line with its major competitors (all of which are publicly held) and is below that of most other Blue Plans. Please address the ROE metrics of a publicly held entity, which are different from those of a privately held company, and how Horizon intends to incorporate such ROE metrics into its business operations. Please explain what Horizon means by the "same general range." Is Horizon willing to commit to maintain that level of surplus for a fixed period?
24. Please explain why Horizon could not maintain its current rating from Standard & Poor's Ratings Service as a not-for-profit. Please describe in detail any discussions with A.M. Best regarding the drop in Horizon's rating. Please discuss what steps are being taken to address the drop in ratings.
25. This question asks about underwriting losses in 2007 and the first six months of 2008 and asks why Horizon has been operating at an underwriting loss. Horizon cites its 2005 pricing decision to grow enrollment, which resulted in losses at Horizon Healthcare Services, Inc. Horizon indicates it is no longer pricing below trend and makes the point that underwriting profits were made in 2007 and 2008 on a consolidated basis. Please update answer to reflect year-end 2008 results. We reviewed the P&L statements (i.e., "Health Statement of Rev. & Exp. Pg. 4/5" documents; source: SNL Financial) for HHSI, HHNJ, and Horizon consolidated (Horizon Dental representing less than \$1M). According to these reports, Horizon had an underwriting loss of \$31M in 2008 on a consolidated basis. This data appears to contradict Horizon's response that Horizon has had "underwriting profits at a consolidated level in 2007 and 2008." Please explain.
26. Has Horizon performed any stress tests, including with respect to "worst case scenarios," to assess its ability to successfully adjust to changes in the market place as a for-profit stock insurer?
27. Please provide an expanded explanation of estimated costs to Horizon of operating as a public company. Please include an estimate of costs for the IPO and for day-to-day operations, and costs attributable to culture changes and communication and public relations efforts with respect to becoming a public company owned by shareholders.
28. This question asks about network tiering. Horizon indicates it is inevitable that tiering of networks and designing products around such tiered networks will occur.
 - a. Please submit any preliminary tiering plans, including supporting data.
 - b. How would additional spending affect tiering of networks?
 - c. Please provide any insight available related to Horizon's publicly held peers' current practices in this area.
 - d. Please address how tiering may be affected by conversion on a comparative converted and non-profit basis.

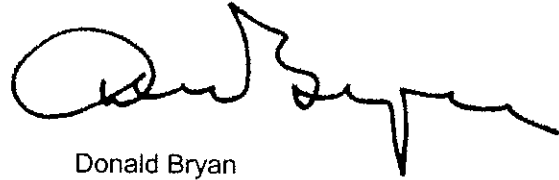
Additional Follow-Up Questions to Supplement the Initial Plan of Conversion Questions:

29. Full disclosure of anticipated future stock based compensation is required as part of the conversion application, and has not yet been provided. Please provide.

30. Did the Board in its deliberations on conversion consider how the company would satisfy the statutory approval standards? If not, why not? If so, please describe and provide related documents and presentations.
31. Please respond to the following questions:
 - a. Please provide an outline of each step of the transaction with corresponding step-by-step tax analysis.
 - b. If Horizon restacks the subsidiaries as an I.R.C. section 311(b) distribution, what amount of deferred intercompany gain will be triggered?
 - c. Does Horizon anticipate claiming a tax deduction for stock placed in the Foundation?
 - d. Please provide a comprehensive tax analysis of the restructuring.
32. Explain the effect, if any, that the conversion will have upon Horizon's agreements with third parties, e.g., providers. For example, could the conversion enable any such third party to cancel the agreement under a change of control provision?
33. Does Horizon contemplate any changes in its practices with respect to consumer information, including changes applicable to privacy policies, following conversion?
34. Please discuss whether consummation of the conversion or the IPO will trigger consequences under any compensation or benefit arrangement, e.g., increased additional benefits, accelerated payouts, forgiveness of debt, etc., and if so, please provide a description of these consequences.
35. Please describe which existing executive compensation and employee benefit programs will remain in place post-conversion, how they will be amended and whether the benefit levels will remain the same.
36. Please describe any new arrangements that will be put in place, new employment or retention agreements and the terms of these arrangements.
37. Please discuss whether Horizon intends to hire any other compensation consultants.
38. Please provide the basis for the assertion that officer pay has been 7.5% below market.
39. Horizon states that there will be a one time grant of either stock options or restricted stock, valued at \$2.2 million, to all eligible employees at or near the time of the IPO. Please explain why you believe these grants are permissible under N.J.S.A. 17:48E-57.
40. Please discuss (i) whether the pool of options and restricted stock available for equity awards is in lieu of Horizon's existing Long Term Incentive Plan, (ii) how the 12% figure for the size of the pool was derived, (iii) how much of the pool will be granted upon closing of the IPO or earlier, (iv) who will receive the initial grants and what are the terms of these awards, and (v) why Horizon believes that the equity grants would not change the level of compensation for officers.

Questions regarding the specific items requested above should be directed to me unless otherwise notified by the Department.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Donald Bryan', with a large, stylized initial 'D'.

Donald Bryan

Director, Division of Insurance

cc: Robert Romano, Department of Law and Public Safety
Marc Lambricht, Oliver Wyman
Cynthia Shoss, Dewey & LeBoeuf LLP
Martin Smith, The Blackstone Group
Patrick Tracy, RSM McGladrey