

Plan of Conversion Question #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.**

Plan of Conversion Answer #1

The following is a brief history of the organizational status of what is now Horizon Blue Cross Blue Shield of New Jersey. As per guidance from the Department of Banking and Insurance and the Office of the Attorney General at a meeting held on January 6, 2009, the response is limited to Horizon Blue Cross Blue Shield of New Jersey and does not include any such information for its affiliates.

1929 – Eleven hospitals in Essex County, NJ formed the Hospital Council.

1932 – The First Hospital Service Plan was organized as the Associated Hospitals of Essex County, as of December 7, 1932. This organization would later become Blue Cross. This company was a not-for-profit.

1936 – The Associated Hospitals of Essex County became a state-wide organization, the Hospital Service Plan of New Jersey, or Blue Cross. The company continued to be a not-for-profit.

1938 – An act regulating hospital service plans became effective October 1.

1940 – Enabling legislation was enacted providing for the formation of non-profit medical service corporations was signed into law in May.

1942 – The Medical-Surgical Plan of New Jersey, or Blue Shield, was incorporated on March 24. This company was a not-for-profit.

1962 – Dumont Commission released a report with 12 recommendations, in response to a NJ Senate resolution that included legislation for single Blue Cross Blue Shield medical contracts.

1985 – Legislation passed permitting the merger of Blue Cross and Blue Shield, with the merger effective on February 4, 1986. The company is now Blue Cross Blue Shield of New Jersey. The surviving company remains a not-for-profit.

1996 – The State of New Jersey passed legislation that gave Blue Cross Blue Shield of New Jersey the option to convert to a mutual insurance company.

1998 – Blue Cross Blue Shield of New Jersey changed its name to Horizon Healthcare Services, Inc., doing business as Horizon Blue Cross Blue Shield of New Jersey.

2001 – The State of New Jersey passed legislation that gave Horizon the option to change from a health services corporation to a for profit accident and health insurance company.

A description of Horizon BCBSNJ's tax status is set forth in the response to Foundation Plan Question #21.

Plan of Conversion Question #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 conversion.**

Plan of Conversion Answer #2

Horizon BCBSNJ has a well-defined executive compensation program and process with a number of checks-and-balances to ensure that compensation is appropriate, market-driven, and equitable internally. This process ensures market-driven compensation and high governance standards, and the Company does not anticipate any change to the governance of this program going forward.

Historically, Horizon BCBSNJ has been very conservative in its approach to executive compensation and the average total direct compensation of its officer team over the last five years has been 7.5% below market. In 2007 and 2008, RSM McGladrey conducted a limited scope examination of Horizon BCBSNJ's executive compensation process and governance and issued a favorable report. As part of that limited scope examination, RSM McGladrey found that the compensation of the top five officers at Horizon BCBSNJ was below market by approximately 17%.

Horizon BCBSNJ's executive compensation philosophy establishes a strong relationship between executive pay with market-driven compensation and Company performance based on the achievement of enterprise, business unit and individual goals. Horizon BCBSNJ's incentive goals are approved by its Board of Directors.

The Personnel and Compensation ("P&C") Committee's authority and responsibility are governed by its Charter. The P&C Committee reviews all executive compensation actions, in conjunction with its independent compensation consultants, and recommends actions to the Board of Directors for approval.

Beginning in November of each year, Management reviews a detailed executive compensation methodology and compensation philosophy with the P&C Committee. In December, Management reviews detailed information regarding executive pay levels and programs based on a review of publicly-available information and industry-based survey sources, and potential pay adjustments with the P&C Committee and its independent compensation advisors. The P&C Committee and its compensation and legal advisors review the data in preparation for potential actions to be taken in February when the P&C Committee recommends to the Board of Directors any adjustments to compensation. On several occasions over the past five years, salary levels for officers have not been adjusted.

Plan of Conversion Question #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.**

Plan of Conversion Answer #3

N.J.S.A. 17B:18-52 b. provides:

No domestic insurer shall:

Make any agreement with any of its officers, senior officers, directors, trustees or salaried employees whereby it agrees that for any service rendered or to be rendered he shall receive any salary, compensation or emolument that will extend beyond a period of 24 months from the date of the agreement, but nothing herein shall be construed to prevent a domestic insurer from deferring the payment of any salary, compensation or emolument for such period of time and upon such terms as it may determine or from entering into contracts with its agents or brokers for the payment of renewal commissions.

Horizon BCBSNJ is not currently subject to N.J.S.A. 17B:18-52b, but will comply with such requirement when applicable.

Plan of Conversion Question #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?**

Plan of Conversion Answer #4

***Federal Income Taxes***

Technically, Horizon BCBSNJ became taxable under the Tax Reform Act (TRA) of 1986, specifically due to Internal Revenue Code (“IRC”) §501(m). IRC §501(m) provides that any corporation exempt under IRC §501(c)(3) or (c)(4) that provides a substantial amount of commercial-type insurance is subject to taxability pursuant to IRC §831.

However, Congress recognized that while the Blue Plans provide commercial-type insurance, at that time they still had an obligation in most states to insure the uninsurable. Therefore, Congress provided them with a favorable tax regime with the enactment of IRC §833.

As a result of Section 833, Horizon BCBSNJ has been able to report its income for tax purposes using certain beneficial tax rules afforded Blue Plans. As a Blue Plan in existence on August 16, 1986, Horizon BCBSNJ has been allowed a deduction based on the amount by which 25% of its claims and claim adjustment expenses exceeds its “adjusted surplus” (generally, taxable income without taking into account the Section 833(b) deduction or loss carryovers and adding back certain exempt income) along with a 100% deduction for increases to its unearned premium reserve (rather than the 80% deduction that is afforded most insurance companies). In addition, Horizon BCBSNJ has been entitled to adjust the tax basis of assets that it owned on January 1, 1987, to their fair market value as of that date. Use of these special Section 833 benefits has permitted Horizon BCBSNJ to pay federal tax on its income at an effective rate of 20% under alternative minimum tax (“AMT”) regulations.

These special tax benefits will remain available to Horizon BCBSNJ as long as it does not undergo a “material change” in operations or structure. Current tax law does not directly address whether the conversion will constitute such a material change and, therefore, eliminate these special tax benefits. The Company is aware, however, that the IRS has taken the position related to other Blue Plan conversions, most notably the WellChoice conversion, that a conversion would result in the inability of a Blue Plan to utilize the Section 833 benefits. A loss of the Section 833 benefits would result in an effective federal tax rate on Horizon BCBSNJ’s income approaching 35%, subject to the availability of other tax attributes, such as tax losses and credits, to offset such income. However, Horizon BCBSNJ’s actual cash outlays for Federal income taxes will be effectively reduced back to the 20% AMT rate by using AMT credits, which represent AMT payments made by Horizon BCBSNJ since 1987. Under Federal law, such credits

have no expiration date. Therefore, the conversion is not expected to have a negative impact on actual Federal income tax payments for a number of years until the prior year AMT credits are fully utilized.

### ***State and Local Taxes***

Currently, other than State premium taxes, Horizon BCBSNJ is exempt from most state and local taxes, including sales & use taxes. After conversion, Horizon BCBSNJ expects to pay state sales & use taxes on all non-exempt purchases. The Company's financial projections assume that Horizon BCBSNJ will be paying the full 7.0% New Jersey sales & use tax on approximately 15% of applicable selling, general and administrative expenses. However, since Horizon BCBSNJ's Newark headquarters is currently located in an Urban Enterprise Zone, several options are being investigated to take advantage of existing state programs to minimize these projected incremental sales & use tax expenses.

As noted above, Horizon BCBSNJ currently is not subject to certain state and local taxes, which has exempted Horizon BCBSNJ's employee salaries from the Newark City Payroll tax. This tax has historically been paid only for Horizon BCBSNJ subsidiaries located in Newark, including, most significantly, its wholly-owned New Jersey HMO, Horizon Healthcare of New Jersey, Inc. The Company expects that all Newark salaries will be subject to a 1.0% payroll tax, effective upon conversion.

Horizon BCBSNJ does not pay State income taxes since it is a premium tax payer, however, its "for-profit" subsidiaries currently pay, and will continue to be subject to, State income taxes.

### ***State Premium Taxes***

Horizon BCBSNJ was exempt from premium taxes through 1991. Beginning in 1992, through 2004, Horizon BCBSNJ had been subject to premium taxes on only experience rated business and thus was not subject to tax on its Individual and Small Employer business. In addition, in compliance with established New Jersey premium tax law, the amount of premiums subject to tax was limited to 12.5% of the Company's total premiums.

Beginning in 2005, pursuant to new legislation, Horizon BCBSNJ became subject to premium taxes on its Individual and Small Employer business and, as a "health service corporation", was barred from calculating its premium tax using the 12.5% limitation on premiums. Horizon BCBSNJ is currently challenging this loss of exemption in litigation.

Upon conversion from a health service corporation to a for-profit entity, the Company will calculate its taxable premiums using the 12.5% limitation of premiums, as is the case with all other insurance companies in New Jersey.

In addition, current Federal law prohibits the State from imposing a premium tax, or similar type of tax or assessment with respect to premiums paid for its Medicare Advantage, Medicare Part D and Federal Employee Program (FEP) products. This will not be impacted by conversion.

### ***HMO Premium Assessment***

In June 2004, the New Jersey State legislature passed a bill that imposed a temporary 1.0% premium assessment on Commercial and Medicaid HMO premiums. The assessment was specifically earmarked in the legislation for the State's fiscal year 2005, to be billed on a quarterly basis, beginning in the third calendar quarter of 2004. It was originally believed that the basis for the assessment would be 2003 premiums as submitted on the annual filings, but the State subsequently revised its interpretation to say that the assessment would be based upon the calendar year 2004 filed premiums, since the legislation just stated that the assessment would be based upon direct premiums as reported on the annual financial statement submitted pursuant to section 9 of P.L.1973, c.337 (C.26:2J-9) (i.e. the annual blank). While the assessment did apply to Medicaid premiums, the State subsequently increased the Medicaid HMO rates that it was paying for managed Medicaid services, to offset the additional assessment.

In June 2005, the New Jersey State legislature revised the bill to make the assessment permanent.

In June 2006, the New Jersey State legislature doubled the assessment rate to 2.0% of premiums for fiscal year 2007 and each fiscal year thereafter. To placate the Medicaid HMOs, the State also promised an additional increase to the Medicaid HMO rates to offset the additional expense.

Plan of Conversion Question #5

**N.J.S.A 17:48E-55 (b) provides that for so long as the foundation owns at least 10% of the share 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 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.**

Plan of Conversion Answer #5

Attached please find a revised form of the proposed Commissioner Pre-Approval. Set forth below is a discussion of each issuance contained in the revised Commissioner Pre-Approval and the reasons such issuances would not materially dilute the shares owned by the Foundation and would be priced in a manner consistent with the fair market value of the aggregate equity of the Holding Company. As a general matter we note that our advisors have stated that the constraints on the Holding Company's ability to issue Capital Stock under Section 7(b) of the Conversion Statute is highly unusual for public companies and that a failure to have appropriate capabilities to access the capital markets may well have, in itself, material adverse consequences on the value of the Common Stock owned by the Foundation.

*1. Capital Stock of the same class and series as the Capital Stock owned by the Foundation ("Common Stock"), pursuant to a firm commitment underwritten public offering under the Securities Act of 1933, as amended (the "Act").*

As indicated in the comment, Section 7(b) of the Conversion Statute presumes that such issuances do not materially dilute the value of the Foundation's stock and are priced in a manner consistent with the fair market value of the Holding Company.

*2. Preferred Stock that pays a specified dividend (whether fixed or floating) and provides for class voting rights only with respect to certain materially adverse amendments to the terms of such Preferred Stock and to elect up to two members of the Board of Directors of the Holding Company in the case of a failure to pay*

*dividends for a specified number of dividend payments, pursuant to a firm commitment underwritten public offering under the Act or pursuant to an offering under Rule 144A (promulgated under the Act) (“Rule 144A”) where such offering is conducted by one or more nationally recognized investment banks, at least one of which is listed on Schedule 1 hereto (which will contain a list of investment banks to be agreed with you) and is acting as a bookrunner or joint-bookrunner (each such investment bank an “Approved Bank”).*

The Preferred Stock specified in paragraph 2 would be issued pursuant to either a firm commitment public underwritten offering or a Rule 144A offering. As indicated in the Conversion Statute, firm commitment underwritten public offerings are conducted in a manner which is presumed to result in pricing that is at the fair market value of the securities offered and is not materially dilutive to the stock owned by the Foundation. Rule 144A offerings, since the time the Conversion Statute was enacted, have become a widely accepted alternative to underwritten public offerings and are considered to be consistent with underwritten public offerings in terms of the depth and liquidity of the market as reflected by the absence of any price differential between comparable Rule 144A and public offerings. In either case, at least one nationally recognized investment bank approved by the Commissioner as part of the Plan of Conversion will participate in the management of the offering.

The Preferred Stock has a specified return and unlike Common Stock does not participate in earnings of the Holding Company and is an alternative to debt financing. Such “straight preferred” is not materially dilutive to common stock. The issuance of such Preferred Stock as set forth in paragraph 2 is comparable to the issuance of debt, and if the Holding Company determines that issuing such Preferred Stock in an offering conducted by an Approved Bank is preferable to offering straight debt, the offering would not materially dilute the shares owned by the Foundation and would be priced in a manner consistent with the fair market value of the aggregate equity of the Holding Company.

*3. Shares of Common Stock issued in connection with stock option plans and other equity-based compensation arrangements that are approved by an Independent Board Majority (and shareholders of the Holding Company, if so required), including shares of Common Stock issued upon exercise of options or pursuant to any other award; provided that any stock options or other equity-based compensation, including restricted stock, is awarded at its fair market value based on the most recent reported closing price of the Common Stock on the New York Stock Exchange (the “NYSE Closing Price”), without regard to any diminution in value arising from restrictions on transfer, vesting schedules or other terms of such award.*

Any plan that the Holding Company adopts in the future will not permit awards of stock options, restricted stock or any other equity-based compensation to be granted at less than fair market value (without consideration to any diminution of value that may result from the terms of the award, such as transfer restrictions and

vesting schedules). Such grants would be approved by the independent compensation committee of the Holding Company and would be made for services provided to the Company. As payment for services in the form of stock options or other equity compensation issued at its fair market value, such grants (and subsequent issuances of Capital Stock pursuant to such grants, as applicable) would not materially dilute the shares owned by the Foundation and would be priced in a manner consistent with the fair market value of the aggregate equity of the Holding Company.

*4. Shares of Common Stock issued (i) at fair market value based on the NYSE Closing Price and (ii) to acquire the assets or stock of a Person (whether by asset or stock purchase or otherwise) or in connection with a merger to which the Holding Company or any of its affiliates (as defined in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended) are a party, provided that in each case such transaction is approved by an Independent Board Majority and the Board of Directors of the Holding Company receives a “fairness opinion” provided by an Approved Bank.*

Shares will only be issued under paragraph 4 if an Independent Board Majority has approved the transaction, an Approved Bank has issued a “fairness opinion” and the shares are issued at their fair market value. As a result, any such issuances will be consistent with the aggregate equity of the Holding Company and will not materially dilute the shares owned by the Foundation.

*5. Shares of Common Stock issued (i) at fair market value based on the NYSE Closing Price and (ii) in any recapitalization or restructuring of the Capital Stock, or any amendment to the Certificate of Incorporation of the Holding Company, in connection with any agreement, plan or proposal involving any sale of Capital Stock, merger, consolidation, recapitalization, exchange of shares or other transaction that, if consummated in accordance with its terms, would result in the holders of the voting Capital Stock immediately prior to such sale of Common Stock, merger, consolidation, recapitalization, exchange of shares or other transaction owning less than 50.1% of the outstanding voting securities of the Holding Company or, if not the Holding Company, the resulting entity arising out of such merger, consolidation, recapitalization, exchange of shares or other transaction or any agreement, plan or proposal involving the sale of all or substantially all of the assets of the Holding Company and subsidiaries on a consolidated basis, which is submitted by the Board of Directors to the stockholders of the Holding Company for a vote thereon.*

Under the terms of the Voting Trust and Divestiture Agreement, the Foundation will have a vote with respect to any transaction specified in paragraph 5 and will be able to vote against any proposed transaction that it believes would materially dilute the shares owned by the Foundation or would result in the issuance of Capital Stock that is not priced in a manner consistent with the fair market value of the aggregate equity of the Holding Company. We believe that the approval of

the transaction by the required percentage of independent stockholders provides compelling evidence that the transaction satisfies the statutory criteria.

*6. Debt securities that are convertible into or exchangeable for shares of Common Stock and any shares of Common Stock issued upon conversion or exchange of such securities, provided that at the time of issuance such securities have a conversion or exchange price equal to not less than 110% of the NYSE Closing Price.*

The issuance of the debt itself has no material dilutive effect and when issued, the conversion or exchange price of such debt may not equal less than 110% of the NYSE Closing Price, which requires significant appreciation in the price of the Common Stock in order to convert or exchange. As a result, the issuance of such convertible debt securities will be priced consistently with the fair market value of the aggregate equity of the Holding Company and will not materially dilute the shares owned by the Foundation.

*7. Preferred Stock that is convertible into or exchangeable for shares of Common Stock and any shares of Common Stock issued upon conversion or exchange of such Preferred Stock, pursuant to a firm commitment underwritten public offering under the Act or pursuant to an offering under Rule 144A where such offering is conducted by one or more Approved Banks; provided that at the time of issuance such Preferred Stock has a conversion or exchange price equal to not less than 110% of the NYSE Closing Price and provided further that such Preferred Stock (x) provides for class voting rights only with respect to certain materially adverse amendments to the terms of the Preferred Stock and to elect up to two members of the Board of Directors of the Holding Company in the case of a failure to pay dividends for a specified number of dividend payments and (y) specifies the dividend payable (whether fixed or floating).*

The issuance of such convertible Preferred Stock itself will be at a value that is consistent with the fair market value of the aggregate equity of the Holding Company and will not materially dilute the shares owned by the Foundation for the same reasons discussed in paragraphs 2 and 6 above.

*8. Private issuances of Common Stock at a discount of not more than 10% from the Closing Price that have been approved by an Independent Board Majority after obtaining advice from an Approved Bank as to available financing alternatives and determining, based on such advice, that (i) there is a relatively immediate need on the part of the Holding Company to raise capital to preserve its credit rating or for other important business reasons and (ii) the private issuance is the most cost-effective financing alternative available given the applicable time constraints on raising capital.*

If the Board of Directors determines that it has an immediate need for capital and has consulted with an Approved Bank regarding the Holding Company's financing alternatives for capital, then a private placement of Common Stock only

after determining that such private placement is the most cost-effective financing alternative available, given that such sale may not be at a discount of more than 10% from the Closing Price, will not materially dilute the shares owned by the Foundation and would be consistent with the fair market value of the aggregate equity of the Holding Company. In such circumstances, a failure to raise capital will result in adverse consequences to the fair market value of the Common Stock owned by the Foundation.

*9. Shares of Capital Stock issued ratably to all holders of Common Stock in connection with a stock split, stock dividend, recapitalization or similar transaction.*

Because the shares issued as set forth in paragraph 9 are ratably issued to all holders, no dilution results from such an issuance. Whether such shares are priced in a manner consistent with the fair market value of the aggregate equity of the Holding Company is inapplicable in the case of such a transaction.

*10. Additional shares of Capital Stock in connection with a shareholder rights plan.*

While the shares issued under a shareholder rights plan are highly dilutive to the presumptive acquirer who has triggered such issuance, they would be issued proportionally to all other holders of the Capital Stock of the Holding Company and would therefore not have a dilutive effect on such holders (including the Foundation) and would instead have a slightly accretive effect as a result of the acquirer having purchased shares of Capital Stock and contributed capital to the Holding Company without receiving its proportionate number of newly issued shares at the time the rights plan is triggered. As a result, the issuance of such shares would not materially dilute the shares owned by the Foundation and would be consistent with the fair market value of the aggregate equity of the Holding Company.

**Proposed Commissioner Pre-Approval of  
Securities Issuances Under Section 7(b) of the Conversion Statute**

In connection with the conversion (the “Conversion”) of Horizon Healthcare Services, Inc., d.b.a. Horizon Blue Cross Blue Shield of New Jersey, from a nonprofit health service corporation to a domestic stock insurer licensed to issue accident and health insurance (the “Converted Company”) and the merger of the Converted Company into a wholly-owned subsidiary of a newly-formed New Jersey holding company (the “Holding Company”), all of the Capital Stock of which shall be owned at the time of the Conversion by [\_\_\_\_], a New Jersey nonprofit corporation organized under N.J.S.A. Title 15A that is intended to qualify for federal income tax exemption under §501(c)(3) of the Federal Tax Code (the “Foundation”), the Commissioner of the Division of Insurance of the State of New Jersey Department of Banking and Insurance (the “Commissioner”) hereby irrevocably (A) determines that the following issuances of securities by the Holding Company would not materially dilute the value of the Capital Stock issued by the Holding Company to the Foundation at the time of the Conversion, and that any Capital Stock sold as set forth below will be priced in a manner consistent with the fair market value of the Converted Company and the Holding Company and (B) pre-approves such issuances by the Holding Company without any further approval being required from the Commissioner under N.J.S.A. 17:48E-49 et seq., including N.J.S.A. 17:48E-55(b), or under the terms of the Conversion:

1. Capital Stock of the same class and series as the Capital Stock owned by the Foundation (“Common Stock”), pursuant to a firm commitment underwritten public offering under the Securities Act of 1933, as amended (the “Act”);
2. Preferred Stock that pays a specified dividend (whether fixed or floating) and provides for class voting rights only with respect to certain materially adverse amendments to the terms of such Preferred Stock and to elect up to two members of the Board of Directors of the Holding Company in the case of a failure to pay dividends for a specified number of dividend payments, pursuant to a firm commitment underwritten public offering under the Act or pursuant to an offering under Rule 144A (promulgated under the Act) (“Rule 144A”) where such offering is conducted by one or more nationally recognized investment banks, at least one of which is listed on Schedule 1 hereto (which will contain a list of investment banks to be agreed with you) and is acting as a bookrunner or joint-bookrunner (each such investment bank an “Approved Bank”);
3. shares of Common Stock issued in connection with stock option plans and other equity-based compensation arrangements that are approved by an Independent Board Majority (and shareholders of the Holding Company, if so required), including shares of Common Stock issued upon exercise of options or pursuant to any other award; provided that any stock options or other equity-based compensation, including restricted stock, is awarded at its fair market value based on the most recent reported closing price of the Common Stock on the New York Stock Exchange (the “NYSE Closing Price”), without regard to any diminution in value arising from restrictions on transfer, vesting schedules or other terms of such award;

4. shares of Common Stock issued (i) at fair market value based on the NYSE Closing Price and (ii) to acquire the assets or stock of a Person (whether by asset or stock purchase or otherwise) or in connection with a merger to which the Holding Company or any of its affiliates (as defined in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended) are a party, provided that in each case such transaction is approved by an Independent Board Majority and the Board of Directors of the Holding Company receives a “fairness opinion” provided by an Approved Bank;

5. shares of Common Stock issued (i) at fair market value based on the NYSE Closing Price and (ii) in any recapitalization or restructuring of the Capital Stock, or any amendment to the Certificate of Incorporation of the Holding Company, in connection with any agreement, plan or proposal involving any sale of Capital Stock, merger, consolidation, recapitalization, exchange of shares or other transaction that, if consummated in accordance with its terms, would result in the holders of the voting Capital Stock immediately prior to such sale of Common Stock, merger, consolidation, recapitalization, exchange of shares or other transaction owning less than 50.1% of the outstanding voting securities of the Holding Company or, if not the Holding Company, the resulting entity arising out of such merger, consolidation, recapitalization, exchange of shares or other transaction or any agreement, plan or proposal involving the sale of all or substantially all of the assets of the Holding Company and subsidiaries on a consolidated basis, which is submitted by the Board of Directors to the stockholders of the Holding Company for a vote thereon;

6. debt securities that are convertible into or exchangeable for shares of Common Stock and any shares of Common Stock issued upon conversion or exchange of such securities, provided that at the time of issuance such securities have a conversion or exchange price equal to not less than 110% of the NYSE Closing Price;

7. Preferred Stock that is convertible into or exchangeable for shares of Common Stock and any shares of Common Stock issued upon conversion or exchange of such Preferred Stock, pursuant to a firm commitment underwritten public offering under the Act or pursuant to an offering under Rule 144A where such offering is conducted by one or more Approved Banks; *provided* that at the time of issuance such Preferred Stock has a conversion or exchange price equal to not less than 110% of the NYSE Closing Price and *provided further* that such Preferred Stock (x) provides for class voting rights only with respect to certain materially adverse amendments to the terms of the Preferred Stock and to elect up to two members of the Board of Directors of the Holding Company in the case of a failure to pay dividends for a specified number of dividend payments and (y) specifies the dividend payable (whether fixed or floating);

8. private issuances of Common Stock at a discount of not more than 10% from the NYSE Closing Price that have been approved by an Independent Board Majority after obtaining advice from an Approved Bank as to available financing alternatives and determining, based on such advice, that (i) there is a relatively immediate need on the part of the Holding Company to raise capital to preserve its credit rating or for other important business reasons and (ii) the private issuance is the most cost-effective financing alternative available given the applicable time constraints on raising capital;

9. shares of Capital Stock issued ratably to all holders of Common Stock in connection with a stock split, stock dividend, recapitalization or similar transaction; and

10. additional shares of Capital Stock in connection with a shareholder rights plan.

Except as otherwise defined herein, capitalized terms shall have the meaning set forth in the Certificate of Incorporation of the Holding Company.

Schedule I

[list of banks to be discussed]

Plan of Conversion Question #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.**

Plan of Conversion Answer #6

The Company will continue to comply with all applicable regulatory requirements.

Horizon BCBSNJ does business in a highly competitive and highly regulated environment. Since the early 1990s, New Jersey has been in the forefront of states that have legislated protections for the individual and small group markets. Some of those protections include guaranteed issue, mandatory rate filings and community rating. In July 2008, the laws regulating the individual and small group markets were changed substantially. The changes impacting both the individual and small group markets include, but are not limited to, modified community rating, increase in minimum loss ratios, reduction in the number of plan offerings required and mandatory participation in the individual market if a carrier participates in the small group market. The imposition of the types of restrictions described above would put Horizon BCBSNJ at a competitive disadvantage to other insurers, negatively impact its business results, undermine its competitiveness and negatively impact the value of its shares of common stock held by the Foundation.

Plan of Conversion Question #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?**

Plan of Conversion Answer #7

The proposed Restructuring described in Section 5.04 of the Plan of Conversion is not a condition of the conversion. The Restructuring is expected to involve the distribution of the equity interest of each of Horizon Healthcare Plan Holding Company, Inc. and Enterprise Holding Company, Inc. by Horizon BCBSNJ to Holdco. As such, it is expected that the Restructuring may involve a distribution requiring compliance with applicable insurance holding company system standards, including reporting and approval requirements, set forth in N.J.S.A. 17:27A-4. The Restructuring as currently proposed is not expected to involve an acquisition of control of or merger with a domestic insurer subject to the filing and approval requirements of N.J.S.A. 17:27A-2.

Plan of Conversion Question #8

**N.J.S.A. 17:48-54e allows for the 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 the 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 of 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?**

Plan of Conversion Answer #8

Section 4.05(m) of the Plan of Conversion contemplates as a condition to the conversion an initial public offering of the stock of the Holding Company (as defined therein) unless such condition to effectiveness of the conversion has been waived by the Holding Company. The Company expects that any such initial public offering may, subject to agreement with the State, include a "directed share program" pursuant to which directors, officers and employees of the Holding Company or its subsidiaries will be offered the opportunity to purchase up to 5% of the aggregate number of shares offered in the initial public offering on the same terms as those offered to the public. While at this time the Company expects that any such initial public offering (including any shares sold pursuant to a directed share program) will consist solely of shares offered by the Foundation, no decision has been made at this time. Horizon BCBSNJ does not believe that the one year limitation set forth in N.J.S.A. 17:48E-57 would prevent directors and officers from participating in a directed share program, because N.J.S.A. 17:48E-57 prohibitions apply to equity compensation and purchases of stock under a directed share program would not constitute compensation as directors and officers would pay the same price for any shares they purchase as is paid by the public.

Horizon BCBSNJ understands the question regarding stock option or grant plans for directors, officers or employees to be separate from the question of whether there will be a directed share program. At this time, the Company has not adopted any equity based compensation arrangements for directors or officers that would be effective upon conversion. The Company is evaluating whether any employee benefit plan, subject to the limitations of N.J.S.A. 17:48E-57, will be adopted upon conversion. If the Company decides to adopt such a plan it will provide the proposed plan.

Plan of Conversion Question #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.**

Plan of Conversion Answer #9

The health care industry is undergoing rapid change as a result of the shifting needs of employers, individuals, and hospital and physician providers. Horizon BCBSNJ needs to invest in its infrastructure and to build further capability in Quality Management, Utilization Management, Claims Processing, Member Service and Provider Service. In addition, members and providers need appropriate tools to navigate the health care system and to have easy access to information. Horizon BCBSNJ must develop tailored solutions and enhance product offerings to compete in the evolving environment.

Moreover, the recent changes in the economy have impacted the health care delivery system and the affordability issue is the basis of expected reform which will have significant impact on all players in the health care arena. The likelihood of significant reform requiring new operating models has increased with the new administration in Washington and economic deterioration. Horizon BCBSNJ will need to be able to react to a myriad of potential requirements both imposed by regulation and by competitive forces. The investments that may be required are expected to significantly increase Horizon BCBSNJ's normal spend on infrastructure and needed flexibility to fund through means that would be easier to secure as a converted Company.

Plan of Conversion Question #10a

**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 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?**

Plan of Conversion Answer #10a

A vision statement has been defined as an “Aspirational description of what an organization would like to achieve or accomplish in the mid-term or long-term future. It is intended to serve as a clear guide for choosing current and future courses of action.”<sup>1</sup>

Horizon BCBSNJ aspires to be the best health plan, both locally and nationally, by helping its members become and stay healthy. In this way, Horizon BCBSNJ seeks not only to fulfill, but to exceed its statutory mission to provide health insurance services to its members.

There are a number of external surveys that Horizon BCBSNJ uses to measure success in being the “best health plan” and providing quality services to its members including, but not limited to:

- Certification by healthcare rating agencies: Utilization Review Accreditation Commission (URAC) and National Committee for Quality Assurance (NCQA)
- Results of audits and report cards: Healthcare Effectiveness Data and Information Set (HEDIS), New Jersey State HMO Performance Report, Blue Card Indicators (BCBSA), Performance Guarantee Audits (national account groups)
- Results of surveys to key constituents: Member Satisfaction, (Physician) Office Manager Satisfaction, Hospital Satisfaction, JD Powers, U.S. News & World Report

By setting a target of “being the best” and using externally generated data to gauge progress to that goal in comparison to other health plans, Horizon BCBSNJ can continue to improve to best meet the needs of those members and providers served. These external surveys provide objective analysis of whether Horizon BCBSNJ is moving toward achieving the goal of being the best plan as well as identify ongoing opportunities.

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<sup>1</sup> vision statement. BusinessDictionary.com. WebFinance, Inc.  
<http://www.businessdictionary.com/definition/vision-statement.html> (accessed: January 12, 2009).

Conversion will better position the Company to realize the goal of providing the financial flexibility to fund additional capability investments that will enable it to continue to provide market leading products and services to its groups, members and providers.

Plan of Conversion Question #10b

**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 purposes of conversion and believes that the Plan of Conversion should address these questions.**

**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?**

Plan of Conversion Answer #10b

Horizon BCBSNJ has developed a comprehensive portfolio of programs with the specific intent to improve the quality of health care. These programs range from Wellness and Prevention to Acute Care Management to Complex Case and Disease Management as well as Palliative and End of Life Care programs. A significant amount of detail on these programs, including information on how impact on members is measured, is included in the response to question #11 under the Plan of Conversion.

Horizon BCBSNJ intends to continue to provide better care and to promote targeted healthcare initiatives to improve the health status of members by developing added capabilities:

- Expansion of Disease Management Programs
- Collaboration with physicians/hospitals to create programs that incent those with patterns of care that reflect evidence based medicine
- Expansion of MedMined Program to reduce hospital-acquired infections
- Identification of gaps in care to allow for physician intervention
- Transparency to provide members with tools/information to select best providers of care
- Programs that incent electronic prescribing
- Support for Health Information Technology (HIT)/Electronic Medical Records/Personal Health Records
- Tools to aid members in navigation through the healthcare system
- Expansion of Preventive/Wellness Programs
- Responsiveness to Reimbursement Reform that aligns incentives and pays for performance
- Development of new products/tools that help members make healthy choices
- Expansion of products/coverages to reach more members
- Continued targeted efforts to improve HEDIS scores in ever increasing categories
- Providing health security programs to prepare members for lifetime health needs
- Programs/products targeted at early retirees and those in that age bracket

Plan of Conversion Question #10c

**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 purposes of conversion and believes that the Plan of Conversion should address these questions.**

**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.**

Plan of Conversion Answer #10c

Horizon BCBSNJ does not intend to expand its operations into other states after conversion.

Plan of Conversion Question #10d

**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 purposes of conversion and believes that the Plan of Conversion should address these questions.**

**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?**

Plan of Conversion Answer #10d

The specific investments are outlined in response to various Confidential Business Plan Questions. Investments that include services offered by competitor plans include, but are not limited to:

- Electronic referrals
- Physician profiling
- Online Credentialing
- Electronic funds transfer (EFT)
- Point-of service member liability estimation, real time claims processing
- Member liability and fund estimators – enabling members to track expenses in health care spending accounts
- Online member services (enhancements to portal)
- Online physician services (enhancements to portal)
- Member health system navigation tools

#### Plan of Conversion Question #10e

**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 purposes of conversion and believes that the Plan of Conversion should address these questions.**

**e. Provide detail as to how conversion will enable Horizon to respond better to state and federal reform.**

#### Plan of Conversion Answer #10e

Health care reforms at the state and federal levels continue at a rapid pace and it is expected that such reforms, once implemented, will require significant investments by managed care companies. The new administration in Washington is making federal health care reform a top priority. The significant number of reform proposals makes it critically important that a health plan has the ability to move quickly to adapt to industry changes.

Conversion will allow Horizon BCBSNJ to make investments needed to meet reform requirements without imperiling Horizon's capital position by giving Horizon the same capital raising tools available to its for-profit competitors. Flexibility and agility will be required as reform efforts transform the nation's health care system. As New Jersey's largest health insurer, Horizon BCBSNJ needs to have the same tools at its disposal as its competitors. This is not just a matter of what is in the best interests of Horizon BCBSNJ and its more than 3.6 million members. Horizon BCBSNJ's long-term viability affects the stability of the state's entire health care system.

There are many possibilities that Horizon BCBSNJ will need funding flexibility to respond to adequately. Much is unknown, but great changes are expected as a result of potential reform in the following areas:

- Health Information Technology regulation
- Expansion of COBRA, SCHIP and other programs
- Buy-In Medicare Program
- Connectors
- Kid Mandate / Individual Mandate
- Employer Subsidies

Plan of Conversion Question #10f

**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 purposes of conversion and believes that the Plan of Conversion should address these questions.**

**f. Explain how conversion enhances Horizon's ability to earn and maintain ratings from Standard & Poor's and other rating agencies.**

Plan of Conversion Answer #10f

Two of the primary criteria that Standard & Poor's and other rating agencies use in evaluating the financial strength of health insurance companies are capital adequacy and earnings adequacy. Conversion would enable the Company to access the capital markets. To the extent that the Company's capital adequacy were to decline, due, for example, to the impact of declining returns on Horizon BCBSNJ's investment portfolio, the Company would be in a position to raise capital and improve its capital adequacy position. With respect to earnings adequacy, conversion would result in an immediate improvement in earnings and pretax margins as a result of reinstatement of the 1/8 rule in calculating premium tax liabilities. If the Company were to convert in 2009, the Company would be able to fund more of the capability building initiatives described separately while simultaneously improving pretax margins closer to the 3% level that Standard & Poor's expects of A- rated companies. The financial projections reflect a pretax margin of 3% for 2010 in the scenario where conversion occurs on July 1, 2009, whereas the projected pretax margin in the not-for-profit scenario is approximately 2.7% in 2010.

Debt levels are another key consideration in the rating agency evaluations. Conversion would allow the Company to use common stock as a currency to acquire businesses that would add to the Company's capabilities. In the absence of conversion, significant acquisitions would likely be financed through debt, to the extent that the debt markets recover enough to allow for that. Substantial increases in debt resulting from acquisitions would be viewed negatively by Standard & Poor's and other rating agencies.

## Plan of Conversion Question #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 does these programs relevant to the conversion application, i.e. how does not converting prevent or inhibit further improvements?**

## Plan of Conversion Answer #11

Horizon BCBSNJ has developed a comprehensive portfolio of programs with the specific intent to improve the quality of health care. The programs range from Wellness / Prevention to Acute Care Management (including coordination of discharge when patients are admitted to the hospital) to Complex Case and Disease Management as well as Palliative and End of Life Care. In Horizon BCBSNJ's Medicaid line of business, Horizon BCBSNJ has funded many innovative programs that include participation in over 200 community health education programs that provided screenings and interactive programs with story boards in schools and local community centers. In addition, Horizon BCBSNJ introduced the use of two Care-a-Vans that serve as medical/dental exam rooms on wheels that are utilized in the local communities for health screenings and education. Finally, The Horizon Foundation for New Jersey has donated significant amounts towards community health care programs, Family Qualified Health Centers (FQHC) safety net clinics, Shape It Up program (with over 400 schools), as well as the partnership work with the Boys and Girls Club.

The effectiveness of these programs is measured in various ways including:

- 1) use of Health Risk Assessments and Biometric testing to assess population risk,
- 2) standard comparative Healthcare Effectiveness Data and Information Set (HEDIS) data, which measures process and Horizon BCBSNJ's standing relative to other health plans,
- 3) outcome measures, specific outcomes for diseases included in our Disease Management (DM) Programs, and
- 4) effectiveness of the Company's programs to ensure evidence-based care is delivered.

For many of these quality improvement programs, Horizon BCBSNJ measures improvement both in absolute scores and standing relative to the industry and Horizon BCBSNJ's competitors.

The cost of these programs is proprietary and confidential business information for Horizon BCBSNJ and will be disclosed in the Confidential Business Plan. These amounts cover the cost of staff (nurses, doctors), infrastructure (medical management technology), consultants and specialty vendor relationships (use of best in class capabilities).

Numerous studies have demonstrated widespread industry noncompliance with evidence-based standards of care (Rand, Dartmouth Atlas, etc.). In addition, Horizon BCBSNJ specific data (compliance with DM programs, HEDIS, adherence with medications, patient safety) has shown significant variance from evidence-based care.

Over the last six years, there have been concerted and highly successful efforts to improve quality. These efforts included:

- 1) Implementation of technology (Eliza) to outreach to members,
- 2) Use of member incentives to promote adherence to wellness/treatment recommendation,
- 3) Use of 24 by 7 on-line tools (PrismMD) to provide physicians with quality and disease management gaps for their members,
- 4) Use of mobile mammography vans to promote high rates of screening for breast cancer,
- 5) Use of gaps in care programs (Resolution Health) to specify which patients have gaps,
- 6) Use of multifaceted program (Eliza telephonic reminders and Resolution Health targeted reminders and Incent One reminders) to get at resistant members,
- 7) Use of innovative program (Health Integrated) to reach highly resistant members,
- 8) Medication adherence programs focused on patient and physician reminders to support Disease Management / Care Management care managers,
- 9) Point of care messaging through e-prescribing tools to remind physicians on best practice,
- 10) Adoption of health information technology in physician's offices utilizing "seed" money (\$5 million technology enablement fund targeting physicians/hospitals) providing access to free licenses and/or training to help practices get started using e-prescribing and electronic medical record tools,
- 11) Patient safety efforts to fund hospital medication reconciliation start-up which enables access to all-payor outpatient Rx records through a transactional database (RxHub),
- 12) Medication Therapy Management focusing on eliminating duplicate therapy, drug-drug and drug-disease interactions, inappropriate utilization (under and over) as well as optimization of medication dosing,
- 13) Use of a post hospital stay discharge program to ensure that care for patients discharged from the hospital have their care transitioned to outpatient health care professionals, and
- 14) Partial implementation of an integrated clinical environment through a clinical technology platform called MEDecision.

All of these potential activities are subject to available funding for capability development. The following two opportunities highlight the need for continued and increased funding to maintain and enhance quality. The first example is screening for breast cancer. Both nationally and regionally, breast cancer screening rates (mammography) have been decreasing. In fact, the American Cancer Society commissioned a Strike Task Force to evaluate the root causes for this decrease. One of

the major findings was limited access to mammography screening centers. As an interim solution, Horizon BCBSNJ engaged mobile mammography screening units that were sent out to companies so that employees could get the needed screening. This effective solution was not continued because of funding.

Another example is the use of technology to integrate clinical information and apply automated evidence-based guidelines to ensure quality care is delivered. This approach enables more real-time identification of gaps in care and opportunities to collaborate with physicians and other health care professionals to improve compliance with evidence-based standards. Without up-to-date versions of this clinical software, Horizon BCBSNJ's ability to ensure quality is threatened.

Nevertheless, there have been significant improvements as demonstrated by HEDIS (currently achieving 94% of accreditation quality scores) and improving scores in the Company's larger HEDIS set focused on the US News and World Report. In addition, Horizon BCBSNJ has been the clinical leader in the New Jersey State HMO Performance Report for the past six years and is now the number 2 plan, as the competition keeps raising the bar. In order to make the necessary improvements in member/physician outreach as well as manage the data, further investments in innovative outreach capabilities as well as improved data management need to be funded. Key advocacy organizations need support for collaborative programs, such as joint advertising on the need to get colon cancer screening or the efforts to educate the high risk populations (breast cancer, prostate cancer) in faith-based environments such as churches. These partnerships deliver high value in raising New Jersey citizens' awareness and willingness to have recommended screening. There have also been enhancements to Horizon BCBSNJ's wellness program with the combination of health risk assessments and other biometric testing (cholesterol, body mass index, blood pressure), but the ability to expand this program is limited by funding constraints. Horizon BCBSNJ also has a Member Advocacy Program, that is designed to assist the membership in navigating the complex health care maze, which could be expanded with additional access to capital.

Horizon BCBSNJ's investments in clinical innovation have been significantly limited by financial pressures and is also fueled by the need to remain competitive in an increasingly challenging economic environment. Programs that showcase quality improvement in the State of New Jersey, like the Newark Immunization Project, which was sponsored by Horizon BCBSNJ, resulted in Newark achieving the best improvement in immunization rates of all cities in the country, are threatened by lack of committed funds.

Further innovation to improve quality requires ongoing funding and investment. Without the flexibility to access capital markets, and the influx of the monetary support needed for infrastructure and human capital development, the quality of health care in the State will lag behind other parts of the country.

Plan of Conversion Question #12a

**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.**

Plan of Conversion Answer #12a

The license agreement between Horizon BCBSNJ and BCBSA and any addenda thereto are proprietary and confidential to BCBSA. At the request of BCBSA itself, the requested materials will be made available for inspection by representatives of the New Jersey Department of Banking and Insurance and the Office of the Attorney General and their advisors at Horizon BCBSNJ's office.

Plan of Conversion Question #12b

**Appendix A refers to Horizon's status as the exclusive licensee of the Blue Cross Blue Shield Association ("BCBSA") in New Jersey.**

**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.**

Plan of Conversion Answer #12b

The capital, ownership and operating requirements of BCBSA are proprietary and confidential to BCBSA. At the request of BCBSA itself, the requested materials will be made available for inspection by representatives of the New Jersey Department of Banking and Insurance and the Office of the Attorney General and their advisors at Horizon BCBSNJ's office.

Plan of Conversion Question #12c

**Appendix A refers to Horizon's status as the exclusive licensee of the Blue Cross Blue Shield Association ("BCBSA") in New Jersey.**

**c. Provide a copy of the BCBSA rules, identifying those that require restrictions on stock ownership following conversion.**

Plan of Conversion Answer #12c

The BCBSA rules, including those that require restrictions on stock ownership following conversion, are proprietary and confidential to BCBSA. At the request of BCBSA itself, the requested materials will be made available for inspection by representatives of the New Jersey Department of Banking and Insurance and the Office of the Attorney General and their advisors at Horizon BCBSNJ's office.

Plan of Conversion Question #13

**Has Horizon notified the BCBSA of the proposed conversion? Has BCBSA approved or otherwise commented on any aspect of the proposed conversion? Attach copies of all communications (including electronic communications) with the BCBSA regarding proposed conversion.**

Plan of Conversion Answer #13

See response to Foundation Plan Question #34.

Plan of Conversion Question #14

**Provide a description of the national BlueCard system and a copy of the BCBSA's requirements regarding BlueCard.**

Plan of Conversion Answer #14

The BlueCard is a national program that enables members of one Blue Plan to obtain health care services while traveling or living in another Blue Plan's service area. The program links participating health care providers with the independent Blue Cross and Blue Shield Plans across the country and in more than 200 countries and territories worldwide through a single electronic network for claims processing and reimbursement. Members obtain the benefit of the local Blue Plan's network of contracting health care providers, and electronic submission of claims.

Providers submit claims for patients to their local Blue Plan, and the local plan coordinates with the Blue Plan that issued the member's contract (the "Home Plan").

By the terms of the License Agreements that exist between all Blue Plans and the Blue Cross Blue Shield Association, licensees including Horizon BCBSNJ and its Blue-licensed affiliates are required to participate in national programs, including BlueCard.

Plan of Conversion Question #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?**

Plan of Conversion Answer #15

Horizon BCBSNJ has not considered giving up its status as a licensee of the BCBSA.

Horizon BCBSNJ's status as an exclusive licensee would not be affected if were to withdraw from certain markets or from certain regions of the State.

Plan of Conversion Question #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.**

Plan of Conversion Answer #16

The detailed nature and timing of Horizon BCBSNJ's capability investments and their intended functional improvements are confidential and are set forth in response to the Confidential Business Plan questions.

Plan of Conversion Question #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?**

Plan of Conversion Answer #17

The detailed nature and timing of Horizon BCBSNJ's capability investments and their intended functional improvements are confidential and are set forth in response to the Confidential Business Plan questions.

The capability buildout analysis was completed recently, precipitated by the Booz & Co. report and mounting evidence that Horizon BCBSNJ will need to invest more heavily to remain competitive. Decisions made in 2005 about the affordability dividend and the commercial market pricing were made in a different era. The affordability dividend was a one time item resulting from a lower than expected medical cost ratio in 2004. With regard to pricing in the commercial market, the pricing strategy adopted in 2005 was determined at a time when the outlook for both the Company and the entire industry reflected quickly growing profits and risk based capital levels. The industry outlook has changed considerably since then, and risk based capital has declined considerably in 2008, both at the Company and throughout the industry. The Company is no longer pricing below medical cost trend, reflecting the changing environment and the need to improve profit margins to sustain an A- rating from Standard & Poor's.

Plan of Conversion Question #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?**

Plan of Conversion Answer #18

The detailed nature and timing of Horizon BCBSNJ's capability investments and their intended functional improvements are confidential and are set forth in response to the Confidential Business Plan questions.

The Company does not currently have specific plans to raise capital to fund system capability improvements. Senior management of the Company consulted with its advisors, including its investment bankers, with respect to alternatives. The Company's investment banking advisors have advised senior management of the Company that there is no viable alternative for accessing long term funding at reasonable rates in the current economic environment. The credit crisis has resulted in a significant reduction in borrowing ability for companies such as Horizon BCBSNJ, and any long term borrowing, to the extent that financing could be secured, would carry an exorbitant interest rate. With regard to surplus notes, management's understanding is that the current regulatory environment does not allow for surplus notes, so that alternative was quickly rejected. Management did not seriously consider selling off assets, such as the HMO, as such assets in general, and HMO product offerings in particular, are a vital part of the Company's value proposition. In management's opinion, selling the HMO would reduce the long term viability of the Company.

Plan of Conversion Question #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?**

Plan of Conversion Answer #19

The detailed nature and timing of Horizon BCBSNJ's capability investments and their intended functional improvements are confidential and are set forth in response to the Confidential Business Plan questions.

Management does not believe that the funding gap described therein can be bridged by premium increases because the gap already reflects assumed pricing at market levels. Any increase above market levels would undermine Horizon's competitive position and adversely affect New Jersey. The Company employed a pricing strategy that focused on growing enrollment in selected markets for a short period of time beginning in late 2005. Pricing below trend is not sustainable long term strategy. The Company returned to a strategy or pricing at or above trend in those markets beginning in the third quarter of 2008, after management determined that continued pricing investments would likely lead to a downgrade in the financial strength rating from Standard & Poor's. The vast majority of the technology investments are recorded as expenses under the relevant accounting rules, while a small portion is capitalized. The required additional annual expenses described in the Confidential Business Plan are significant from the standpoint of maintaining the pretax margin level necessary to sustain an A rating with Standard & Poor's.

Plan of Conversion Question #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?**

Plan of Conversion Answer #20

Because of information technology limitations, Horizon BCBSNJ cannot be as responsive to participating hospital and physician requests for different types of reimbursement structures. For example, some hospitals have asked to be reimbursed using DRG groupers rather than using Horizon BCBSNJ's standard method of negotiated per diems. Horizon BCBSNJ does not currently have the ability to systemically pay for trailer payments on hospital claims.

Physician groups have asked for administrative simplifications (e.g. no referral requirements in "in-group" referrals), but Horizon BCBSNJ is limited in its ability to offer this type of flexibility group by group. Some competitors are able provide this flexibility because their system architecture may be more advanced.

At times, requests can be accommodated through special reimbursement arrangements and allow for a certain degree of competitiveness, but it often involves a non-automated or workaround process, resulting in higher administrative expenses.

Moreover, Horizon BCBSNJ has recently launched a Primary Care Medical Home (PCMH) pilot. This model has gained traction and is being developed nationwide as it is designed to support, retain, and reward primary care. It is recognized that this model has the potential for reversing the trend in primary care ( i.e. to attract more physicians into primary care as a result of better reimbursement), and, at the same time, improve the care of patients as the model supports and rewards for total coordination of care. The issue of declining primary care is evident in New Jersey and this model is critical to Horizon BCBSNJ members receiving better care not only now, but in the longer term. The Horizon BCBSNJ pilot is very rudimentary, and in order to expand its scope in collaboration with physicians and their requirements, Horizon BCBSNJ must develop more sophisticated data collection and system capabilities not yet supported by current infrastructure. These expanded capabilities will allow for identifying care needs, measuring care coordination results, and providing reimbursement based upon results.

The fact is these examples do not reflect the enormity of reimbursement changes expected in the future. Rather, they reflect capability that is required to meet today's needs.

Plan of Conversion Question #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.**

Plan of Conversion Answer #21

Enactment of S-1557 is not directly related to conversion. Horizon BCBSNJ will have to meet the minimum loss ratio requirements regardless of its corporate form. However, S-1557 is indicative of interest in health care reform, which will require Horizon BCBSNJ to be more agile and responsive from both a financial and operational perspective. The likelihood of significant but unpredictable restructuring of the health care delivery system increases the need for Horizon BCBSNJ to convert to a for profit status to give it the financial flexibility to deal with this change.

There is no additional expense anticipated for stockholder dividends in our financial projections. Currently investors do not expect dividends from for-profit health insurance companies. We estimate the additional cost of operating as a for profit to be insignificant in terms of our total selling, general and administrative expenses and so should not cause any problems in meeting the minimum loss ratio requirements of S-1557.

Plan of Conversion Question #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 present surplus level. Provide these studies, and Horizon's analysis of them, if any.**

Plan of Conversion Answer #22

A health insurer's reserves (or capital) are necessary to protect members and the financial stability of the entire health care system. Reserves are the safety net providing resources to pay claims and finance the health care system when unforeseen events happen and premiums payments are disrupted. As such, Horizon BCBSNJ cannot utilize its reserves to fund needed investments. Appropriate reserve levels must be properly maintained, and it would not be prudent to allow the company's reserves to drop below their current levels. This is particularly the case when the insurer in question is the largest in the state, as is Horizon BCBSNJ.

The actuarial studies described above are confidential and have been provided in response to Confidential Business Plan questions.

Plan of Conversion Question #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?**

Plan of Conversion Answer #23

Management's intention is that the converted company will maintain surplus in the same general range. The Company's risk based capital level is approximately in line with that of its major competitors (all publicly-held) and below that of most of the other Blue Plans. The Company does not intend to move capital from the insurance companies to the holding company upon conversion. Management will ensure that surplus levels in its insurance subsidiaries continue to be adequate and meet all regulatory requirements.

Plan of Conversion Question #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.**

Plan of Conversion Answer #24

A.M. Best recently downgraded Horizon's financial strength rating from A- to B++. More recently, Standard & Poor's downgraded Horizon's financial strength rating from A to A-. To date, the Company has not seen a material adverse impact on its business. Most of the Company's primary competitors are currently rated as A- by Standard & Poor's, so the Company is not at a competitive disadvantage. The Standard & Poor's rating carries far more weight in the marketplace than the A.M. Best rating, primarily because the Company engages Standard & Poor's annually to conduct a thorough review, including reviewing financial and operational information and interviewing management. In contrast, the Company does not engage A.M. Best and the rating provided is based exclusively on their review of publicly available financial information. Further Standard & Poor's downgrades would make Horizon less competitive, particularly with large employers who require that insurers have strong credit ratings in order to be considered for their business. The loss of such business would compound Horizon's financial pressure and further restrict the Company's ability to make needed investments. Conversion would provide the Company with access to equity capital markets, enabling it to increase investments in critical capabilities without compromising its capital position.

Plan of Conversion Question #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 net underwriting loss for the past year and a half and does the company plan to continue to operate at this level?**

Plan of Conversion Answer #25

The Company adopted a pricing strategy in August 2005 that facilitated growth in enrollment. That was a short-term strategy of pricing below medical cost trend in selected markets to grow enrollment and increase leverage with providers. That strategy resulted in underwriting losses at Horizon Healthcare Services, Inc., although Horizon Healthcare of New Jersey, Inc. has continually generated underwriting profits during the same period, resulting in underwriting profits at a consolidated level in 2007 and 2008. The results referenced above do not reflect consolidated results. The Company is no longer pricing below trend and the projections reflect increasing underwriting profits over time. This pricing strategy remains the same whether the Company is a non-profit or converts to a for-profit stock company.

Plan of Conversion Question #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.**

Plan of Conversion Answer #26

See response to Plan of Conversion Question #25 above regarding reversing the trend of underwriting losses. As described in the responses to other questions, the incremental expenses associated with public company status are not expected to be material, and the Company does not plan to pay shareholder dividends. Conversion is not expected to result in reduced surplus levels and, therefore, should have no impact on investment income.

Plan of Conversion Question #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?**

Plan of Conversion Answer #27

Conversion costs, to date, have aggregated approximately \$5 million, and the Company expects to incur an additional \$5 to \$15 million, not including the costs relating to the State's advisors. However, Management believes that the strategic benefits of conversion far outweigh the estimated costs.

Horizon BCBSNJ has obtained only anecdotal information from bankers regarding the costs of other Blue Plan conversions or attempted conversions.

Plan of Conversion Question #28

**Exhibit 1 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?**

Plan of Conversion Answer #28

Horizon BCBSNJ has not finalized plans to tier the provider network. It is inevitable that future demands will require tiering of networks and designing products around tiered networks. Members need to be incented and educated to utilize the best providers in terms of cost and quality. In order to do so, they need to have enough information about those providers to make their own choices. Horizon BCBSNJ currently participates in Blue Distinction, a BCBSA initiative, which promotes centers of excellence based upon stringent criteria. The program allows for members to utilize Blue Distinction centers across the nation. It is anticipated that there will be development of benefit designs that will incent and maybe even require use of this network for certain procedures.

Horizon BCBSNJ intends to be able to capture data to measure and distinguish those providers who render superior care (through critical pathways and adherence to guidelines) and to develop products that incent members to use of these providers for certain procedures/types of care.

Investments are necessary to capture data to establish best practices, identify best performers, create new networks and develop systemic capability to offer products with tiered networks. As described elsewhere, capital needed for such investments is more accessible in a scenario in which Horizon BCBSNJ is a converted company. Tiered network products would be available across a broad spectrum of products underwritten and/or administered by Horizon BCBSNJ and its HMO subsidiary.