



To: Interested Stakeholders in Horizon BCBS
From: Renée Steinhagen, Esq., Executive Director, NJ Appleseed

Date: November 16, 2020, revised November 30, 2020

Re: Proposed Legislation Governing Change in Form and Mission of
Horizon Despite Statutory Declarations To the Contrary

This memo is intended to provide you with New Jersey Appleseed's and New Jersey Citizen Action's concerns regarding the November, 2020 proposed legislation authorizing Horizon's desired change in form and mission, with some comparison points to a similar bill that was circulated among legislators and stakeholders in November-December 2019, and to the existing 2001 conversion statute.

POINT ONE: The bottom line is that the proposed reorganization results in the business of the health service corporation -- i.e., the legacy insurer -- being placed in a for-profit stock subsidiary that is controlled, and in the latest version seemingly owned, by a nonprofit mutual insurer holding company that is declared to be charitable and benevolent. However, since assets can be transferred between and among for-profit subsidiaries, this change does not sufficiently protect the value of Horizon's current charitable assets. This holding company is not an insurer and does not engage directly in any nonprofit, charitable activities; its mission is achieved only through its for-profit subsidiaries revealing it to be a charity in name only. Unless further significant changes are made to the bill, the proposed reorganization constitutes a de facto conversion or change in material form despite statutory declarations to the contrary.

Overall Assessment:

The proposed legislation permits Horizon to circumvent the approval process and many of the substantive public protections included in N.J.S.A. 17:48E-49 et seq. (the "2001 Conversion Law"), even though the result is the same -- i.e., converting the health service corporation into a for-profit stock company. If enacted as proposed, the nonprofit mutual holding company structure offers the worst of all worlds for the public and the policyholders. It weakens, if not eliminates, the interests of both the State and Horizon policyholders by prohibiting the payment of a charitable trust settlement to the State at the time of conversion (Sections 8, 17-18), while barring the policy

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holders from receiving dividends and building future equity, contrary to the fundamental principles of mutual insurance (Section 9(g)).

Remarkably, this statute would preclude New Jersey from ever fully reclaiming the \$7 billion in current-estimated charitable assets to which it is entitled, stemming from decades of state support of Horizon BCBS as a charitable corporation. (The \$7 billion is a rough fair market value estimate based on information regarding “listed assets” filed with the Department of Banking and Insurance, “DOBI” in 2018; the 2019 report is not posted). Similarly, policyholders will be barred from benefiting from their future contributions to the mutual holding company (*i.e.*, profits from their premiums paid to the former health service corporation). This structure benefits only management and future private shareholders, not policyholders or citizens of New Jersey. These facts are not disclosed in the advocacy materials distributed by Horizon in support of the proposed legislation.

Notwithstanding the above, we believe that unless the legislation is changed to require that the mutual holding company owns 100% of the outstanding capital stock shares of all its for-profit subsidiaries and the mission of the mutual holding company is expanded to benefit the broader public and/or State (in Section 3, not just 1(c),) the common law regarding charitable trusts applies even though the proposed bill declares that the 2001 conversion statute does not. (The 2019 version of the bill was silent on this issue.) There is a strong argument that the Attorney General, or persons with a special interest in the current health service corporation, with the approval of the Chancery Division of the New Jersey Superior Court, may compel a charitable trust settlement under common law at the time of reorganization regardless of the bill’s declarations to the contrary in Section 1(e) and Section 17.

POINT TWO: In the proposed bill, the Legislature declares that this reorganization is necessary to “utilize 21st century technologies and tools to address current challenges [that] will improve the State’s healthcare infrastructure” benefiting Horizon’s members and the State. This is the same reorganization proposed by Horizon BCBS in 1995-1996, when it sought to convert to a mutual insurer and then merge with Anthem, while becoming a for-profit stock company (*i.e.*, Anthem East). There was no credible connection between the proposed restructuring and Horizon’s ability to deploy 21st century technologies 15 years ago and there is no connection today.

Furthermore, the proposed mission of the mutual holding company (Section 3(a)) is devoid of any community benefit or assistance to the State to improve the health status of its residents, to administer a publicly financed insurance option or to advance any other charitable health purpose. The legislation continues to say that the holding company retains its charitable and benevolent mission though it restates that mission as that of a mutual insurer, not a charity. Horizon BCBS is the most successful health insurance company in New Jersey with the largest market share. It has had no difficulty in utilizing emerging electronic technologies, and there is no established connection between the proposed reorganization and Horizon’s ability to function as a health insurance company to the benefit of its policyholders or the public; however, it is now proposing relinquishing its mission as a nonprofit, charitable association that to date included an additional obligation to assist the State and provide community/public benefits beyond its production of an “affordable

insurance product” to its policyholders. It fails to acknowledge that it will also have to act on behalf of the private shareholders of its many for-profit stock subsidiaries rendering its formal status as a “nonprofit,” let alone charity, meaningless.

The Transaction:

The proposed legislation defines the “Reorganization” as “the simultaneous mutualization of a health service corporation to a domestic mutual insurer and the transformation from a domestic mutual insurer to a mutual holding company.” In the new version that definition drops the phrase “with a subsidiary legacy stock insurer (former health service corporation),” Now, the definitions no longer include a definition of “health service corporation” nor its second permutation, “legacy insurer.” Instead, we just have the definition of “reorganized insurer,” which is defined as “a stock insurer authorized pursuant to Title 17B of the New Jersey Statutes to transact health insurance as defined in N.J.S.A.17B:17-4. Though each version of the bill has tried to make the connection between “health service corporation” and “for-profit stock insurer” less transparent, this underlying fact has not changed from the 2019 version of the bill. However, one important point must be noted. The definition of “reorganized insurer” now includes the following language:

All health insurance or risk-bearing obligations of the health service corporation shall be undertaken by the reorganized insurer pursuant to subsection c. and e. of [this pending bill.]

What this means is that as a result of the proposed transaction, the reorganized insurer has the obligation to take on all the liabilities of the health service corporation/legacy insurer; however, this is no corresponding reference to the assets of that corporation. This is important to note when determining whether or not the proposed transaction adequately protects the charitable assets of the current health service corporation (which we believe it does not).

In any event, let me break this proposed reorganization down, even though the three corporate changes are proposed to happen simultaneously.

First, employing N.J.S.A. 17:48E-45 et seq., the 1995 statute that Horizon secured in anticipation of its merger with or acquisition by Anthem, then a for-profit mutual insurer under Indiana law, the health service corporation is permitted to transition to a for-profit domestic mutual insurer without dissolving. This statute is entitled “**Conversion** of health service corporation to domestic mutual insurer.” **The approval standards set forth in this 1995 statute are minimal. Rather than requiring the conversion be beneficial to policyholders or in their best interests, it instead ties the hands of the Commission with a non-prejudicial standard.**

Second, in a nanosecond, as part of the same process, the former health service corporation incorporates as a for-profit stock insurance company governed by Title 17B. service corporation are undertaken by this for-profit (Section 3(c)) though it is not subject to annual regulatory filings, annual audit, solvency rules and other regulations currently

applicable to a health service corporation (Section 3(e)). This exemption not only applies to the reorganized insurer, but “any insurance company or risk-bearing entity within the mutual holding company system” that may receive the assets of the reorganized insurer or may be the focus of growth for the new mutual holding company. In addition, all subsidiaries of the holding company, including the reorganized insurer, are permitted to make dividends or distributions to the mutual holding company, or other subsidiaries, as well as private shareholders in accord with N.J.S.A. 17:27A-4. (Section 3(g).) This provision permits the mutual holding company to take assets and value out of the reorganized insurer and transfer it to other subsidiaries. Again, even if the holding company owns 100% of the capital stock of the health service corporation, the charitable assets of that company are not adequately protected. (For example, if Horizon had \$7 billion in assets, \$6 billion could be put in different subsidiaries, leaving the mutual holding company owning only \$1 billion of the original assets)

POINT THREE: The health service corporation, with all its risk-bearing and health insurance obligations (not necessarily all its assets) becomes a for-profit stock company, and is regulated as a for-profit stock insurer, enjoying all the privileges and rights of such insurer, including the fact that it is no longer excluded from the payment cap on the insurance premium rate tax law. (Section 3(f).) Of course, it is no longer a charitable, let alone, nonprofit organization.

And third, the for-profit stock insurance company is transferred to, or becomes a subsidiary of, a new type of entity under New Jersey law called a nonprofit mutual holding company. Such mutual holding company “is not an insurer and is not licensed to issue insurance policies, contracts or health benefit plans.” (Section 3) It is an “entity without permanent capital stock” (id.); nonetheless the “mutual holding company system” created by the proposed legislation will be “considered an insurance holding company system” governed by N.J.S.A. 17:27A-1 et seq. (Section 6).

The nonprofit mutual holding company will conduct its business exclusively through its for-profit subsidiaries, including the former health service corporation and other for-profit stock insurance companies, as well as for-profit non-insurance stock companies. (Section 3(g).) It is the ability of the holding company to transfer assets from one subsidiary to another (Section 4(g)(3).) and “to transfer the assets of the health service corporation and its subsidiaries to the mutual holding company or one or more subsidiaries of the mutual holding company in connection with the formation of the mutual holding company system” (Section 5(a).), that is the most troubling aspect of the proposed transaction, and the crux of our argument that this reorganization constitutes a substantial change in material form. **Both provisions explicitly permit transfer of the assets from the reorganized insurer to some other subsidiary that is not 100% owned by the mutual holding company, and both undermine the nonprofit, let alone charitable nature of the mutual holding company.**

POINT FOUR: The holding company concept, with its ability to transfer assets among and between for-profit subsidiaries does not protect the charitable assets of the health service corporation, and the failure of the mutual holding company to hold 100% of the capital stock of all its subsidiaries undermines its claim to be a nonprofit, and for sure a charitable nonprofit.

In addition, the mutual holding will not be subject to all of the provisions found in the health service act, except that it will be deemed charitable and benevolent. (Section 3(d).) Furthermore, though organized under Title 15A, the nonprofit mutual holding company will not be subject to the requirements of that law to the extent that it is inconsistent with the provisions of this proposed bill. (Section 4(d).) For example, would the holding company be subject to filings with the Charities Bureau of the Office of the Attorney General? The proposed bill simply requires the mutual holding company to file with the DOB Commissioner an “annual statement pursuant to applicable laws.” (Section 11.) The new version of the bill now for the first time spells out that such reporting includes information regarding the mutual holding company’s missions, activities, revenues, expenses, assets, liabilities and total compensation provided to officers, directors, trustees and the five other highest compensated employees who are not trustees. Seeming to replicate some of the information otherwise required of charities, it is clear that the public will not be able to see movement of assets and ownership among all the for-profit subsidiaries, nor does such reporting prevent private gain.

POINT FIVE: If one is to take the Legislature’s declaration that the nonprofit mutual company is a charitable organization organized under Title 15A as well as this proposed bill, then it must make all filings required by that law, not have a special law tailored to avoid scrutiny by the Attorney General. The legislation must require that the nonprofit mutual report to the AG as a Title 15A charitable activity, and all its actions must be monitored to protect against private gain, and to ensure that all profits generated by all the for-profit subsidiaries are used to further charitable health purposes.

The proposed bill also states the mutual holding company is to carry on the charitable mission of the health service corporation and is to benefit its members in three designated ways (Section 3(a)). However, how can the holding company carry on the charitable mission of the health service corporation if it is not an insurer and has no activities or business activities except for those of its for-profit subsidiaries? Also, it must be noted that its members -- *i.e.*, policyholders -- have no right to dividends or ability to build future equity in the surplus. (Section 9(d).)

POINT SIX: A nonprofit mutual insurance holding company is established that is deemed charitable and benevolent, although its specific mission is only to benefit its members, and all its business is operated through its for-profit subsidiaries. Such an entity is not likely to receive tax-exempt status under the federal (IRS) law nor property tax exemption under New Jersey law. A “mutual” organization is not considered charitable under common law because it serves only its members. Unless the proposed legislation requires such entity to receive all profits generated from the operation of its for-profit subsidiaries and to spend those dividends/profits on activities that benefit not only its members, but also the public or the State, it is not a charitable organization in fact. Simply put, the nonprofit mutual holding company, as currently proposed, is a shell corporation that is neither an insurer nor a mutual company in the true understanding of those concepts. And certainly, it is not a charitable or benevolent corporation as is a health service

corporation pursuant to its governing statute, N.J.S.A. 17:48E-41, even though the proposed bill declares to the contrary.

As an aside, it should be noted that even if Horizon were converting to a mutual insurer rather than a mutual holding company, the nonprofit designation is without meaning because all mutual insurers are supposed to provide “insurance at cost” and “operate without a traditional profit motive.” In theory, the purpose of a mutual is to serve the interests of its policyholder-owners, not the broader public.¹ However, even if one were able to structure a mutual insurer with a public mission, which the proposed bill does not do (as stated above), the rights of policyholders would have to be suppressed (unless all surplus/profits generated by for-profit subsidiaries were retained by the mutual); and, when policy holders are disenfranchised, the more insular and powerful management becomes, making the insurer vulnerable to abuse and a loss of mission, while leaving both the public and policyholders alike subject to the whims of private investors.²

The mutual holding company structure, which is one step away from a mutual insurer, creates additional problems and, as will be further discussed *infra.*, begs some important questions: who will actually control the “subsidiary legacy stock insurer,” in this latest version called the “reorganized insurer” (policyholders will have limited voting rights in the mutual holding company), who benefits from the former health service corporation’s success (such as dividends) and what rights will policyholders possess with regard to future operations and potential corporate changes of the mutual holding company and the legacy insurer subsidiary (*e.g.*, mergers, acquisitions or demutualization).

The Issue of Ownership

One of our major criticisms of the proposed bill circulated in 2019 was that the mutual holding company only had to hold a majority of the voting shares of the for-profit legacy insurer and other for-profit subsidiaries. This was problematic for the policyholders (due to the conflict of interest they would have with private investors), but also, it was the mechanism by which the holding company could and would siphon off value from the legacy insurer, supporting our argument that the restructuring was indeed a conversion or a material change in form. This year,

¹ See, *e.g.*, Penn Mutual v. Lederer, 252 U.S. 523, 525 (1920)(“It is the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder”); *id.* at 533 (mutual insurers act wholly for the benefit of their policyholders and are co-operative enterprises); and *id.* (policyholders are the owners of a mutual and elect the board of directors).

² An example of just such a nonprofit mutual insurer is The Beacon Mutual Insurance Company, which was created and capitalized by the Rhode Island Legislature, with a public mission and gubernatorially-appointed directors. Despite this hybrid mutual/public designation, the mutual insurer devolved into a bastion of favoritism, corruption and incompetence, while policyholders were overcharged and mistreated. An examination report by the state Department of Business Regulation documents Beacon Mutual’s pervasive misdeeds and breaches of duty. See http://www.dbr.sate.ri.us/documents/divisions/insurance/examinatins/Beacon_Mutual-4-20-07.pdf.

the issue has simply gone underground and has gotten lost in a maze of cross-references. However, if one reads the language of the statute carefully, spells out requirements found in statutory citations, and points out what issues are not addressed, one realizes that the same problem remains. This latest version just seems to bury the issue further.

Earlier this year, a mutual holding company was defined as being organized for the “purpose of holding, directly or indirectly, a controlling interest in a legacy insurer pursuant to a plan of reorganization as provided in this act.” (Section 2.) “Control” was defined as:

the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. . .
N.J.S.A. 17:27A-1 (emphasis added).

In this way, the proposed bill still contemplated control of the legacy insurer through the ownership of voting securities, and did not require ownership by the holding company. We pointed this out and a change was made only in the definition section of the bill. No other provision was changed. Now, the latest version changes the language in the definition to state that the mutual holding company is organized for the “purpose of holding, directly or indirectly, one-hundred percent interest in a reorganized insurer.” Interest is not defined (what kind of interest?), and most importantly, all other relevant provisions in the bill have remained the same keeping the issue clouded, and for sure providing wiggle room for Horizon, especially in the event of a merger.

Let’s look at some of these other provisions that raise doubt that Horizon is really interested in requiring the mutual holding company to hold a 100% of all the capital stock of the reorganized insurer; or at least, 100% of all the charitable assets of the legacy insurer. That is, even if they intend to own 100% of the capital stock of the insurer (at the time the transaction is approved) as we already discussed, holding 100% of the capital stock of the reorganized insurer is not sufficient to protect all of Horizon’s charitable assets.

For example, one must look at Section 4(b) that has remained the same. It states that “the mutual holding company system shall consist of a mutual holding company and one or more controlled subsidiaries, including the legacy insurer”. “Control” remains the operative word. Several other provisions of the statute also refer to “majority of voting shares” making clear that the holding company simply has to control the legacy insurer and not own it. *See* Definitions of “intermediate holding company” and “majority of the voting share of the capital stock”; Section 7(a), requiring that “any surviving or new company resulting from a merger or consolidation of a mutual holding company . . . shall at all times own, directly or indirectly through one or more intermediate holding companies or subsidiaries, all of the voting shares of the capital stock of the legacy insurer.” This is a substantial loop hole; it notably, does not require all the shares of the capital stock of the reorganized insurer, only the voting shares.

On one hand, the proposed bill seems to contemplate, at least at the time of reorganization, that “the shares of the capital stock of the legacy insurer” will be issued and held by the mutual

holding company or an intermediate holding company that is wholly owned by the mutual holding company (Section 4(f)). However, “shares” are not defined and the term “all” does not qualify the term shares. Are we talking about only “voting shares” of the capital stock? Like, the undefined term “100% interest” in the definitions, we are not given a straight explicit statement. Also, “one or more intermediate holding companies” is defined, in Section 2, to mean:

An entity of which at least a majority of the voting shares of the capital stock are at all times owned directly or indirectly through other intermediate holding companies by a mutual holding company.

This difference between the definitions contained in the proposed bill and Section 4(f) – though different in this latest version -- is still confusing, and seems to indicate an attempt to obscure the true intent of the reorganization: to get the full fair market value of the assets of the legacy insurer into a for-profit stock company that in the future can be shared with private investors and/or acquired by another mutual insurer or holding company that allows sale of capital stock to private investors. *See* Section 7(a) (noting that a surviving company from a merger must only hold a majority of the voting shares of the legacy insurer). Does the mutual holding company have to own 100% of the capital stock or only a majority of the voting shares of the stock of the intermediate holding company? This corporate maze is further complicated by provisions, we discussed earlier, in the bill that permit subsidiaries of the mutual holding company to be formed by transfer of assets among two or more companies, acquisition or transfer of capital stock or merger or consolidation with other for-profit companies that already issue shares of capital stock to private investors (Section 4(g).) This means that assets of the legacy insurer can be transferred to other subsidiaries of the holding company that do not require 100% of the capital stock to be owned by the holding company. *See also* Section 6 (permitting acquisition of controlling stock, ownership interest, assets or control or merger or consolidation and a host of other activities not to require separate approval if set forth in the application to reorganize/convert).

POINT SEVEN: Either Horizon seeks to become a for-profit stock company that is wholly held by a nonprofit mutual holding company at the time of reorganization and in the future or it seeks only to be controlled by such entity with its ownership held by private investors or acquired by another for-profit mutual insurer or stock insurer. The proposed bill is less than clear. The public demands that the proposed bill eliminate all its ambiguous provisions with regard to ownership versus “control by holding a majority of voting shares;” and instead include a clear statement that the mutual holding company would, at the time of reorganization and, at all times thereafter, hold 100% of the all the capital stock of the legacy insurer as well as all its for-profit subsidiaries. In this way, and only in this way, will the public be assured that this is simply a reorganization and not a conversion permitting the value of the legacy insurer to be sold to private investors or merged with another holding company that permits private ownership.

The Charitable Trust Settlement Issue

A charitable trust payment represents the full and fair market value of a nonprofit, charitable corporation’s assets. It must be made to a similarly missioned entity (pursuant to the doctrine of *cy pres*) when the corporation dissolves and/or transforms itself to a for-profit entity or

relinquishes its charitable/benevolent mission even though designated a nonprofit. In this transaction, the legacy insurer is becoming a for-profit stock company, and the health service corporation, devoid of its insurance business and assets, is becoming a mutual holding company that no longer has a charitable mission, despite proclamations otherwise.

The proposed legislation attempts to eliminate such payment at the time of reorganization, even though the health service corporation is becoming a for-profit stock insurance company. Section 8 does not permit any distribution or payment to any fund or entity of any nature. This provision appears to prohibit the Attorney General or the public from demanding an independent appraisal or demand the charitable assets be preserved at the time of conversion, let alone permit that a payment to be made to a foundation at the time of conversion. Horizon seems to have convinced some legislators that a charitable trust payment is not necessary because the health service corporation is becoming part of a nonprofit mutual holding company system that continues the mission of Horizon to benefit its policyholders/prospective members of the mutual. However, as noted *infra*, the mutual holding company that is the center of such system is not a mutual insurer, and even if it were, a mutual insurer is not a charitable corporation, even if organized as a nonprofit and the legislature declares it to be a charitable organization.

Though Horizon may have persuaded some legislators that it is not converting to a for-profit stock company (despite the fact that the health service corporation will become and remain a for-profit stock company) and thus the approval process set forth in the 2001 Conversion Law should not apply and a different process is appropriate, we believe that this is misguided and contravenes principles of charitable corporations and public policy.

In our comments to the proposed bill circulated in 2019, we stated that “N.J.S.A. 17:48E-65 to 67 still applies to the proposed transaction, and its applicability should be acknowledged in the proposed legislation.” Instead, the Legislature has done the opposite; in this 2020 version of the bill, the legislature has allowed Horizon to keep the structure of its proposed reorganization the same as proposed in 2019, and has simply stated that “the reorganization is not a material form change under P.L. 2001, c.131 (C. 17:48E-49) (Section 1(e).) See also Section 14 providing that the provisions of the 2001 Conversion law providing for conversion of a health service corporation to a domestic stock insurer shall not apply to a mutual holding company formed under the proposed bill. In general, the 2001 conversion law was designed by the Legislature a few years after Horizon withdrew its application to convert to a mutual insurer, merge with Anthem (then a mutual insurer) and become a for-profit stock company to be held by a mutual insurance holding company (the corporate form that Anthem was to become by the time the transaction was to be consummated). The application was withdrawn when the Whitman administration took the position that a charitable trust settlement payment would be required to be paid to the State, and an Appellate Court agreed.

From the perspective of NJ Appleseed and NJ Citizen Action, who testified in support of the bill, the 2001 conversion law was a political compromise on how the charitable trust payment would be determined, to whom it would be paid, and how it would be spent by a foundation, controlled by government officials and appointees, and dedicated to improving the health status of all New Jersey residents--not just the policyholders of Horizon at the time of the change. Although in 2001 Horizon was again floating the idea that it needed to become a for-profit stock company

in order to modernize and improve its information and technology systems, the bill made sure that a charitable trust payment would also be triggered by a transaction like the one proposed in 1996 and now again in 2020. The law specifically noted that it was to apply to a health service corporation that seeks to undertake actions constituting a material change in form such as the proposed reorganization. The Attorney General must review the material changes in form in furtherance of his common law responsibilities as protector, supervisor and enforcer of charitable trusts and charitable corporations (N.J.S.A. 17:48E-65), and may compel the payment of a charitable trust settlement payment pursuant to an “alternative foundation plan” (with valuation of the health service corporation conducted by the Commissioner of Insurance). N.J.S.A. 17:48E-66.³ An action that has been determined to constitute a material change in form shall not be consummated unless the New Jersey Superior Court has issued its approval. Id. The court’s jurisdiction over charitable trusts and corporations is a requirement of the 1947 New Jersey Constitution.

POINT EIGHT: We acknowledge that the Legislature in some cases can change common law, and for sure, has the authority to declare a previous statute to be inapplicable to a situation that otherwise would trigger that statute; however, in this matter, the Court’s oversight of charitable trusts and corporations is constitutional, and the Legislature is restricted from retroactively changing the principles that have governed Horizon BCBS, as a charitable corporation since its inception in the late 1920s. Therefore, there is a strong case to believe that the Chancery Division of the New Jersey Superior Court would prohibit the Legislature from permitting Horizon trustees to violate their fiduciary duty by failing to make a charitable trust payment at the time they approve a material change in form that changes or relinquishes the health services corporation’s charitable mission (even if it accepts the Legislature’s desire that the 2001 Conversion Law is not triggered). There is little doubt that the State may permit Horizon to change its form and set forth a process different than one previously enacted; there is less certainty whether the Legislature may permit it to change its form and mission without making a charitable trust settlement. Nonetheless, we request that Section 8 of the proposed legislation be eliminated.

³ The fact that Horizon ends up as a nonprofit mutual holding company with the former health service corporation as a for-profit stock subsidiary does not mean that the financing of an alternative foundation plan is not feasible. There are possible mechanisms for financing a charitable trust payment to the citizens of New Jersey without limiting the mutual holding company’s or the stock insurer’s ability to operate. For one, guarantee stock is available, a form of equity which is what mutual insurers have issued for over a hundred and fifty years to the providers of their start-up capital. By issuing guarantee stock to a foundation, Horizon would retain all of the funds it needs to continue operating, and the guarantee stock, in the amount of Horizon’s current fair market value, would be owned by the foundation as set forth in the 2001 Conversion Law. No money would exchange hands as Horizon would retain its capital. However, an annual income stream could be established to fund the charitable activities of the foundation and/or gradually retire the foundation’s guarantee stock through stock repurchases. A similar option for funding the foundation, and/or retiring the guarantee stock, includes the issuance of surplus notes, which is subordinated debt treated as surplus. A combination of these mechanisms or other combinations are feasible and merit thorough analysis and discussion. The proposed legislation ignores this issue completely.

Section 14 of the earlier 2020 proposed legislation required the nonprofit mutual holding to make a charitable trust payment at the time that it implicitly demutualizes and entirely becomes a for-profit stock company. I noted that this provision was a chimera and that I believed that it merely confused the issue and pulled the wool over everyone's eyes. It has now been eliminated. But my reasoning is still relevant to understand the inherent problems and deficiencies of the proposed transaction.

First, demutualization may never happen. This is the case because the legislation would allow the mutual holding company to operate the insurer and other subsidiaries on a for-profit basis long before fully demutualizing, thus negating the need to ever demutualize and compensate the state and the public. That is, the former health service corporation and all other insurance and non-insurance subsidiaries are already for-profit stock companies; and it seems that all subsidiaries are entitled to have outside shareholders, perhaps with the exception of the legacy insurer (at least at the time the proposed reorganization is complete). More likely is the potential merger of the nonprofit mutual holding company with any out-of-state mutual insurer or mutual holding company (whether for-profit or nonprofit) pursuant to Section 7 of the proposed legislation that will extinguish the existence of the New Jersey nonprofit mutual holding company; and the resulting entity will only need to hold a majority of the voting shares of the legacy insurer. The mutual holding company may also simply dissolve in accordance with Title 15A (Section 10) without making a charitable settlement payment, because a mutual is not a charitable corporation requiring such payment at the time of dissolution.

Second, even if the mutual holding company were to convert to a for-profit stock company (as Anthem did in the early 2000s after converting from a mutual insurer to a mutual insurance holding company in 1999), most of the value of the company is likely to be owned by private investors of all the for-profit subsidiaries, not the holding company itself.

These criticisms still exist, even though the provision was removed.

POINT NINE: The proposed legislation fails to restrict the converted BCBS mutual holding company from engaging in for-profit business and, even worse, anticipates such practices occurring through stock subsidiaries, including the former health service corporation, without providing any limits on the amount of capital stock in those for-profit subsidiaries that can be owned by private investors. Although Section 4(f) of the proposed legislation seemingly requires “the shares of the capital stock of the legacy insurer” to be issued to and at all times owned by the mutual holding company, that restriction is still inconsistent with the definition of the legacy insurer in the proposed bill (which still does not require the reorganized insurer to be 100% owned by the mutual holding company; in the first version, the mutual company had to have a “controlling interest” now it just has to have a “100% interest”) and does not apply to any other for-profit subsidiary in the holding company system. Because the bill authorizes the shifting of assets among and between subsidiaries, the acquisition of new for-profit subsidiaries and the merger of the for-profit subsidiaries, it is clear that Horizon is employing the “holding company” mechanism to minimize the value of any charitable trust payment that would have been made at the time of demutualization, whether or not acknowledged by the proposed bill.

Notwithstanding, the proposed legislation must be amended to explicitly state that all the capital stock of the legacy insurer and all other for-profit subsidiaries must be issued to and held by the mutual holding company if the Legislature wants to authorize a reorganization that does not warrant a charitable trust payment at the time of its approval. All references in the statute to the contrary must be eliminated; and Section 14 must be amended to clearly state that a charitable trust payment is triggered at the time any for-profit subsidiary, including the legacy insurer, issues capital stock to private investors or merges with or acquires a company whose capital stock is owned privately. In addition, Section 7 must be amended to reflect the principle that a charitable trust payment is also triggered at the time of merger or consolidation of the mutual holding company with other holding companies or mutual insurers, which is currently controlled by Section 7 (which already acknowledges that approval by the Attorney General is required).

The Approval Process:

It appears that the proposed legislation does an end run around the procedural and substantive requirements that the Legislature included in the 2001 Conversion Law, which was based on “model legislation” issued by the National Association of Insurance Commissioners or the National Association of State Attorney Generals. Perhaps the sponsors of the proposed legislation sincerely believe that because the initial step in the proposed reorganization process is for the health service corporation to become a domestic mutual insurer, the 2001 Conversion Law is not triggered and instead, the 1995 statute is sufficient (despite the fact that the health service corporation is converting to a for-profit stock company). If this were true, the 1995 statute should be amended to include the same consumer protections that the 2001 Conversion Law included. Currently, minimal standards of approval (e.g., “non prejudicial” to policyholders, not beneficial to policy holders) and absence of the Attorney General cannot be justified. These are as follows:

1. The proposed legislation severely **constrains the authority of the Attorney General to protect the State and its residents.** The Attorney General must be provided, at minimum, the powers identified in the 2001 Conversion Law, including provisions governing: (a) N.J.S.A. 17:48E-51. *Filing of application.* The health service corporation must jointly file applications with the Attorney General and the Commissioner; (b) N.J.S.A. 17:48E-62. *Participation of Attorney General.* Granting the Attorney General, the right to participate in any proceeding before the Commissioner under this act and the right to receive any documents or other information received by the Commissioner in connection with the proceeding; (c) N.J.S.A. 17:48E-58. *Documents considered public records; exceptions.* Allowing the Attorney General to share authority with the Commissioner to determine whether supporting documents provided by the converting company deserve to be treated as confidential and withheld from the public; and (d) N.J.S.A. 17:48E-65, requiring notification of the Attorney General preceding any material change in form should be acknowledged in the proposed legislation, and not denied.

2. The proposed legislation **adopts a *de minimis* review standard** (Section 5(b) incorporating N.J.S.A. 17:48E-47(a), i.e., prejudicial to members or inequitable, contrary to law, detrimental to soundness of domestic mutual insurer) that does not protect the interests of policyholders and the interests of New Jersey. At minimum, the standards of the 2001 Conversion

Law (N.J.S.A. 17:48E-52) should apply: “the plan of conversion adequately protects the existing contractual rights of the subscribers”; the “plan of conversion is fair and equitable”; and “The plan does not adversely affect the distribution of the health service corporation’s value to the foundation.” N.J.S.A. 17:48E-51 requires a comparative premium rate analysis report that “shall address the projected impact, if any, of the proposed conversion upon the cost to subscribers” as well as a host of other factors. In 2010, the Senate passed S. 375, which required additional public participation and a more extensive health impact study as a condition of conversion of a health service corporation to a domestic stock insurer, amending N.J.S.A. 17:48E-51. The health impact analysis set forth in Section g(1) of that bill shall be included herein.

POINT TEN: Furthermore, Section 5(a)(5) simply requires financial information to be disclosed with respect to the legacy insurer and other insurance subsidiaries for the sole purpose of proving solvency. Financial information must be produced to establish the fair market value of the health service corporation (i.e., the legacy insurer and all its wholly-owned for-profit subsidiaries). Even if the bill is amended as we have indicated to ensure that this is a reorganization and not a conversion, the public must know the FMV of Horizon to ensure that such value is protected, to ensure, at minimum, payment of that amount at a future date.

3. The proposed legislation provides **no consumer protections regarding adequate hearing notices, timing and the ability to submit and make comments** at a public hearing on a conversion plan. Section 5(b), incorporating N.J.S.A. 17:48E-47(a), only requires one public hearing 30 days after the filing of the application. At minimum, the hearing provisions of the 2001 Conversion Law set forth in N.J.S.A. 17:48E-51 (at least 45 days advance notice of public hearings, hearing notice publication and right to comment on the transaction), as amended by S. 375 should be included in the proposed legislation. Given the importance of Horizon as a charitable corporation to New Jersey residents, multiple public hearings must be mandatory.

4. The **confidentiality provision** in Section 12 of the proposed legislation is far too broad and is contrary to the interests of policyholders and the reviewing public. At minimum, the standard provided in the 2001 Conversion Law, N.J.S.A. 17:48E-58, should apply. Moreover, as noted above, N.J.S.A. 17:48E-58 requires that to be withheld from public review, both the Attorney General and the Commissioner have to concur that something should be confidential.

POINT ELEVEN: The proposed bill requires that all information and documents obtained by or disclosed to DOBI or any person preparing or processing the application to reorganize, including the annual statement filed by the mutual holding company with DOBI, are to be deemed confidential. This provision is overbroad and makes a mockery of this process with respect to the ability of the public to review the application as well as of appellate review of DOBI’s final agency decision with respect to the application or chancery court review of the proposed reorganization. The same standard as exists in the 2001 conversion law should be adopted.

Differences in Substantive Limitations on the “Conversion”:

There are at least three significant differences between the 2001 Conversion Law and the proposed legislation with respect to the substantive limitations on the material change in form/reorganization of the health service corporation. Briefly, they are as follows:

1. The proposed legislation eliminates **limits on management stockholdings and the bar on profiting** from the reorganization that were included in N.J.S.A. 17:48E-57. *Receipt of compensation contingent upon approval of plan prohibited*.

2. The proposed legislation contains **no limit barring in excess of 50% of equity of the reorganized insurer from being sold to outside investors in contrast to the limit of 50% contained in N.J.S.A. 17:48E-49**. *Definitions relative to conversion of health service corporation to domestic stock insurer*. In the 2019 version of the proposed bill, only a majority of voting shares of the capital stock of the former health service corporation was required to be held by the mutual holding company, while a majority of the equity in the former health service corporation was able to be acquired by outside shareholders. We noted that allowing a majority of the equity interest in Horizon to be sold to outside shareholders would be harmful to 1) the state of New Jersey (the loss of the state’s charitable assets if not disgorged at time of reorganization) and Horizon’s policyholders would be subject to the interests of such investors seeking to maximize profits at policyholder expense. Over time, the charitable assets (if their value was not transferred to a foundation) sitting in the for-profit stock company would likely dwindle as outside investors would gain more equity in the stock insurer and under all circumstances, the private shareholders would be able to leverage the premiums of policyholders for their own ends.

We additionally noted that, even if the current language were modified (for example, to make the trigger for a valuation and charitable trust settlement payment, when 50% of the business of Horizon is sold through the subsidiary legacy stock insurer), once stock was sold to investors in any amount, it would trigger a fiduciary duty in the holding company to operate the subsidiary for the benefit of the minority stockholders. As a matter of black letter corporate law, the issuance of stock to outside investors in a stock subsidiary would obligate the nonprofit mutual holding company to run the former health service corporation in the sole interests of its stockholders. Even if the mutual (and thus its members/policyholders) maintained ownership of 51% to 99% of the entire stock (not just voting shares), the mutual holding company would have a fiduciary duty to operate the stock subsidiary in the interests of minority stockholders.⁴

⁴ See, e.g., Pepper v. Litton, 308 U.S. 295 (1938)(a director of a stock corporation, under long-settled law, owes a fiduciary duty to the shareholders of the company). Neither a board of directors nor a majority shareholder can use his or her voting power for personal benefit at the expense of minority shareholders. See, e.g., Connecticut General Mortgage and Realty Investments et al. v. Normal Siddal et al., Fed. Sec. L. Rep. (CCH) P98,409 (D. Mass. 1981)(neither directors nor majority shareholders can use their voting power for personal benefit at the expense of minority shareholders); Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 81 Cal. Rptr. 592, 460 P.2d 464 (Cal. 1969); Donahue v. Rodd Electrotpe Co. of New England, Inc., 367 Mass. 578, 593-594 & n.20, 328 N.E.2d 505 (Mass. 1975). Any action taken by a board of directors that benefits a majority

As we noted *supra*, it appears that the proposed bill requires the mutual holding company to hold the shares of the legacy insurer. However, the term “shares” is not defined and the phrase is not qualified by “all;” and as we noted, such requirement would not apply to other subsidiaries within the mutual holding company system. The bill would have to be amended to make clear that 100% of the capital stock of the legacy insurer and all the other for-profit subsidiaries must be owned by the holding company to prevent the diminution of value and change in fiduciary duties of the legacy insurer (and the other subsidiaries) noted above.

3. The proposed legislation also **eliminates the protection and regulatory oversight regarding the issuance of stock to outside investors** that is found in the 2001 Conversion Law. Section (6) represents a major change from N.J.S.A. 17:48E-54(e), shifting the Commissioner’s review of future stock transfers and issuances from 5% of voting control to 10%, which could allow for significant enrichment of management from a stock program, among other things. This change is not explicit but is orchestrated by applying the Insurance Holding Company Systems Law to such transactions not approved as part of this application. At minimum, management equity plans should always be subject to Commissioner review, should be capped at 5% per the 2001 Conversion Law and should also require an approval vote by shareholders as is common in publicly traded companies.

The same substantive limitations included in the 2001 Conversion Law should also govern the proposed reorganization.

The New Corporate Form: Nonprofit mutual corporation:

As noted above, the nonprofit mutual holding company is not an insurance company and has no capital stock. Moreover, current and future policyholders have no equity interest in the holding company so it is not even a “real” mutual. Section 9(d) prohibits policyholders/members from benefitting through future profits (via dividends) of the profits of the mutual holding company, or any subsidiary, including the reorganized insurer. Section 9(g) makes this especially clear when stating that “a membership interest in a mutual holding company shall not constitute a security pursuant to the laws of the state.” This provision reflects the mutual holding company’s commitment not to pay or share any profits with policyholder-members in order to avoid having the membership interests being deemed regulated securities. Such provision guarantees that “membership rights” are worthless.

Moreover, pursuant to Section 9(b), directors of the mutual holding company shall be elected from nominees selected by the nominating and governance committee of the board of directors of the mutual holding company. This provision effectively bans policyholders from nominating independent candidates. Again, insiders will control the board in perpetuity, and “members” will have no say. Thus rendering their membership rights meaningless.

shareholder at the expense of minority shareholders constitutes a breach of the director’s fiduciary duties. *See, e.g., Heckmann v. Ahmanson*, 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985).

Notwithstanding, in accordance with Section 9(a) of the proposed legislation, it is not even clear who the members of such entity will be: Membership “May be based upon: (1) the amount of health insurance policies in force with the subsidiary legacy stock insurer [Horizon]; the amount of health insurance premiums paid to the subsidiary legacy stock insurer; or (3) other reasonable factors.” All of these factors must be considered before approving conversion of Horizon to a mutual health care holding company (with the legacy insurer reorganized as a for-profit stock company).

POINT TWELVE: Entities holding administrative services agreements with the mutual holding company may also be members of the mutual holding company, but this issue is left open. This is a significant issue for state and various local government entities in terms of holding membership interests, which theoretically could be potentially powerful for controlling holding company board decisions, but only to the extent that such decisions can control the business operations of the for-profit subsidiaries (who must consider the interests of private investors). However, the proposed bill makes clear that members will have no say in nominating the board of the mutual holding company and will not be able to receive any dividends; thus, rendering their membership rights both meaningless and worthless.

The proposed legislation treats the mutual holding company as an insurance holding company system pursuant to N.J.S.A. 17:27A-1 et seq. and permits it to merge or consolidate with one or more mutual holding companies or mutual insurers (whether nonprofit or for-profit), subject to Commissioner approval, with only one public hearing. (Section 7, incorporating N.J.S.A. 17:27A-2. Acquisition of control of or merger with domestic insurer). This means that the mutual may merge with an out-of-state mutual insurer or mutual holding company (such as the Florida or Michigan Blue plans) and cease to be a New Jersey based corporation without much resistance.

As previously noted, the mutual holding company only has to hold a “100% interest” in the legacy insurer (section 2), and a “controlling interest” its other subsidiaries (Section 4(b)). Though the previous proposal explicitly stated that a “controlling” interest meant simply holding a 51% voting majority, it appears that the current proposal implicitly mandates the same requirement for all the for-profit stock subsidiaries other than the legacy insurer and may simply require the mutual holding company to hold a 100% voting majority of the reorganized insurer. (100% interest is not defined). A voting majority, however, does not authorize the holding company to dominate or ignore minority shareholder interests. As a result, there exists a potentially irreconcilable conflict between the nonprofit mutual holding company, which is organized for the benefit of its members, and the private investors of the former health service corporation or any of the other for-profit insurance stock subsidiary that may hold the assets of the reorganized insurer, which is and remains a for-profit domestic insurer.⁵ This conflict would exist

⁵ More specifically, the conflict is as follows: You cannot have policyholders looking for minimized cost and stockholders looking for maximized returns in the same pot, because the two invariably work against each other. Compounding the problem is that, invariably, there is shared overlapping management. The board of directors of the mutual holding company will, 99% of the time, be the same as the membership of the stockholder company, except for one or two people. So, you have people trying to maximize dividends in the stock company. And, at the next tier up,

even if the mutual holding company were to hold a majority of all shares, not just the voting shares. Moreover, the shares of the for-profit stock insurer are typically sold to private investors at a discount rate due to the minority voting rights of those shares.

When New York regulators were considering approving the conversion of a mutual insurer to a mutual holding company, Joseph M. Belth, Emeritus Professor of Insurance at Indiana University stated:

The mutual holding company concept is fundamentally flawed. If the implications of the type of reorganization were disclosed, most mutual policy owners would vote against the reorganization. On the other hand, if safeguards not contemplated in the proposed bill were instituted, prospective shareholders would be reluctant to invest in the reorganized enterprise. (emphasis added)

In a thorough assessment of the mutual holding company structure, the New York Assembly Standing Committee on Insurance characterized the conflicts of interest in a mutual holding company with downstream stock subsidiaries by noting:

The duty of a mutual company's management is to provide insurance to its member/owners at the lowest possible cost. Stock companies' primary obligations, however, are to their shareholder/owners. Most observers agree that stockholder pressures force publicly held companies to focus more heavily on short-term objectives impacting stock price and investor returns, while mutual insurers tend to concentrate on longer-term objectives. It is not clear how management in a company structure in which ownership is split between policyholders and stockholders can reconcile these divergent and quite possibly conflicting responsibilities.⁶

POINT THIRTEEN: Since the mutual holding company is a problematic entity, closer scrutiny by both the Attorney General and the Commissioner of Insurance is warranted, with several public hearings and the undertaking of a health impact study. Furthermore, given the problematic nature of a mutual holding company that has for-profit insurance subsidiaries, why does Horizon want to convert to this form? In 2019, a Horizon representative told us that the company was acting on the advice contained in a report produced for Horizon by McKinsey & Company. We would hope that the Legislature and the Governor's office would be able to see that report to better understand why Horizon wants to operate as a mutual holding company system with its traditional insurance business in for-profit stock subsidiary companies,

the same people are sitting in the mutual holding company still trying to maximize dividends but to the detriment of the mutual company's members.

⁶ See generally, "The Feeling is Not Mutual", A Report by the Assembly Standing Committee on Insurance (1998) at <http://assembly.state.ny.us/Reports/Ins/199803/insureport.html#t20> at "Findings" and also "Potential for Conflicts of Interest in MHC Governance."

given that such corporate form is typically unfavorable to its current policyholders, and creates an inefficient mechanism to raise private capital.

We would venture to guess that this is for the same reason it secured the passage of the 1995 statute, which on its face permitted Horizon, a health service corporation, to convert to a domestic insurer without dissolving: to avoid the payment of a charitable trust settlement. There is little doubt that Horizon, with all its charitable assets built up over the years, is a more valuable target for acquisition than one that is obligated to make a charitable trust payment.

Payment In Lieu of Taxes:

Section 13 of the proposed legislation contemplates an initial assessment of \$600,000,000 dollars, and then a recurring payments for 17 years (together capped at \$1.250 billion), a portion of which is to compensate the State for the premium tax revenue that the State would lose if Horizon were to convert to a mutual holding company with its legacy insurer operating as a for-profit stock subsidiary (i.e., \$50 million/year). This loss would be incurred due to the fact that the new entity would be able to take advantage of a premium tax cap that is now unavailable to a health service corporation. We simply ask, if the policy reason that a health service corporation is not able to take advantage of the cap because its entire business is in New Jersey, and not just a certain percentage of its business, why can't the Legislature remove the ability to enjoy the cap from any for-profit insurance company whose entire business is similarly only in New Jersey?

In any case, this payment will end after 17 years, and the State again will again be left with figuring out a way to fill the budget gap. Secondly, the payments can be deferred without interest, the debt is extinguished after 20 years, and the State's interest in the debt is neither secured or given any particular status. What happens in the event of sale of all the for-profit insurance subsidiaries to an out-of-state insurer? Will the state have to sue to receive payment? Perhaps, giving the Governor, Speaker and Senate President three additional appointments on the board of the mutual holding company will ensure payment, but this is a very not a revenue stream on which the State can rely.

In short, the annual assessment represents a limited duration state business tax on the reorganized insurer's business payable by the mutual holding company or any of its affiliates, and shall be based on a 17-year schedule with earned premiums defined consistently with 45 C.F.R. 158.130. It appears to cap all charitable asset preservation to a flat maximum of \$1.25 billion, which is far lower than the \$7-\$8 billion actual value of Horizon. This provision implicitly prevents any independent valuation of the company. Such a tax has been imposed by other states when faced with a conversion; no one would disagree, however, that approving such alternative approach has cost such states and their public billions of dollars in chartable health care assets. The fact that other states have permitted their Blues to convert without making a charitable trust settlement based on an independent valuation of the company is not just bad law but bad public policy. New Jersey rejected such method in 2001, and should do so again.

POINT FOURTEEN: We would like to reiterate that this annual payment in lieu of taxes cannot replace a charitable trust payment, which must be spent on a similar charitable health care purpose; not be placed into general revenue to be spent on unrelated purposes. The value of Horizon today far exceeds the present value of the initial payment of \$600,000,000 and recurring payments of \$650,000,000-over--17 years (the maximum value of such payments, though such payments are not staggered evenly and may be lower under certain circumstances) which is actually the equivalent of \$472,000,000 million at a reasonable 4% discount rate because the payment is staggered over so many years. No matter the rationale for the payment, \$1.250 billion over 17 years grossly short changes New Jersey on its financial interest in Horizon. Such payment in lieu of taxes also permits the converted company to get billions of dollars in capital for free—which amounts to an extraordinary privatization and give-away of the public’s interest in the charitable health care assets of Horizon.

I want to thank you for this opportunity to share New Jersey Appleseed’s and New Jersey Citizen Action’s thoughts. Please let me know if you have any questions.

Respectfully submitted,

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