
PUBLIC INTEREST LAW CENTER OF NEW JERSEY

an affiliate of the Appleseed Foundation

15 Washington Street, Newark, N.J. 07102
Tel: (201) 648-5521 Fax: (201) 648-0712

December 11, 1996

Mr. Peter Verniero
Attorney General
Richard J. Hughes Justice Complex
CN-080
Trenton, New Jersey 08625-0080

Dear Mr. Verniero:

Re: The Proposed Conversion of Blue Cross and
Blue Shield of New Jersey to a Domestic Mutual
Insurer and Subsequent Merger Into Anthem
Insurance Companies, Inc.

The Task Force on Health Care Conversions, and the 50 consumer and community organizations that we currently represent, submit the enclosed memorandum to you as counsel to the Commissioner of Insurance and the protector of charitable trusts. We urge you to ensure that Blue Cross and Blue Shield of New Jersey's ("BCBS of NJ") charitable assets are safeguarded and directed toward a continued charitable purpose in the proposed conversion of BCBS of NJ, a not-for-profit health services corporation, to for-profit status. This conversion clearly raises important issues of public policy concerning the use and control of billions of dollars in charitable assets that are "owned" by the citizens of New Jersey.

In other states, upon such health care conversions, the public has benefitted by the dedication of billions of dollars to foundations devoted to the health care of their state's residents. For example, in California, \$3 billion was committed to public foundations for health care purposes when Blue Cross of California converted to a for-profit entity. Similar action should be taken here.

Furthermore, this conversion has ramifications in New Jersey far beyond the transformation of BCBS of NJ alone. Every health care organization conversion carries with it similar concerns and possible benefits for the citizens of New Jersey. Absent strong action from your office, vast charitable assets will disappear into an Indiana corporation and the health system of New Jersey will lose what the public has permitted BCBS of NJ to build.

The Transaction

In October 1996, BCBS of NJ filed two related applications with the Commissioner of Insurance, seeking approval of its conversion to a domestic mutual insurer under New Jersey law, and of its subsequent merger with Anthem Insurance Companies, Inc. ("Anthem"), an Indianapolis-based for-profit mutual insurance company doing business in all 50 states. These applications come in the wake of BCBS of NJ's application to the appropriate regulators in Delaware to acquire 100% of the shares of AllNation Life Insurance Company, a stock insurance company that will hold all the business assets of BCBS of Delaware, and the announcement by BCBS of Connecticut, itself a mutual insurer, of its intent to merge with Anthem.

Pursuant to these applications, BCBS of NJ will convert to a mutual insurance company, New Jersey Mutual Insurance Co., and, within several months of the conversion, will merge into Anthem. As stated in the application to mutualize, the primary purpose of the conversion is to merge with Anthem. Immediately following the merger, Anthem will cede all the assets, liabilities, obligations and policies formerly held by New Jersey Mutual to a stock insurance company, New Jersey Health Insurance Co. ("NJHIC"). The stock of NJHIC, together with that of BCBS of NJ's former for-profit subsidiaries, will be transferred by Anthem to a stock holding company, Anthem East. Anthem East will be formed as a direct, wholly-owned subsidiary of Anthem, and NJHIC will operate (for at least seven years) in New Jersey as a subsidiary of Anthem East and as the New Jersey BCBS Association licensee.

The Task Force's Analysis and Position

The for-profit status of New Jersey Mutual and Anthem indicates that the applications filed represent BCBS of NJ's definitive move to become an integral part of a major regional, for-profit insurance company. However, BCBS of NJ is by statute a "charitable and benevolent institution," N.J.S.A. 17:48E-41, which has developed its market value by virtue of decades of tax benefits and generous publicly-directed subsidies in exchange for its commitment to provide affordable health coverage to the people of New Jersey.

In the normal course of events, when a New Jersey nonprofit corporation abandons its public mission to enter the commercial sector it must transfer its asset value to another nonprofit corporation that will serve similar charitable purposes. In addition, if a nonprofit corporation attempts to merge with a mutual or other for-profit corporation, it must first dissolve, and as part of that dissolution, it is similarly required by law to transfer its assets to a corporation or receiver dedicated to its charitable mission.

There is no reason why BCBS of NJ should not be required to do what all nonprofits have had to do when they give up their nonprofit status: transfer the fair market value of their assets to a nonprofit corporation with substantially similar charitable purposes. The special legislation passed in 1995 permitting BCBS of NJ to convert to a mutual insurance company without first dissolving does not dictate otherwise.

As further explained in the enclosed memorandum, the special legislation does not remove the charitable trust obligations of converting health service corporations. Indeed, the statute includes specific language that requires that the "obligations and liabilities" of the health service corporation, N.J.S.A. 17:48E-47(b), including the obligation to administer its assets for benevolent and charitable purposes, also be transferred to the new mutual. In this way, the 1995 statute amends the New Jersey Nonprofit Corporation Law by excusing the corporation from the technical requirements of dissolution and reincorporation when converting to a domestic mutual insurer; it does not relieve the converting nonprofit of its common law charitable trust obligations.

In New Jersey as elsewhere in the United States, charitable obligations can be enforced under the common law doctrine known as cy pres. Pursuant to this doctrine, if a corporation fails to fulfill its charitable purposes as set forth in its certificate of incorporation, or it abandons those charitable purposes by converting to a profit-making enterprise, or it becomes impossible to operate the corporation for the charitable purposes for which it was chartered, a court has the power to direct that the assets be administered in conformity with the original charitable purposes. In this case, New Jersey Mutual Company and Anthem, both for-profit mutual insurers, by definition will not be using assets that have been held by BCBS of NJ exclusively for nonprofit, charitable purposes for such purposes. On this basis alone, it is appropriate to invoke the chancery court's cy pres authority to require a transfer of the fair market value of BCBS of NJ's charitable assets to another nonprofit organization with similar purposes -- i.e., a so-called charitable settlement.¹

In addition to the statutory mandate described above, and even in its absence, BCBS of NJ must still comply with the mandates of its certificate of incorporation. It is our position that the transfer of all of BCBS of NJ's assets to New Jersey Mutual is equivalent to the closing of its affairs and must be done in the

¹It is established law that the Attorney General, as the protector and guardian of charitable assets, or a person with a special interest in the charitable assets, has the authority to bring an action seeking to enforce BCBS of NJ's charitable obligations.

manner prescribed in its certificate of incorporation--i.e., to transfer its assets to a corporation with charitable purposes similar to its original objectives. Because the 1995 conversion statute says nothing to the contrary, BCBS of NJ's dissolution provision still governs a transaction that in all effects is a dissolution.

Accordingly, BCBS of NJ's proposal to transfer all of its charitable assets to a for-profit entity violates both its charitable trust obligations and the dissolution provision of its certificate of incorporation, and thus is "contrary to law." N.J.S.A. 17:48E-47(a)(1).

Given that the directors of BCBS of NJ cannot ignore the charitable purposes to which BCBS of NJ's assets are irrevocably dedicated under the doctrine of cy pres and the dissolution clause of its certificate of incorporation, it is disturbing to find that the directors of BCBS of NJ have made a commitment to "use their best efforts" to obtain all government approvals and consents necessary to consummate the transactions without making any payment to a third party for the "establishment or funding of any charitable foundation or trust." This attempt to avoid BCBS of NJ's charitable obligations constitutes a breach of fiduciary duty.

In addition to the aforementioned concerns regarding BCBS of NJ's application to mutualize, the specific terms of BCBS of NJ's proposal to merge into Anthem raises several important questions about Anthem's commitment to keep its operations in New Jersey, and the ability of New Jersey policyholders to exert effective control over the surviving corporation.² The proposed merger is a transfer of New Jersey charitable assets to a for-profit mutual insurer organized under the laws of the state of Indiana. Anthem's commitment to maintain a substantial presence in New Jersey and to provide health care benefits and related products to the residents of New Jersey is for only seven (7) years, and New Jersey policyholders will share membership on Anthem's board of directors with policyholders from several other states. In this way, the terms of the merger agreement are "inequitable to the policyholders of [New Jersey Mutual]," and may indicate a reduction in "the security of and service to be rendered to [them] . . ." N.J.S.A. 17B:18-61(2), (3).

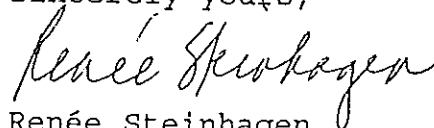
All the above issues, as well as the compensation or other benefits received by current members of BCBS of NJ's board of directors as a result of the proposed transaction, must be

² In this memorandum, we do not address the anticipated impact that this transaction generally will have on the cost and delivery of health insurance in New Jersey. Nonetheless, this is an important issue that must be evaluated by the appropriate state regulators.

considered by the Attorney General and Commissioner of Insurance prior to the state's approval of the submitted applications.

The Task Force on Health Care Conversions respectfully requests that you review the enclosed memorandum and consider the issues raised therein before approving the proposed transaction as presented. We look forward to being of any further assistance.

Sincerely yours,



Renée Steinhagen
Associate Director

-and-

John Grogan, Esq.
Camden Center for Law
and Social Justice
Al Evanoff, United
Seniors Alliance
Anthony Wright, NJ
Citizen Action
Jeanne Oterson, Health
Professionals and
Allied Employees
Joy Schulman, Communications
Workers of America

Enclosure

cc: Jaynee LaVecchia
Director, DOL
Cynthia L. Codella
Deputy Comm'r of
Banking and Insurance

MEMORANDUM

TO: Peter Verniero, New Jersey Attorney General

FROM: Task Force on Health Care Conversions¹

DATE: December 10, 1996

RE: Analysis of Proposal by Blue Cross and Blue Shield of New Jersey to Covert to a Domestic Mutual Insurer and to Merge Into Anthem Insurance Companies, Inc.

I. Industry Context of BCBS of NJ's Proposal to Convert to a Mutual Insurer

The conversion of not-for-profit corporations to for-profit status, either through a change in entity structure or the transfer of entity assets, is a growing phenomenon in the health care industry. This trend reflects structural changes in the health care industry that have included the regionalization of managed-care, the expansion of integrated health care delivery systems, and increased pressures on operating efficiencies from the competition of both for-profit providers and insurers. Philip M. Gassel and Jay E. Gerzog, Conversions of Not-for-Profit Organizations Proliferate, N.Y.L.J., August 26, 1996, at 7. Specifically, for-profit conversions have been fueled by the fact that traditional sources of not-for-profit capital have become limited and the prohibitions against offering private inurement, such as stock options, have limited nonprofit organizations' ability to negotiate employment contracts. Id. See also Beth Fitzgerald, Blue Cross Considers

¹ This Memorandum was prepared on behalf of the Task Force on Health Care Conversions by Renée Steinhagen, Esq., Public Interest Law Center of New Jersey (PILC), with the assistance of John Grogan, Esq., Camden Center for Law and Social Justice, certain members of the PILC Board, and materials provided by Julie Silas, Esq., and Charles F. Bell of Consumers Union of U.S., Inc.

Making Switch to For-Profit Status With Stock Sales, STAR-LEDGER, July 1, 1994, at 1. No suggestion has been made that such conversions assist in delivering health services to those persons currently unable to afford such services.

Until mid-1994, Blue Cross and Blue Shield plans across the country were not allowed to operate for-profit but were only permitted to have for-profit subsidiaries. In June 1994, the national Blue Cross and Blue Shield Association, the trade group that licenses and regulates the Blues, eliminated its 60-year-old bar against member plans being for-profit and established standards for permitting the Blue Cross and Blue Shield trademark and service mark to be licensed to for-profit entities. Milt Freudenheim, Blue Cross Lets Plans Sell Stock, N.Y. TIMES, June 30, 1994, at C1. Since that time, several Blue Cross and Blue Shield plans have converted or have announced plans to convert into for-profit entities, including those plans in California, Colorado, Georgia, Virginia, Missouri, Ohio, Kentucky, and New York.

It is important to understand that the principle asset of these Blues plans is the value of their subscribers. With approximately 1.9 million enrollees, some analysts have valued the assets of Blue Cross and Blue Shield of New Jersey ("BCBS of NJ") at approximately \$1 billion. Milt Freudenheim, Blue Cross-Shield in New Jersey Sets Tie to Big Insurer, N.Y. TIMES, May 29, 1996, at C1, C5.

Whether the conversions entail a change in structure or the transfer of all or a substantial portion of the nonprofit's assets,

the mechanisms of the conversion are governed primarily by state law. State Attorneys General often play a major role to ensure that the fair market value of the nonprofit corporation's assets at the time of conversion are preserved for the charitable purposes for which they were acquired.²

It is well established that when nonprofit health service corporations convert to for-profit status, they must leave the value of the assets that they have accumulated for charitable purposes in the non-profit sector. See Theresa McMahon, Fair Value? The Conversion of Nonprofit HMOs, 30 U.S.F.L. REV. 355 (Winter 1996). Converting corporations, in New Jersey and elsewhere, customarily transfer the value of their assets to charitable foundations to ensure that the charitable purposes for which they were chartered are continued. Anne Lowrey Bailey, Charities Win, Lose in Health Shuffle, THE CHRON. OF PHILANTHROPY, June 14, 1994,

² Within the past several months, the Attorneys General in Michigan and Ohio have initiated court actions challenging the acquisition by Columbia/HCA of interests in not-for-profit health service corporations, including Blue Cross & Blue Shield Mutual of Ohio. See Transcript, 60 MINUTES, October 27, 1996 (available upon request from PILC). The Attorney General in Texas has also filed suit to block the merger of Blue Cross and Blue Shield of Texas with Blue Cross and Blue Shield of Illinois on the basis that the Texas Blue, a nonprofit corporation, cannot merge with a foreign mutual insurance company that is not a nonprofit corporation as defined by Texas law. Milt Freudenheim, Texas Sues to Halt Move By Blue Cross, N.Y. TIMES, November 15, 1996, at D6. See also Letter from Daniel E. Lungren, California Attorney General, to John F. Walker, Attorney, Latham & Watkins 2-3 (November 8, 1996), attached hereto, regarding proposed joint venture between Sharp Memorial Hospital- Sharp Cabrillo Hospital and Columbia/HCA, in which the California Attorney General alleges that directors of the nonprofit hospital have breached their fiduciary duties with respect to the use of the hospitals' charitable assets.

at 1, Rhonda Rundle, Big Charities Born as Health Plans Go for Profit, WALL ST. J., April 4, 1995, at B1.

Regardless of the exact nature of the nonprofit recipient and the method of the conversion to for-profit status, there are several issues that must be addressed by state regulators. Regulators must ensure that the fair market value of the assets of the not-for-profit health service corporation is received by the public and continues to be used to further charitable purposes. They must also ensure that such charitable assets are managed by appropriate individuals, and that the management of the not-for-profit corporation does not improperly benefit from the conversion transaction.

With these issues in mind and within the context of the aforescribed industry trend, we have analyzed Blue Cross and Blue Shield of New Jersey's ("BCBS of NJ") proposal to convert to a domestic mutual insurer and subsequently to merge with a foreign mutual insurance company. We have concluded, for the reasons stated below, that this transaction represents a transfer of nonprofit, charitable assets to a for-profit entity, thus requiring the payment of a charitable settlement. Indeed, the failure of BCBS of NJ to acknowledge the need for such payment, and its undertaking to use its best efforts to avoid making such payment, represent not only an unconscionable violation of public policy, but also a violation of state law.

In addition, the proposed form of the merger raises several important questions regarding the transfer of BCBS of NJ's assets

out of the state without any guarantee of control of these assets by New Jersey policyholders.

II Statement of the Proposed Transaction

In October 1996, BCBS of NJ filed two related applications with the Commissioner of Insurance, seeking approval for its conversion to a domestic mutual insurer as provided in N.J.S.A. 17:48E-45 et seq., and of its subsequent merger with Anthem Insurance Companies, Inc. ("Anthem"), under N.J.S.A. 17B:18-61. Anthem is an Indianapolis-based, for-profit, mutual insurance company doing business in all 50 states. See Edward R. Silverman, Blue Cross Operations Transform in Merger, STAR-LEDGER, May 30, 1996, at 1. BCBS of NJ's application to mutualize contemplates its acquisition of 100% of the shares of AllNation Life Insurance Company, a stock insurance company that will hold all the business assets of BCBS of Delaware (see Business Plan and charts attached thereto submitted as part of mutualization application), and its application to merge presumes the merger of BCBS of Connecticut, itself a mutual insurer, into Anthem. See Merger Application, Tab 3 ("Merger Agreement"), at 8-9.

Pursuant to the documents filed with the Department of Banking and Insurance, BCBS of NJ proposes a two-step transaction: 1) BCBS of NJ would first convert to a mutual insurance company, Blue Cross and Blue Shield of New Jersey Mutual Insurance Co. ("New Jersey Mutual"), and 2) within several months of the conversion, New Jersey Mutual would merge into Anthem. See Mutualization Plan, Exhibit A, at 2. As set forth in the Mutualization plan, the

primary purpose of the conversion to a mutual is to merge with Anthem, id. at 2, at which time "the separate existence of New Jersey Mutual [will] cease." Merger Agreement, Article II, Section 2.1.

Immediately following the merger, Anthem will cede all of New Jersey Mutual's assets, liabilities, obligations and policies to a stock insurance company, New Jersey Health Insurance Co. ("NJHIC"). Id. Article III, Section 3.2. The stock of NJHIC, together with that of BCBS of NJ's former for-profit subsidiaries, will be transferred by Anthem to a stock holding company, Anthem East. Merger Application, Tab 5, at 4. Anthem East will be formed as a direct wholly-owned subsidiary of Anthem, and NJHIC will operate in New Jersey as a subsidiary of Anthem East and as the New Jersey BCBS Association licensee. Merger Agreement, Article III, Section 3.1.

For purposes of the analysis below, the following aspects of the proposed transaction must be noted: First, although the documents fail to identify New Jersey Mutual or Anthem as for-profit entities, the Mutualization Plan allows all persons who receive full health benefits insurance from BCBS of NJ or its HMO Blue subsidiary, Medigroup of New Jersey, Inc., to become mutual members, and to have the "right to receive any dividends that may be declared from divisible surplus." Mutualization Plan, Exhibit

A, at 3.³ The for-profit status of New Jersey Mutual after the conversion is therefore evident.

Second, the documents indicate no intent to make a charitable settlement to the State, other governmental entity or third party, including a charitable foundation or trust. Rather, the documents indicate that the directors of BCBS of NJ intend to "use their best efforts" to avoid such payment (Merger Agreement, Article VIII, Section 8.5), and assert that the corporation has satisfied any "expected social obligations" it may have. Merger Application, Tab 2, at C5.

Third, although the merger agreement states that Anthem has no present intention to engage in a voluntary demutualization of the surviving entity, it is silent as to whether it intends to take NJHIC or Anthem East public. Merger Agreement, Article VIII, Section 8.6(B). Accordingly, the ultimate owners of New Jersey assets cannot now be determined by your office or the regulators. It is to be noted that Anthem utilizes a public entity, with substantially overlapping management, as the agent to market and in some respects manage Anthem's business in the health care field, making the issue of ultimate beneficial ownership even more confusing.

³ Of course, given the brief time contemplated between step 1 of the transaction (i.e., mutualization of BCBS of NJ) and step 2 (i.e., its successor's merger into Anthem), it can be assumed that the policyholders will receive no dividends or other benefits of any significance. Step 1 of the proposed transaction should in fact be ignored.

Finally, Anthem covenants in the merger agreement to "use its reasonable efforts" to maintain a physical presence in New Jersey and to provide health care benefits and related products to the State's residents for "not less than seven years." Merger Agreement, Article VIII, Section 8.6(A). This covenant is simply not adequate to protect the health care and employment interests of New Jersey residents.

III. The Conversion of BCBS of NJ to a Domestic Mutual Insurer Involves the Transfer of Charitable, Nonprofit Assets to a For-Profit Entity.

A. BCBS of NJ Holds its Assets for Charitable Purposes.

It is the position of the Task Force that BCBS of NJ has always been a nonprofit health service corporation with charitable purposes. BCBS of NJ's charitable nature is reflected in its certificate of incorporation and the history of the corporation and its predecessors.

1. BCBS of NJ Has Historically Been Defined as a Charitable Institution.

During the Depression, health insurance was virtually nonexistent and the inability of many Americans to pay for their medical care placed a financial strain on the voluntary hospital system throughout the United States. GAO, BLUE CROSS AND BLUE SHIELD, Experiences of Weak Plans Underscore the Role of Effective State Oversight 2 (April 1994) ("GAO Report"). As a result, Blue Cross and Blue Shield plans were established on a not-for-profit basis and were dedicated to the charitable purpose of providing "affordable coverage to all individuals, regardless of health status." Id. See also Cathy Tokarski, Mergers, Conversions: Blues'

Survival Strategies, AM. MED. NEWS, May 20, 1996, at 1 (discussing original purposes of Blue Cross).

In the course of establishing Blue Cross plans in the various states, the American Hospital Association sought and obtained special state enabling legislation which included: (1) exemption from state taxes and insurance laws; and (2) status as a charitable and benevolent organization.⁴ Thomas K. Hyatt and Bruce R. Hopkins, The Law of Tax-Exempt Healthcare Organizations 208 (1995); Sylvia Law, Blue Cross: What Went Wrong? 9 (2d ed. 1976). That special legislation promised our citizens health care for the community and particularly for low income families. Id. See also Herman M. Somers and Anne R. Somers, Doctors, Patients, and Health Insurance 323 (1961) (noting that states intended the Blue plans "to be operated as a public trust" when enacting special enabling legislation).

Enabling legislation was enacted in 48 states, including New Jersey, where it was codified in Title 17 of the New Jersey Statutes. In 1938, the enabling act authorizing non-profit hospital service corporations was enacted, N.J.S.A. 17:48-1 et seq., and in 1940, the act providing for the organization of non-

⁴ Until 1986, Blue Cross and Blue Shield plans were also given federal tax exemption under Sec. 501(c)(4) of the Internal Revenue Code which provides that "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare" shall be exempt. GAO Report at 3 n.5. The Tax Reform Act of 1986 rescinded this exemption and subjected the Blue plans to taxation as stock insurance companies under 26 U.S.C. §833. However, the Act also gave Blue plans a special deduction equal to 25 per cent of the claims and expenses incurred during the taxable year less the adjusted surplus at the beginning of the year. Id.

profit medical services corporations was passed. N.J.S.A. 17:48A-1 et seq.⁵ The Hospital Service Plan of New Jersey (Blue Cross of New Jersey) was incorporated in 1932, and Medical-Surgical Plan of New Jersey (Blue Shield of New Jersey) was incorporated in 1942. These "were the only corporations ever organized under this legislation, and their investment with the public interest, as intended by the statutes, [was] never . . . in doubt." In the Matter of the 1989 Non-group Rate Filing by Blue Cross and Blue Shield, 239 N.J. Super. 434, 436 (App. Div. 1990) ("In the Matter of Blue Cross and Blue Shield").⁶ See also Radiological Society of New Jersey v. Sheeran, 175 N.J. Super. 367, 375 (App. Div. 1980), cert. den. 87 N.J. 311 (1981).

In 1985, the New Jersey Legislature enacted the Health Service Corporations Act, N.J.S.A. 17:48E-1 et seq., which, in effect,

⁵Indiana, Anthem's home state, was one of only two states that did not enact legislation authorizing nonprofit health service corporations. Law, supra. at 9 n.36.

⁶ The court in the Matter of Blue Cross and Blue Shield, quoted the trial court in Borland, et al. v. Bayonne Hosp. et al, 122 N.J. Super. 387 (Ch. Div. 1973), aff'd 136 N.J. Super. 60 (App. Div. 1975), aff'd 72 N.J. 152 (1977), cert. den. 434 U.S. 817 (1977), as follows:

[N.J.S.A. 17:48-1 et seq. is] designed to accomplish the purpose of a broad-based community health program, i.e., to satisfy the needs of the hospitals and the community as a whole through a partnership between hospitals and a non profit prepayment plan. 122 N.J. Super. at 398.

239 N.J. Super. at 437. It also noted that the New Jersey Supreme Court affirmed the lower courts in Borland by indicating "that Blue Cross, in its organization and operation is 'clearly * * * affected with a public interest.'" Id.

provided for the merger of Blue Cross and Blue Shield into one entity. In 1986, that merger was consummated and BCBS of NJ became the first and only health service corporation operating in the State. See In the Matter of Blue Cross and Blue Shield. 175 N.J. Super. at 437.

Pursuant to the Act, BCBS of NJ continued to operate as a non-profit, "charitable and benevolent institution" enjoying state tax exempt status, N.J.S.A. 17:48E-41.⁷ Like its separate predecessor corporations, BCBS of NJ was exempt from all regulations governing commercial insurers, except those specified in the Act, and those provisions governing unfair trade practices. N.J.S.A. 17:48E-42. Because of its non-profit, tax-exempt status, as well as the provider discounts it received from hospitals, BCBS of NJ was required, until 1992, to "maintain a continuous open enrollment period, providing coverage to persons who are otherwise unable to obtain hospital, medical-surgical, or major medical coverage," N.J.S.A. 17:48E-3(d) (modified in accordance with provisions of P.L. 1992, c.168), and its rates were not allowed to be "excessive, inadequate, or unfairly discriminatory..." N.J.S.A. 17:48E-27 (deleted by L. 1992, c.161, §19). See In the Matter of Blue Cross and Blue Shield, 239 N.J. Super. at 438. In 1992, however, legislation was enacted that effectively ended BCBS of NJ's role as the state's insurer of last resort. See Individual Health Insurance Reform Act (IHIRA), N.J.S.A. 17B:27A-2 et seq. Pursuant to IHIRA,

⁷ In 1990, for the first time, BCBS of NJ was subject to a state tax on premiums in lieu of state income taxes. P.L. 1989, c. 295, § 2, effective January 12, 1990.

responsibility for assuming the risk for the individual, hard to insure market was spread among all health insurance carriers who operate in New Jersey.⁸

Notwithstanding this statutory change, BCBS of NJ continues to operate as a health services corporation, and thus is obligated under law to use its assets for charitable and benevolent purposes. Consistent with these purposes imposed by the Health Services Corporation Act, BCBS of NJ is also required to conduct its business pursuant to the provisions of Title 15A of the New Jersey Statutes, The Nonprofit Corporations Act.⁹ Accordingly, it cannot operate for pecuniary profit, N.J.S.A. 17:48E-3(a), and it is prohibited from holding or issuing capital stock or shares and paying dividends. N.J.S.A. 15A:2-1.

2. BCBS of NJ was incorporated and continues to exist for charitable purposes.

In accordance with its statutory mandate as a charitable institution, BCBS of NJ, and its predecessor corporations, have maintained a public purpose designed to benefit the community as a whole. In its 1932 certificate of incorporation, Blue Cross articulated one of its purposes as "to negotiate, aid and assist in

⁸ There are now over twenty (20) commercial carriers in the individual market offering guaranteed issue, community-rated standard coverage. Mutualization Plan, Exhibit F at 3. Each, unless exempt, must contribute to a fund from which a carrier can obtain reimbursement for certain losses. 1996 is the first year since the inception of the IHIRA that BCBS of NJ does not expect to file for reimbursable losses. Id.

⁹ However, if a provision of the Health Services Act is inconsistent with the NonProfit Corporations Act, the former governs. N.J.S.A. 17:48E-2(b).

the development of a health program for the community served by [the] hospital service plan." It has maintained this specific public benefit purpose throughout its more than 60-year existence.¹⁰

Similarly, in 1942, Blue Shield was founded upon the 1938 resolution of the Medical Society of New Jersey "to make available to every man, woman and child in New Jersey adequate personal and sympathetic medical care, preventive and curative, at the lowest cost compatible with efficient service." Alan A. Siegel, Caring For New Jersey A History of Blue Shield of New Jersey 1942-1986 7 (1986) (Forward written by Joseph A. Cox, M.D., Chairman and CEO, Medical Surgical Plan of New Jersey).

Although the restated certificate of incorporation that was adopted at the time of the 1986 merger of Blue Cross and Blue Shield did not explicitly state the principle which "shaped" Blue Shield's practice for over four decades, (id.), it did articulate a similar purpose:

to inaugurate, operate and maintain a [nonprofit] health service plan whereby various coverages may be provided for under contract with such [members] of the public. . . who become subscribers to said plan to safeguard their health or in event of ailment, illness or accidental injury.

In addition, the restated certificate expressly stated that "the corporation has been organized to serve a public purpose . . ."

¹⁰ In 1986, the term "health" was substituted in lieu of "hospital" to reflect the merger with Blue Shield and changes in the law.

These provisions have not been amended or repealed since 1986.¹¹

The "test of whether an enterprise or institution is charitable is whether it exists to carry out purposes recognized in law as charitable or whether it is maintained for gain, profit, or private advantage." 14 C.J.S. Charities §3 (1990). A charitable purpose must be for the public use or benefit, and it must be for the benefit of the public at large or a portion thereof, or for the benefit of an indefinite number of persons." Id. In re Butler's Estate, 1337 N.J. Eq. 48, 50 (Prerog. Ct. 1945), aff'd, 137 N.J. Eq. 457 (E & A 1946).¹²

¹¹ The fact that non-profit Blue Cross and Blue Shield plans around the country hold public, charitable purposes was repeatedly emphasized by the BCBS Association during its fight to retain the Blue's federal tax-exempt status. As part of his testimony to the Senate in 1986, the President of the Association stated:

There has always been an important difference between the Blue Cross and Blue Shield plans and the commercial insurers, however. That difference is one of purpose and philosophy underscored by day-to-day operating practices. The Plans have a strong obligation to their communities as well as their subscribers, and discharge those community obligation in ways that do not add to the bottom line. Commercial insurers do not share those community obligations and, quite understandably, operate to maximize the return to their shareholders. The philosophical differences between the Plans and the commercial insurers lead to very real differences in behavior. . . . In short, . . . they also maintain a pattern of behavior that is far more community-oriented than their competition.

U.S. Senate Committee on Finance, 99th Cong., 2d Sess. (February 4, 1986) (Statement of Bernard R. Tresnowski, President, Blue Cross and Blue Shield Association) at 29-30.

¹² See also BLACK'S LAW DICTIONARY 212 (5th ed. 1979). (A charitable corporation is a nonprofit corporation organized for charitable purposes, i.e., for purposes as promoting the welfare of mankind at large or that of a community. "Charitable Purposes" have as their "common element the accomplishment of objectives

It "is well settled that the promotion of health is a charitable purpose." Austin W. Scott & William Fratcher, The Law of Trusts 130 (1989). RESTATEMENT (SECOND) OF TRUSTS §368(d) (1959). In New Jersey, providing health care to a large portion of the public or the community as a whole on a not-for-profit basis is a charitable purpose. In re Pfizer, 33 N.J. Super. 242, 262 (Ch. Div. 1954) ("protection of the public health").¹³ In accordance with these definitions, BCBS of NJ's specific mission to provide low-cost health coverage to an indefinite number of persons in the event of illness or injury and to safeguard the health of those persons as well as its mission to aid in the development of community health plans are indeed charitable.

In addition, Article IX of BCBS of NJ's certificate of incorporation states that "upon dissolution of the corporation, any remaining assets of the corporation shall be turned over to, and distributed among, one or more charitable non-profit institutions, which are at the time tax-exempt under federal tax laws. . . ." (emphasis added). This dissolution clause, which has not been amended or repealed since 1986, is further evidence that BCBS of NJ

which are beneficial to [the] community or area").

¹³ Other courts and commentators have similarly regarded the "promotion of health" as a charitable purpose. Eastern Kentucky Welfare Rights Org. v. Simon, 506 F.2d 1278, 1287 (D.C. Cir. 1974), vacated on other grounds, 426 U.S. 26 (1976); Arthur M. Reginelli, Tax Exemption to Health Maintenance Organizations: What's the Issue and Who Should Decide It?, 9 J.L. & HEALTH 187, 195-196 (1994-95). "[T]he promotion of health is a valid charitable purpose in all American jurisdictions." Fisch, et al., Charities and Charitable Foundations 275 (1974).

is a non-profit corporation holding its assets for charitable purposes.

In short, even if BCBS of NJ believes that in 1996 it is best for the corporation to shed its non-profit status and to relinquish its public obligations, it still must acknowledge that, to date, it has held its assets for charitable purposes. N.J.S.A. 15A:2-8(a)(2) (requiring articles of incorporation of nonprofit to state charitable purpose with specificity). Cf. Austin W. Scott, Education and the Dead Hand, 34 HARV. L. REV. 1, 17-18 (1920), quoted in, City of Paterson v. Paterson General Hosp., 97 N.J. Super. 514, 522 (Ch. Div. 1967) (affirming principle that directors of charitable corporation cannot use corporate assets or amend articles of incorporation to "subvert the general purposes for which the corporation was founded").

B. Under New Jersey Law, a Domestic Mutual Insurer is a For-Profit Entity.

Under New Jersey law, a domestic mutual insurer is defined as a corporationwithout permanent capital stock. N.J.S.A. 17B:18-3. Such mutual insurer, and its members and directors, have all the powers granted, and are subject to "all the duties and obligations imposed, by the New Jersey Business Corporations Act, N.J.S.A. 14A:11-1 et seq. . . . , " N.J.S.A. 17B:18-43, including the authority to pay dividends. N.J.S.A. 14A:7-15. Such authority is recognized in BCBS of NJ's application to mutualize. See Mutualization Plan, Exhibit A., at 3.

In contrast to nonprofit corporations, mutual insurers are also allowed to establish profit-sharing plans for their officers,

trustees and employees. N.J.S.A. 17B:18-52(c). Accordingly, it is clear that under New Jersey law, "a mutual insurance company is not a benevolent [or charitable] association, but a corporation organized for pecuniary profit." WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §68.05 (perm. ed. rev. vol. 1990) ("FLETCHER CYCLOPEDIA"). See also N.J.S.A. 15A:2-1(b) (prohibiting a corporation organized under another statute of the state from being a non-profit unless that statute explicitly permits organization under Title 15A).

The for-profit status of a mutual insurer under New Jersey law was openly assumed in 1995, before the issue of a whether BCBS of NJ's conversion to such corporation would trigger a charitable settlement was raised. See e.g., Dan Weissman, Blues Ask State For 'Profit' Tag, STAR-LEDGER, August 23, 1995, at 55; Matthew P. Schwartz, New Jersey Blues Switch To For-Profit Status, NAT'L UNDERWRITER CO., September 11, 1995, at 8. Today, there is no justification for characterizing such entity otherwise.

C. Under Indiana Law, Anthem is a For-Profit Entity.

Anthem is a mutual insurance company domiciled in Indiana and incorporated in 1944 under the name Mutual Hospital Insurance, Inc., commonly known as Blue Cross of Indiana. Merger Agreement, Tab 5, at 1. In 1946, Blue Shield of Indiana incorporated as Mutual Medical Insurance, Inc. The two companies merged in 1985, with the surviving company bearing the name "Associated Insurance Companies, Inc." Id. In 1995, the company adopted the Anthem name

and in March 1996, it filed a name change to Anthem Insurance Companies, Inc.

Since 1944, Anthem has been incorporated as a for-profit corporation under Indiana Insurance Law. See IND. CODE ANN. §27-1-7-1 et seq. Anthem's articles of incorporation have never stated that it was incorporated under the Indiana NonProfit Corporations Law, IND. CODE. ANN. §23-17-1-1 et seq., nor more recently, that it is a "mutual benefit corporation" as defined under that law as amended in 1991. IND. CODE ANN. §23-17-2-8. Although the proposed merger agreement with BCBS of NJ makes no mention of whether Anthem intends to issue dividends, it is empowered to do so pursuant to §27-1-7-17 of the Indiana Insurance Law.

In the past fifteen years, Anthem has established a number of for-profit subsidiaries, many of which are stock companies.¹⁴ It is currently ranked 217th on the Fortune 500, (see Anthem, Inc., Blue Cross and Blue Shield of NJ to Merge, PR NEWSWIRE ASSOC., INC., May 29, 1996, attached hereto), and as of March 1, 1996, it owned approximately 62% of the outstanding stock of Acordia, Inc. See 1995 SEC filing for Acordia, Inc. According to Acordia, Inc.'s 1995 SEC filing, it acts as Anthem's sales, underwriting,

¹⁴ Anthem currently operates in New Jersey through its subsidiaries Anthem Health and Life Insurance Company and Acordia, Inc., a network of insurance brokers, which is an investor owned company listed on the New York Stock Exchange. Anthem provides government contracting services nationwide through its AdminaStar subsidiary, property and casualty insurance through Anthem Casualty Insurance, and health care and insurance products through stock companies operating in Indiana, Ohio and Kentucky. Anthem also owns several other subsidiaries, including, but not limited to, American Health Network, The Anthem Health Companies, and Athena of North America. See Anthem website at <http://www.anthem-inc.com>.

management and marketing, and customer service agent. This business relationship clearly underscores Anthem's for-profit status. Id.

In conclusion, the for-profit status of New Jersey Mutual and Anthem indicates that the applications filed represent BCBS of NJ's definitive move to become an integral part of a major regional for-profit insurance company. In this way, the proposed transaction entails the transfer of assets that have been held for charitable purposes to a for-profit corporation, which is organized for the benefit of its members (and the shareholders of its publicly traded stock subsidiary).

IV. The 1995 Special Legislation Does Not Abrogate BCBS of NJ's Charitable Trust Obligations and Its Duties Under its Certificate of Incorporation.

In the normal course of events, when a New Jersey nonprofit corporation abandons its nonprofit status to enter the commercial world it must transfer its asset value to a nonprofit corporation that will serve its original charitable purposes. Cf. N.J.S.A. 15A:12-11(a)(9) (allowing Attorney General to bring an action seeking to dissolve nonprofit corporation when conducting activities in violation or articles of incorporation); N.J.S.A. 15A:12-12(a)(5) (permitting court to dissolve nonprofit corporation when it is no longer able to carry out its charitable purposes). In addition, if a nonprofit corporation attempts to merge with a mutual or other for-profit corporation, it must first dissolve, and as part of that dissolution, it must transfer its assets to a corporation dedicated to its charitable mission. N.J.S.A. 15A:10-1 and accompanying Law Revision Committee Notes; N.J.S.A. 15A:12-

8(4). This is the case because the assets of a nonprofit corporation may be used only for the charitable purposes for which it was chartered. See Queen of Angels Hosp. v. Younger, 66 Cal. App. 3d 356, 136 Cal. Rptr. 36 (Ct. App. 1977) (imposing charitable trust obligation on all assets acquired by nonprofit corporation); charitable trust doctrine discussed infra.

There is no reason why BCBS of NJ should not be required to do what all nonprofits have to do when they give up their nonprofit status: transfer the fair market value of the assets developed while they were the beneficiary of public favors to a nonprofit corporation with similar charitable purposes. The special legislation enacted in 1995, N.J.S.A. 17:48E-45 et al., permitting BCBS of NJ to convert to a mutual insurance company without first dissolving does not dictate otherwise. This is particularly true when the "conversion" is only a step in a transaction which makes BCBS of NJ part of a national for-profit enterprise.

Pursuant to N.J.S.A. 17:48E-47(b), the domestic mutual insurer "shall be deemed to have assumed all of the obligations and liabilities of the health service corporation" simultaneous with the transfer of "[a]ll the rights, franchises and interests" of that nonprofit entity. In order to be consistent with the common law doctrine of charitable trusts, as explained below, this provision must be construed to include the obligation to administer the assets acquired by the new mutual for benevolent and charitable purposes. In this way, the 1995 statute amends the New Jersey Nonprofit Corporation Law by excusing the corporation from the

technical requirements of dissolution and reincorporation when converting to a domestic mutual insurer; it does not relieve the converting nonprofit of its common law charitable trust obligations or its duty to comply with the mandates of its certificate of incorporation.

A. The Charitable Trust Doctrine Applies to BCBS of NJ.

Ordinarily the principles and rules applicable to charitable trusts are applicable to charitable corporations. RESTATEMENT (SECOND) OF TRUSTS §348, cmt. f (1959). In New Jersey, when a nonprofit corporation is organized for some charitable, social welfare or other public benefit purpose, its assets are impressed with a charitable trust by operation of law. See Leeds v. Harrison, 7 N.J. Super. 558 (Ch. Div. 1950) (affirming principle that charitable corporation is one organized not for private gain or profit, but for the "administration of charitable trusts"). See also, Thomas E. Blackwell, The Charitable Corporation and the Charitable Trust, 24 WASH. L.Q. 1, 42 (December 1938) (noting that the courts in New Jersey have consistently held since McKenzie v. Trustees of Presbytery of Jersey City, 67 N.J. Eq. 652 (E & A 1905) that gifts and bequests to charitable corporations are trusts). Thus, where property is given to or acquired by a charitable corporation without restrictions, it must be applied to one or more of the charitable purposes for which the corporation is organized. RESTATEMENT (SECOND) OF TRUSTS §348, cmt. f. (1959). See also Montclair Nat'l Bank & Trust Co. v. Seton Hall College of Medicine, 90 N.J. Super. 419 (Ch. Div. 1966), rev'd on other grounds, 96 N.J.

Super. 428 (App. Div. 1967) (noting that corporation must use funds requested for the "accomplishment of its proper corporate purposes").

Although the principle that a charitable corporation is incorporated for the administration of charitable trusts has developed in New Jersey in the context of private gifts or bequests, it is equally applicable to all assets acquired by the nonprofit corporation. This is the case because it is the charitable purpose for which the incorporators organized the corporation and for which the state granted its charter as a tax-exempt entity that constitutes the basis for its charitable trust obligation. See Gassel and Gerzog, supra, at 7 (noting that public support in the form of economic subsidies, such as reduced taxes and other benefits, creates expectations that not-for-profit corporation will operate in accordance with the charitable purposes for which it was organized).¹⁵

As the appellate court in California has explained:

[A]ll the assets of a corporation must be deemed to be impressed with a charitable trust by virtue of the express declaration of the corporation's purposes, . . . It follows that . . . [a nonprofit corporation cannot] legally divert its assets to any purpose other than charitable purposes, and said property [is] therefore 'irrevocably dedicated' to exempt purposes within the meaning of the welfare exemption." Queen of Angels Hosp., 66 Cal. App.3d at 365, 136 Cal. Rptr. at 39.

¹⁵ Although the principal reason that Blue plans were granted tax and other legal exemptions over the years was the specific and unique purpose for which they were formed, i.e., to benefit the public health, it is this charitable purpose, and not the resulting subsidies, that confers a charitable trust obligation on such corporations.

See also FLETCHER CYCLOPEDIA §2:21 (noting that a nonprofit, like any corporation, cannot operate for purposes other than those specified in its articles of incorporation). In this way, both the original incorporators of BCBS of NJ and the State of New Jersey, by virtue of the chartering process, imposed an irrevocable obligation on BCBS of NJ to devote its assets exclusively to the charitable purposes contained in its certificate of incorporation at the time such assets were acquired. See Blocker v. State, 718 S.W.2d 409, 416 (Tex. Ct. App. 1986) (noting that Houston Conservatory of Music "by its very incorporation" for charitable purposes had made a contract with the state to use its assets for purposes specified in its charter).¹⁶

B. The Doctrine of 'Cy Pres' Applies to BCBS of NJ's Proposal To Convert to For-Profit Status.

In New Jersey, as elsewhere in the United States, the charitable obligations of a nonprofit corporation can be enforced under the common law doctrine of cy pres. See e.g., Fidelity Union Trust Co. v. Ackerman, 18 N.J.Super. 314, 326 (Ch. Div. 1952) (cy pres found applicable to prevent defeat of testamentary gift when charitable corporation merged with another charitable corporation with similar purposes); Nicholas v. Newark Hosp., 71 N.J.Eq. 130,

¹⁶ See also Nacol v. State of Texas, 792 S.W.2d 810, 811 (Tex. Ct. App. 1990) (court rejected appellants' argument that nonprofit corporation conducting multiple sclerosis research was not a charitable trust and affirmed trial court's order that corporate assets "are deemed impressed with a charitable trust by virtue of an expressed declaration of the corporation's purpose"); Attorney General v. Hahnemann Hosp., 494 N.E.2d 1018, 1021 (Mass. 1986) (sale of a nonprofit hospital to a for-profit corporation constituted an abandonment of the hospital's principal activity resulting in violation of charitable trust principles).

132 (Ch. Div. 1906) (cy pres invoked to effectuate donor's intent when charitable corporation failed to undertake any activities in furtherance of its purposes).¹⁷ Pursuant to this doctrine, if a corporation fails to fulfill its charitable obligations, or it abandons those charitable obligations by, inter alia, converting to a profit-making enterprise, or it becomes impossible to administer the corporation for the charitable purposes for which it was chartered, a court has the power to direct that the assets be administered in conformity with the original purposes. Morristown Trust Co. v. Protestant Episcopal Church, 1 N.J. Super. 418 (Ch. Div. 1948) (cy pres applied when church moved); Cinnaminson Library Ass'n v. Fidelity-Philadelphia Trust Co., 141 N.J.Eq. 127 (Ch. Div. 1948) (cy pres applied when construction of library no longer possible); Crane v. Morristown School Found., 120 N.J.Eq. 583 (E & A 1936) (cy pres applied when school became insolvent). Cf. In re Matzo Food Products Litigation, 56 F.R.D. 600, 605 (D.N.J. 1994) (applying cy pres doctrine in context of class action litigation by distributing unclaimed funds for the indirect benefit of the class).

Specifically, the doctrine of cy pres states:

¹⁷ Courts in many other jurisdictions have similarly applied the cy pres doctrine when nonprofit corporations abandoned their charitable purposes. See e.g., Riverton Area Fire Protection Dist. v. Riverton Volunteer Fire Department, 566 N.E. 2d 1015, 1020 (Ill. App. 1991) (doctrine of cy pres invoked to prevent the conversion of corporate assets when corporation changed its corporate purposes); Blocker, 718 S.W. 2d at 415 (affirming lower court's decision to apply cy pres as to property wrongfully transferred by charitable corporation to private estate).

If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.

RESTATEMENT (SECOND) OF TRUSTS §399 (1959). See also Fidelity Union Trust Co., 18 N.J. Super. at 326 (citing same section of earlier edition of the Restatement).¹⁸ As a prerequisite to applying the doctrine, a court must find that (1) a valid charitable trust was created; (2) there exists some degree of impossibility or impracticality to implement the specific purpose(s) of the trust; and (3) the settlor indicated a general charitable intention. Edith L. Fisch, Cy Pres Doctrine in the United States 128 (1950).

In the instant case, all three of the above elements are satisfied. As established above, the incorporators of BCBS of NJ, by delineating the charitable purposes set forth in its certificate of incorporation, and the State, by authorizing BCBS of NJ to

¹⁸ See for more recent statement of cy pres doctrine Sharpless v. Religious Society of Friends, 228 N.J. Super. 68, 74 (App. Div. 1988) (doctrine allows court to apply trust funds to a charitable purpose as similar as possible to particular purpose of settlor if settlor manifested intent to devote property to more general purpose than that expressed); Matter of Gonzalez, 262 N.J. Super. 456, 459 (Ch. Div. 1992) (judicial mechanism for preservation of charitable trust when accomplishment of particular purpose becomes frustrated); Matter of Frieda Crichfield Trust, 177 N.J. Super. 258, 261 (Ch. Div. 1980) (doctrine permits court "to redirect the precise terms of a trust" when it becomes impossible to administer the trust according to its terms "to prevent impairment of trust's primary purpose").

operate for those same purposes, established a valid charitable trust.

Second, BCBS of NJ will substantially depart from its dominant charitable purpose when it operates as a for-profit mutual insurance company with profits and/or dividends available to its members. Clearly, when profit-making objectives, rather than BCBS of NJ's public mission, become its primary goal, it will be impossible for the new mutual to satisfy BCBS of NJ's specific charitable purposes, i.e., to offer and provide nonprofit health plans to those members of the public who become subscribers and to assist in the development of health programs in the communities in which it provides such plans.

Of course, this is accentuated when the final plan is completed and New Jersey Mutual is absorbed by Anthem. This is the case because Anthem, by its interrelationship with the public business corporation it controls, will be able to move the profits obtained by using BCBS of NJ's assets to various entities with private ownership.

Finally, as indicated above, BCBS of NJ's certificate of incorporation indicates an intent on the part of its incorporators and the State to promote both the general charitable purpose of increasing New Jersey residents' access to health care and of improving their medical status. Furthermore, the debates surrounding the State's approval of BCBS of NJ's continuous requests for rate increases over the years, which were directed at

keeping BCBS of NJ solvent, are additional evidence that the State intended BCBS of NJ to serve a broad public interest. See e.g., Anne Savage, Transfusions Saving Blue Cross, THE RECORD, December 12, 1969, at A1, A5; Mel Most, Rate-rise Foes Huddle With State, THE RECORD, November 7, 1972, at 5; David Gordon, Blue Cross is Healthier Financially, STAR-LEDGER, December 1, 1977, at 1; Vincent R. Zarate, Bailout for Blue Cross-Blue Shield Wins Final Approval in Legislature, STAR-LEDGER, July 12, 1988, at 20; Joseph F. Sullivan, Trenton Backs Increase in Health Insurance Rates, N.Y. TIMES, April 17, 1992, at B5.

For the foregoing reasons, the doctrine of cy pres applies and BCBS of NJ must be forced to do what other converting nonprofit health care organizations have done: transfer its assets to an independent nonprofit corporation dedicated to similar charitable purposes as itself. On the other hand, if the regulators permit BCBS of NJ to depart from its original charitable purposes without transferring its assets to a such a nonprofit corporation, vast assets will disappear into an Indiana corporation and the health system of New Jersey will lose what the public has permitted BCBS of NJ to build.

C. BCBS of NJ's Certificate of Incorporation Requires a Charitable Settlement.

As noted above, N.J.S.A. 17:48E-47(b) amends the New Jersey Nonprofit Corporation Law to allow a nonprofit health service corporation to convert to a domestic mutual insurer without first dissolving. The statute, however, is silent as to whether such a health service corporation must nonetheless satisfy any other

requirements it may have had under its certificate of incorporation.

It is the position of the Task Force that the transfer of all of BCBS of NJ's assets to New Jersey Mutual is equivalent to the closing of its affairs and must be done in the manner prescribed in its certificate of incorporation --i.e., to transfer its assets to one or more corporations with charitable purposes similar to the original objectives of BCBS of NJ. Article IX of Restated Certificate of Incorporation, 1986. The conversion statute states nothing to the contrary and thus, BCBS of NJ's dissolution provision still governs a transaction that in all effects is a dissolution. Cf. Hahnemann Hosp., 494 N.E. 2d at 1019 (finding that the sale of the hospital would render the nonprofit an empty shell thus requiring a dissolution proceeding).

If one were to conclude otherwise, BCBS of NJ would be able to evade its original charitable purposes simply by reconstituting itself as a mutual and directing all its funds to newly stated 'for-profit' objectives. Such an interpretation is clearly inconsistent with the established principle that the provisions of a charitable trust cannot be changed merely by amending the articles of incorporation of a charitable corporation. 14 C.J.S. Charities §60 (1990). Cf. City of Paterson v. Paterson Gen. Hosp., 97 N.J. Super. at 522 (prohibiting corporate amendments that "subvert" general principles for which the corporation was founded). Moreover, such an interpretation would also "eviscerate the Attorney General's power and responsibility to enforce the due

application of charitable funds. . . and prevent breaches of trust in the administration thereof." Hahnemann Hosp., 494 N.E. 2d at 1021. See generally infra Point IV.D.

In summary, the incorporators of BCBS made certain decisions about the essential nature of the corporation, which were set forth and established in its certificate of incorporation. Because the current directors of BCBS of NJ are now seeking approval to transfer all the assets of the non-profit corporation to a for-profit mutual, they are essentially seeking authorization to amend its certificate and, in effect, to dissolve. Although the 1995 special legislation authorizes BCBS of NJ to convert without meeting the technical requirements of dissolution, it does not exonerate the corporation from meeting the substantive requirements of dissolution imposed by its certificate of incorporation. It therefore follows that BCBS of NJ is still required to make a charitable settlement pursuant to the mandates of its charter.

D. The Directors of BCBS of NJ Have Breached Their Fiduciary Duty By Seeking to Transfer the Corporation's Charitable Assets to a For-Profit Entity.

Given that the directors of BCBS of NJ cannot ignore the charitable purposes to which BCBS of NJ's assets are irrevocably dedicated under the doctrine of cy pres and the dissolution clause of its certificate of incorporation, it is disturbing to find that the directors of BCBS of NJ have made a commitment to "use their best efforts" to obtain all government approvals and consents necessary to consummate the transactions without making any payment to a third party for the "establishment or funding of any

charitable foundation or trust." Merger Agreement, Article VIII, Section 8.5. This attempt to avoid the transfer of charitable assets constitutes a breach of fiduciary duty.

1. **Directors of Non-profit Corporations are Under a Fiduciary Duty to Promote and Protect the Charitable Purpose of the Non-profit Corporation.**

A non-profit corporation's certificate of incorporation, which sets forth its charitable purpose, serves as a binding contract which gives life to the nature of the fiduciary duties of a non-profit corporation's directors. Leeds v. Harrison, 7 N.J.Super. at 56. See also Obley v. Kirby v. Kirby, 592 A.2d 445, 468 n.17 (Del. 1990) (noting that non-profit directors incur a special fiduciary responsibility to "protect and advance [the corporation's] charitable purpose."); Blocker, 718 S.W.2d at 415 (noting that by their very incorporation for charitable and benevolent purposes charitable corporations make a "contract with the state . . . constituting those in charge of the enterprise trustees of an express trust. . .").

Although it is now clear that directors of non-profit corporations are not held to the identical fiduciary standards of trustees of charitable trusts, the substance of their fiduciary responsibilities to the non-profit corporation continues to be drawn, at least in part, from the basic principles of trust doctrine. In City of Paterson v. Paterson Gen. Hosp., 97 N.J. Super. at 516, Judge Mountain explained the idiosyncratic nature of the law of charitable corporations as follows:

To some extent this body of law has its roots in the law of trusts; to some extent in the

law of corporations; to some extent it may partake of both or be sui generis.

Id. See also Johnson v. Johnson, 212 N.J.Super. 368, 385-86 (Ch. Div. 1986) (recognizing that courts should apply either trust principles or the law of corporations depending on the circumstances); Holt v. College of Osteopathic Physicians and Surgeons, 395 P.2d 932, 936 (Ca. 1964) ("It is true that trustees of a charitable corporation do not have all the attributes of a trustee of a charitable trust . . . however, . . . they are fiduciaries in performing their trust duties.")

Unlike the directors of most for-profit corporations, non-profit directors are charged with a responsibility to oversee a corporation chartered to pursue a particular charitable purpose or mission. See 15A:2-8(a)(2) (requiring that the corporation's purpose be stated with specificity).¹⁹ The fundamental difference between the fiduciary duties of non-profit directors and their for-profit counterparts emanates directly from the charitable purposes of the non-profit corporation as expressed in their certificates of incorporation.²⁰ The charitable purpose clause, which is required by N.J.S.A. 15A:2-8(a)(2), defines the nature of the corporation

¹⁹New Jersey's Non-Profit Corporation Act does not allow non-profit corporations to avail themselves of the "general purposes" clause in their articles of incorporation that most business corporations employ. N.J.S.A. 15A:2-8 and accompanying Law Revision Committee Notes ("The committee believes that such an authority is not appropriate for a non-profit corporation.").

²⁰In other respects, the standards governing the duties of directors of for-profit corporations and non-profit corporations are the same. Compare N.J.S.A. 14A:6-14 (for-profit director's duties) with N.J.S.A. 15A:6-14 (non-profit director's duties). See generally Revised Model Non-Profit Corporation Act, §8.30 (1986).

setting a functional boundary for legitimate corporate action. See Rob Atkinson, Reforming Cy Pres Reform, 44 HASTINGS L.J. 1111, 1120 (1993) (arguing for judicial flexibility in departures from donative intent so long as the intended use of charitable assets remains within the definition of charity). See also Developments in the Law of Non-Profits: The Fiduciary Duties of Directors, 105 HARV. L. REV. 1590, 1603 (1992) (acknowledging that a non-profit's charitable purposes clause is often the sole constraining force operating to guide directors' action); Dimeri and Weiner, The Public Interest and Governing Boards of Non-Profit Health Care Institutions, VAND. L. REV. 1029, 1045 (1981) (same); and Note, The Fiduciary Duties of Loyalty and Care Associated with the Directors and Officers of Charitable Organizations, 64 VA. L. REV. 449, 460 (1978) (same).²¹

As a result, for directors of non-profit corporations, fidelity to the charitable intention to which the corporation is dedicated is at the heart of the concept of fiduciary duty.

This conclusion is further supported by the established principle that a non-profit corporation may not amend its certificate of incorporation to the point that it no longer espouses a charitable purpose. See Bible Presbyterian Church v.

²¹The centrality of the corporate charter in defining the non-profit corporation's nature and purpose is demonstrated in other contexts as well. Court's look to the corporate charter of a donee non-profit corporation to impute donative intent to otherwise undirected contributions and bequests. Blocker, 718 S.W.2d at 409; In re Los Angeles County Pioneer Soc'y, 257 P.2d 1 (Cal. 1953), cert. denied, 346 U.S. 888 (1953); In re Harrington's Estate, 36 N.W.2d 577 (Neb. 1949).

Harvey Cedars Bible Conference, 84 N.J. Super. 441, 448 (App. Div. 1964) (inquiry into whether there had been a "change of purpose, activities or dedication."). Indeed, N.J.S.A. 15A:9-1(a) is absolutely clear that a non-profit corporation may amend its certificate of incorporation only to the extent that the amended certificate would still qualify under the charitable purposes provisions of N.J.S.A. 15A:2-1(a).

Similarly, other courts have stressed that directors of non-profit corporations risk breaches of their fiduciary duties if they seek to substantially alter the charitable purpose of a non-profit corporation by amendment of its charter and thereby avoid prescribed dissolution proceedings. See e.g., Hahnemann Hosp., 494 N.E.2d at 1019 (noting that amendment to corporate charter rendering a charitable organization an "empty shell" unable to fulfill its purposes" would trigger dissolution proceedings); Alco Gravure, Inc. v. Knapp Foundation, 479 N.E.2d 752, 758 (N.Y. 1985) (rejecting attempt to avoid statutory dissolution proceedings by amendment of non-profit corporation's charter). Cf. Allgood v. Bradford, 473 So.2d 402, 415 (Miss. 1986) (implying that trustees violated fiduciary duty by amending corporate charter to eliminate references to the corporation's property being held "in trust").

In short, the directors of a non-profit corporation, such as BCBS of NJ, are required to administer and use the assets of the corporation for charitable purposes; to divert the assets for any other purpose would violate their accepted standard of care.

2. Directors of BCBS of NJ Cannot Avoid Making A Charitable Settlement Without Breaching

Their Fiduciary Duties.

In the instant case, the directors of BCBS of NJ seek permission to transfer all the corporation's charitable assets to New Jersey Mutual, a for-profit mutual insurance corporation. In so doing, they violate their fundamental fiduciary duty to promote and protect BCBS of NJ's charitable nature.²²

First, insofar as the proposed certificate of incorporation of New Jersey Mutual eliminates all references to its predecessor's charitable purposes or obligations, BCBS of NJ directors in effect have ratified an unlawful amendment to BCBS of NJ's certificate of incorporation. Therefore, unless the directors modify their application to include a charitable settlement in accordance with charitable trust law, they will breach their fiduciary duties of loyalty and due care to BCBS of NJ.

In this light, the commitment of the directors of BCBS of NJ to "use their best efforts" to obtain all government approvals and consents necessary to consummate the transactions without making any payment to a third party for the "establishment or funding of

²²The standard of loyalty for a fiduciary is uncompromising. As stated by Mr. Justice Cardozo in Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (N.Y. 1928):

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. . . Id. 249 N.Y. at 463, 164 N.E. at 546.

See e.g., In re Imperial "400" National, Inc., 456 F.2d 926, 931 n.12 (3d Cir. 1972) (quoting Meinhard).

any charitable foundation or trust" is particularly egregious. Merger Agreement, Article VIII, Section 8.5. Failing to comply with the objectives of a charitable trust in order to further noncharitable purposes is a breach of duty; clearly it is a breach to undertake to actively circumvent such obligations. Since fidelity to the charitable intention to which BCBS of NJ is dedicated is the core of a non-profit director's fiduciary duty, to covenant to defeat this purpose constitutes an abandonment and obvious breach of that duty.

V. The Proposal to Merge With Anthem Fails to Protect New Jersey Residents' Access to Health Care Insurance and Indicates Minimum Control By New Jersey Policyholders in the Surviving Corporation.

In addition to the aforementioned concerns regarding BCBS of NJ's application to mutualize, the specific terms of BCBS of NJ's proposal to merge into Anthem raises several important questions about Anthem's commitment to keep its operations in New Jersey, and the ability of New Jersey policyholders to exert effective control over the surviving corporation.

First and foremost, the proposed merger is a transfer of extremely valuable New Jersey charitable assets, without any compensation for such assets, to a for-profit mutual insurer which is organized under the laws of the state of Indiana. In this way, assets that have accrued for the benefit of New Jersey citizens will be placed under the control of a foreign corporation with no particular allegiance to New Jersey. While the proposal contemplates the establishment of local stock subsidiaries that will be incorporated under New Jersey law (or Delaware law, in the

case of Anthem East), New Jersey policyholders will hold their membership rights solely through guaranty policies issued by Anthem. Merger Agreement, Article III, Sections 3.3 and 3.4. It is thus clear that from the onset of the merger, the Indiana mutual will have the absolute power to make business decisions concerning "New Jersey assets," including the decisions to demutualize, liquidate or cease doing business in New Jersey.²³ In this regard, it should be noted that Anthem's commitment to maintain a substantial physical presence in New Jersey and to provide health care benefits and related products to the residents of New Jersey is for only seven (7) years. Merger Agreement, Article VIII, Sec. 8.6(A).²⁴

Second, the structure and operation of Anthem raise serious questions as to the equity of the merger to New Jersey policyholders and the security of service to be rendered to them. N.J.S.A. 17B:18-61(2), (3). Although New Jersey policyholders will have voting rights,²⁵ they will share membership on Anthem's Board with policyholders from Indiana, Kentucky and Ohio, and most

²³ In its agreement to merge, Anthem merely "confirms that it has no present intention to engage in voluntary demutualization or liquidation of the Surviving Corporation." Merger Agreement, Article VIII, Section 8.6(B).

²⁴ Moreover, once New Jersey Mutual ceases to exist, there is no corporate party who has standing to enforce such commitment.

²⁵ The annual meeting of the members of Anthem will be held in Indiana, and in order to get copies of the agenda, a member has first to write the corporate secretary. See Merger Application, Tab 3, Exhibit B, at 8. Rather than travel to Indiana, it is more likely that New Jersey policyholders will exercise their right to vote by giving a proxy to the Board of Directors of Anthem, id., thus minimizing their involvement in decisionmaking.

probably, from Connecticut and Delaware as well. As indicated in the submitted documents (Merger Application, Tab 5, at 4), Anthem does not intend to cease its merger activities with the proposed transaction, and as more mergers into Anthem occur, the membership rights of New Jersey policyholders will become further diluted.

The dilution of ownership is further aggravated by the corporate structure of Anthem. Anthem utilizes Acordia, Inc., an investor-owned corporation, as the agent to market and in some respects manage its health care business. While Anthem's 1995 listing on the Fortune 500 indicates consolidated revenues of \$6 billion for all its stock subsidiaries, it also reported a \$33 million loss to its policyholders for that same time period. See Lore Postman, \$33 Million Loss Stings Anthem, 17:8 INDIANAPOLIS BUS. J. 1 (May 13, 1996). Together, these facts raise serious questions as to the real beneficiaries of Anthem's business operations.

The merger agreement is also silent as to whether Anthem intends to take NJHIC or Anthem East public. Accordingly, the regulators cannot determine the ultimate owners of New Jersey assets.

For the foregoing reasons, the specific terms of the merger agreement are "inequitable to the policyholders of [New Jersey Mutual]" and may indicate a reduction in "the security of and service to rendered to [them]." N.J.S.A. 17B:18-61(2), (3).

VI. Conclusion

As explained above, it is the conclusion of the Task Force that New Jersey regulators must condition their approval of BCBS of NJ's proposal to convert to a mutual and to merge with Anthem by requiring BCBS of NJ to make a charitable settlement. During its sixty-year history in New Jersey, BCBS of NJ has held, under the charitable trust doctrine, an irrevocable obligation to preserve its charitable assets for the nonprofit purposes set forth in its certificate of incorporation and the Health Services Corporation Act. It is clear that its board members owe a fiduciary duty to the corporation to protect its charitable assets and, accordingly, to transfer them to another nonprofit corporation with similar purposes at the time BCBS of NJ ceases to exist.

For the foregoing reasons, BCBS of NJ's proposal to mutualize is contrary to law, (N.J.S.A. 17B:45-47(a)(1)), and cannot be approved. Unless and until the Attorney General acts to preserve and protect the charitable assets of BCBS of NJ by requiring the converting entity to satisfy its charitable obligations, New Jersey residents stand to lose the use and control of billions of dollars that otherwise could be deployed to improve their access to adequate health care.

Similarly, BCBS of NJ's application to merge into Anthem cannot be approved on the terms specified. Regulators should act to ensure that New Jersey policyholders are treated fairly for purposes of N.J.S.A. 17B:18-61(2), (3), and to protect New Jersey residents, as health care consumers and employees.

DANIEL E. LUNGREN
Attorney General

State of California
DEPARTMENT OF JUSTICE



50 FREMONT STREET, SUITE 300
SAN FRANCISCO, CA 94105
(415) 356-6000

FACSIMILE: (415) 356-6257
(415) 356-6266

November 8, 1996

John F. Walker, Jr.
Latham & Watkins
633 West 5th St., Suite 4000
Los Angeles, CA 90071-2007

Re: San Diego Hospital Assn., et al. ("Sharp")

Dear Mr. Walker:

This is to acknowledge receipt of the materials forwarded to us on November 7, 1996 -- we will, without delay, begin the process of checking them for completeness. As I indicated in our recent conversation, we have now finished our review of the original submission (dated August 16, 1996) and have made substantial progress in analyzing the materials provided to us on October 25, 1996.

Pursuant to our understanding with Sharp, and as confirmed in Carlisle Lewis' June 26, 1996 letter to me, Sharp has agreed to provide the Office of the Attorney General with adequate time to review this transaction, notwithstanding the 20 day period provided by Corporations Code section 5913. Moreover, it was understood that the review process would take approximately 60 days from receipt of the necessary documents. Per our recent telephone conversation, and as confirmed by my letter to you of October 25, 1996, section 5913 notice is deemed to have occurred effective November 8, 1996, assuming the completeness of the materials received today.

While we will, of course, need to complete our review and analysis of all of the submitted materials, we have nonetheless reached certain conclusions based on the review conducted to date. Because of the time pressures created by the desired year-end closing and because these conclusions significantly impact the transaction, we felt it only fair to apprise you of them at this time. Were we to wait for the full time anticipated in order to complete our review prior to bringing these issues to your attention, there would, quite frankly, be insufficient time left for you to respond. This seems to us inconsistent with the spirit of cooperation and candor with which we have been dealing. For clarity's sake, we have dealt with the key issues separately below. I would, however, expect that additional issues might

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arise from our ongoing review of the recently submitted documents.

1) Sharp Memorial Hospital-Sharp Cabrillo Hospital

The Articles of Incorporation of both of these hospitals (now combined) define the charitable trust on which their assets are held. Those articles require that the assets of these two hospitals be used solely for the purpose of "acquir(ing) and operat(ing) a non-profit charitable hospital and medical center in the City of San Diego..." Moreover, those articles of incorporation specifically prohibit any activities not in furtherance of those specific purposes, except to an insubstantial degree.

In our view, the transfer of these hospitals into the for-profit LLC constitutes an abandonment and breach of that trust. While it is our opinion that the directors of those hospitals are permitted, pursuant to Corporations Code section 5911, to sell all or substantially all of the assets of the hospitals--the proceeds of any such sale are required to be used for the same charitable purposes. (See Queen of Angels v. Younger (1977) 66 Cal.App.3d 359; Holt v. College of Osteopathic Physicians & Surgeons (1964) 61 Cal.2d 750.

Since, post closing, your charitable foundation will not be operating any non-profit hospital within the City of San Diego and since the sale and contribution agreement and LLC agreement, by their express terms, do not permit the removal of the sale proceeds attributable to these hospitals from the joint venture, nor their transfer to another non-profit hospital within the City of San Diego or other entity providing such services, the inclusion of these hospitals within the transaction constitutes, in our view, a breach of trust.

Moreover, our review of the materials provided to date, and confirmed by interviews with Board members of Sharp Memorial Hospital, indicates that these issues were never presented to, nor considered by, that Board prior to its approving this transaction.

The Sharp Memorial Hospital Board is an independent Board of Directors of a non-profit corporation that itself is separate and distinct from SDHA. That Board of Directors owes a fiduciary

The assets of these hospitals constitute a significant portion of the Sharp value -- contributing a fund balance of approximately \$170 million (61% of the Sharp total) and operating income of \$1.3 million per year, compared to a loss of approximately \$6 million in the system as a whole.

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duty of loyalty and due care to Sharp Memorial Hospital and its failure to address these issues and to comply with charitable trust law constitutes, in our view, a breach of that duty.

2) Undervaluation of the Charitable Assets

It seems clear from a review of the documents provided to us that in order to meet their fiduciary obligations, the Sharp directors will be compelled to exercise the "put" option and to do so almost immediately. This conclusion is confirmed by virtually all of the available information, including:

a) Sharp's own analysis that confirms that the put's value is highest if exercised immediately and that holding it for any substantial time before exercising it results in a significant loss of charitable assets, e.g. exercising it at the end of the three-year period causes a loss of charitable value in the amount of \$57.7 million (a loss of 29% of its total value);

b) The LLC membership interest is, by its express terms, virtually unmarketable (except at an enormous discount) after the expiration of the "put" term -- thereby prohibiting fiduciaries from holding it past that date;

c) Sharp's planned borrowing of \$50 million dollars, secured by the assignment of the put option to the lender, will necessitate the exercise of that option as there is no adequate source of funds to repay that loan except the exercise of the option;^{2/} and

d) Sharp's own projections show that the income to be generated by the LLC is substantially less than would be generated by any reasonable diversified investment portfolio, with the guaranteed amount being less than the one year T-bill rate.

As such, it is clear that in order to meet their fiduciary obligations to the charitable beneficiaries, the Sharp Board will be required to exercise the put at its initial price, i.e. \$202 million. This is the price that Columbia is, in fact, paying for the Sharp assets.

However, our review indicates that this sale price is over \$109 million less than the amount offered by Tenet Healthcare and over \$200 million less than the amount apparently offered by

2. Sharp's own projections indicate that the income to be generated by the LLC is insufficient to repay the loan thereby necessitating the use of the put option funds.

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ORNDA -- resulting in a loss of one-third to one-half of the equity value of the Sharp system.

This enormous price differential is made even worse by the presence of additional financial benefits within the non-Columbia deals, including higher opening cash balances for the Foundation, better cash flows, and opportunities to share in capital appreciation. These factors require us to conclude that the Sharp Board's acceptance of the Columbia proposal represents a serious breach of trust which will cost the charity's public beneficiaries between \$100-\$200 million. Should this deal close in the proposed form, we will seek to hold the Sharp directors who voted to approve the transaction personally liable for this amount.

3) Lack of Due Diligence

We are, in addition, particularly concerned that the Boards of Directors of SDHA and the affiliated corporations voted to approve the transaction without knowledge of, or resolution of, a number of key matters which will have a material financial effect on the charitable assets. This appears to us to be in direct contravention of the Board members' duties of due care after reasonable inquiry.

Among the key unresolved matters which materially effect the transaction are the following:

- a) the failure to determine the financial effect of the ~~Medicare/Medicaid recapture liability~~ given the inevitability of exercising the put option;
- b) the failure to obtain, or even seek, IRS rulings on the issues of Sharp's ongoing status as a public charity as distinguished from a private foundation and the potential subjection of Sharp's joint venture income to UBIT;
- c) the failure to identify the excluded liabilities not being assumed by the joint venture;
- d) the failure to consider what effect changes in the initial RFP (re inclusion of the Ross Stealy Medical Group & Grossmont Hospital in the transaction) would have had on potential alternative bidders;
- e) the failure to consider the charitable trust issues posed by Queen of Angels and Holt; and
- f) the failure to explore the alternative of outright sale of all of the assets to either a for-profit or non-profit entity in lieu of the joint venture proposal.

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4. Imprudent Investment

Were one to assume this to be a real joint venture proposal, it would, in our view, raise serious issues of imprudent investment. We doubt that it is ever prudent for a non-profit public benefit corporation to invest virtually all of its assets in a single investment, let alone an LLC in which it is not the managing partner, which has virtually no capital appreciation potential, which is virtually unmarketable after three years, and which yields a return which the charity itself projects at well below the expected rate of return for a properly-managed portfolio.

If we are correct in assuming the inevitability of the immediate exercise of the "put" option, these concerns become moot. Were the Sharp Board to retain its interest in the joint venture, however, they would become relevant.

5) Process Concerns

In the course of our review, we have become concerned over whether the actual process was managed in a way to allow the free market to work or whether there was a bias in the process to favor one party over others. Given our analysis of the relative values of the rejected proposals compared to that of the accepted proposal, those concerns are magnified. In addition, our preliminary inquiry indicates that essential information necessary to the proper review of this transaction was denied to certain members of the SDHA and affiliated corporation Boards of Directors, notwithstanding their request for such. In our view, this creates serious issues regarding possible breaches of trust.

As such, the Attorney General has authorized a Government Code section 11180 investigation into this transaction (I have attached a copy of the authorization for your information). We are desirous of taking statements under oath, at a mutually agreeable time, from the members of the Sharp Special Committee and from the Shattuck Hammond investment bankers who worked on this transaction. Please advise me if you will make these individuals available voluntarily or whether it will be necessary to subpoena them.

As we discussed in our recent telephone conversation, we are available to meet with you to discuss these issues. In the interim, however, the time pressures inherent in the statutory scheme create some difficulties. As such, we have prepared a "standstill agreement" and enclosed it herewith. If it is acceptable to you, we are prepared to delay initiating legal action while discussions take place. To do so, we will need to have the agreement signed by November 15, 1996. Should the

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standstill agreement not be signed by November 15, 1996, we will initiate legal proceedings in order to protect the public's interest in these assets.

Sincerely,

DANIEL E. LUNGREN
Attorney General

JAMES R. SCHWARTZ
Deputy Attorney General

JRS:mdm

cc: Carlisle C. Lewis, III

PR Newswire Association, Inc.

May 29, 1996, Wednesday

ANTHEM, INC., BLUE CROSS AND BLUE SHIELD OF NJ TO MERGE: Deal Will Create Multi-Regional Integrated Health Care Company

Anthem, Inc. and Blue Cross and blue Shield of New Jersey (BCBSNJ) announced today they have agreed to merge, creating an integrated health care company with more than \$9 billion in revenues, and significant market share in two separate regions of the United States.

The Boards of Directors of BCBSNJ and Anthem, Inc. have approved the merger. Insurance commissioners in Indiana and New Jersey, as well as the policyholders of both companies, must approve the merger, scheduled to be finalized by the end of 1996.

Anthem is an Indianapolis-based, Fortune 500 health care management company doing business in all 50 states. In Indiana, Ohio and Kentucky, Anthem offers its health products under the name Anthem Blue Cross and Blue Shield. Anthem covers more than 4 million people in the tri-states, and over 9 million people nationwide. Its consolidated 1995 revenues were \$6.1 billion.

BCBSNJ recently agreed to acquire the assets of Blue Cross Blue Shield of Delaware. The combined companies cover 2.1 million lives in those states, and anticipate 1996 revenues of more than \$3 billion.

A new holding company to be known as Anthem East, Inc. will be based in Newark, which will serve as the center of operations for Anthem on the East Coast. Subsidiaries of Anthem East will be licensed to offer Blue Cross and Blue Shield products in New Jersey and Delaware, as Anthem Blue Cross and Blue Shield.

Anthem East will be governed by its own board of directors. William J. Marino, President and CEO of BCBSNJ, will serve as Chairman and CEO of Anthem East. Marino will also serve as Senior Executive Vice President of Anthem, Inc. and will be a member of its board.

As part of the merger agreement, BCBSNJ will begin the process of becoming a mutual insurance company. Mutual companies are owned by their policyholders. BCBSNJ currently is a not-for-profit health services organization in New Jersey. BCBSNJ policyholders will be issued guaranty policies with Anthem, Inc. which will give them ownership rights in Anthem, Inc.

"Our merger with Anthem will give our policy holders added security and ownership of one of the most forward-thinking health care companies in America," said Marino. "The formation of Anthem East to be based in Newark, means that we will have tremendous resources available to be innovative, to expand and most importantly, to provide high-quality, cost-effective health coverage and products for our customers in New Jersey and Delaware."

"Creating a second independent operating region on the East Coast is a key part of our strategic plan," said L. Ben Lytle, President and CEO of Anthem. "By concentrating our efforts in well-defined, autonomous regional markets, we can give our customers the benefit of tremendous competitive economies, and have the expertise to provide high quality care at the lowest possible price."

After the merger, Anthem, Inc. will rank among the top five health care management companies in the United States, with consolidated revenues of more than \$9 billion. Combined assets will equal more than \$6 billion. Policyholder's equity will be more than \$1.5 billion.

As part of the merger agreement, Anthem, Inc. board of directors will be reconstituted

to include 18 persons: 12 from Anthem, Inc.'s current board; 2 from BCBSNJ's current board; BCBSNJ's current CEO, Marino, and chairman, Vincent Giblin; and Anthem, Inc.'s current CEO, Lytle, and chairman Dwane R. Houser.

Anthem, Inc. currently operates in New Jersey under the name Anthem Health and Life Insurance Company, and through its publicly traded insurance brokerage firm, Acordia (NYSE; ACO). Anthem also provides government contracting services nationwide through its AdminaStar subsidiary and property and casualty insurance through Anthem Casualty insurance.

Anthem Inc. is ranked 217th on the Fortune 500.

Blue Cross and Blue Shield of New Jersey, a not-for-profit health services corporation, is the state's largest health insurer, providing coverage to over 1.9-million New Jerseyans. In 1993, BCBSNJ began implementing a strategy to become a total managed care company, creating hospital, dental, pharmacy and physician networks and introducing HMO Blue as its premier managed care coverage. BCBSNJ anticipates revenues of nearly \$3 billion in 1996, and has reserves of nearly \$200 million.

CONTACT: Fred Hillmann of Blue Cross and Blue Shield of NJ, 201-466-8755, or Michael B. Murphy of Anthem, Inc., 317-488-6579.