

## PRELIMINARY STATEMENT

Plaintiff, Blue Cross and Blue Shield of New Jersey, Inc. ("BCBS of NJ"), brings this action in lieu of prerogative writs to circumvent the administrative process. It challenges the authority of the Commissioner of Banking and Insurance of the State of New Jersey (the "Commissioner") to deem its mutualization application incomplete, and, most significantly, seeks to avoid its charitable trust obligations upon its conversion from a nonprofit health insurance company to a for-profit mutual insurer. BCBS of NJ attempts to accomplish the latter by ignoring its institutional history and Certificate of Incorporation and distorting its enabling statute and the conversion statute.

After creating from whole cloth a contention that it is not a "charity" in the face of its enabling statute and corporate charter, BCBS of NJ it mischaracterizes the common law governing charitable corporations by equating its federal tax status with its status as a charitable corporation under New Jersey law. With "righteous indignation," it labels a legal "obligation" as an "exaction," and uses cases decided under the charitable immunity and property tax exemption statutes to support its unsustainable assertion that BCBS of NJ does not constitute a valid charitable trust. Because it is afraid that its sham and

its objectives cannot stand the light of day, BCBS of NJ is underplaying the historical and legal significance of its application to convert to a domestic mutual insurer and is undermining the Commissioner's ability to determine whether its proposed mutualization plan should be approved.

Defendant-Intervenors, New Jersey Citizen Action, and fifty (50) individual recipients of BCBS of NJ's health care services, submit this memorandum of law in opposition to BCBS of NJ's request for summary judgment on the basis that (1) the Attorney General's advisory opinion that BCBS of NJ is a "charity," and the Commissioner's adoption thereof, is in accordance with law; (2) the Commissioner has the authority, which she has yet to exercise, to require that BCBS of NJ's mutualization plan contemplate the payment of a charitable trust settlement; and (3) the Commissioner has the attendant authority to request information she deems necessary, including information regarding the fair market value of BCBS of NJ's assets and its proposed merger into Anthem Insurance Companies, Inc. ("Anthem"), an Indianapolis-based, for-profit mutual insurance company doing business in all fifty (50) states.

In Point I, defendant-intervenors establish that the conversion of BCBS of NJ to a domestic mutual insurer involves the transfer of charitable, nonprofit assets to a for-profit

entity. BCBS of NJ is defined by statute as a "charitable and benevolent institution." Further it was incorporated and continues to exist for 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.

Plaintiff attempts to argue that mutualization "is simply a clarification and recognition of BCBS of NJ's status as a mutual benefit organization," Amended Complaint at ¶13, a distinct status that does not exist in Title 15 of the New Jersey Nonprofit Corporation Law or BCBS of NJ's enabling statute. It also states that what it is seeking "represent[s] such a minor change," BCBS of NJ Memorandum of Law In Support of Plaintiff's Order to Show Cause at p.7.<sup>1</sup> Contrary to BCBS of NJ's assertions, conversion from a health services corporation to a domestic mutual insurer constitutes a legally significant change from a nonprofit to a for-profit entity.

In Point II, defendant-intervenors support the Commissioner's authority to request information she deems necessary to determine whether the mutualization plan is

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<sup>1</sup> Hereinafter "BCBS Mem. at p.\_\_\_\_".

"contrary to law" or "prejudices the interests of the subscribers." N.J.S.A. 17:48E-47.

The 1995 special legislation allowing BCBS of NJ to convert to a domestic mutual insurer without first dissolving does not relieve BCBS of NJ of its common law charitable trust obligations, but rather transfers such obligations to the mutual. Accordingly, information relating to the value of BCBS of NJ's assets is necessary to enforce its charitable trust obligations under the common law doctrine of cy pres. Nor does the 1995 legislation abrogate BCBS of NJ's duty to comply with the substantive requirements of dissolution imposed by its Certificate of Incorporation. BCBS of NJ, or its successor, is therefore required to make a charitable settlement pursuant to the mandates of its charter, thus also justifying the Commissioner's request for financial information relating to the value and payment of such a settlement. The failure of BCBS of NJ to acknowledge the need for such charitable settlement payment, and its contractual commitment to Anthem "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. Finally, it is incomprehensible that since the mutualization plan submitted to the Commissioner explicitly states that the primary purpose of the conversion to

a mutual is to merge into Anthem, information regarding Anthem and its subsidiaries would not be considered relevant to the mutualization application currently pending before the Commissioner.<sup>2</sup>

#### STATEMENT OF FACTS

##### **Industry Context of BCBS of NJ's Proposal to Convert**

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

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<sup>2</sup> Defendant-Intervenors do not take a position as to whether the Commissioner violated the procedural requirements of N.J.S.A. 17:48E-47(a) by responding to BCBS of NJ's application on November 14, 1996, allegedly four (4) days after the 30-day period for conducting a public hearing had expired. Nonetheless, intervenors strongly support the Commissioner's right to deem an application "incomplete" and to stay the statute's timetable until all documentary information on which a decision must be based is submitted.

inurement, such as stock options, have limited nonprofit organizations' ability to negotiate employment contracts. Id. See also Beth Fitzgerald, Blue Cross Considers 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 and/or Commissioners of Insurance 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.

### **1995 Special Legislation**

Within the context of the aforescribed industry trend, BCBS of NJ, in 1995, sought permission from the Legislature to convert from a nonprofit health service corporation to a for-profit mutual insurer without formally dissolving. 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. Pursuant to N.J.S.A. 17:48E-47(b):

All the rights, franchises and interests of the health service corporation in and to every species of property, . . . shall be deemed transferred to and vested in the domestic mutual insurer, . . . and

simultaneously therewith the domestic mutual insurer shall be deemed to have assumed all of the obligations and liabilities of the health service corporation and shall hold and enjoy the same to the extent as if the health service corporation had continued to retain title and transact business.

Given that the statute transfers all the obligations and liabilities of the health service corporation to the mutual as well as the rights in and to its property, BCBS of NJ, and its mutual successor, are not relieved from satisfying BCBS of NJ's charitable trust obligations or any other obligation otherwise imposed by its Certificate of Incorporation. The Legislature that provided for a means for conversion to a for-profit entity did not exonerate BCBS of NJ from satisfying its legal obligations, whether under its charter or otherwise.

#### 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 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.

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.

#### **Commissioner's Requests for More Information**

It is clear that the documents submitted with BCBS of NJ's application to convert raise many factual issues about related corporate transactions, a charitable trust settlement, the operation of Anthem, and other matters that bear on whether the mutualization plan satisfies criteria set forth in the statute. Because more information is necessary to adequately address these issues, the Commissioner, in a letter dated November 14, 1996, deemed BCBS of NJ's application "incomplete" and requested further documentation. Notwithstanding plaintiff's assertions to the contrary, BCBS of NJ's application to convert has not yet

been disapproved. The State has actively been processing its application, and the State has not denied BCBS of NJ or defendant-intervenors the right to participate in a public hearing on the mutualization plan. To require the Commissioner to hold a hearing and to make a decision on incomplete information and financial data is both wasteful and irrational, not arbitrary and capricious as plaintiff asserts.

#### ARGUMENT

#### I. 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.

Throughout its brief, BCBS of NJ adamantly denies that it ever had a "charitable" purpose, and rather that it was organized for the "sole benefit of its subscribers." E.g., BCBS Mem. at p. 4. To reach this conclusion, it misrepresents the common law definition of charitable corporation, distorts its enabling statute, and ignores its historical role in benefitting the public. Moreover, BCBS of NJ, though admitting to be a nonprofit corporation, never informs the court the nature of the purposes it holds. It does, however, admit that the Legislature endowed "BCBSNJ with the objective of . . . provid[ing]

affordable health coverage to many of New Jersey's citizens, thereby reducing the number of uninsured." BCBS Mem. at p. 14.

It is the position of defendant-intervenors, as more fully developed herein, that BCBS of NJ has always been a nonprofit health service corporation that has been invested with a public charitable purpose. 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).

health coverage to many of New Jersey's citizens, thereby reducing the number of uninsured").

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.<sup>3</sup> 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

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<sup>3</sup> These two elements are often related insofar as certain tax statutes exempt certain types of charitable corporations from certain types of taxes, but they are distinct concepts that cannot be collapsed into one as plaintiff suggests. Plaintiff's argument that it received its status as a charitable and benevolent organization "only for the limited purpose of creating a restricted tax exemption" makes no sense. BCBS Mem at p. 27; see also Id. at 24 ("The declaration does nothing more than provide for certain tax exemptions"). It was not necessary for state legislatures to deem Blue Cross and Blue Shield plans as charitable in order to grant them tax-exempt status; they could have done so through separate tax legislation. Similarly, it is an established principle that an organization's status under a particular tax statute--i.e., whether it is an exempt "charitable" organization,-- is not necessarily determinative of its status as a charitable corporation for purposes of whether a charitable trust has been created. IVA William Fratcher, Scott on Trusts §375.2 (4th ed. 1989)(hereinafter "Scott on Trusts"). Each tax statute has its own criteria and each embodies its own policy considerations that may differ from the common law understanding of charitable purpose or from another non-tax statute. See Point I.A.3. for further discussion of this issue.

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-profit medical services corporations was passed. N.J.S.A. 17:48A-1 et seq. 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").<sup>4</sup> See also

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<sup>4</sup> 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.

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, 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 nonprofit, "charitable and benevolent institution" enjoying state tax exempt status, N.J.S.A. 17:48E-41.<sup>5</sup> 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,

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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.

<sup>5</sup> 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. Similarly, in 1986, BCBS of NJ, like other Blue plans, lost its federal tax exemption under Sec. 501(c)(4) of the Internal Revenue Code. GAO Report at 3 n.5. However, the 1986 Tax Reform 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.

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, responsibility for assuming the risk for the individual, hard to insure market was spread among all health insurance carriers who operate in New Jersey.<sup>6</sup>

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. Contrary to plaintiff's argument that the

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<sup>6</sup> 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



Legislature did not mean what it said when it declared a health service corporation to be a "charitable and benevolent institution," BCBS of NJ has historically served a broad public purpose.<sup>7</sup> That public mission is consistent with BCBS of NJ's statutory mandate to operate for the benefit of its subscribers. N.J.S.A. 17:48E-3(a).

**2. BCBS of NJ was incorporated and continues to exist for charitable purposes under the common law.**

In its memorandum of law, BCBS of NJ misstates the common law in order to conclude that it never had charitable purposes by (1) distorting the nature of the beneficiary requirement; (2) employing the term "charity" in only one sense of the word, i.e., a nonprofit organization whose purpose is to aid the indigent and the poor; and (3) erroneously imposing the requirement that a charitable corporation give "gifts" and receive "contributions." Furthermore, it is quite telling that BCBS of NJ never refers to its Certificate of Incorporation, its

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certain losses. 1996 was the first year since the inception of the IHIRA that BCBS of NJ did not expect to file for reimbursable losses. Id.

<sup>7</sup> 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.

governing charter, when making its argument that it holds no charitable purposes; to do so would reveal its pretense.

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 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.<sup>8</sup>

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"

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<sup>8</sup> In 1986, the term "health" was substituted in lieu of "hospital" to reflect the merger with Blue Shield and changes in the law.

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 . . . ." These provisions have not been amended or repealed since 1986.<sup>9</sup>

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,

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<sup>9</sup> 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.

profit, or private advantage." 14 C.J.S. Charities §3 (1990).

First, 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, 137 N.J. Eq. 48, 50 (Prerog. Ct. 1945), aff'd, 137 N.J. Eq. 457 (E & A 1946). This is commonly known as the beneficiary requirement.

Contrary to plaintiff's assertion, BCBS of NJ does satisfy this prong of the common law. It has clearly been established that a trust or corporation may be charitable although the persons to receive benefits are of a defined class, if the class is not so small that the community is not interested in the enforcement of the trust. IVA Scott on Trusts at §§369.5, 373. Moreover, in such cases, as is the case of BCBS of NJ, the beneficiaries are only limited in the sense that at any one point in time they are definite; in total, over time, since the group changes, they are clearly indefinite. Id. at §375.1.

Second, a valid charitable trust or corporation must have purposes beneficial to the community.<sup>10</sup> Contrary to plaintiff's

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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.

<sup>10</sup> 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

narrow use of the word "charity" to mean relief to the poor and indigent, it "is well settled that the promotion of health is a charitable purpose." Id. at §368; RESTATEMENT (SECOND) OF TRUSTS §368(d) (1959).<sup>11</sup> 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").<sup>12</sup> In accordance with these definitions, BCBS of NJ's

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"common element the accomplishment of objectives which are beneficial to [the] community or area").

<sup>11</sup> Plaintiff's presentation of valid charitable purposes is disingenuous. In its memorandum of law, plaintiff cites to the Statute of Charitable Uses, quoted in Scott on Trusts, to support its assertion that the "fundamental attribute of English common law 'charity'--relief to the poor and indigent-- was carried into New Jersey law. . ." BCBS Mem at p. 16. What plaintiff fails to mention is that Fratcher immediately follows this quote with the following qualification:

This enumeration is now and clearly was not intended to be exhaustive. . . The tendency of the courts through the centuries that have elapsed since the enactment of the statute has been gradually to enlarge the scope of charitable purposes, with the result that the purposes enumerated in the statute include only a few of those now regarded as charitable.

Id. at §368.1. See also Miranda v. King, 11 N.J. Super. 165, 171 (App. Div. 1951) ("The list of charitable objects contained in the ancient statute is not now to be regarded as exhaustive."). Similarly, plaintiff quotes the New Jersey court in McKenzie v. Trustees of Presbytery of New Jersey, 67 N.J. Eq. 652, 665 (E & A 1905), and forgets to tell the court that this definition has also been outdated. In fact, Fratcher notes in regard to this specific definition,

The only difficulty with this definition is that it is not broad enough; it includes purposes that are undoubtedly charitable, but these are not the only purposes that are held to be charitable.

IVA Scott on Trusts at §378.1.

<sup>12</sup> 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

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.

Furthermore, "the mere fact that fees are charged does not prevent a trust from being charitable, so long as any profits that may accrue do not inure to the benefit of private individuals." IVA Scott on Trusts at §277. See also Hilliard v. Parker, 76 N.J. Eq. 447 (Ch. Div. 1909) (contribution to library considered charitable even though borrowing privileges depended upon payment of annual \$1 membership fee or payment of five cents per volume for nonmembers). In fact, a nonprofit hospital that requires payment by all its patients and does not provide free or reduced rate of service to those who are unable to pay is still considered a charitable trust for the promotion of health under common law. Id. at §372. Not one of the cases presented by plaintiff indicate otherwise.<sup>13</sup> Plaintiff's

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purpose in all American jurisdictions." Fisch, et al., Charities and Charitable Foundations 275 (1974).

<sup>13</sup> Plaintiff cites to three cases to support its conclusion that a "organization must provide at least some of its services for free to those with the inability to pay" to qualify as a charitable organization under common law. BCBS Mem. at p. 17. However, in Church Contribution Trust v. Mendham Borough, 224 N.J. Super. 643 (App. Div. 1988), the court was determining whether a mansion owned by a church trust, and used by three nonprofit tenants, qualified as "charitable" under the local property tax statute, not the common law. Similarly, in Jacobs v. North Jersey

notion that an organization must provide a "gift" and receive "contributions" from the public in order to qualify as a charitable corporation or trust is similarly flawed. First, neither the court in Mackenzie, 67 N.J. Eq. at 665, quoted on p. 18 of plaintiff's memorandum, nor the court in Hewitt v. Camden County, 7 N.J. Misc. 528, 533 (Camden County Ct. 1929), quoted on p. 19, state that an organization must provide gifts in order to be charitable. Both courts use the word "gift" to refer to the funds that create, or are the source of, the charitable trust, as in the case of a bequest or endowment. They simply do not state that a charitable trust or corporation has to provide free service or give gifts in order to be valid under common law.

In addition, plaintiff provides no evidence that an organization must solicit and receive money from members of the public in order to be found to hold charitable purposes. Certainly, plaintiff is correct in noting that many charitable corporations "undertake fund-raising activities and receive

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Blood Center, 172 N.J. Super. 159 (Law Div. 1979) the court determined that a blood center was not operated for a purpose that was specifically designated in the charitable immunity statute to be deemed charitable; again, the common law was not involved. And finally, in Greisman v. Newcomb Hospital, 76 N.J. Super. 149 (Law Div. 1962), aff'd, 40 N.J. 389 (1963), involving a complaint brought to review the legality of the hospital's refusal to consider the plaintiff for admission as a member of its curtesy medical staff, the court noted in passing that the hospital was a "public charity" "even though it receives pay patients as well as charity patients." Id. at

contributions from the public." BCBS Mem. at p.19. However, not one of the cases cited by plaintiff support the converse, i.e., that BCBS of NJ is not charitable under common law because it does not engage in such activity.<sup>14</sup> If that were the case, most foundations who do not solicit funds would not be considered charitable institutions.

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 in fact conclusive evidence that BCBS of NJ is a nonprofit corporation holding its assets for charitable purposes.

**3. BCBS of NJ's status under tax exemption laws and the charitable immunity statute does not determine whether it is a "charity" for charitable trust purposes.**

In its memorandum of law, BCBS of NJ conflates its

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157. The court did not hold, as plaintiff suggests, that the hospital had to service indigent people in order to qualify as a charitable corporation.

<sup>14</sup> Each of the cases cited by plaintiff involve the interpretation of a statute, not the common law: Parker v. St. Stephens Urban Development Corp., Inc., 243 N.J. Super. 317 (App. Div. 1990)(holding that 501(c)(3) entity did not receive private contributions so did not receive benefit of charitable immunity statute); Allen v. Summit Civic Found., 250 N.J. Super. 427 (Law Div. 1991)(same); Alfred University v. Hancock, 69 N.J. Eq. 470, 471 (Prerog. Ct. 1900)(noting



status under several tax or immunity statutes with its status as a charitable corporation. As previously noted infra. n.4, whether an organization is "exclusively charitable" for purposes of awarding tax-exempt status or immunity from tort liability does not control the determination of whether it has been invested with a public charitable trust for purposes of state law. E.g. Presbyterian Home of Synod v. Division of Tax Appeals, 55 N.J. 275, 286 n.3 (1970) (finding that nonprofit corporation's 501(c)(3) status has no relation to state law governing property tax exemption); Parker, 243 N.J. Super. at 324 (501(c)(3) status irrelevant to charitable immunity analysis).

For example, it is clear under the New Jersey Charitable Immunity Statute, N.J.S.A. 2A:53A-7 et seq., that an entity that is otherwise considered to have charitable purposes will not receive the immunity benefit unless it receives private contributions. See Parker, 243 N.J. Super. at 327 (essence of public policy behind charitable immunity is "preservation of private charitable contributions for their designated purposes."); Pelaez v. Rugby Labs, Inc., 264 N.J. Super. 450, 456 (same). Whether an organization will receive a property

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that bequests for promotion of education are exempt under estate tax statute, if "scheme is, in part, supported by public or private contributions").

tax-exemption under N.J.S.A. 54:4-3.6 depends "upon the manner in which a particular property is used to accomplish [the organization's charitable purpose]" and the "exclusiveness" of its purpose. Presbyterian Home of Synod, 55 N.J. at 283, 288. Typically, a corporation that receives more than insignificant fees for its services will not qualify for this tax-exemption. Id. at 284 n.2. See also IVA Scott on Trusts at §368 n.8 (cases involving state tax-exemption often interpret the word "charity" to be limited to relief of the poor).

BCBS of NJ's argument that it is not a "charity" for charitable trust purposes because it was tax-exempt under §501(c)(4) of the Internal Revenue Code as a "social welfare organization" rather than under §501(c)(3) also fails. As defined by the relevant treasury regulations, "social welfare" is similar to "charitable" as that term is used §501(c)(3). Treas. Reg. §1.501(c)(3)-1(d)(2) ("charitable" includes promotion of social welfare by charitable or similar activities). The two statutory provisions are "saved from complete redundancy, however, by the exclusion of "action organizations" from §501(c)(3) but not §501(c)(4)." Bittker, B. and Lokken, L., Federal Taxation of Income, Estates and Gifts, §102.1.2 (2d ed. 1991). Therefore, BCBS of NJ did not receive tax-exempt status

under §501(c)(3) because it was an action organization, not because it did not qualify as "charitable."<sup>15</sup>

In summary, even if BCBS of NJ believes that in 1997 it is best for the corporation to shed its nonprofit status and to relinquish its public obligations, it still must acknowledge that, to date, it has held its assets for charitable purposes.<sup>16</sup>

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

In its papers, BCBS of NJ asserts that its conversion to a mutual represents "a minor change." BCBS Mem. at p. 7. This "minor" change entails the conversion to a for-profit entity.

Under New Jersey law, a domestic mutual insurer is defined as a corporation .....without 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

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<sup>15</sup> See Treas. Reg. §1.501(c)(3)-1(c)(3)(defining "action" organizations as organizations who engage in such activities as attempting to influence legislation)

<sup>16</sup> 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").

mutualize. See Mutualization Plan, Exhibit A., at 3 (all members have the "right to receive any dividends that may be declared from divisible surplus").<sup>17</sup>

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). It is thus evident 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 nonprofit unless that statute explicitly permits organization under Title 15A).

The for-profit status of New Jersey Mutual after the conversion is also supported by the status of Anthem, the corporation into which BCBS of NJ intends to merge. 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.

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<sup>17</sup> 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 and will not have a meaningful voice in the management of the mutual as asserted by plaintiff. BCBS Mem. at 7.

In the past fifteen years, Anthem has established a number of for-profit subsidiaries, many of which are stock companies.<sup>18</sup> 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, and as of September 30, 1996, it owned approximately 62% of the outstanding stock of Acordia, Inc. See SEC Form 10-Q at pp. 8, 13, Steinhagen Cert., Ex. B. According to Acordia, Inc.'s SEC filing, it acts as Anthem's sales, underwriting, management and marketing, and customer service agent. This business relationship clearly underscores Anthem's for-profit status. Id. at 13.

II. BECAUSE A CHARITABLE TRUST SETTLEMENT IS REQUIRED BY LAW, THE COMMISSIONER HAS THE AUTHORITY TO REQUIRE THAT BCBS OF NJ'S MUTUALIZATION PLAN CONTEMPLATE SUCH PAYMENT AND TO REQUEST INFORMATION RELATING TO SAME.

In its Amended Complaint, plaintiff seeks that this Court, inter alia, (1) declare that its mutualization application is complete and should be approved and (2) enjoin the Commissioner from requesting further information that is allegedly not required by the 1995 Amendments. Amended Complaint, Seventh

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<sup>18</sup> 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

Count, F, G. Judicial interference in the administrative process is clearly not warranted in this case.

Pursuant to N.J.S.A. 17:48E-47(a), the Commissioner must evaluate the proposed mutualization application in accordance with three substantive criteria: legality of the plan, financial safety and soundness of the emerging mutual insurer, and equitable and nonprejudicial treatment of the health service corporations's subscribers. In order to do so, she must have the authority to request from the applicant financial data and documentation necessary to make her decision.

Because the documents submitted by BCBS of NJ in support of its application to convert indicate related corporate transactions (e.g., an intent to acquire BCBS of Delaware, and intent to merge into Anthem), the absence of an intent to make a charitable trust settlement at any time following BCBS of NJ's conversion to a for-profit entity, and other matters that bear on whether the mutualization plan should be approved, the Commissioner has the authority to request more information concerning these issues.

Furthermore, because a charitable trusts settlement is required by law, the Commissioner must require that the

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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>.

mutualization plan contemplate the payment of such settlement. In this way, the charitable trust settlement is an "obligation" and not an "exaction" as plaintiff so adamantly asserts.

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

In its memorandum, plaintiff denies that it has any charitable obligations whether under its Certificate of Incorporation or under the common law. Accordingly, it never reaches the question of whether the 1995 Amendments transfer such obligations to the mutual thus requiring the payment of a charitable settlement by New Jersey Mutual, or its successor. Defendant-intervenors answer this question affirmatively.

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.<sup>19</sup> In addition, if a nonprofit corporation attempts to merge with a 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

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<sup>19</sup> 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).

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. Most important of those



obligations is the obligation to administer the assets acquired by the new mutual for benevolent and charitable purposes. Had the New Jersey legislature intended to repeal this obligation, it certainly would have expressed such intent explicitly.<sup>20</sup>

In 1995, the Legislature expressly amended the Health Service Corporations Act and the Nonprofit Corporation Law to permit BCBS of NJ to convert to mutual without satisfying the technical requirements of dissolution and reincorporation; it did not relieve BCBS of NJ of its common law charitable trust obligations or its duty to comply with the substantive mandates of its Certificate of Incorporation.

#### **1. The Charitable Trust Doctrine Applies to BCBS of NJ.**

Ordinarily the principles and rules applicable to charitable trusts are applicable to charitable entities. 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

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<sup>20</sup> There is a strong presumption in the law against repeal by implication. Such repeal requires clear and compelling evidence of legislative intent that is missing in this case. Mahway

"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 bequested 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 that

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TP. v. Bergen County Bd. of Taxation, 98 N.J. 268 (1984).

constitutes the basis for its charitable trust obligation. 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).<sup>21</sup>

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.

See also FLETCHER CYCLOPEDIA §2:21 (noting that a nonprofit, like any corporation, cannot operate for purposes other than

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<sup>21</sup> 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

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, not just some of its assets.<sup>22</sup>

## **2. 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, 132 (Ch. Div. 1906) (cy pres invoked to effectuate donor's intent when charitable corporation failed to undertake any activities in furtherance of its

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to a for-profit corporation constituted an abandonment of the hospital's principal activity resulting in violation of charitable trust principles).

<sup>22</sup> 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.

purposes).<sup>23</sup> 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:

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<sup>23</sup> 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).<sup>24</sup> 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

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<sup>24</sup> 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").

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: 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 operate for those same purposes, established a valid charitable trust; 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;<sup>25</sup> and finally, 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.

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<sup>25</sup> 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.

For the foregoing reasons, the doctrine of cy pres applies and BCBS of NJ, or its successor, must be forced to do what other converting nonprofit health care organizations in other jurisdictions have done. It must transfer its assets to an independent nonprofit corporation dedicated to similar charitable purposes as itself. On the other hand, if this Court permits 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.

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

As noted above, N.J.S.A. 17:48E-47(b) amends the Health Service Corporations Act and the Nonprofit Corporations Law to allow BCBS of NJ to convert to a domestic mutual insurer without formally dissolving. The statute, however, does not eliminate any obligation BCBS of NJ may otherwise have under its Certificate of Incorporation.

Defendant-intervenors assert that the transfer of all of BCBS of NJ's assets to New Jersey Mutual is equivalent to the closing of its affairs and the substantive obligations imposed by its dissolution clause still exist --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 does not erase this obligation imposed by BCBS of NJ's charter, but rather transfers it to the mutual. In this way, the substantive requirements of BCBS of NJ's dissolution provision still govern 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. Indeed, that is what they are trying to do. 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).

In summary, the incorporators of BCBS of NJ 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 nonprofit 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 BCBS of NJ from meeting the substantive requirements of dissolution imposed by its Certificate of Incorporation. It is thus evident that BCBS of NJ, or its successor, is required to make a charitable settlement pursuant to the mandates of its charter.

C. 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, defendant-intervenors are disturbed 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).<sup>26</sup> 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.<sup>27</sup> The charitable purpose clause, which is required by N.J.S.A. 15A:2-8(a)(2), defines the nature of the corporation 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

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<sup>26</sup>New 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.").

<sup>27</sup>In 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).

of Loyalty and Care Associated with the Directors and Officers of Charitable Organizations, 64 VA. L. REV. 449, 460 (1978) (same).<sup>28</sup>

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. 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

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<sup>28</sup>The 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

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

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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).

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.<sup>29</sup>

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 the payment of a charitable settlement (by BCBS of NJ or its successor) 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 any charitable foundation or trust"

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<sup>29</sup>The 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.



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.

D. Because the "Primary Purpose" of the Mutualization Plan is to Merge Into Anthem, Information Related to Anthem and its Subsidiaries is Relevant.

As set forth in BCBS of NJ's Mutualization Plan, the primary purpose of the conversion to a mutual is to merge into Anthem, (Mutualization Plan, Exhibit A, at 2), at which time "the separate existence of New Jersey Mutual [will] cease." Merger Agreement, Article II, Section 2.1. For the Commissioner to adequately address whether the mutualization is prejudicial to the interests of subscribers, such as defendant-intervenors, she must therefore obtain certain information about the corporate structure and operation of Anthem. In particular, specific terms of BCBS of NJ/New Jersey Mutual's proposal to

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

merge into Anthem raise 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. Further information on these issues must be supplied before a public hearing on BCBS of NJ's application to mutualize is held.

For example, the structure and operation of Anthem raise serious questions as to the equity of the merger to New Jersey policyholders, such as defendant-intervenors. Although New Jersey policyholders will have voting rights,<sup>30</sup> they will share membership on Anthem's Board with policyholders from Indiana, Kentucky and Ohio, and most 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

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<sup>30</sup>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

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 that need to be explored by the Commissioner.

The merger agreement is also silent as to whether Anthem intends to take NJHIC or Anthem East public. Accordingly, the Commissioner cannot determine from the information submitted the ultimate owners of New Jersey assets. Again, information on this issue must be obtained by the Commissioner before she can schedule a public hearing and make a decision on the application in accordance with the criteria set forth in the conversion statute.

#### CONCLUSION

For the foregoing reasons, this Court should deny plaintiff's motion for summary judgment and declare that (1) BCBS of NJ is a charitable, nonprofit corporation; (2) the

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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.

Commissioner has the authority to require that BCBS of NJ's mutualization plan contemplate the payment of a charitable trust settlement; and (3) the Commissioner has the authority to request further information she deems necessary to complete BCBS of NJ's application.

Respectfully submitted,

Dated: March 8, 1997

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