Rutgers Center for State Health Policy

Sustaining the Charitable Mission of Horizon Blue Cross Blue Shield after Conversion to a For-Profit Corporation: Issues and Best Practices

Discussion Paper

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About This Paper

In anticipation of Horizon Blue Cross Blue Shield filing an application with New Jersey regulators to convert to a for-profit company, the Council of New Jersey Grantmakers commissioned Rutgers Center for State Health Policy (CSHP) to prepare an Issue Brief and a Discussion Paper addressing some of the salient issues for public policy consideration. The Issue Brief, *"Horizon Blue Cross Blue Shield of New Jersey: Current and Historical Role in Providing Health Insurance Coverage in New Jersey"* provides a compilation of data describing Horizon's role in providing health care coverage in New Jersey, its long-standing mission as a non-profit organization, and the regulatory milestones that have influenced Horizon's business portfolio and membership. This paper provides a discussion for consideration should Horizon initiate the conversion process. The purpose of both products is to provide New Jersey policymakers and other stakeholders with information to advance the debate on the most appropriate way to continue the charitable mission of Horizon Blue Cross Blue Shield in the event of a conversion. The intent of these papers is to bring impartial information to light to help those who will shape the conversion process rather than to present arguments for or against the conversion or for any particular disposition of charitable assets after a conversion. CSHP researchers are solely responsible for our analyses and conclusions.

Foreword

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COUNCIL OF NEW JERSEY GRANTMAKERS/*Strengthening Philanthropy in our State*

February 2003

For seventy years, Blue Cross Blue Shield has been a pioneer in providing broad access to affordable health insurance in New Jersey. Blue Cross Blue Shield of New Jersey was granted non-profit status in 1986, making it exempt from federal and state taxes. The state granted Blue Cross Blue Shield this status because of Blue Cross' mission of being the "insurer of last resort" for poor and elderly residents of New Jersey. And today, Horizon Blue Cross Blue Shield of New Jersey is the state's largest health carrier for our rural, poor and elderly.

But much is changing in the world of health insurance, and a wave of conversions across the country is transforming traditional non-profit insurers into profit-making corporations. New "conversion foundations" are being created from the assets of the non-profit corporations in order to carry on their essential charitable work. In 2001, New Jersey Governor DiFrancesco signed legislation paving the way for Blue Cross Blue Shield to convert and to create such a charitable foundation.

The Council of New Jersey Grantmakers is a membership organization of over one hundred foundations and corporate giving programs dedicated to the education of best practices in the field of philanthropy. The potential conversion of Horizon Blue Cross Blue Shield is of immediate importance to the Council and the people of our state for two reasons:

- With assets of a conversion foundation variously estimated at between $500 million and $1 billion, the independence, effective board governance, and upstanding administration of the charitable entity are vitally important. It is also important that the foundation created to manage the assets that such a conversion would follow best practices in grantmaking.

- The conversion to a for-profit corporation has huge potential consequences for poor, rural, high-risk, and elderly people. The foundation formed as the result of this conversion should also help to ensure access to quality medical care for vulnerable families consistent with Blue Cross Blue Shield's historical mission.

With these two issues before the people of New Jersey, the Council has commissioned Rutgers Center for State Health Policy to prepare a Discussion Paper entitled, *Sustaining the Charitable Mission of Horizon Blue Cross Blue Shield after Conversion to a For-Profit Corporation: Issues and Best Practices,* and a companion Issue Brief containing relevant data, to help elevate and educate the coming debate over conversion. It is our intent to foster informed dialogue and oversight for the conversion process, and our hope to welcome into the grantmaking community a conversion foundation worthy of wide respect and admiration.

Polly Seitz, President

Mark M. Murphy, Co-Chair, Public Policy

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Sustaining the Charitable Mission of Horizon Blue Cross Blue Shield after Conversion to a For-Profit Corporation: Issues and Best Practices Discussion Paper

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Executive Summary

For over 70 years Horizon Blue Cross Blue Shield (BCBS) has played a vital role providing health insurance in New Jersey. Today, Horizon is the largest provider of health benefits in the state, with its approximately 2.6 million members. As a not-for-profit health service corporation and growing out of a tradition as New Jersey's insurer of last resort for those unable to obtain coverage from other carriers, Horizon plays a large role in programs that traditionally serve vulnerable populations. Although state policy reforms in the early 1990s effectively ended Horizon's role as the only plan required to insure all applicants, it remains very active in programs and markets serving New Jersey's most vulnerable groups. Today, Horizon provides coverage to 60 percent of Medicare beneficiaries who elect to join an HMO, 40 percent of coverage under state programs for low income residents (NJ FamilyCare and Medicaid), and 60 percent of coverage in the individual health coverage program (IHCP) which serves people without access to employer-sponsored coverage.

When Horizon raised the idea of becoming a for-profit organization, initially in 1996 and again in 2001, two concerns surfaced. First, without a committed, not-for-profit health coverage carrier, questions were raised about future accessibility of affordable health coverage in New Jersey. Second, since the BCBS plan that became Horizon was chartered as a non-profit entity, questions were raised about the value of its charitable assets and what would be done with those assets after a conversion. If Horizon moves forward with for-profit conversion plans, a step it has not yet formally taken, it would follow in the footsteps of the sixteen other BCBS plans around the country that, by 2002 had already converted to for-profit status.

A Horizon for-profit conversion would be guided by a 2001 New Jersey statute that includes provisions governing analysis of premium rates and health impact following a conversion, valuation of non-profit assets, the establishment of a health care foundation, and other considerations. This Discussion Paper and a companion Issue Brief, prepared at the request of the Council of New Jersey Grantmakers, review the historical and current role of Horizon Blue Cross

Blue Shield of New Jersey, and discuss the implications of a possible conversion of Horizon to a for-profit company. In this paper, the provisions of the New Jersey conversion law are critically examined and lessons are drawn from the experiences of other for-profit conversions of health care organizations. The 2001 New Jersey conversion statute goes a long way to avoid the pitfalls of previous BCBS conversions. The New Jersey law provides clear guidance for the disposition of the charitable assets and the establishment of a successor health care foundation. However, in other areas the law leaves considerable discretion to state regulators or elected officials, including the methods by which Horizon's assets are to be valued, whether and how a health impact study will be conducted, and how a conversion foundation will be governed.

Despite much strength in New Jersey's conversion statute, a Horizon conversion warrants continued close scrutiny. Prior BCBS conversions offer few clues about whether a for-profit Horizon BCBS that is accountable to shareholders will be able to sustain its commitment to providing affordable coverage to vulnerable populations. As well, the danger that Horizon's charitable assets following a conversion will not be dedicated to continuing the organization's non-profit mission effectively is heightened as policymakers grapple with the unprecedented budget shortfalls facing the state. Finally, assuring accountability of a Horizon conversion foundation may be difficult in light of the current statutory provisions guiding the appointment of foundation board members, which leaves room for politicization of the foundation agenda. How health care in New Jersey fares following a Horizon BCBS for-profit conversion depends on many decisions and details that will unfold in the early months following the formal initiation of the conversion process.

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Introduction

Since the mid-1990's there has been a rapid increase in the number of non-profit health care organizations converting to for-profit status. A changing health care marketplace has provided an impetus for non-profit hospitals and health plans to find access to new forms of capital, develop more efficient business practices, and increase market share. Non-profit organizations may also see advantages in becoming for-profit to reduce the regulatory constraints they face or to increase compensation for their executive management teams. Recently, the number of health plan conversions is growing relative to those of other health care entities, including hospitals.[1]

The National Blue Cross Blue Shield (BCBS) Association decided in June of 1994 that for-profit firms could affiliate with the organization, spurring a rush of conversions among BCBS plans, all of which had previously been non-profit. Horizon Blue Cross Blue Shield of New Jersey is exploring the option of converting, though as of February 2003 Horizon had yet to file the required application with the New Jersey Department of Banking and Insurance and has not indicated imminent intention to do so. Nevertheless, it is important to identify and study the issues and understand the potential ramifications of such a conversion.

The purpose of this Discussion Paper is to inform a broad group of New Jersey policymakers and stakeholders about the issues surrounding a possible for-profit conversion of Horizon Blue Cross Blue Shield. The following examines recent conversion activity in other states and frames a possible Horizon conversion in the context of a 2001 New Jersey statute regulating health service corporation conversions. We draw upon published literature for background about these issues, and where possible draw lessons for "best practices" for conversion regulation, community involvement, and the design and operation of a health care foundation resulting from a conversion. Should a Horizon conversion proceed, we expect that a clear understanding of underlying issues and potential best practices, particularly as they relate to valuation and disposition of assets and the formation of a charitable foundation, will be of great value to decision makers.

After an overview of for-profit conversions of not-for-profit health care organizations, we provide a description of the New Jersey law that will govern the conversion of Horizon BCBS and discuss pre-conversion and post-conversion considerations. Pre-conversion issues discussed include

assessing the potential health impact of the conversion, placing a monetary value on the charitable assets of the pre-conversion entity, and notifying and seeking input from the public regarding the conversion. The post-conversion issues includedetermining the appropriate disposition of charitable assets, creating and operating a new charitable foundation, and determining the mission and assuring the accountability of a new foundation.

Conversions of Non-Profit Health Care Organizations

When non-profit health care entities begin the for-profit conversion process, regulators and consumer advocates often express concern about the potential loss of community benefits and disruption to the organization's original non-profit mission. Non-profit organizations have historically been given preferential tax treatment in exchange for providing benefits to the community that commercial businesses would not typically offer. Furthermore, the stated mission of most not-for-profit health care groups includes serving the health care needs of the local community, which often includes the provision of charity care. The types of community benefits provided by non-profit health care organizations can include, but often extend beyond, indigent care and services to vulnerable populations. Non-profit hospitals may establish outreach clinics in local "at risk" areas, organize community health education and wellness programs, or support other public health initiatives.

The community benefits that health plans provide can be more difficult to measure than those provided by hospitals, but they may include enrollment of members whom other companies would refuse to cover, or maintenance of affordable premiums that attract subscribers with chronic health problems through community rating and related pricing practices. Blue Cross Blue Shield plans have traditionally had such a community service orientation, however, they are no longer the "insurer of last resort" in most states; and after enactment of Section 501 (m) of the Internal Revenue Code (P.L. 99-514) in 1986, they no longer receive full tax exemption from the federal government. Nonetheless, BCBS plans do continue to hold large market shares in products traditionally viewed as providing coverage to vulnerable populations, including the managed Medicare and non-group coverage markets and are still seen by many consumers as providing a unique public benefit.[2]

The research literature provides evidence that community benefits can be lost when a not-for-profit hospital changes status, but research has not established the impact on at-risk populations when health plans convert. Several studies show that for-profit hospitals are less likely to provide charity care, maintain unprofitable services including emergency rooms and intensive care units, or keep prices lower than competitors.[3] To date, research has not documented the loss of community benefits in for-profit health plan conversions. However, by employing a broader definition of community benefits, for example, by including contracting with essential community

providers, involvement in research and education, and participation in Medicare and Medicaid programs, some argue it is possible to assess the community impact of a for-profit health plan conversion. [4]

Our review of the literature revealed that many observers of conversion activity assume that such an organizational change will result in some loss to the community (e.g., increased premiums, or reduced choice of carriers in public programs) though it is possible that conversions can also have positive impacts and lead to some advantages for consumers. For example, if conversion results in a more financially sound and profitable corporation, the organization may have the resources to dedicate additional funds to health improvement initiatives or more effective cost control strategies. In addition, the creation of a health care foundation from the proceeds of the conversion transaction (discussed in the following section) may result in a more effective mechanism to channel funds to meet community health needs. Finally, the new tax revenues a for-profit entity generates could be used for expanded or enhanced community health care services.

Most Converting BCBS Plans Led to the Establishment of a New Charitable Foundation

The legal "charitable trust" doctrine states that a corporation formed with a charitable mission must always use its assets and income for charitable purposes. Since financial contributions from governments and private citizens are given to non-profit agencies for the sole purpose of supporting public needs, there can be no private financial benefit to any individuals involved in a for-profit conversion. Upon conversion and in order not to violate the intent of the charitable contributions, non-profit entities must create a mechanism to carry out, as closely as possible, the original charity's mission. This is referred to as the doctrine of approximation or "*Cy Pres*". The most common way of meeting this obligation is for the converting organization to use valued assets to create a new charitable foundation that will continue to promote the original goals of the non-profit. Alternatively, assets from conversion may be given to existing charities with consonant missions or to a supporting organization which is "organized exclusively to support one or more public charities."[5]

Among Blue Cross Blue Shield plans that have already converted to for-profit status, the majority have established new foundations, however, their formation has often taken place under politicized and litigious circumstances, a scenario that may play out in New Jersey. It is challenging to draw conclusions from the outcomes of previous BCBS conversions because the laws governing non-profit health care corporation conversions and the disposition of charitable assets vary widely among states. In order to contextualize the discussion of Horizon's case, the remainder of this brief summarizes important pre- and post-conversion issues, including the creation of a foundation, within the framework of requirements in New Jersey's legislation. We use examples from BCBS conversions in other states to highlight issues and practices that may be relevant for New Jersey.

Looking Forward to the Critical Issues in the Conversion of Horizon Blue Cross Blue Shield

This section offers background on Horizon Blue Cross Blue Shield, with an emphasis on its charitable mission, its organizational structure and provides an overview of the New Jersey statute that governs health service organization conversions. See page 5 for a summary of Horizon's organizational milestones.

In December 2001, the Board of Directors of Horizon Blue Cross Blue Shield of New Jersey announced that the management at the non-profit company would begin exploring the process for converting to a for-profit corporation. To date, Horizon has not submitted an application to the Commissioner of the Department of Banking and Insurance, the initial step in the process as required by New Jersey's conversion statute. After a period of inactivity Horizon made a public statement in early December 2002 indicating that the company has no immediate plans to convert to for-profit status, in part due to the unfavorable economic climate in which to launch an initial public offering (IPO).

Nonetheless, consumer advocates have begun to mobilize and focus on the potential conversion and have organized educational and lobbying coalitions to assure community involvement in the conversion process. For example, in the summer of 2002, advocates met with Governor James McGreevey's staff to present the community's principal concerns regarding the prospect of a change in Horizon's status.[6]

New Jersey's Conversion Statute Addresses Critical Issues But Leaves Some Questions Unanswered

In May 2001, acting New Jersey Governor Donald DiFrancesco conditionally vetoed proposed conversion legislation that would impact health services corporations, which are organized "without capital stock and not for profit, for the purpose of (1) establishing, maintaining and operating a nonprofit health service plan and (2) supplying services in connection with (a) the providing of health care or (b) conducting the business of insurance as provided for in this act."[7] Governor DiFrancesco requested that language be added to the bill establishing a Health Services Corporation Conversion Temporary Advisory Commission, within the New Jersey Department of the Treasury. The following month, in June 2001, the bill was amended to include the authorization for the advisory commission and Governor DiFrancesco signed the legislation. Under New Jersey statute 17- 48E-49 *et seq*, this advisory commission was established and by law consists of fifteen members; seven of whom are appointed by the Governor, three by the Senate President, one by the Senate Minority Leader, three by the Speaker of the Assembly and one by the Minority Leader of the Assembly. According to the statute, after conversion and upon the establishment of the health care

foundation, the members of the advisory commission would constitute the board of the foundation and begin new three-year appointments as board members. The same rules of composition would apply for the reappointment of the board members.

Horizon Through the Years

1930's —Blue Cross was born out of the Association of Hospitals of Essex County

1942 -- Medical Surgical Plan of New Jersey (Blue Shield) formed to provide coverage for non-hospital costs

1986 —Two plans formally merged and become a health service corporation under the name Blue Cross Blue Shield of New Jersey (BCBSNJ), NJ's "insurer of last resort". Created first HMO under the health services organization, designed as a wholly owned for-profit subsidiary of the parent company

1993—Medigroup Services, Inc., directly owned by Blue Cross Blue Shield of New Jersey, partnered with Mercy Health Plan of PA in a joint venture to administer coverage to Blue Cross Blue Shield's HMO Medicaid membership

1996—Blue Cross Blue Shield announced plans to become a mutual company preparing for merger with Anthem Insurance Company, Inc. an Indiana-based managed care giant. Anthem walks away from the deal after a dispute over the disposition of valued assets

1998— Blue Cross Blue Shield of New Jersey changes its corporate name and becomes Horizon Healthcare of New Jersey (d/b/a Horizon HMO). Mercy Health Plan becomes Horizon Mercy
Health Plan

2001— Horizon Blue Cross Blue Shield's Board of Directors authorizes exploration of for-profit conversion

2002— Horizon Blue Cross Blue Shield has an estimated 2.6 million members, including approximately 500,000 in Horizon HMO

2003—Horizon acquires Mercy Health Plan's interest in Horizon Mercy, resulting in Horizon's full ownership (through its subsidiaries) of this Medicaid plan

A bill, A 1873, introduced by Assemblymen Caraballo (D- Essex and Union) and Roberts (D-Camden and Gloucester) in February 2002 would abolish the advisory commission and require the new appointment of a foundation Board of Directors.[8] The foundation board would be selected in the same manner as the members of the advisory commission. If this bill passes, the current advisory

commission members would not become board members, rather an entirely new board would be chosen by current state officeholders. This bill has been assigned to the Senate Commerce Committee since October 2002 with no additional action taken.

In addition to requiring the creation of the advisory commission, the current statute governing the conversion of any health services corporation in New Jersey explicitly outlines the required process for filing an application for state permission to convert, valuing the corporate assets, conducting public hearings, and establishing a charitable foundation.[9] The starting point for this legislation was the "Model Act for Nonprofit Healthcare Conversion Transactions," prepared by the National Association of Attorneys General. The requirements of the New Jersey law are discussed in the sections that follow.

Pre-Conversion Activities

Development of a Health Impact Study

As discussed above, one of the primary concerns of health advocacy groups and regulators regarding conversions is the impact a change in company status could have on the health coverage of populations served by the converting organization. The governing statue in New Jersey requires that before a non-profit health care organization may convert to for-profit status, it must file a formal application for conversion with the Commissioner of the Department of Banking and Insurance and the State Attorney General. While submission of a health impact study is not required as part of the application, submission of a premium rate analysis is. This analysis must include premium rates for the three years prior to the filing of the conversion application and projected premium rates for the three years following a conversion. Such analysis is intended to help regulators determine if coverage will become unaffordable for existing or future plan members.

The New Jersey statute also permits the Commissioner to request any additional information from the converting company that he or she deems necessary to determine if "the plan promotes the public interest." Though not a mandatory part of the application process, the Commissioner does have the discretion to request a formal study to assess the projected community health impact and subsequently determine if indeed the public interest is being met. If such additional documentation is requested, the converting entity is responsible for the cost of the independent studies.

As in New Jersey, the majority of other states with conversion legislation, while not mandating a formal health impact study, require regulators to assess if the conversion is in the best interest of the public and consider its community health effects.[10] For example, California and Oregon statutes simply call for a determination to be made on whether the conversion will

significantly impair access to affordable health care in the community. The Arizona conversion law requires converting entities to develop a comprehensive report, which they are required to submit at the public hearing, that details the impact on the access, cost and availability to health care. Still other states, including Hawaii and Rhode Island, have required the new for-profit company to engage in a minimum level of charity care.[11]

Whether a health impact assessment requires a formal independent study, has varied depending on the circumstances of the conversion. In most cases, health impact studies have not been used to block BCBS conversions, although recently the Kansas Insurance Commissioner blocked a conversion in that state based, in part, on the results of an independent impact study. See summary of Kansas case below.

Kansas Insurance Commissioner, Citing Negative Impact, Halted that State's Blue Cross Blue Shield For-Profit Conversion

Based in part on the results of an independent health impact evaluation which concluded that over a five year period premiums in the individual and small group market could increase as much as $248 million, potentially forcing members to drop coverage, Commissioner Kathleen Sebelius of the Kansas Department of Insurance blocked the sale of Blue Cross Blue Shield of Kansas to Anthem Insurance Company of Indiana. Commissioner Sebelius determined that the for-profit acquisition was "hazardous and prejudicial to the insurance buying public."[12] While this matter is currently under review in the Kansas Supreme Court, the Kansas example demonstrates the potential importance of regulators' review of health impact findings. It should be noted that Commissioner Sebelius successfully ran for governor in November 2002 and will take office in January 2003.

In New Jersey, Horizon plays significant roles in products offered to populations that may be considered vulnerable by regulators: the elderly, low-income populations and individuals without access to employer group coverage. For example, Horizon HMO covers 60 percent of Medicare + Choice members in New Jersey, just over 40 percent of the statewide NJ FamilyCare and Medicaid managed membership, and 60 percent of membership in the Individual Health Coverage Program. The potential impact of a Horizon for-profit conversion is unclear, as much of this coverage is offered through Horizon Healthcare and Horizon Mercy, for-profit subsidiaries of the non-profit Horizon Blue Cross Blue Shield corporation. Horizon's commitments to coverage of public program beneficiaries

has continued to grow even as it has prepared to convert. The compelling question is whether after conversion Horizon would continue to pursue the activities now conducted by its for-profit subsidiaries.

Valuation of Assets

One of the most complicated and often contentious phases in the conversion process is determining the value of a non-profit's assets. The proper valuation of a non-profit organization's worth will ensure that charitable assets are preserved and used in fulfillment of the converting entity's charitable mission.

Since non-profit organizations benefit from tax exempt status, by law, the money accrued as a result of this charitable treatment must always be used in service to the community.

In some of the earliest conversions of health care organizations, the assets of the non-profits were either seriously undervalued or a fair market valuation of assets did not occur. For example, in 1985 Group Health of Greater St. Louis, a health insurer, was valued at 33 cents a share at the time of its purchase. When a quarter of the stock was sold by the new for-profit a year later, it sold for $14.28 a share.[13] Therefore, the value generated from the company's assets ultimately did not benefit the public but rather the for-profit entity and its individual stockholders twelve months later.

In the 1996 transition of Trigon Blue Cross Blue Shield of Virginia from a mutual insurance company to a for-profit, no formal valuation of assets took place. The Virginia State Corporations Commission accepted Trigon's contention that as a mutual company it did not hold any charitable assets and therefore the valuation was not required. The Virginia Attorney General assumed some jurisdictional oversight and while not mandating the creation of a health care foundation, he did require Trigon to distribute $175 million to the state and a small amount of stock was subsequently issued to policy holders. Although the $175 million transferred to the state likely had a positive budget impact, the benefit to the community was likely short-term.

Subsequent to these examples, increased attention has been paid to health care organization conversions and some states, including New Jersey, have enacted legislation governing asset valuation. This attention makes it less likely that a transaction could move forward without valuation occurring or that an egregious under-valuation will result. These earlier transactions highlighted some of the loopholes in the valuation process and while under-valuation now seems less likely, the valuation process is intricate and valuation methods vary widely. The most appropriate valuation method to use is often the subject of debate among involved parties. A health institution's "value" does not only include tangible assets but also, "its provider contracts, name recognition, subscriber lists, trademark, and goodwill."[14] This is a particularly critical point since marketing

studies have revealed that the Blue Cross Blue Shield symbols are two of the most widely recognized corporate trademarks in the country.

There are three generally accepted accounting methods of asset valuation: Comparative Market Transactions, Reproduction/Replacement Cost, and Income/Discounted Cash Flow. None of these models independently address the entire portfolio of "assets" that a health insurer might hold. For example, while the Income/Discounted Cash-flow model (used frequently by non-profit health care entities) examines the net cash flow of a health plan, it does not capture the more qualitative components of the business, such as the value of brand recognition. Therefore, it may take some combination of all three methods to exhaustively inventory a heath insurer's assets. See the box below for a brief description of each approach.

Standard Accounting Methodologies for Valuing Assets

Comparative Market Transaction—Estimates worth in comparison to the asset value of comparable companies.

Reproduction/Replacement Cost—Price of replacing all assets, minus the depreciation costs
and liabilities.

Income/Discounted Cash Flow Approach—Deriving a cash flow analysis from the operating entity's characteristics; discounted cash flow involves future projections with discounts made to the present value.[15]

New Jersey's conversion statute requires that experts who are independent of the converting health services corporation determine the value of the company. While the statute does not prescribe a particular valuation method nor list specific elements that should be considered in determining value, the appraisal must include an account of each corporate component considered in the valuation method and a justification for the methodology used. The health care organization is responsible for finding independent experts to conduct the valuation and for compensating the consultants for their services, though the organization may not disburse any other form of payment to the appraiser. Because of the complicated financial issues involved in valuation, regulators often consult with experts, investment bankers for instance, to determine if the valuation process has resulted in a fair financial deal. The pending conversion in Maryland illustrates both the intricacies of the valuation process and the impact of an insurance commissioner who chooses to exercise the authority with which he has been vested. See the box on page 10 for an overview of the pending Maryland conversion.

New Jersey's statute does not explicitly call for a separate financial "fairness opinion," though the Commissioner of Banking and Insurance is given the discretion to request any information deemed critical to the decision-making process. This can be an important step in evaluating whether the full market value of a non-profit health care organization will be preserved for charitable use. Overall, possibly the most important language in the statute regarding fairness is that the appraisers have no stake in the conversion itself, are not affiliated with the original non-profit entity, its future for-profit counterpart or political constituents, and can render an objective evaluation of the converting organization's true market value. Once the valuation process has been completed to the satisfaction of regulators, the approval process can move forward. If the Commissioner approves the conversion, the converting company can then hold an initial public offering (IPO) of company stock.

CareFirst Blue Cross Blue Shield of Maryland—A Model for Regulatory Oversight

In seeking to purchase the non-profit CareFirst Blue Cross Blue Shield plan in Maryland, WellPoint Health Networks, Inc., the large for-profit California-based managed care company, negotiated a purchase price in excess of $1.3 billion. In an effort to validate the price of the sale, the Maryland Insurance Administration retained the counsel of The Blackstone Group, L.P. , a New York-based financial advisory group. In August 2002, Blackstone released a preliminary report to Maryland Insurance Commissioner Steven Larsen that detailed its analysis that drew from four distinct methods to comprehensively value CareFirst's assets. Blackstone's valuations ranged from $1.35 billion to $2.25 billion, depending on the accounting method it employed.[16]

The range in the valuation estimates has clouded the picture in Maryland and while the CareFirst conversion is still pending, recent developments signal the Commissioner's active oversight role throughout all phases of the process. In November 2002, a report authorized by Maryland's Insurance Commissioner harshly criticized the bonus structure and large severance packages that would be offered to the CareFirst executive team should they leave the company after the WellPoint sale. The report concluded that CareFirst would distribute nearly $78 million in severance payments to its top ten executives. Such swollen compensation packages are likely to continue to draw attention and community ire. In early December 2002, Commissioner rejected CareFirst's proposed 20% premium increase and reduced the amount to 8%, claiming the increase was "excessive" and would have a particularly adverse impact on individual and small employer group members.[17] Such proposed increases now raise the question of the premium level that might be sought, post-conversion.

Public Notice and Hearings— Engaging the Voice of the Community

Since the conversion of a health plan may affect the access, availability, and affordability of health care for the general public, most experts and consumer advocates agree there needs to be a substantial role for public participation in the process. The New Jersey statute calls for a public hearing within 90 days of the date the Commissioner deems the conversion application complete. The converting health care organization must notify the public of the hearing at least 45 days in advance and the time and place of the hearing must be published in at least two New Jersey newspapers on two separate occasions. All conversion-related documents are considered public in New Jersey, except for those already deemed confidential by law and any other information the Commissioner and Attorney General judge would be harmful to the converting corporation or the public if released. In addition, all of these public documents must be made freely available at least 30 days before a public hearing date.

The New Jersey statue states, "The purpose of the hearing shall be to receive comments and information for the purpose of aiding the Commissioner in making a decision whether to approve the plan of conversion."[18] With its 45-day required notice and liberal public document definition, the statute appears to create the opportunity for the public's interest to be meaningfully considered in this process. However, the statutory hearing process does not provide the opportunity for members of the public to question regulators or representatives of the converting entity. Moreover, it does not specifically outline the ways in which public opinion is to be considered within the parameters of the Commissioner's decision-making, and there is no mandate for a regulatory response to the public comments made at the hearing. So while the Commissioner must produce a written report detailing the reasons for approving or rejecting the conversion plan, this report may not necessarily explicitly address the concerns that were articulated in the public hearing. This is arguably a shortcoming of the legislation. Ultimately, the extent to which public concerns are considered in the review process is a function of the discretion exercised by state regulators.

Post-Conversion Activities

The Distribution of Charitable Assets to a Healthcare Foundation

The New Jersey conversion statue requires that a converting corporation submit a plan for creating a foundation to the Attorney General at the same time as submission of the conversion plan to the Commissioner of the New Jersey Department of Banking and Insurance. The foundation plan must describe a strategy for distribution of the health services corporation's fair market value of assets to one or more charitable foundations. An acceptable foundation plan must satisfy the requirement that, "any proceeds of the conversion will be used solely for the purposes of expanding

access to affordable, quality health care for underserved individuals and promoting fundamental improvements in the health status of New Jersyans".[19] A public hearing specifically on the foundation plan must be held no later than 90 days after the date the Attorney General determines the petition for review of a foundation plan is complete, with the requirements for public notification identical to those for the conversion hearing.

In New Jersey, according to the existing statute, converting non-profits must direct their assets to at least one new foundation. However, there have been media reports suggesting that upon conversion, at least some of the valued assets (estimated by some to be close to $1 billion) would be used by the State to offset the ballooning deficit, projected to be close to $5 billion in fiscal year 2003.[20] It is likely that such disposition of assets would require either amendment to the existing conversion legislation since it clearly calls for the assets to be used to create a new foundation, or the enactment of a new statute. Without legislation, it is possible that a new foundation could award grant funds to pay the costs of sustaining or expanding coverage under New Jersey's public coverage initiatives. Some advocates have suggested that this would be an appropriate use of charitable proceeds from a Horizon conversion, so long as the assets are preserved for future generations as well.[21] Since the submission of Horizon's conversion application does not appear to be imminent, it seems highly unlikely that the State will seek to capture assets to cover the projected 2004 budget deficit. Nevertheless, the appropriate distribution of assets is an important area for public discussion in the event the Horizon conversion application is filed.

With regard to the conversion of assets, New Jersey's statute is more restrictive than those in many other states. State rules vary from requiring only that control of the assets be transferred to an independent organization to specifically mandating, as in New Jersey's case, that the entire fair market value of a non-profit be transferred to a charitable foundation. The most common outcome of previous Blue Cross Blue Shield conversions has been the creation of a new foundation whose grantmaking goals are consistent with the mission of the converting entity, that is, to positively impact the health and health care needs of the community it serves. See the chart on the following page for a list and description of all previous BCBS conversion transactions, through November 2002.

While the establishment of a new health care foundation is the most frequent result of for-profit conversions, there are exceptions. For example, when BCBS of Illinois (a mutual insurance company) and BCBS of Texas (a non-profit health services corporation) merged in 1998, assets were given to the "Texas Healthy Kids Corporation,"[22] a non-profit, public/private partnership whose chief mission is to provide preventive and primary care benefits to the estimated 1.3 million uninsured children in Texas.[23] There has also been at least one BCBS case where assets were not endowed to a foundation. As discussed earlier, no foundation was created in the 1996 Trigon Blue Cross Blue Shield of Virginia conversion from a mutual insurance company to a for-profit corporation. In this case, the Virginia Attorney General required Trigon to distribute $175 million to the State and a small

amount of stock to policy holders after the Virginia State Corporations Commission accepted Trigon's claim that their standing as a mutual company, not a non-profit, precluded the holding of charitable assets. As a result of this decision, no foundation was created after the conversion.

Finally, the recent for-profit conversion of WellChoice Inc. in New York, which does business as Empire Blue Cross Blue Shield and has the state's largest health insurance membership, created considerable controversy throughout many phases of the process, including the valuation of the assets and perhaps more contentiously, the manner in which the $1.1 billion in funds were be distributed. See the box below for a description of the Empire conversion transaction.

Once a new foundation is created, foundation managers and regulators face a number of critical issues to assure that the charitable purpose of the converting health care organization is effectively continued. Foremost among these issues are establishment of a board of trustees, creation of the foundation mission, and provisions for ongoing accountability of the foundation.

Politics and Policy: Controversy over the Empire Blue Cross Blue Shield Conversion

Proceeds from the conversion of WellChoice (Empire BCBS) are currently being held in escrow as a result of a temporary restraining order issued in response to a lawsuit by Consumers Union of U.S., Inc., et al. New York regulators allocated 95% of WellChoice IPO shares to the New York State Public Asset Fund that will be used to fund hospital labor contracts. The enabling legislation was passed in January 2002, literally under the cloak of darkness and after Governor George Pataki and Dennis Rivera, President of 1199, the powerful New York Hospital Workers' Union, negotiated a deal involving the disbursement of the assets. The Consumers Union suit contends that this arrangement is unconstitutional.[24] While not successful in completely halting the conversion, the Consumers Union lawsuit has effectively prevented the release of the assets and has illustrated the significant impact activist groups can have on the conversion process.

BCBS Conversion Transactions and Outcomes*

Plan Name	Year of Conversion, Merger, or Filing of Conversion Application	Nature of Transaction	Outcome of Transaction
Blue Cross of California	1996	For-profit conversion (named WellPoint)**	2 foundations endowed
BCBS of Colorado	1999; 2001	Acquisition by Anthem**; for-profit conversion	1 foundation endowed from acquisition
BCBS of Connecticut	1999; 2001	Merger with Anthem; for-profit conversion	1 foundation endowed from merger
BCBS of Delaware	2000; 2002	Affiliation with CareFirst**; merger with Wellpoint	Merger pending
Group Hospitalization and Medical Services, Inc. (D.C.)	1998; 2002	Merger with Maryland BCBS; merger with Wellpoint	Merger pending
BCBS of Georgia	2001	Acquisition by WellPoint	1 foundation endowed
BCBS of Illinois and BCBS of Texas	1998	Merger between the 2 plans	Assets transferred to an existing nonprofit organization
BCBS of Indiana	1996; 2001	Transition to a mutual insurance company named “Anthem Insurance Companies”; for-profit conversion	No foundation endowed

* Table information is as of 11/30/02 and is gathered from Community Catalyst Blue Cross Blue Shield Update and other sources; see Bibliography

**In this table WellPoint refers to Wellpoint Health Networks, Inc.; Anthem refers to Anthem Insurance Companies, Inc.; CareFirst refers to CareFirst, Inc.

BCBS Conversion Transactions and Outcomes *Continued*

BCBS of Kansas	2002	Acquisition by Anthem	Acquisition denied by Insurance Commissioner, lawsuits pending
BCBS of Kentucky	1999; 2001	Merger with Anthem; for-profit conversion	1 foundation endowed from merger
BCBS of Maine	2000; 2001	Acquisition by Anthem; for–profit conversion	1 foundation endowed from acquisition
BCBS of Maryland (CareFirst)	2002	Merger with WellPoint	Pending
BCBS of Missouri	2000; 2001	Restructuring of company; acquisition by WellPoint	1 foundation endowed
BCBS of Nevada	1996; 2001	Merger with BCBS of Colorado (later acquired by Anthem); for-profit conversion	1 foundation endowed from merger
BCBS of New Hampshire	1999	Acquisition by Anthem	1 foundation endowed
BCBS of New Mexico	2001	Acquisition by Health Care Service Corporation	1 foundation endowed
Empire BCBS (New York)	2002	For-profit conversion	95% of assets to go to the state, 5% to endow a foundation; lawsuits pending
BCBS of North Carolina	2002	For-profit conversion	Pending
BCBS Mutual of Ohio	1997	Lost BCBS license	Court decreed charitable assets must be preserved if new company converts

BCBS Conversion Transactions and Outcomes *Continued*

Plan Name	Year of Conversion, Merger, or Filing of Conversion Application	Nature of Transaction	Outcome of Transaction
Community Mutual Insurance (2nd BCBS plan in Ohio)	1999; 2001	Merger with Anthem; for-profit conversion	1 foundation endowed from merger
La Cruz Azul de Puerto Rico	1998	For-profit conversion	No foundation endowed
Blue Cross of Western Iowa and S. Dakota and South Dakota Blue Shield	1996	Merger of the 2 plans creating a for-profit company	No foundation endowed
Trigon BCBS of Virginia	1996	For-profit conversion	$175 million went to state, small distribution of stock to policyholders
BCBS United of Wisconsin	2000	For-profit conversion	Assets given to 2 medical schools

Establishing a Skilled and Independent Foundation Board

The purpose of creating a foundation from the conversion of a non-profit health care organization is to preserve the accumulated charitable assets and maintain the commitment to serving public health care needs. The configuration of the board of directors is a very important step that will influence the foundation's mission, grantmaking focus, and potentially aspects of the affected communities' health care services. The board will make executive decisions that can foster or hinder the attempt to carry out the charitable purpose of the original non-profit organization. The composition of the board will also influence the foundation's relationship with the new for-profit organization.

In addition to requiring that a new foundation be dedicated to expansion and improvement of health care for state residents, the New Jersey conversion statute specifies who should govern the organization and how they will be appointed. As discussed earlier, the legislation calls for a fifteen member board of directors who hold three year terms and are appointed by the Governor, the President of the Senate, the Minority Leader of the Senate, the Speaker of the General Assembly, and the Minority Leader of the General Assembly. The board must include members of specific health care and community groups, including physicians, hospitals, and community based organizations, as well as members of the public.

In an effort to maintain impartiality, according to the statute, all of these board members must be "independent of any influence or control by the converted insurer" or any of its affiliates and cannot have been employed by the converting organization in the preceding three years.[25] An independent board can protect the foundation from being beholden to financial or political influences that may interfere with its charitable mission. The foundation plan must also explain how conflict of interest between the foundation's activities and the fortune of the new for-profit will be avoided.

Few other states have legislation that specifically outlines the board appointment process. Therefore, health care foundation boards across the states have very different compositions and varying degrees of independence from other parties involved in the conversion transaction. For example, a Grantmakers in Health study of new health foundations found that 45 percent of 101 foundations (created primarily from the conversion of hospitals) had boards that were made up entirely of former board members of the original non-profit entity, while the remaining foundations had boards appointed or elected by various groups.[26] The New Jersey legislation aims to create an independent and diverse board of directors, yet some consumer groups are concerned that a board that is completely based on political appointment could result in handpicked, partisan representation.[27] Some fear that the loyalties of board members may influence the composition of the executive staff they choose to run the day-to-day operation of the foundation. In order for the new

foundation to quickly begin issuing grants, both the initial board and staff must have appropriate professional skills and grantmaking expertise. The New Jersey statute does not address the skills board members should have, nor does it require that members have a record of commitment to public health improvement. Without these specifications, watchdog groups point out, there is a danger that members may be chosen for political or personal reasons and lack specific grantmaking knowledge or philanthropic interest in community health care. [28]

Insulating the board of a Horizon conversion foundation from politics while sustaining its independence from the converting entity is a difficult challenge. The creation of the California Endowment, following the conversion of a California BSBS plan may have struck the appropriate balance in its board formation. The Endowment board selection process sought to maintain public transparency and arms-length involvement of regulators. The box below provides the highlights of the California Endowment Board's process.

The Creation of the California Endowment Board—Valuing Diversity and Maintaining Autonomy

The California Endowment, created from the conversion of Blue Cross of California to a for-profit corporation in 1996, provides an example of an open board selection process. With the goal of constructing an ethnically and occupationally diverse board, search firms conducted outreach across the state to locate qualified and interested board candidates. A Search Advisory Group comprised of representatives of the business and health care community screened and selected the board members from the pool of candidates, and the California Department of Corporations approved the final list. This extensive, open process resulted in a board that reflects the population it serves and that brings diverse skills and expertise to the grantmaking endeavor.

Setting Priorities and Articulating a Mission

The majority of non-profit organizations are guided by a mission statement that articulates the goals and grantmaking priorities of the establishment. Beyond stating that a new health care foundation must be a charitable entity dedicated to improvement in state residents' health care, the New Jersey statute does not explicitly define how the mission of a foundation should be determined. In order to meet the obligations of the *cy pres* doctrine, however, a foundation's mission should be as consistent as possible with the original purpose of the former non-profit. At the same time, the mission should be responsive to the current health care needs of the community the foundation is serving and flexible enough to accommodate future needs.

The missions and grantmaking priorities of new health foundations have recently come under scrutiny as some have taken an expansive definition of health or even funded non-health related projects. The Jackson Foundation in Tennessee, which was created from a hospital conversion, focuses its grantmaking on "education, arts, and technology training," for example. [29] Yet overall, the majority of conversion foundations has maintained a focus on health care in their grantmaking or has broadened their missions beyond direct care to include the general well being of a population. The Caring for Colorado Foundation born of a BCBS conversion, for instance, has adopted the broad mission "to promote and serve the health care needs of the citizens of Colorado."[30] The public has an important role to play in guiding a foundation to an appropriate mission and responsive grantmaking process. Foundations can employ several different strategies to ensure community input and to assess the population's health care needs. For example, foundations may interview community health representatives, hold focus groups, consult with local academics, or develop health surveys.[31] Some foundations have established community advisory committees with representation from diverse segments of the population to provide insight on local health care needs and recommendations for foundation programs.

The California HealthCare Foundation, which was created from the same Blue Cross of California conversion that established The California Endowment mentioned previously, uses advisory committees to review and comment on major grantmaking activities. Separate committees are formed for specific initiatives and members are involved with the foundation from the early request for proposal stage to the final issuing of grants. For health care conversion foundations as a group, continuous engagement with community organizers can ensure a foundation's grantmaking evolves with the ever-changing needs of the community it serves. Considering the opinion of a variety of community voices will also reduce the chance of real or perceived bias in a foundation's programs.

Accountability and the Oversight of Foundation Activities

State lawmakers and regulators across the United States have spent a significant amount of effort examining and developing legislation related to certain conversion issues, for instance, valuation of assets and the formation of a foundation. Other crucial issues, including post-conversion oversight of the involved parties, have received much less regulatory and legislative attention.

Unlike many other conversion statutes, New Jersey's does include follow-up requirements for the new foundation. The foundation must annually provide a report including financial information and detailing all grantmaking activity to the New Jersey Attorney General. The annual report provides regulators with a means to monitor charitable asset expenditures and examine

whether the foundation maintains a focus on meeting health care needs over time. The statute also requires that this report be publicly available from the Attorney General's office as well as from the foundation itself.

In addition to regulatory reporting, involvement of community and other non-profit groups can also serve as a mechanism for foundation oversight and accountability. Washington's Northwest Health Foundation, created in 1997 with the proceeds from the sale of a health plan, is an example of a foundation whose mission and guiding principles illustrate the organization's desire to engage the community in many aspects of its operational activities. See the box below for more details on the Northwest Health Foundation's community outreach efforts.

Northwest Health Foundation Strives to Include Community

Northwest Health Foundation (NWHF) in Washington was created in 1997 after the for-profit sale of PACC Health Plans and HMO. Their mission states that they will operate in a "socially responsive manner,…seeking advice from the public while preserving the decision-making authority of the Board." [32] The organization's staff, led by Thomas Aschenbrener the Foundation's President, stress the importance of focused community forums, outreach meetings and environmental scans to ensure that NWHF is adequately serving the community's needs. After the Foundation was successfully established, one of the organization's primary goals was to promote greater community involvement and grass roots participation in their strategic grant-making activities. In addition, a component of the Foundation's organizational charge includes acting as a "service entity" for future conversion foundations. Aschenbrener has consulted with a number of converting entities, offering guidance and best practices on managing the functions of a newly created foundation, including engagement of community-based and non-profit organizations. [33]

Conclusion

There is no road map for New Jersey to follow if Horizon BCBS elects to convert to a for-profit corporation. Research on prior BCBS conversions provides little guidance for policymakers or advocates on how to minimize negative impacts on health insurance markets or to maximize community benefits following conversions. However, as acquisitions, mergers and other for-profit activities of health care organizations have increased in the past five years, there are lessons to be learned and best practices to be modeled. Specifically, critical pre- and post-conversion lessons have emerged in four areas:

- There is no single, generally accepted method for valuing charitable assets of converting health care organizations, and in fact a "mixed model" can be the most effective method. Active regulatory oversight is needed to assure thorough, accurate, and impartial asset valuation.
- Regulators can use the results of "health impact studies" to effectively monitor access to affordable coverage among vulnerable populations during and following conversions.
- Continuing the non-profit mission of a BCBS plan requires broad input from the public and community leaders, throughout the conversion process and in the operation of the resulting foundation.
- Establishing the governing body of the conversion foundation is difficult, and careful attention to the appointment process is needed to assure the perpetuation of the non-profit mission of the converting organization, independence from the converting entity's for-profit successor, and a high level of professionalism and skill in employing the tools of philanthropy.

The 2001 New Jersey conversion statute goes a long way to avoid the pitfalls of previous BCBS conversions. Though every piece of legislation is open to debate and interpretation, the language of the New Jersey statute appears unambiguous with regard to several steps in the conversion process, including the disposition of valued assets and the establishment of a health foundation. However, there is considerable risk, despite New Jersey's strong statute, that Horizon's conversion could lead to a diminution of the rich charitable legacy of New Jersey's BCBS plan. Horizon has a distinguished track record of service to vulnerable populations (a commitment that it appears to have strengthened even as it has publicly positioned itself to convert). Prior BCBS conversions offer few clues about whether a for-profit Horizon BCBS that is accountable to shareholders will be able to sustain this commitment. Also, the danger that Horizon's charitable assets will not be used effectively to continue the organization's non-profit mission is heightened as policymakers confront a difficult economic climate and grapple with the significant budget shortfalls facing the state. Finally, assuring public accountability of a Horizon conversion foundation may be at risk in light of the statutory process for appointment of foundation board members, which leaves room for politicization of the foundation agenda. How health care in New Jersey fairs following a Horizon BCBS for-profit conversion depends on many decisions and details that will unfold in the early months following the formal initiation of the conversion process.

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