



OFFICE OF  
INSURANCE COMMISSIONER

FILED

2009 AUG 14 A 11:38

Hearings Unit, DIC  
Patricia D. Petersen  
Chief Hearing Officer

IN THE MATTER OF

PacifiCare of Washington, Inc.,

Authorized Health Care Service Contractor.

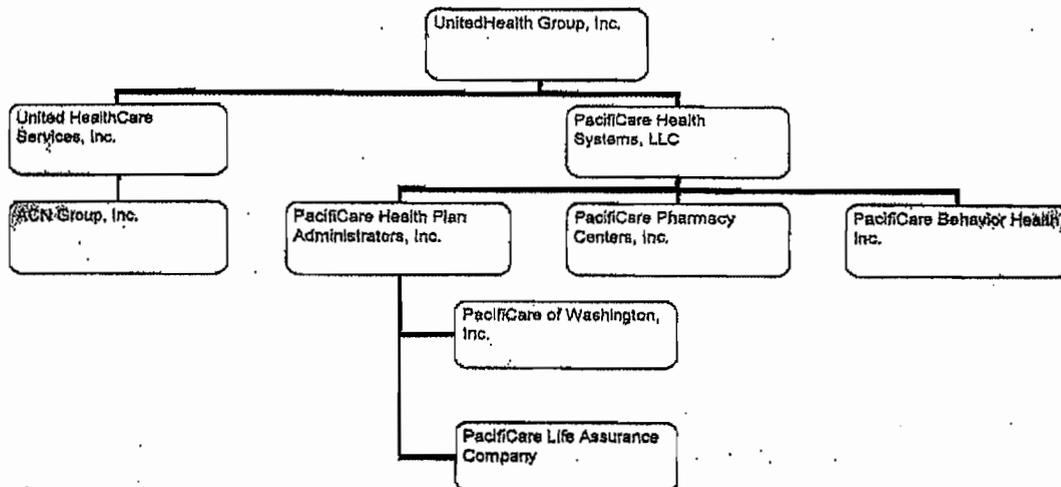
ORDER NO. 09-0010

NOTICE OF REQUEST FOR  
HEARING FOR IMPOSITION OF  
FINES

I. REQUEST FOR IMPOSITION OF FINES

A. BASIS

1. PacifiCare of Washington, Inc. ("PacifiCare of Washington") is a health care service contractor authorized to do business in the state of Washington.
2. PacifiCare of Washington, Inc. is wholly owned by PacifiCare Health Plan Administrators, Inc. ("PHPA"). That company is wholly owned by PacifiCare Health Systems, LLC. which is, in turn, owned by UnitedHealth Group, Inc. Below is the organizational chart as of December 31, 2006, included as part of the Office of Insurance Commissioner's Financial Examination of PacifiCare of Washington for January 1, 2003 – December 31, 2006.



Prior to that time, from 2002 to 2006, PacifiCare of Washington also had a sister company called PacifiCare Life and Health Insurance Co., also wholly owned by PHPA.

3. On or about November 24, 1998, PacifiCare of Washington filed a copy of a licensing agreement and requested input from the Office of Insurance Commissioner ("OIC") regarding the payment of royalty fees by PacifiCare of Washington to its holding company. OIC informed the Company that statutory accounting principles did not allow such payments because such transactions, by definition, are not fair and reasonable. That is because they have no basis in fact. They are therefore a potential method whereby a parent company can take inappropriate amounts of money out of a subsidiary, imperiling the solvency of the subsidiary and the security of its Washington enrollees. In order to be considered "fair and reasonable," payments by a subsidiary to a parent for services must be at cost and not become a distribution of income. As a result, PacifiCare of Washington's Chief Financial Officer informed OIC that PacifiCare would not implement these royalty payments.
4. Over the intervening years, OIC has questioned payments PacifiCare has made to its parents (PacifiCare Health Plan Administrators, Inc., and subsequently UnitedHealth Group, Inc.).
5. In 2001, the Washington Holding Company Act became effective. RCW 48.31C.050 of the Act codified the longstanding statutory accounting principle that transactions within a holding company system must be fair and reasonable. That statute has consistently been applied in harmony with the pre-existing accounting principles to prohibit payment of royalties by a subsidiary insurer to its parent.
6. During these years, whenever OIC questioned its payments to its parent companies, PacifiCare denied that the payments were royalties. During a financial examination for the period of January 1, 1997 through December 31, 2002, the Company classified these royalties as "corporate charge back" fees and stated that they were for services provided by the Corporate Office for treasury, legal, taxes, and other regulatory functions not performed directly by the Company. During a second examination period of January 1, 2003 through December 31, 2006, the Company classified the royalties as "management contract fees." At that time, the Company claimed that these fees were for marketing costs.
7. In addition to these methods of mischaracterizing the payments on the Company's financial reports, the payments were also made indirectly. The royalties were paid by PacifiCare of Washington's immediate parent company, PHPA to an affiliate, PacifiCare Life and Health Insurance Company, which then paid them to the parent company. The royalty charges were then recouped by being included in the inter-company billing from PHPA to PacifiCare of Washington.
8. Finally, the issue of royalties was again raised during the financial examination of PacifiCare as of December 31, 2006. For months during this examination, the Company denied payment of royalty fees. However, PacifiCare of Washington finally acknowledged the amount of the 2004 royalty fees in a letter to OIC in a written response to the draft report of the examination. The Company admitted it had been paying royalties to its parent companies since 1999, and the amounts of those royalties.

9. PacifiCare of Washington calculated the total royalties paid as \$72,914,631. At OIC's request, the Company has now provided satisfactory documentation to OIC that it has recouped this money from PHPA.
10. PacifiCare of Washington's payment of royalties to its parent company violated RCW 48.31C.050.
11. The number of violations is calculated as at least 96. Each royalty payment is a violation and, at a minimum, a payment was made in each month for 8 years. The effect on Washington consumers was indirect – moving such a significant amount of money out of the insurer could have placed the insurer in a hazardous financial condition under WAC 284-16-300 to -320, and possibly required premium increases.
12. The classification of these payments on PacifiCare of Washington's financial records had another effect. At any time, these payments could have been made from PacifiCare of Washington to its parent without violating Washington law. They would simply have had to be classified in financial reports as what they truly are, dividends. However, in California, "dividends" are subject to an additional tax in addition to the base corporate tax on profits. Both PacifiCare of Washington's current and former parent companies are or were California corporations. Therefore, by classifying these payments as royalties, the parent companies avoided paying taxes that would have been owed if they had been appropriately classified as dividends. That appears to be the reason for the subterfuge of classifying them as "corporate charge backs" and "management contract fees," to avoid their being prohibited by Washington or taxed by California.
13. By its officers' verification of annual financial statements which they knew or should have known did not accurately state PacifiCare of Washington's financial condition, the Company violated RCW 48.44.095.
14. By knowingly filing with the OIC annual financial statements which did not accurately state PacifiCare of Washington's financial condition, the company violated RCW 48.44.100.

#### **B. PENALTIES AND RELIEF REQUESTED**

15. The OIC seeks to impose a fine against PacifiCare of Washington, Inc. in the total amount of \$400,000 for the following violations:
16. Pursuant to RCW 48.44.160 and RCW 48.44.166, for approximately 96 violations of RCW 48.31C.050 by illegally paying royalties to its parent company within a holding company system and repeatedly denying to OIC that such payments were being made.

17. Pursuant to RCW 48.44.095 and RCW 48.44.100, for 8 years of violations of each of RCW 48.44.095 and RCW 48.44.100, by attempting to disguise these royalty payments by making them through another company and by falsely classifying them within the Company's annual financial reports.

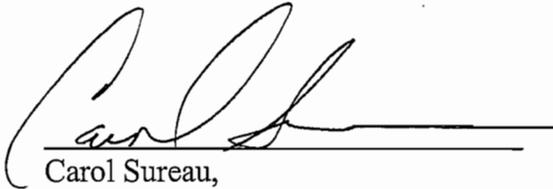
## II. NOTICE OF HEARING

18. The Insurance Commissioner will convene a hearing at a date, location, and time to be determined, to consider the allegations above and the sanctions to be imposed upon PacifiCare of Washington pursuant to RCW 48.04.010 and RCW 48.05.185. At the hearing, the OIC will present evidence showing that PacifiCare of Washington violated the Insurance Code as summarized above and that the sanctions requested above are authorized under the law. PacifiCare of Washington may cross-examine OIC witnesses and present any defenses, evidence, or arguments it may have in opposition.

19. The Insurance Commissioner's staff will participate in this matter through its designated representative, Andrea L. Philhower, P.O. Box 40255, Olympia, Washington, 98504-0255, [AndreaP@oic.wa.gov](mailto:AndreaP@oic.wa.gov), (360) 725-7063. The Insurance Commissioner has been informed that PacifiCare of Washington is represented by attorney Jeff Gingold of the Lane Powell law firm. Pursuant to RCW 34.05.428 and WAC 10-08-083, OIC requests that, should this information be or become inaccurate, the Company provide the Chief Presiding Officer and Ms. Philhower with written notification of the person who will appear at all conferences and hearings, including the person's name, address, e-mail address, and telephone number.

Executed at Tumwater, Washington, this 14<sup>th</sup> day of August, 2009.

MIKE KREIDLER  
Insurance Commissioner

By:   
\_\_\_\_\_  
Carol Sureau,  
Deputy Commissioner Legal Affairs

CERTIFICATE OF MAILING

The undersigned certifies under the penalty of perjury under the laws of the State of Washington that I am now and at all times herein mentioned, a citizen of the United States, a resident of the State of Washington, over the age of eighteen years, not a party to or interested in the above-entitled action, and competent to be a witness herein.

On the date given below I caused to be served the foregoing NOTICE OF PRE-HEARING CONFERENCE on the following individuals in the manner indicated:

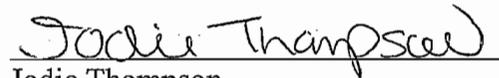
Patricia Peterson, Administrative Law Judge  
5000 Capitol Blvd., MS 40255  
Olympia, WA 98501

(XXX) Via Hand Delivery

Jeffery Gingold  
Lane Powell, PC  
1420 Fifth Avenue, Suite 1400  
Seattle, WA 98101-2338

(XXX) Via U.S. Regular Mail

(  
**SIGNED** this 14<sup>th</sup> day of August, 2009, at Tumwater, Washington.

  
\_\_\_\_\_  
Jodie Thompson