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STATE OF WASHINGTON
OFFICE OF ADMINISTRATIVE HEARINGS

Hearings Unit, DIC
Patricia D. Petersen
Chief Hearing Officer

IN THE MATTER OF

Respondent PacifiCare of Washington,
Inc.
Authorized Health Care Service Contractor.

ORDER NO. 09-0010

MOTION FOR SUMMARY
JUDGMENT RE: STATUTE OF
LIMITATIONS

I. INTRODUCTION & RELIEF REQUESTED

PacifiCare of Washington ("PCW") respectfully moves for entry of a Decision that all of the Office of the Insurance Commissioner ("OIC")'s claims in this matter are barred by the two-year statute of limitations of RCW 4.16.100(2). All of the conduct at issue in OIC's Notice of Request for Hearing for Imposition of Fines ("Notice of Request") occurred between 1999 and 2006. OIC possessed the facts necessary to bring this action no later than March 13, 2003, yet waited until August 14, 2009 to do so. Even if OIC's own statements are accepted for purposes of this motion, at the latest, OIC had actual knowledge of the facts on which it bases this matter by August 9, 2007, a date more than two years before OIC filed its present Notice of Request. Accordingly, a Decision should be entered that OIC's request for imposition of a fine is time barred.

II. STATEMENT OF FACTS

A. General Overview.

1. On August 14, 2009, OIC filed its Notice of Request, through which it sought to impose a fine of \$400,000.00 against PCW for what OIC characterizes in pertinent part as 96 royalty payments made by PCW to an affiliate. Gingold Decl., Ex. R-1, at 2-3 (Notice of Request, ¶¶ 7, 15, 16).

1 2. Previously, on February 9, 2009, OIC had sent a Proposed Consent Order to PCW.
2 Gingold Decl., Ex. R-2, at 1-5 (Proposed Consent Order).

3 3. OIC acknowledges and it is undisputed that all the payments in question, regardless
4 of how they are characterized, were fully reversed and re-couped by PCW. Ex. R-1, at 3 (Notice of
5 Request ¶ 9).

6 4. All conduct for which OIC seeks to fine PCW occurred between 1999 and 2006. Ex.
7 R-1, at 3-4 (Notice of Request, ¶¶ 11, 16, 17).

8 5. PCW respectfully maintains that all payments in question were proper and
9 appropriate under the insurance laws and regulations which were then in force and applicable to
10 PCW during the relevant time period.

11 6. PCW's instant motion is limited to its statute of limitations defense. OIC is barred by
12 the statute of limitations from obtaining an order authorizing a fine of PCW for the conduct at issue.
13 Accordingly, disposition of this motion at the outset of this proceeding is consistent with the
14 interests of judicial economy and the conservation of resources of all parties and the Office of
15 Administrative Hearings ("OAH").

16 **B. OIC's Investigation and Awareness of the Payments At Issue.**

17 7. The history of OIC and PCW's dealings regarding royalty payments issues is
18 extensive. For purposes of this particular motion, however, only those facts directly pertinent to
19 PCW's present motion are included herein, subject to our general reservation of rights to present
20 additional facts and analysis in the event of further proceedings.

21 (1) **The '97-'02 and '03-'06 Exams.**

22 8. OIC conducted two full scope Financial Examinations of PCW. Gingold Decl., Exs.
23 R-3 and R-4 ('97-'02 Exam Report and '03-'06 Exam Report).

24 9. The first exam ("97-'02 Exam") covered the period from January 1, 1997 through
25 December 31, 2002, is dated February 8, 2006 and resulted in order No. G06-4 dated February 13,

1 2006. Ex. R-3, at 1, 4-5 ('97-'02 Exam Report, Salutation, 1, 5); Gingold Decl., Ex. R-5, at 1-2
2 (OIC Order No. G06-4).

3 10. The second exam ("03-'06 Exam") covered the period from January 1, 2003 through
4 December 31, 2006, is dated August 11, 2008, and resulted in order No. 08-111 dated August 13,
5 2008. R-4, at 1-2 ('03-'06 Exam Report, at 1, Salutation); Gingold Decl., Ex. R-6, at 1-2 (OIC
6 Order No. 08-111).

7 11. The Exam Reports each state that they "comprise[] a comprehensive review of the
8 books and records of [PCW]." Ex. R-3, at 5 ('97-'02 Exam Report, at 1); Ex. R-4, at 5 ('03-'06
9 Exam Report, at 1).

10 12. A review of both exams reveals the OIC was aware of and investigating the issue of
11 royalty payments by PCW or on its behalf as part of these exams. See, e.g., Ex. R-3, at 11 ('97-'02
12 Exam Report, at 7); Ex. R-4, at 8, 10 ('03-'06 Exam Report, at 4, 6); see also Ex. R-1, at 2 (Notice of
13 Request, ¶ 6).

14 13. As reflected in the following section of '03-'06 Exam Report, OIC was investigating
15 the same inter-company charges on which it bases its present request to fine PCW:

16 **"4. Royalty Costs are Included in Management Fees Paid to an Affiliate.**

17 Included in the management fees paid by the Company to PHPA are royalty fees
18 based on 1.75% of premiums. Royalty fees are not permitted pursuant to RCW
19 48.31C.050 and SSAP No. 70, paragraph 8, which states, 'Shared expenses, including
20 expenses under the terms of a management contract, shall be apportioned to the
21 entities incurring the expense as if the expense had been paid solely by the incurring
22 entity.'

23 The Company denied that it paid royalty fees during this examination period and the
24 prior examination period. In the prior examination period of January 1, 1997 thru
25 (sic) December 31, 2002, royalty fees were classified as "Corporate charge back"
26 fees. The Company stated that "Corporate charge back" fees were for services
provided by the Corporate Office for treasury, legal, taxes and other regulatory
functions not performed directly by the Company. For the current examination
period, the Company classified royalty fees as "Management contract fees".
However, the Company now states that royalty fees (Management contract fees) are
for marketing costs and that the use of PacifiCare intellectual property is integral to
the marketing of PCWA's products. The Company's parent, PHPA, pays the royalty
fees to another affiliate, PacifiCare Life and Health Insurance Company, and then
royalty charges are included in the inter-company billing from PHPA to PCWA.

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The royalty charges were included in all inter-company monthly estimated billings and were never excluded when estimated costs were adjusted to actual costs. Royalty payments made by PCWA through inter-company transactions are as follows:

1999	\$7,320,233
2000	8,666,280
2001	9,483,600
2002	9,539,984
2003	10,187,748
2004	9,898,531
2005	8,659,782
2006	9,158,473
	\$72,914,631

...

Pursuant to RCW 48.31C.050(1)(a-c) and SSAP No. 70, paragraph 8, the Company is instructed to discontinue paying royalty fees either directly or indirectly and to seek reimbursement from PHPA for all royalty fees paid."

Ex. R-4, at 8 ('03-'06 Exam Report, at 4).

14. In its August 12, 2008 order resulting from the '03-'06 Exam Report, OIC adopted the findings of the examiners, but did not seek to fine PCW. Ex. R-6, at 1-3 (OIC No. 08-111, at 1-3).

15. Rather, OIC simply instructed PCW to discontinue its practice regardless of how the payments were characterized and seek reimbursement from PHPA, which PCW did, thus effecting the complete recoupment that OIC has acknowledged. See Ex. R-6, at 3; (OIC No. 08-111, at 3); Ex. R-1, at 3 (Notice of Request ¶ 9).

(2) PCW's 2003 Form B Filing Informed OIC of What It Now Claims Were PCW's Indirect Royalty Payments to PHPA.

16. On May 7, 2001, Washington's Health Care Service Contractor Holding Company Act ("HCSC Act"), Chapter 48.31C RCW, became effective. See RCW 48.31C.901.

17. As evidenced by the 2001 Final Bill Report of SHB 1792, legislation specific to health care service contractor holding companies was necessary in order to provide OIC with the statutory authority to regulate these entities:

1 “There are three types of health carriers in Washington: (1) disability insurers,
2 which are traditional insurance companies that reimburse policyholders for covered
3 health care expenses; (2) health care service contractors (HCSCs), which are
4 organizations that provide health care service through a provider network to enrollees
5 who have contracted with the HCSCs; and (3) health maintenance organizations
(HMOs), which are organizations that provide health care services to enrollees on a
6 prepaid basis (generally monthly). All health carriers are regulated by the OIC as
7 provided in state law. *The OIC does not apply the Insurance Holding Company Act
8 to HCSCs or HMOs, only to traditional insurance companies.*”

9 Emphasis added. Gingold Decl., Ex. R-7, at 1-2 (2001 Final Bill Report of SHB 1792, at 1-
10 2).

11 18. Under regulations promulgated late in 2002 pursuant to OIC’s new authority under
12 the HCSC Act, roughly three years after the underlying ten-year management services agreement
13 between PCW and PPHA became effective, PCW first became obligated to file with OIC a Form B
14 Registration Statement disclosing, among other things, all management agreements, service
15 contracts and cost-sharing arrangements. See WAC 284-18A-290, Form B; RCW 48.31C. 150.¹
16 PCW’s Form B filing dated May 13, 2003, stated in pertinent part:

17 (5)(e) All management agreements, service contracts and all cost-sharing
18 arrangements:

19 Effective January 1, 1999, the Registrant entered into a Management and
20 Administrative Services Agreement (with) PPHA, whereby PPHA provides
21 comprehensive management and administrative services for the Registrant’s
22 operations, subject to the ultimate control and direction of Registrant’s Board of
23 Directors. The fees associated with this Agreement during the 2002 calendar year
24 were \$9,539,984.”

25 Gingold Decl., Ex. R-8, at 4 (PCW Form B filing, dated May 13, 2003, at 4).

26 19. The \$9,539,984 in fees paid by PCW to PPHA in 2002 and disclosed to OIC in May
2003 were subsequently identified by OIC as part of the “Royalty payments made by PCW[] through
inter-company transactions” identified in its ’03-’06 Exam. Ex. R-4, at 8 (’03-’06 Exam, at 4).

¹ PCW respectfully submits that it is questionable at best from a constitutional perspective whether
the requirements of the HCSC Act can be retroactively applied to contracts such as the one between
PCW and Pacific Healthcare Plan Administrators, Inc., which were already in place prior to the
effective dates of the HCSC Act and its implementing rules.

1 20. The \$9,539,984 in fees are part of the royalty payments now at issue in OIC's Notice
2 of Request. Ex. R-1, at 9 (Notice of Request, ¶ 9); Ex. R-4, at 8 ('03-'06 Exam, at 4).

3 **(3) OIC's Own Statements Show the Agency Was Aware of the Alleged**
4 **Indirect Royalty Payments No Later Than August 9, 2007.**

5 21. An August 9, 2007 conference call between OIC examiners and "Corporate Financial
6 Management" of PCW was described by OIC as follows in its file related to this matter:

7 "We asked what made up the amount for "Management Contract Fees". Tom
8 Linguist, Financial Manager, stated that they were royalty fees that PCW paid to
9 PacifiCare Life and Health Insurance Company."

10 Gingold Decl., Ex. R-9, at 2 (OIC File, "Baker Chronology, Current Examination Period", entry for
11 8-09-07).

12 22. The same day, OIC noted its conclusion from this conversation as follows: "This was
13 the first time in two examination periods covering year 1999 through 2006 that anyone in the
14 Company identified payment of royalty fees." Ex. R-9, at 2 (OIC File, "Baker Chronology, Current
15 Examination Period", entry for 8-09-07, referring to Attachment 8).

16 23. OIC's summary of the conference call references the question, ". . . what made up
17 Management Contract Fees," and the corresponding answer, ". . .royalty fees that PCW paid to
18 PacifiCare Life and Health Insurance Company. . ." Ex. R-9, at 2-4 (OIC File, Attachment 8,
19 "Conference Call Regarding UIE Expenses").

20 24. Regardless of the accuracy of the referenced characterization of payments in the
21 quoted statement in OIC's file that appears in paragraph 21 above, August 9, 2007 marks the latest
22 possible date on which OIC became specifically aware of the alleged indirect payment of royalty
23 fees at issue in OIC's present Notice of Request. See Ex. R-9, at 2 (OIC File, "Baker Chronology,"
24 08-09-07 entry).

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II. AUTHORITY & ARGUMENT

A. The Fine OIC Seeks to Impose is Penal and Therefore Subject to the 2-Year Statute of Limitation in RCW 4.16.100(2).

The statute of limitations for OIC's assertion of a fine is two years. RCW 4.16.100(2) (limiting to a two year statute of limitations actions "upon a statute for a forfeiture or penalty to the state"). The two-year time limit in RCW 4.16.100(2) applies when an administrative agency's fining action is truly penal, but not when the action is a remedial action of recovering a fixed amount (for which no statute of limitations exists). See U.S. Oil & Refining Co. v. Dep't of Ecology, 96 Wn.2d 85, 90, 633 P.2d 1329 (1981) (finding that the Department of Ecology's fine on a refining company for illegally discharging pollutants, was penal, not remedial); see also 15A Washington Practice, § 5.21.

"Unlike penal actions, remedial lawsuits involve compensating the public for a tangible loss it has suffered." U.S. Oil, 96 Wn.2d at 90. Here, it is undisputed that every dollar of the challenged royalty payments have reimbursed to PCW well prior to OIC's filing of the present Notice of Request. See Ex. R-2, at 2-3 (Proposed Consent Order, ¶¶ 5, 6) ("At OIC's request, [PCW] has now provided satisfactory documentation to OIC that it has recouped [the total royalty paid] from PHPA"). There is no dispute that OIC's present action is purely penal in nature: OIC characterizes the fine sought as, "Penalties and Relief Requested," and acknowledges that all challenged payments in question have long since been recouped by PCW. See Ex. R-1, at 3 (Notice of Request, ¶¶ 9, 15-16). The only purpose of the present proceeding is to punish OIC's past conduct.

B. Regardless of How the Accrual Date Is Calculated, A Period Greater than Two Years Has Elapsed Prior to OIC's Commencement of This Action.

The general rule is that a cause of action accrues when the wrongful act occurs. See Samuelson v. Community College Dist. No. 2 (Grays Harbor College), 75 Wn. App. 340, 345, 877 P.2d 734 (1994). PCW respectfully and vigorously disputes that the acts in question were wrongful under then-applicable laws and regulations, but assuming acceptance for purposes of this motion of OIC's characterization of the acts in question as "wrongful," all such acts for which OIC seeks to

1 fine PCW occurred between 1999 and 2006. See Ex. R-1, at 3 (Notice of Request, ¶ 11). OIC,
2 however, will likely argue that it should have the benefit of the “discovery rule,” under which a
3 cause of action is deemed to have accrued when a party discovers, or in the exercise of reasonable
4 diligence should have discovered, the facts giving rise to the claim. 1000 Virginia L.P. v. Vertecs
5 Corp. 127 Wn. App. 899, 909, 112 P.3d 1276 (2005). Indeed, application of the discovery rule is
6 the only way OIC could extend the accrual dates of the 96 alleged violations beyond the dates of
7 their occurrence. “The decision to extend the discovery rule to a cause of action is essentially a
8 matter of judicial policy.” Denny’s Restaurants, Inc. v. Security Union Title Ins. Co., 71 Wn. App.
9 194, 216, 859 P.2d 619, 631 (1993). In this case, however, the decision whether to apply the
10 discovery rule is purely academic because OIC waited too long to commence this action even if it is
11 given the benefit of the rule.

12 Under the discovery rule, a cause of action “accrues when the plaintiff knows or should know
13 the relevant facts, regardless of whether the plaintiff also knows that these facts establish a legal
14 cause of action.” Price v. State 96 Wn. App. 604, 613, 980 P.2d 302 (1999). The discovery rule
15 “will postpone the running of a statute of limitations only until the time when a plaintiff, through the
16 exercise of due diligence, should have discovered the basis for the cause of action[,] [a]cause of
17 action will accrue on that date even if actual discovery did not occur until later.” Allen v. State, 118
18 Wn.2d 753, 758, 826 P.2d 200 (1992). Here, OIC knew or should have known that PCW was
19 making the payments at issue regardless of how they were characterized, well before two years prior
20 to its filing of the Notice of Request.

21 Since 2003 when PCW filed its Form B with OIC consistent with then newly-promulgated
22 rules pursuant to WAC 284-18A-290, OIC was or should have been aware that PCW was
23 reimbursing its parent for payments it made on behalf of PCW. PCW’s filing dated May 13, 2003
24 disclosed \$9,539,984 in fees paid by PCW to PHPA pursuant to a management agreement between
25 the two companies, which were later identified by OIC as part of the “Royalty payments made by
26 PCW[] through inter-company transactions” identified in its ’03-’06 Exam and now at issue. Ex. R-

1 4 at 8 ('03-'06 Exam Report, at 4). OIC was therefore in possession of the facts it relies upon to fine
2 PCW no later than May 13, 2003. Regardless of legal sustainability which we respectfully would
3 dispute, OIC nonetheless had at that time the statutory ability to issue a cease and desist order
4 capable of preventing further alleged violations, and at the least definitively settling this issue in a
5 timely fashion. See RCW 48.31C.080(1).

6 PCW respectfully submits that OIC had ample facts in its possession from which it could
7 determine that, regardless of characterization, PCW was making the challenged payments at least by
8 2003. However, even if for purposes of this motion, the facts were to be construed in a manner
9 suggesting that OIC was not in possession of enough facts for its claim to accrue as of 2003, there
10 can be absolutely no doubt that OIC was specifically aware of what it characterizes as indirect
11 royalty payments at the heart of the current matter no later than August 9, 2007, a date more than
12 two years before OIC filed its Notice of Request. Accepting for purposes of this motion OIC's own
13 file entries as the definitive statement on the matter, August 9, 2007 marks "the first time in two
14 examination periods covering year 1999 through 2006 that anyone in [PCW] identified payment of
15 royalty fees." Ex. R-9, at 2 (OIC File, "Baker Chronology, Current Examination Period", entry for
16 8-09-07, referring to Attachment 8). Accordingly, OIC by its own admission was aware of the
17 challenged conduct by August 9, 2007, more than two years before it commenced this action on
18 August 14, 2009. Id.; Ex. R-1 (Notice of Request). Thus, August 9, 2007 marks the absolute latest
19 date when OIC possessed actual knowledge of all facts necessary to bring this action. OIC has
20 waited too long to bring this action and it is now barred from doing so by the two-year limitations
21 period of RCW 4.16.100(2).

22 **C. OIC's Filing of its Notice of Request for Hearing for Imposition of Fines Is the Act**
23 **which Commenced this Action for Purposes of Tolling the Statute of Limitations.**

24 Under RCW 4.16.170, "[f]or the purpose of tolling any statute of limitations an action shall
25 be deemed commenced when the complaint is filed or summons is served whichever occurs first,"
26 provided the defendant is served within 90 days of filing the complaint. PCW anticipates that OIC

1 may try to avoid application of the statute of limitations by arguing that it commenced this action for
2 purpose of tolling the limitations period when it sent PCW the Proposed Consent Order and Fine
3 dated February 9, 2009. Ex. R-2 (Proposed Consent Order). This argument is, however, without
4 merit.

5 To support its commencement argument, OIC must rely on U.S. Oil and Dolman v. Dep't of
6 Labor & Indust., 105 Wn.2d 560, 716 P.2d 852 (1986). In U.S. Oil, the state supreme court held that
7 Ecology's action was commenced for limitations purposes with the notice of the penalties, rather
8 than when Ecology administratively docketed the matter, as the Court of Appeals had held. The
9 Washington Supreme Court explained:

10 Although the notice is not technically a complaint or a summons, it does as a practical
11 matter commence the action and apprise the penalized party of it. Once the notice is
12 served, the penalized party can either pay the penalty or have the claim fully
13 adjudicated by the otherwise available administrative and judicial forums, with no
liability actually arising until completion of all available judicial review. The notice
has much the same effect as a complaint or summons, and hence the action should toll
when the notice is served.

14 U.S. Oil, 96 Wn.2d at 91-92. Similarly, in Dolman, the Court held that the Department of Labor &
15 Industries' issuance of a notice of assessment of workers compensation premiums to an employer
16 constituted the commencement of the action, rather than the filing of a case or warrant in superior
17 court to collect the assessment (which was never done).

18 The U.S. Oil and Dolman decisions are, however, distinguishable on the basis of the different
19 statutory schemes involved in those cases and this case. Both U.S. Oil and Dolman turned on the
20 language of the statutes under which the agencies were unilaterally authorized to levy their fine or
21 assessment. In U.S. Oil, the statute at issue, RCW 90.48.144(3), provided that any penalty imposed
22 became "due and payable thirty days after receipt of a notice imposing the same ...", but if an appeal
23 were filed, the agency could not commence an action to collect the penalty until all administrative
24 and judicial avenues have been exhausted by the penalized party. 96 Wn.2d at 91.

25 In Dolman, the relevant statutes allowed the agency to unilaterally issue a notice of
26 assessment certifying the amount due after an employer defaulted on a payment to the state fund.

1 The statutes also gave the employer appeal rights and authorized the agent to file a warrant in
2 superior court to collect if the amount was finalized by the employer's non-action. 105 Wn.2d at
3 563. Thus, the statutes at issue in U.S. Oil and Dolman both allowed the agencies to unilaterally
4 issue orders imposing a fine or assessment that would become self-executing absent any action by
5 the aggrieved party.

6 Here, in dispositive contrast, the statutes on which OIC relies for its attempt to impose a fine
7 on PCW preclude unilateral agency action and require a hearing and entry of an order imposing any
8 fine. See, e.g., RCW 48.44.160; RCW 48.44.166; RCW 48.04.010; RCW 48.05.185; see also Ex. R-
9 1, at 3-4 (Notice of Request, ¶¶ 16-18). The filing of a formal Notice of Request is the only way
10 OIC could commence this action for purposes of tolling the statute of limitations pursuant to RCW
11 4.16.170. In order for OIC to obtain an enforceable order against PCW, it must, as it acknowledges,
12 follow the statutorily-mandated procedure for doing so. The statute conferring the authority upon
13 OIC to impose a fine on a health care service contractor such as PCW is RCW 48.44.166 and it in
14 pertinent part specifically mandates a hearing prior to the entry of an order imposing a fine:

15 After hearing or upon stipulation by the registrant...the commissioner may levy a fine
16 against the party involved for each offense[.]

17 RCW 48.44.166. RCW 48.04.010(1)(a) also mandates that the insurance commissioner hold a
18 hearing "[i]f required by any provision of [the insurance code]."

19 The rationale of U.S. Oil and Dolman is therefore wholly inapplicable to this case. Without
20 the statutorily required adjudicative hearing, OIC cannot take any action against PCW in this
21 proceeding that has the force of law unless and until it obtains an order following a hearing before
22 OAH. RCW 48.44.160; RCW 48.44.166; RCW 48.04.010(5). For this reason, the February 9, 2009
23 Notice of Intent does not and cannot be the equivalent of the unilaterally self-executing orders at
24 issue in U.S. Oil and Dolman. OIC only commenced this action on August 14, 2009, when it filed
25 and served OIC with its Notice of Request. Even viewing the facts in the light most favorable to
26

1 OIC, this date is more than two years after OIC actual or constructive knowledge of all facts on
2 which it now bases its current action.

3 **III. CONCLUSION**

4 For the reasons above, PCW respectfully requests that the OAH enter a Decision finding that
5 all of OIC's requested fines herein are barred by the two-year statute of limitations in RCW
6 4.16.100(2).

7 DATED this 30th day of October, 2009.

8 LANE POWELL PC

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10 By 
11 Jeffrey L. Gingold, WSBA No. 18915
12 Andrew G. Yates, WSBA No. 34239
13 Attorneys for PacifiCare of Washington Inc.
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1 CERTIFICATE OF SERVICE

2 I assert that true and exact copies of the Motion For Summary Judgment Re: Statute Of
3 Limitations were hand-delivered by ABC-LMI and mailed postage prepaid on October 30, 2009, to
4 the following parties at the following addresses:

5 Hon. Cindy L. Burdue
6 Office of Administrative Hearings
7 PO Box 9046
8 2420 Bristol St SW
9 Olympia, WA 98507

Andrea Philhower, Esq.
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16 _____
17 Deborah Strayer
18 Legal Assistant

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STATE OF WASHINGTON
OFFICE OF ADMINISTRATIVE HEARINGS

Hearings Unit, DIC
Patricia D. Petersen
Chief Hearing Officer

IN THE MATTER OF

Respondent PacifiCare of Washington,
Inc.

Authorized Health Care Service Contractor.

ORDER NO. 09-0010

**DECLARATION OF JEFFREY L.
GINGOLD IN SUPPORT OF MOTION
FOR SUMMARY JUDGMENT RE:
STATUTE OF LIMITATIONS**

I, Jeffrey L. Gingold, make the following declaration based upon my own personal knowledge:

1. I am over the age of eighteen (18) years and am competent to testify to the facts and matters contained herein, based upon my own knowledge. I am one of the attorneys for PacifiCare of Washington, Inc. ("PCW") in the captioned matter.

2. Attached hereto as Exhibit R-1 is a true and correct copy of the Office of Insurance Commissioner ("OIC")'s Notice of Request for Hearing for Imposition of Fines ("Notice of Request") in the captioned matter. The OIC's Notice of Request was filed on August 14, 2009 and was received by my office on August 17, 2009.

3. Attached hereto as Exhibit R-2 is a true and correct copy of OIC's February 9, 2009 Proposed Consent Order in this matter.

4. Attached hereto as Exhibit R-3 is a true and correct copy of OIC's Financial Examination of PCW for the period from January 1, 1997 through December 31, 2002, dated February 8, 2006 ("97-'02 Exam"). The '97-'02 Exam is available on OIC's website at http://www.insurance.wa.gov/industry/dynamic/marketfinance_srchresults_detail.asp?coname

GINGOLD DECL. ISO MOTION FOR SUMMARY
JUDGMENT RE: STATUTE OF LIMITATIONS - 1
ORDER NO. 09-0010

706501.0036/1771409.2

LANE POWELL PC
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SEATTLE, WASHINGTON 98101-2338
206.223.7000 FAX: 206.223.7107

1 field=pacificare&Submit=Submit&MktID=219, where it is characterized by OIC as a "Full
2 Scope" examination.

3 5. Attached hereto as Exhibit R-4 is a true and correct copy of OIC's Financial
4 Examination of PCW for the period from January 1, 2003 through December 31, 2006, dated
5 August 11, 2008 ("03-'06 Exam"). The '03-'06 Exam is available on OIC's website at
6 http://www.insurance.wa.gov/industry/dynamic/marketfinance_srchresults_detail.asp?coname

7 field=pacificare&Submit=Submit&MktID=325, where it is characterized by OIC as a "Full
8 Scope" examination.

9 6. Attached hereto as Exhibit R-5 is a true and correct copy of OIC Order No.
10 G06-4, dated February 13, 2006.

11 7. Attached hereto as Exhibit R-6 is a true and correct copy of OIC Order No. 08-
12 111, dated August 13, 2008.

13 8. Attached hereto as Exhibit R-7 is a true and correct copy of the 2001 Final Bill
14 Report for SHB 1792, which became Washington's Health Care Service Contractor Holding
15 Company Act ("HCSC Act"), Chapter 48.31C RCW.

16 9. Attached hereto as Exhibit R-8 is a true and correct copy of PCW's Form B
17 filing, dated May 13, 2003. This document was provided to me by OIC in response to my
18 request for PCW's Holding Company Act filings.

19 10. Attached hereto as Exhibit R-9 are true and correct copies of documents
20 excerpted from a larger document entitled "Baker Chronology," which was included within
21 the non-privileged portions of OIC's working file that was provided to me by OIC after I
22 requested a copy of its file on this matter.

1 I declare under penalty of perjury under the laws of the State of Washington that the
2 foregoing is true and correct.

3 Executed this 30th day of October, 2009 at Seattle, Washington.

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GINGOLD DECL. ISO MOTION FOR SUMMARY
JUDGMENT RE: STATUTE OF LIMITATIONS - 3
ORDER NO. 09-0010

706501.0036/1771409.2

LANE POWELL PC
1420 FIFTH AVENUE, SUITE 4100
SEATTLE, WASHINGTON 98101-2338
206.223.7000 FAX: 206.223.7107

CERTIFICATE OF SERVICE

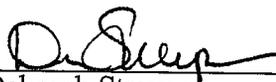
I assert that true and exact copies of the Declaration of Jeffrey L. Gingold in Support of Motion For Summary Judgment Re: Statute Of Limitations were hand-delivered by ABC-LMI and mailed postage prepaid on October 30, 2009, to the following parties at the following addresses:

Hon. Cindy L. Burdue
Office of Administrative Hearings
PO Box 9046
2420 Bristol St SW
Olympia, WA 98507

Andrea Philhower, Esq.
Legal Affairs Division
Office of the Insurance Commissioner
PO Box 40255
5000 Capitol Blvd
Tumwater, WA 98504-0255

Patricia Peterson
Chief Hearing Officer
Office of the Insurance Commissioner
PO Box 40255
5000 Capitol Blvd
Tumwater, WA 98504-0255

Wendy Galloway
Admin. Asst. to Chief Hearing Officer
Office of the Insurance Commissioner
PO Box 40255
5000 Capitol Blvd
Tumwater, WA 98504-0255



Deborah Strayer
Legal Assistant

Exhibit R-1

MIKE KREIDLER
STATE INSURANCE COMMISSIONER

STATE OF WASHINGTON



OFFICE OF
INSURANCE COMMISSIONER

Phone (360) 725-7000
www.insurance.wa.gov

FILED

2009 AUG 14 A 11:30

Heather L. Smith, DDC
Patricia D. Peterson
Chief Hearing Officer
ORDER NO. 09-0010

IN THE MATTER OF

PacifiCare of Washington, Inc.,

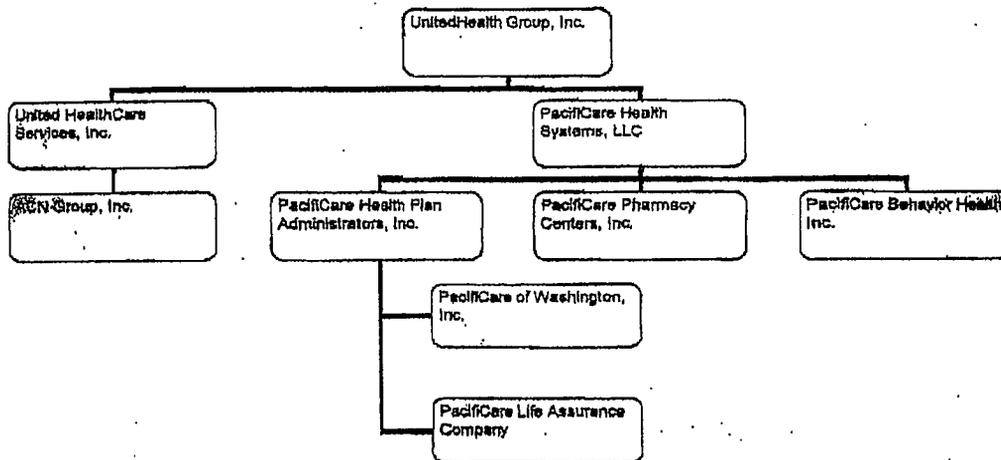
Authorized Health Care Service Contractor.

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.

NOTICE OF REQUEST FOR HEARING
FOR IMPOSITION OF FINES

Page 2 of 5

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.

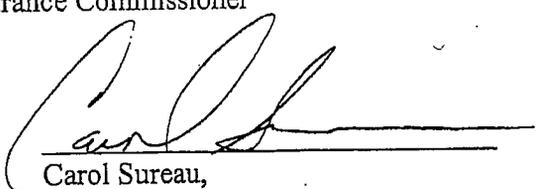
17. Pursuant to RCW 48.44.095 and RCW 48.44.100, for 8 years of violations of each of RCW 48.44.095 and RCW 48.44.100, by attempting to disguise these royalty payments by making them through another company and by falsely classifying them within the Company's annual financial reports.

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, (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 14th 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 14th day of August, 2009, at Tumwater, Washington.

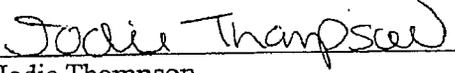

Jodie Thompson

Exhibit R-2

OFFICE OF INSURANCE
COMMISSIONER

IN THE MATTER OF

PacifiCare of Washington,
Inc.,
Authorized Health Care Service
Contractor.

ORDER NO. 09-0010

CONSENT ORDER LEVYING A FINE

The Insurance Commissioner of the State of Washington, pursuant to the authority set forth in RCW 48.44.160(1) and RCW 48.44.166, and having reviewed the official records and files of the Office of the Insurance Commissioner ("OIC"), makes the following:
FINDINGS OF FACT:

1. PacifiCare of Washington, Inc. ("PacifiCare of Washington" or "Company") is a health care service contractor authorized to do business in the state of Washington.
2. In or about November 1998, PacifiCare of Washington filed a form D requesting approval of royalty fee payments to its holding company. OIC denied the form D, at which time PacifiCare of Washington's Chief Financial Officer informed OIC that PacifiCare would not implement royalty payments.
3. Over the intervening years, OIC has questioned payments PacifiCare has made to its parents (PacifiCare Health Plan Administrators, Inc., and subsequently UnitedHealth Group, Inc.), which OIC believed were royalties. A subsidiary insurer may not pay royalties to its parent under RCW 48.31 C.OSO and prior statutory accounting principles, because such transactions, by definition, are not fair and reasonable. In order to be considered "fair and reasonable," payments by a subsidiary to a parent for services must be at cost.

3. 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 and that the use of PacifiCare intellectual property is integral to the marketing of PacifiCare products of Washington's products.

4. The payments were also made indirectly; the royalties were paid by PacifiCare of Washington's immediate parent company, PacifiCare Health Plan Administrators, Inc. ("PHPA") to an affiliate, PacifiCare Life and Health Insurance Company, and then the royalty charges were recouped by being included in the inter-company billing from PHPA to PacifiCare of Washington.

5. 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 (see Paragraph 3 of this Order). 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.

6. PacifiCare of Washington calculated the total royalty 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 PHP A.

7. 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 harmed all policyholders in an insolvency, and possibly required premium increases.

8. The classification of these payments on PacifiCare of Washington's financial records has another effect. These payments could have been made from PacifiCare of Washington to its parent in the form of dividends without violating Washington law. 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 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. Thus the subterfuge of classifying them as "corporate charge backs" and "management contract fees" to avoid their being prohibited by Washington or taxed by California.

CONCLUSIONS OF LAW:

1. PacifiCare of Washington's payment of royalties to its parent company violated RCW 48.31C.050. 2. 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.
3. 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.

CONSENT TO ORDER:

PacifiCare of Washington, acknowledging its duty to comply fully with the applicable laws of the State of Washington, consents to the following in consideration of its desire to resolve this matter without further

Consent Order Levying A Fine Against PacifiCare of Washington, Inc.
Page 3 of 5

Exhibit R-2
Page 3

administrative or judicial proceedings. The Insurance Commissioner consents to settle the matter in consideration of the Company's payment of a fine and such terms and conditions as are set forth below.

1. PacifiCare of Washington consents to the entry of this Order, waives any and all hearing rights, and further administrative or judicial challenges to this Consent Order.

2. By agreement of the parties, the Insurance Commissioner will impose a fine of \$400,000, on

a. Within thirty days of the entry of this Order, PacifiCare of Washington pays the conditions that: \$400,000.

b. PacifiCare of Washington understands and agrees that any future failure to comply with the statutes and regulations that are the subject of this Order constitutes grounds for further penalties.

3. PacifiCare of Washington's failure to timely pay this fine and to adhere to the conditions shall constitute grounds for revocation of the Company's Certificate of Authority, and shall result in the recovery of the amount of the fine through a civil action brought on behalf of the Insurance Commissioner by the Attorney General of the State of Washington.

EXECUTED this ___ day of _____, 2009.

PACIFICARE OF WASHINGTON,

INC.

By:

Printed Name:

Typed Corporate Title:

ORDER

Pursuant to the foregoing Findings of Fact, Conclusions of Law, and Consent to Order, the Insurance Commissioner hereby orders as follows:

1. PacifiCare of Washington, Inc. shall pay a fine in the amount of \$400,000.

2. The Company's failure to pay the fine within the time limit set forth above shall result in the revocation of the Company's Certificate of Authority and in the recovery of the fine through a civil action brought on behalf of the Insurance Commissioner by the Attorney General of the State of Washington. ENTERED AT TUMW ATER, WASHINGTON, this day of , 2009.

MIKE KREIDLER
Insurance Commissioner

By
Andrea L. Philhower
OIC Staff Attorney
Legal Affairs Division

9
V

Exhibit R-3

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE**



FINANCIAL EXAMINATION

OF

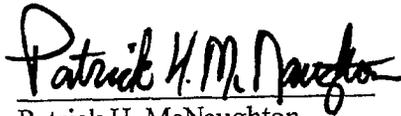
**PacifiCare of Washington, Inc.
Mercer Island, Washington**

**NAIC CODE 48038
DECEMBER 31, 2002**

**Exhibit A
Order No. G 06-04
PacifiCare of Washington, Inc.**

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of PacifiCare of Washington, Inc. of Mercer Island, Washington. This report shows the financial condition and related corporate matters as of December 31, 2002.



Patrick H. McNaughton
Chief Examiner


Date

TABLE OF CONTENTS

SCOPE OF THE EXAMINATION	1
INSTRUCTIONS.....	1
COMMENTS AND RECOMMENDATIONS.....	5
COMPANY PROFILE	5
Company History.....	5
Territory and Plan of Operation	6
Growth of Company	6
<u>AFFILIATED COMPANIES</u>	7
Organization Chart	7
Intercompany Contracts.....	7
MANAGEMENT AND CONTROL.....	7
Board of Directors.....	7
Officers.....	8
Conflict of Interest.....	8
Fidelity Bond and Other Insurance.....	8
Officers' Employees' and Agents' Welfare and Pension Plans	8
CORPORATE RECORDS	8
LOSS EXPERIENCE.....	9
REINSURANCE.....	9
STATUTORY DEPOSITS	10
ACCOUNTING RECORDS AND PROCEDURES	10
SUBSEQUENT EVENTS	10
FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS	11
FINANCIAL STATEMENTS	11
Assets, Liabilities, Capital and Surplus	12
Statement of Revenue and Expenses	13
Five Year Reconciliation of Surplus.....	14
NOTES TO THE FINANCIAL STATEMENTS.....	15
ACKNOWLEDGMENT.....	16
AFFIDAVIT.....	17

SALUTATION

Seattle, Washington
February 8, 2006

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302-14th Avenue SW
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

PacifiCare of Washington, Inc.
of
Mercer Island, Washington

hereinafter referred to as "PCW" or the "Company," at the location of its home office, 7525 SE 24th Mercer Island, Washington 98040. This report is respectfully submitted showing the condition of the Company as of December 31, 2002.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1997 through December 31, 2002 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2002 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. Payment of Surplus Notes Require Prior Approval

The Company made two payments to its parent company, PacifiCare Health Plan Administrators (PHPA) and subsequently asked for OIC's approval to reduce surplus notes. The terms of the surplus notes state that all payments to reduce the surplus notes shall be subject to prior written approval by OIC.

In December 2000, the Company transferred \$21,000,000 to PHPA. Subsequently, on April 10, 2001, OIC approved the cash transfer as a payment on surplus notes. On August 9, 2001, the Company transferred another \$24,000,000 to PHPA. Subsequently, on June 2, 2002 in a Form D filing, the Company requested approval of the transfer as a payment on surplus notes. OIC responded to the Form D filing in a letter dated July 2, 2002 asking for information as to how PCW was going to maintain capital at the 10% level of annualized premium in which the Company had agreed to in a letter dated September 14, 2000. OIC did not approve the reduction of the surplus note for the

second payment until December 15, 2004, by which time the Company supplied the requested information to OIC on its minimum surplus requirements.

The Company justified the payments without receiving prior approval based on its interpretation of the risk-based capital net worth requirements as provided under the Health Carrier Holding Company Act. The adoption of the Health Carrier Holding Company Act (Chapter 48.31C) did not alter or supersede the terms of the solicitation permit. The repayment of the surplus notes is governed by the terms of Solicitation Permit No. 276. According to the terms of the solicitation permit, the Company cannot make any payment on the surplus notes without the prior approval of the Commissioner.

The first and second payments by the Company to PHPA are in violation of Solicitation Permit No. 276 which requires OIC's permission for payment on the surplus notes. The second payment is also in violation of the Health Carrier Holding Company Act 48.31C.050(2) which requires the Company to notify the Commissioner in writing before entering certain specific transactions.

The Company is instructed to comply with RCW 48.31C.060 and the requirements of Solicitation Permit No. 276 as required by RCW 48.06.180, pursuant to RCW 48.44.015.

2. Custodial Agreement with Bank of New York Not in Compliance with NAIC's Annual Statement Instructions

The OIC investment specialist reviewed the Custodial Agreement (Agreement) that PacifiCare of Washington, Inc. (PCW) executed with Bank of New York, Western Trust Company (BNY) to determine if the Agreement was in compliance with Part 1-General, Section IV. H - Custodial or Safekeeping Agreements of the FCEH.

The Company's response to the General Interrogatory 22.01 of its 2002 NAIC Annual statement incorrectly indicated that it complied with the FCEH since the Custodial Agreement with BNY did not comply with Part 1-General, Section IV. H - Custodial or Safekeeping Agreements of the FCEH. The OIC investment specialist determined that the agreement with BNY is not in compliance with pages I-73 - I-75 of the FCEH or with state statutes relating to the safeguarding of securities, as detailed below.

- The Agreement does not state that PacifiCare's certificated securities shall be held separate from all other securities or in fungible bulk.
- The Agreement does not state that PacifiCare's securities held in fungible bulk by BNY through a clearing corporation, or in the Federal Reserve book-entry system, shall be separately identified on BNY's books as being owned by PacifiCare.
- The Agreement does not allow PacifiCare's securities that are not held subject to deposit requirements to be withdrawable upon demand.
- Confirmation of all transfers by hard-copy or in electronic format is not expressly required by the Agreement.

- The Agreement does not require BNY to indemnify PacifiCare for the loss of PacifiCare's securities caused by BNY's negligence or dishonesty of its officers, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.
- For the loss of securities which BNY is obligated to indemnify PacifiCare, BNY is not required to promptly replace the securities or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities.
- The Agreement does not require that in the event BNY gains entry in a clearing corporation through an agent [to include national bank, state bank, or trust company], there will be written agreement between BNY and the said agent, subjecting the agent to the same liability for loss of the securities as BNY.
- The Agreement does not require BNY to provide written notice to our office within three business days of PacifiCare's safekeeping account being terminated or all funds being withdrawn.
- The Agreement does not require BNY to allow an officer or employee of PacifiCare, or an independent accountant selected by PacifiCare and the OIC, to be entitled to examine BNY's records relating to the securities on the premises of BNY during regular business hours.
- The Agreement does not require BNY to send to PacifiCare all reports it receives from its outside auditor, from a clearing corporation, or the Federal Reserve book-entry system, which permit such reports to be redistributed, addressing the respective systems of internal control.
- To the extent that certain information maintained by BNY is relied upon by PacifiCare in preparation of its annual statement and supporting schedules, the Agreement does not require BNY to maintain records sufficient to determine and verify such information.
- The Agreement does not require BNY to provide appropriate affidavits with respect to PacifiCare's securities held by BNY, upon written request from a regulator or an authorized officer of PacifiCare.
- The Agreement does not require BNY to secure and maintain adequate insurance protection over PacifiCare's assets covered by the Agreement.
- The Agreement allows BNY to use depositories or subcustodians acceptable to them. The only acceptable depository is a custodian which meets the statutory qualifications of a qualified custodian. A qualified custodian is either a participating financial institution or clearing corporation. Statutory authority contemplates all depositories being qualified custodians.

The Company is instructed to follow the NAIC's Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). Adherence to the FCEH is included

in these requirements, so the Company is instructed to correct all deficiencies noted above and to execute a revised or amended custodial agreement.

3. The Incurred But Not Paid (IBNP) Model Does Not Reconcile to Company General Ledger

For the review of Claims Unpaid liability for the year ending December 31, 2002, the information supplied to the OIC actuary was incorrect and included inappropriate costs in the Claims Unpaid liability account. In the review of the Claims Unpaid liability as of December 31, 2002, the OIC actuary reviewed paid data claims for the period January 1, 2000 through November 11, 2003 by lines of business to determine the consistency and quality of data. Paid claim amounts, as provided by the Company's actuaries, could not be reconciled to the Company's 2002 NAIC Annual Statement. It was determined late in the examination process that the paid claims information provided by the Company's actuaries included paid claims for both Oregon and Washington.

The general ledger was properly recording paid claims for each state but the actuarial database was overstating paid claims in Oregon's IBNP model and understating paid claims in Washington's IBNP model.

The Company is instructed to comply with RCW 48.12.070 and produce records, books and other information that are reasonably necessary to ascertain the financial condition of the Company.

4. Errors in NAIC Annual Statement Filings

a) Misclassification of Escheat Balance

The Company incorrectly classified uncashed checks pending escheats to Washington State in the Company's 2002 NAIC Annual Statement as General Expenses Due or Accrued. Uncashed checks pending escheats for claims payments, capitation payments and provider services in the amount of \$121,533 should be recorded in the Liabilities, Capital and Surplus Statement as Aggregate Write-Ins for Other Liabilities.

RCW 48.43.097 and WAC 284-07-050(2) require annual statement forms to be in general form and context as approved by the NAIC. The 2002 NAIC Annual Statement Instructions requires checks pending escheats to be classified as Aggregate Write-ins for Other Liabilities. Since capital and surplus was not affected, no examination reclassification is recommended.

b) Misclassification of expenses for Increase in Reserves for Accident and Health Contracts

The Company incorrectly classified expenses for the Increase in Reserves for Accident and Health Contracts in the amount of \$1,304,000 as General and Administrative expenses and as Aggregate Write-ins for Medical and Hospital Expenses.

The 2002 NAIC Annual Statement Instructions require that expenses for accident and health contracts be recorded as an Increase in Reserves for Accident and Health Contracts. Since capital and surplus was not affected, no examination reclassification is recommended.

c) Misclassification of Premium Taxes

The Company incorrectly classified premium tax expense in the Underwriting and Investments Exhibit of its 2002 NAIC Annual Statement as State and Local Insurance taxes. Premium taxes should be recorded in the Underwriting and Investments Exhibit of the NAIC Annual Statement as State Premium Taxes. Total misclassification as of December 31, 2002 is \$3,600,000. Since capital and surplus was not affected, no examination reclassification is recommended.

d) Claims Overpayment Receivables

The Company incorrectly classified claims overpayment receivables in the amount of \$1,595,932 as Claims Unpaid in the Liability section of the Company's 2002 NAIC Annual Statement. Claims overpayment receivables should be reported as a Health Care Receivable in the asset section of the NAIC Annual Statement. Since capital and surplus was not affected, no examination reclassification is recommended.

The Company is instructed to correctly classify all transactions as required by RCW 48.44.095, WAC 284-07-050, and the NAIC Annual Statement Instructions.

COMMENTS AND RECOMMENDATIONS

No comments or recommendations were noted based on our examination.

COMPANY PROFILE

Company History

PCW obtained its Certificate of Registration in Washington State on March 6, 1986 as a Health Maintenance Organization (HMO). On February 28, 1994, PCW purchased Network Health Plan (NHP). NHP began operating in Washington State on June 20, 1986. Its Certificate of Registration is as a Health Care Service Contractor (HCSC). On June 30, 1994 PCW surrendered its HMO license and merged into PacifiCare of Oregon (PCO). On October 1, 1994, NHP changed its name to PacifiCare of Washington (PCW). PCW is owned 100% by PacifiCare Health Plan Administrators (PHPA) and PHPA is owned 100% by PacifiCare Health Systems, Inc. (PHS).

Territory and Plan of Operation

PCW is a health care service contractor that only conducts business in the state of Washington. Its primary operations include managed care products for employer groups and Medicare beneficiaries. The Medicare Plus Choice business segment contributes approximately 70% of the Company's revenues. PacifiCare capitates approximately 48% of its hospital contracts and 52% are shared risks. On the physician side, 78% of the contracts are capitated and 22% are shared risk. PHS is the ultimate parent for thirty-one affiliated companies which includes PCW. The majority of these companies are health, dental and other health related companies predominately located in the Western region of the United States. PCW is a health care service contractor that offers fee for service and capitation arrangements with the following products:

- Medicare - Title XVIII about 71%
- Commercial about 27%
- Federal Employee Health Benefits Act (FEHBA) about 2%
- Individual almost 0%

Growth of Company

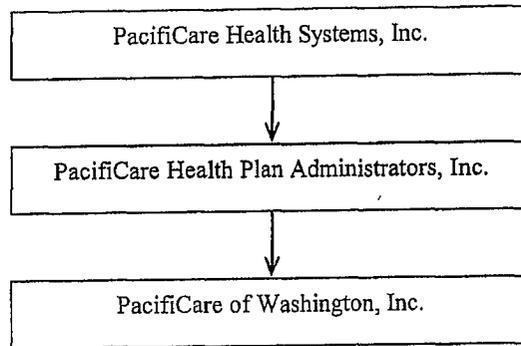
The following schedule shows the Company's growth for selected categories as reported in the Company's NAIC Annual Statement:

<u>Year</u>	<u>Net Premiums Written</u>	<u>Net Losses Paid</u>	<u>Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>
1997	\$ 356,153,613	\$ 67,761,200	\$ 40,620,737	\$ 9,557,342
1998	394,986,293	346,410,018	125,157,274	61,184,817
1999	414,403,533	368,647,694	125,440,133	72,078,219
2000	494,358,063	429,035,632	117,427,497	50,680,761
2001	541,296,333	474,521,204	129,515,253	42,977,496
2002	\$ 544,488,500	\$ 485,598,143	\$139,418,841	\$ 47,492,689

AFFILIATED COMPANIES

The Company's shares are not actively traded and none of the Company's shares are owned by management. PHS, a Delaware corporation, is the parent and sole shareholder of PHPA which is the sole shareholder of the Company. PHS is a publicly traded company on the New York Stock Exchange. PHS is listed as the ultimate parent for thirty-one affiliated companies including PCW.

Organization Chart



Intercompany Contracts

PHPA provides substantially all administrative services necessary to operate and manage the business of the Company pursuant to a management agreement which provides for the Company to pay an administrative fee equal to actual costs. These fees include amounts for compensation, occupancy, depreciation, marketing, utilization review and case management services, professional fees and other administrative services. The charges for these services were included in other general administrative expenses and claims adjustment expenses and totaled \$53,810,000 in 2002.

MANAGEMENT AND CONTROL

Board of Directors (BOD)

<u>Name</u>	<u>Principle Occupation</u>
Bradford Bowlus	Chairman and Executive Vice President
Gregory Scott	Treasurer and Executive Vice President
Samuel Ho, MD	Senior Vice President and Chief Medical Officer
Donald E. Costa	President and CEO

Officers

<u>Name</u>	<u>Title</u>
Donald E. Costa	President
Joseph Samuel Konowiecki	Secretary
Gregory Winfield Scott	Treasurer

Conflict of Interest

The Company has policies and procedures to identify any conflict of interest at the level of manager and above. Annually the Ethics and Integrity Department send to employees at the level of manager and above a copy of the policy along with a Conflict of Interest and Business Ethics Questionnaire. Each manager and above is required to complete and return the questionnaire. When the Ethics and Integrity Department is made aware of a potential conflict of interest, it is its responsibility to discuss the situation with the employee involved. If, after discussion with the employee, the conflict of interest remains unresolved, the matter is brought to the Chief Ethics Officer for review. If, after consideration of the facts, the conflict is deemed by the Company to violate the Company's policy, the employee is instructed to eliminate the conflict or resign from the Company.

Fidelity Bond and Other Insurance

PHPA has a financial institution bond policy that includes coverage for its subsidiaries. The aggregate liability covered by the bond is \$10,000,000 which exceeds the NAIC recommended amount. PHPA also has a program of coverage for its subsidiaries that includes: casualty excess, umbrella, employment practices, professional liability, directors and officers' liability, and fiduciary liability insurance.

Officer's, Employees', and Agents' Welfare and Pension Plans

All employees of the Company are employed by the parent, PHPA. Therefore, all pension plans, profit sharing systems and bonuses are paid by PHPA to PHPA employees. PHS, the parent of PHPA, has a nonqualified and unfunded pension plan for executives from PHS. No executives from the Company are qualified.

CORPORATE RECORDS

There were no changes to the Company's Bylaws and Articles of Incorporation during the examination period. The Stockholders, Board of Directors' and Committee minutes documented approval of the Company's transactions and events. Its primary operations include managed care products for employer groups and Medicare beneficiaries.

LOSS EXPERIENCE

The Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2002, were reviewed by the OIC actuarial staff. This review included: examining the Company's reserving philosophy and methodologies to determine the reasonableness of the claim liabilities, verifying that claims liabilities include provisions for all components noted in the AP&P, reviewing historical paid claims and loss ratios, checking the consistency of the incurred-paid data reported in the Company's NAIC Annual Statements, and estimating claims unpaid for the valuation date of December 31, 2002.

The reserving model and methodologies for claims unpaid is one of the methods prescribed by the American Academy of Actuaries. The unpaid claims and unpaid claim adjustment expenses were estimated based on the incurred claim data. The difference between the estimated figure and the amount recorded in the Company's 2002 NAIC Annual Statement was reasonable. No adjustments were recommended. However, during the review of Claims Unpaid liability for the year ending December 31, 2002, the information supplied to the OIC actuary was incorrect and included inappropriate costs in the Claims Unpaid liability account. This resulted in a great deal of additional time expended by both the OIC actuary and examiners on the issue of data quality. (See Instruction No. 3.)

Premium deficiency reserve assumptions were reviewed and determined reasonable. Since the amount of premium deficiency reserves was not material an independent estimate was not made.

REINSURANCE

PCW has an excess of loss agreement with an affiliate, PacifiCare Life Assurance Company. The excess of loss agreement provides PCW with coverage for claim losses that exceed \$250,000 for up to \$2,000,000 lifetime maximum per member. There were no reinsurance recoveries for year 2002. Due to the infrequency of reinsurance claims, we limited our examination to a review of the reinsurance agreement. A summary of the reinsurance agreement is as follows:

Secure Horizons (Medicare plus program): The deductible amount is \$250,000 of the loss for each member for each contract year. Maximum lifetime benefit for eligible hospital services for each member is \$2,000,000.

Point of Service: The deductible amount is \$250,000 of the loss for each member for each contract year. Maximum lifetime benefit for eligible hospital services for each member is \$2,000,000.

Capitated Provider Groups: The deductible amount is \$250,000 of the loss for each member for each contract year. Maximum lifetime benefit for eligible hospital services for each member is \$2,000,000.

For Eligible Hospital Services: Once the deductible has been satisfied, PacifiCare Life Assurance Company (reinsurer) will indemnify the plan for the excess loss for eligible hospital services.

STATUTORY DEPOSITS

As of December 31, 2002, the Company has the following statutory deposits for Washington State with BNY:

<u>Type of Investment</u>	<u>Total Cost</u>	<u>Market Value</u>
U. S. Treasury Notes	\$ 5,498,788	\$ 5,543,906
Treasury Obligations	128,342	128,342

ACCOUNTING RECORDS AND PROCEDURES

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Principles (SAP) basis for the Company's NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young, LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of the Company is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The Company's Information System (IS) Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, written disaster recovery plan.

SUBSEQUENT EVENTS

1. An amended custodial agreement between PacifiCare and BNY was received on March 3, 2004. The amended agreement has corrected the deficiencies noted above in Instruction 8 except for the following:
 - a. Requiring an agent to be liable to the same extent as the custodian, if the custodian uses the agent to access a clearing corporation.

- b. Requiring the custodian to secure and maintain insurance protection in an adequate amount [custodian wanted the option to maintain financial bond and the have the adequacy standard be determined by the custodian].
 - c. US custodians must hold all securities other than those foreign securities required to do business in a foreign jurisdiction.
2. In a letter to PCW dated December 15, 2004, the Commissioner approved the application of the \$24 million advance made by PCW to PHPA in August 2001 as payment on the surplus notes. The letter further states that the approval does not waive any rights or actions that the Commissioner may take against PCW for violation of RCW 48.31C.060 and the terms of Solicitation Permit No. 276 for having made the advance to PHPA in August 2001 without prior approval.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report instructions and comments were corrected except the following:

1. Custodial Agreement

A review of the custodial agreement with First Interstate Bank disclosed that the agreement did not conform to NAIC requirements which state that the bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody. The bank or trust company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the bank or trust company. The Company is instructed to revise the custodial agreement with First Interstate Bank to include the indemnity clause required by the NAIC. (See Instruction No. 2.)

FINANCIAL STATEMENTS

Statement of Assets and Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Five Year Reconciliation of Surplus

PACIFICARE OF WASHINGTON, INC.
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
DECEMBER 31, 2002

	BALANCE PER COMPANY	REF. NOTE	EXAM ADJ.	BALANCE PER EXAM
Assets				
Bonds	\$64,803,837			\$64,803,837
Stocks:				
Preferred stocks	3,787,081			3,787,081
Cash and short-term investments	51,087,557			51,087,557
Subtotal, cash and invested assets	<u>119,678,475</u>		<u>\$0</u>	<u>119,678,475</u>
Accident and health premiums due and unpaid	3,439,385			3,439,385
Health Care Receivables	771,713			771,713
Investment income due and accrued	790,439			790,439
Amounts due from parent, subsidiaries and affiliates	1,214,102			1,214,102
Federal and foreign income tax recoverable and interest thereon	1,352,164			1,352,164
Aggregate write-ins for other than invested assets	12,172,563			12,172,563
Total assets	<u>\$139,418,841</u>		<u>\$0</u>	<u>\$139,418,841</u>
Liabilities, Capital and Surplus				
Claims unpaid	\$52,789,403			\$52,789,403
Accrued medical incentive pool and bonus payments	780,942			780,942
Unpaid claims adjustment expense	551,821			551,821
Aggregate policy reserves	1,304,403			1,304,403
Premiums received in advance	32,360,482			32,360,482
General expenses due or accrued	1,395,278			1,395,278
Amounts due to parent, subsidiaries, and affiliates	2,743,823			2,743,823
Total liabilities	<u>91,926,152</u>		<u>0</u>	<u>91,926,152</u>
Common capital stock	0	1		0
Gross paid in and contributed surplus	99,456,000			99,456,000
Surplus funds	46,000,000			46,000,000
Unassigned funds (surplus)	4,534,195			4,534,195
Aggregate write-ins for other than special surplus funds	(102,497,506)			(102,497,506)
Total capital and surplus	<u>47,492,689</u>		<u>0</u>	<u>47,492,689</u>
Total liabilities, capital and surplus	<u>\$139,418,841</u>		<u>\$0</u>	<u>\$139,418,841</u>

PACIFICARE OF WASHINGTON, INC.
STATEMENT OF REVENUE AND EXPENSES
DECEMBER 31, 2002

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAM
Member months	1,454,497			
Net premium income	\$ 544,488,500		\$ 0	\$ 544,488,500
Total revenues	544,488,500		0	544,488,500
Hospital and Medical:				
Hospital/medical benefits	448,853,070			448,853,070
Emergency room and out-of-area	14,526,343			14,526,343
Prescription drugs	22,932,778			22,932,778
Aggregate write-ins for other hospital and medical	1,126,468			1,126,468
Incentive pool and withhold adjustments	(1,486,892)			(1,486,892)
Subtotal:	485,951,767		0	485,951,767
Less:				
Net reinsurance recoveries	(353,624)		0	(353,624)
Total medical and hospital	486,305,391			486,305,391
Claim adjustment expenses	7,380,643			7,380,643
General administrative expenses	51,813,315			51,813,315
Total underwriting deductions	545,499,349			545,499,349
Net underwriting gain or loss	(1,010,849)			(1,010,849)
Net investment income earned	3,681,251			3,681,251
Net realized capital gains or (losses)	1,292,852			1,292,852
Net investment gains or (losses)	4,974,103			4,974,103
Net income (loss)	\$ 3,963,254		\$ 0	\$ 3,963,254
CAPITAL AND SURPLUS ACCOUNT				
Capital and surplus prior-reporting period	\$ 42,977,496		\$ 0	\$ 42,977,496
Net income or (loss)	3,963,254			3,963,254
Change in net deferred income tax	629,167			629,167
Change in nonadmitted assets	(60,939)			(60,939)
Aggregate write-ins for gains or (losses) in surplus	(16,289)			(16,289)
Net change in capital and surplus	4,515,193		0	4,515,193
Capital and surplus end of reporting period	\$ 47,492,689		\$ 0	\$ 47,492,689

PACIFICARE OF WASHINGTON, INC.
FIVE YEAR RECONCILIATION OF SURPLUS
FOR THE YEARS ENDED DECEMBER 31,

	2002	2001	2000	1999	1998
Capital and surplus, December 31, previous	<u>\$ 42,977,496</u>	<u>\$ 50,680,761</u>	<u>\$ 72,078,219</u>	<u>\$ 61,184,817</u>	<u>\$ 59,557,342</u>
Net income or (loss)	3,963,254	11,446,723	16,794,563	6,766,644	1,353,692
Net unrealized capital gains or (losses)	0	0	0	0	0
Change in net unrealized foreign exchange capital gain (loss)	0	0	0	0	0
Change in net deferred income tax	629,167	(268,056)	0	0	0
Change in nonadmitted assets	(60,939)	1,344,182	(25,192,021)	126,758	(600,859)
Change in provision for reinsurance	0	0	0	0	0
Change in surplus notes	0	(21,000,000)	(13,000,000)	0	0
Cumulative effects of changes in accounting principles	0	773,886	0	0	0
Aggregate write-ins for gains and losses in surplus	(16,289)	0	0	4,000,000	874,642
Net change in capital and surplus	<u>4,515,193</u>	<u>(7,703,265)</u>	<u>(21,397,458)</u>	<u>10,893,402</u>	<u>1,627,475</u>
Capital and surplus end of reporting year	<u>\$ 47,492,689</u>	<u>\$ 42,977,496</u>	<u>\$ 50,680,761</u>	<u>\$ 72,078,219</u>	<u>\$ 61,184,817</u>

NOTES TO THE FINANCIAL STATEMENTS

1. 7,850 shares of Common Capital Stock with no par or stated value have been issued under the laws of the state of Washington and issued without registration under the securities act of 1933. They were issued for investment only, not for sale or distribution.

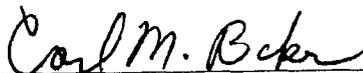
The Company has no special consents, permitted practices or orders from the state of Washington and there were no examination adjustments.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of PacifiCare of Washington, Inc. during the course of this examination.

In addition to the undersigned Mike Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Timoteo L. Navaja, CFE, CIE, Team Leader; John Jacobson, AFE, IS Specialist; Tarik Subbagh, CPA; Constantine Arustamian, CPA, CFE; Juanita Turley, CPA; and Lichiou Lee, Health Actuary, ASA, MAAA; all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Carl M. Baker, CPA, CISA, CFE
Examiner-in-Charge
State of Washington

Carl M. Baker, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of PacifiCare of Washington, Inc., was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Carl M. Baker

Carl M. Baker, CPA, CISA, CFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 8th day of February, 2006.

Colleen Jansen
Notary Public in and for the
State of Washington.

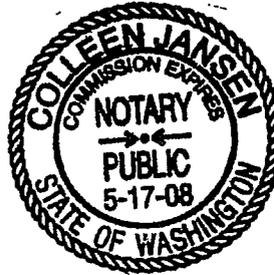


Exhibit R-4

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

of

**PacifiCare of Washington, Inc.
Mercer Island, Washington**

**NAIC CODE 48038
DECEMBER 31, 2006**

Order No. 08-111
PacifiCare of Washington, Inc.
Exhibit A

SALUTATION

Seattle Washington
August 11, 2008

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.44.145 and RCW 48.03.010, an examination was made of the corporate affairs and financial records of

PacifiCare of Washington, Inc.

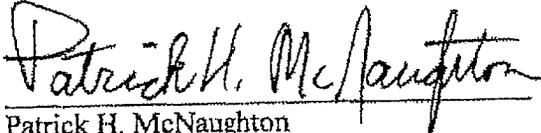
of

Mercer Island, Washington

hereinafter referred to as "PCWA" or the "Company," at the location of its home office, 7525 SE 24th Mercer Island, Washington 98101. This report is respectfully submitted showing the condition of the Company as of December 31, 2006.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of PacifiCare of Washington, Inc., of Mercer Island, Washington. This report shows the financial condition and related corporate matters as of December 31, 2006.



Patrick H. McNaughton
Chief Examiner

8-11-08

Date

TABLE OF CONTENTS

SCOPE OF THE EXAMINATION.....	1
INSTRUCTIONS	1
COMMENTS AND RECOMMENDATIONS	5
COMPANY PROFILE.....	5
Company History.....	5
Capitalization.....	5
Territory and Plan of Operation.....	5
Growth of the Company	5
AFFILIATED COMPANIES.....	6
Organizational Chart.....	6
MANAGEMENT AND CONTROLS	7
Ownership.....	7
Board of Directors (BOD)	7
Conflict of Interest	8
Fidelity Bond and Other Insurance.....	8
Officers', Employees', and Agents' Welfare and Pension Plans	8
COPORATE RECORDS	8
ACTUARIAL REVIEW.....	8
REINSURANCE	9
SPECIAL DEPOSITS.....	9
ACCOUNTING RECORDS AND INFORMATION SYSTEM	9
SUBSEQUENT EVENTS.....	10
FINANCIAL STATEMENTS.....	10
Assets, Liabilities, Capital and Surplus	11
Statement of Revenue and Expenses	12
Four Year Reconciliation of Surplus	13
Analysis of Changes in Financial Statements Resulting from the Examination	14
NOTES TO THE FINANCIAL STATEMENTS.....	15
ACKNOWLEDGMENT	16
AFFIDAVIT	17

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2003 through December 31, 2006 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2006 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the 2006 NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

1. NAIC Annual Statement Errors and Misclassifications

The results of the examination disclosed several instances in which the Company's filing of the 2006 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions.

a. Extraordinary Dividend

The Company obtained approval from OIC to distribute \$24 million in extraordinary dividends in 2005. Since the Company's "Unassigned funds (surplus)" was negative at the time of the approval, the distribution should have been treated as a return of capital, not as a reduction of "Unassigned funds (surplus)" pursuant to the 2006 NAIC Annual Statement Instructions, Page 37, Line 26. (See examination reclassification No. 1., debiting, "Gross paid in and contributed surplus", and crediting, "Unassigned funds (surplus)" in the amount of \$24 million.)

b. Licensing Status as a Health Care Service Contractor

The Company is registered under RCW 48.44.15 as a Health Care Service Contractor in Washington State. In the 2006 NAIC Annual Statement, Schedule Y, and the Management's Discussion and Analysis for the same year, the Company has called itself

a Health Maintenance Organization (HMO). It was also noted in the Company's promotional material on the internet.

c. General Interrogatories - Minimum Net Worth Requirement

The Company has been calculating its minimum net worth based on its risk based capital level in its filed NAIC Annual Statements, General Interrogatories, Part 2, No. 11. RCW 48.44.037(1) requires that minimum net worth be calculated based on earned premiums. The Company incorrectly reported its minimum net worth during the examination period of January 1, 2003 through December 31, 2006.

d. Premiums Received in Advance

The Company included an entry twice for "Premiums received in advance" in the 2006 NAIC Annual Statement in the amount of \$959,157. (See examination adjustment No. 2. debiting, "Premiums received in advance" and crediting, "Uncollected premiums and agents' balances in course of collection" in the amount of \$959,157.)

e. Additional Data Filing

Several items in the Additional Data Statement Form (ADSF) to the NAIC Annual Statement for the year ending December 31, 2006 did not reconcile to the NAIC Annual Statement as required by WAC 284-07-050(8).

- In the ADSF, Analysis of Washington Comprehensive Line Amounts, total medical and hospital (Column 2, Line 17) for individual contacts should equal the totals in the 2006 NAIC Annual Statement, Exhibit of Premiums, Enrollment and Utilization (a), in Column 2, Line 18.
- In the ADSF, Group Enrollment and Utilization in Washington, all lines in Column 1 must be identical to respective lines in the 2006 NAIC Annual Statement, Exhibit of Premiums, Enrollment and Utilization (a).
- In the ADSF, the required indemnity deposit amount was not calculated correctly. PCWA failed to include "Aggregate health policy reserves". Additionally, the amounts recorded in the ADSF for "Incurred but unpaid claims" and "Premium received in advance" did not agree with the 2006 NAIC Annual Statement.

No adjustments are required because the Company has sufficient deposits in its indemnity bank account to cover the estimated \$780,000 shortage in its calculation of required indemnity deposit. (See section, SPECIAL DEPOSITS, of this report.)

f. Claim Expenses and Claim Adjustment Expenses

PCWA misclassified claim adjustment expenses in its 2006 NAIC Annual Statement in the amount of \$3,605,347. The Company recorded expenses for disease management fees and vendor fees as "Hospital/medical benefits". These are cost containment expenses as defined by SSAP No. 85, paragraph 4.a. Cost containment expenses should be classified as claims adjustment expenses. (See examination reclassification No. 3., debiting "Claim adjustment expenses" and crediting, "Hospital/medical benefits" in the amount of \$3,605,347.)

The Company is instructed to file an accurate statement of its financial condition, transactions, and affairs in compliance with RCW 48.43.097, which requires the filing of its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions.

2. Premium Sample Enrollment/Application Records

The Company could not provide supporting records for Medicare policyholders such as original applications forms and demographic forms. A sample of 29 items was selected from the Medicare premium database. Of the 29 items selected, the Company provided support documents for only 10 policyholders. The Company stated that the information was stored on magnetic reels and that it would take too long to search. The Medicare contract between the Company and the Federal Center for Medicare Services (CMS) requires the Company to keep records for the current year and the prior 10 years.

The Company is instructed to keep and maintain sufficient detail records in accordance with RCW 48.03.030(1) and RCW 48.44.145(2).

3. Costs Sharing Between Affiliates are Based on Estimated Costs Not on Actual Costs

A Management and Administrative Services Agreement (MASA) between PCWA and its parent, PacificCare Health Plan Administrators, Inc. (PHPA), require that costs between the affiliates be based on actual costs. During the examination period of January 1, 2003 through December 31, 2006, PCWA was charged a management fee by PHPA based on 9.19% of net premiums which were not reconciled to actual costs. The amounts charged for management fees during the examination period were reported as \$198,481,345. The actual costs as calculated by the Company were \$207,336,213.

Our examination was able to verify costs incurred by PHPA on behalf of PCWA, but the accounts and records of affiliates were not received timely enough to determine that expenses flowing into PHPA from other affiliates on behalf of PCWA were fair and reasonable in compliance with RCW 48.31C.050(1)(d). (See examination adjustment No. 4, debiting, "Unassigned funds (surplus)" in the amount of \$9,209,498 for prior year adjustments, crediting, "Amounts due to parent, subsidiaries and affiliates" in the amount of \$8,854,868, and crediting, "General administrative expenses" in the amount of \$354,630 for the 2006 adjustment.)

Pursuant to RCW 48.31C.050(1)(a-d) and SSAP No. 70, paragraph 8, the Company is instructed to reimburse affiliate transactions based on actual costs incurred by its affiliate. Pursuant to RCW 48.31C.070 and RCW 48.31C.050(1)(d), the Company is instructed to maintain accounts and records of each affiliate so that transactions clearly and accurately disclose the nature and details, including such accounting information as is necessary to support the reasonableness of the charges or fees at cost.

4. Royalty Costs are Included in Management Fees Paid to an Affiliate

Included in the management fees paid by the Company to PHPA are royalty fees based on 1.75% of premiums. Royalty fees are not permitted pursuant to RCW 48.31C.050 and SSAP No. 70, paragraph 8, which states, "Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the entities incurring the expense as if the expense had been paid solely by the incurring entity."

The Company denied that it paid royalty fees during this examination period and the prior examination period. In the prior examination period of January 1, 1997 thru December 31, 2002, royalty fees were classified as "Corporate charge back" fees. The Company stated that "Corporate charge back" fees were for services provided by the Corporate Office for treasury, legal, taxes and other regulatory functions not performed directly by the Company. For the current examination period, the Company classified royalty fees as "Management contract fees". However, the Company now states that royalty fees (Management contract fees) are for marketing costs and that the use of PacifiCare intellectual property is integral to the marketing of PCWA's products. The Company's parent, PHPA, pays the royalty fees to another affiliate, PacifiCare Life and Health Insurance Company, and then royalty charges are included in the inter-company billing from PHPA to PCWA.

The royalty charges were included in all inter-company monthly estimated billings and were never excluded when estimated costs were adjusted to actual costs. Royalty payments made by PCWA through inter-company transactions are as follows:

1999	\$ 7,320,233
2000	8,666,280
2001	9,483,600
2002	9,539,984
2003	10,187,748
2004	9,898,531
2005	8,659,782
2006	<u>9,158,473</u>
	<u>\$ 72,914,631</u>

The adjustments required in conjunction with Examination Adjustment No. 4. above are as follows:

(For the year 2006, see examination adjustment No. 5., debiting "Receivables from parent, subsidiaries and affiliates" and crediting, "General administrative expenses" in the amount of \$9,158,473.) (For years 1999 through 2005, see examination adjustment No. 6., debiting "Receivables from parent, subsidiaries and affiliates" and crediting, "Unassigned funds (surplus)" in the amount of \$63,756,158.)

Pursuant to RCW 48.31C.050(1)(a-c) and SSAP No. 70, paragraph 8, the Company is instructed to discontinue paying royalty fees either directly or indirectly and to seek reimbursement from PHPA for all royalty fees paid.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

PCWA obtained its Certificate of Registration in Washington State on March 6, 1986 as a Health Maintenance Organization (HMO). On February 28, 1994, PCWA purchased Preferred Health Resources (PHR). PHR consisted of Network Health Plan, a Health Care Service Contractor (HCSC), and Network Management, Inc., a third party administrator. On June 30, 1994, PCWA was dissolved and all assets were transferred to Network Health Plan. On October 1, 1994, Network Health Plan changed its name to PacifiCare of Washington (PCWA). On December 20, 2005, PCWA's previous parent, PacifiCare Health System, LLC, was acquired by UnitedHealth Group, Inc., (the Parent).

Capitalization

Minimum capital requirements pursuant to RCW 48.44.037 were met with approximately \$134 million in net worth (capital and surplus) as of December 31, 2006.

Territory and Plan of Operation

The Company is registered as a HCSC in the state of Washington only. It engaged in the following lines of business: Comprehensive hospital and medical, Federal Employees Health Benefit Plans, and Title XVIII Medicare. Approximately 80% of the business comes from Medicare, which is marketed under the Secure Horizons brand name.

Growth of the Company

The following reflects the growth of the Company based on its filed NAIC Annual Statements for the years ending December 31:

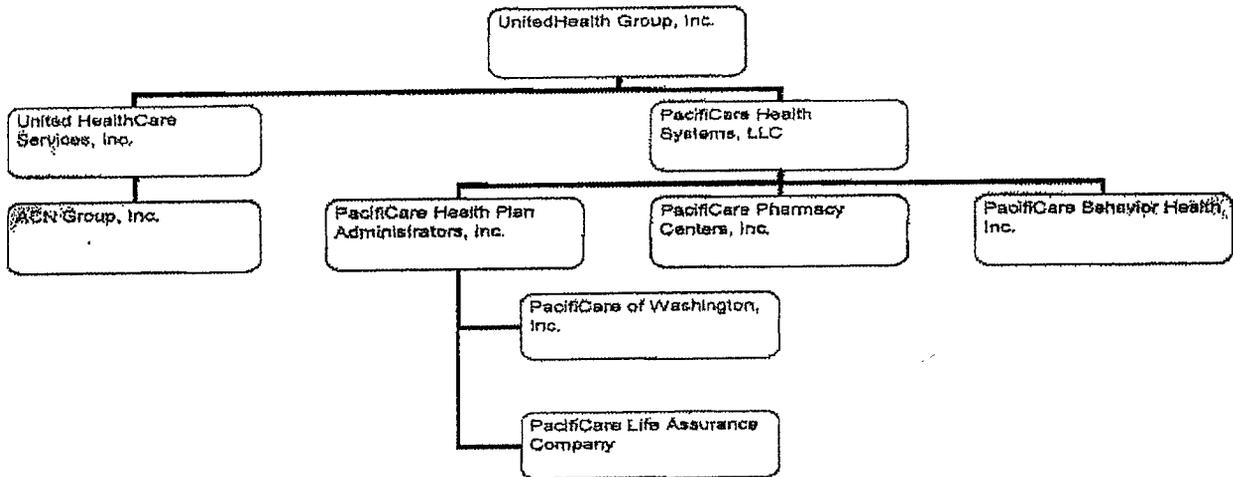
<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>	
2006	\$197,796,845	\$63,973,194	\$133,823,651	
2005	153,841,212	53,869,959	99,971,253	
2004	135,394,003	48,856,116	86,537,887	
2003	137,723,018	92,300,266	45,422,752	

<u>Year</u>	<u>Premiums Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2006	\$514,720,411	\$57,046,720	\$7,231,183	\$42,709,390
2005	493,573,184	41,422,383	5,179,452	42,709,545
2004	565,030,258	48,723,778	4,820,310	53,544,088
2003	581,797,579	(6,654,755)	3,246,558	(3,408,197)

AFFILIATED COMPANIES

Organizational Chart

The following organizational chart as of December 31, 2006 shows the Company's Parent and direct reporting insurance subsidiaries:



Inter-Company Agreements

Management and Administrative Service Agreement

A management and administrative service agreement entered on January 1, 1999 between PHPA and PCWA. PHPA is to provide management and administrative services to PCWA in order to streamline administration and operations for PCWA and improve customer service and support through investments in technology. This agreement is effective for ten years with two ten year renewal options. (See Instruction No. 4.)

Reinsurance Agreement

A reinsurance agreement was entered into on January 1, 2003 for a continuous period. PacifiCare Life Assurance Company (PLAC) agreed to reinsure, and PCWA agreed to cede, a specified portion of Membership Service Agreements issued by PCWA. This reinsurance agreement was amended and updated annually on January 1, but was terminated as of January 1, 2007.

Tax Sharing/Allocation Agreement

Effective February 10, 2003, PCWA was included in the consolidated federal income tax filings of PacifiCare Health System, LLC. On December 20, 2005, PCWA was acquired by UnitedHealth Group, Inc., and included in its consolidated tax return filing.

Pharmaceutical Services Agreement

Effective January 1, 1998, PCWA agreed that PacifiCare Pharmacy Centers, Inc., would provide consultative, administrative, and claims processing services for the administration of PCWA's pharmacy benefit program.

Behavioral Health Services Agreement.

A service agreement was entered on September 15, 1997 between PCWA and PacifiCare Behavioral Health, Inc., (PBHI) for a period of three years and then renewed annually. PBHI agrees to manage the provision and delivery of chemical dependency and mental health services to PacifiCare policyholders.

Cost Reimbursement Agreement

A cost reimbursement agreement was entered on February 14, 2006 between United HealthCare Services, Inc. (UHS) and PHPA for an infinite duration. UHS agrees to provide management and administrative services to PHPA and its subsidiaries which include PCWA. In return, PHPA agrees to reimburse UHS for all costs and expenses incurred by UHS in providing such services.

MANAGEMENT AND CONTROL

Ownership

The Company is a wholly owned subsidiary of PHPA. PHPA is solely owned by PacifiCare Health Systems, LLC, formerly PacifiCare Health Systems, Inc. Effective December 20, 2005, PacifiCare Health Systems, LLC, became a wholly owned subsidiary of UnitedHealth Group, Inc.

Board of Directors (BOD)

Management of the Company is vested in a BOD comprised of not less than two and not more than nine members as provided for by the Company's Bylaws. A majority of the directors constitutes a quorum for the transaction of business.

Directors as of December 31, 2006:

Robert John Sheehy
Steven Arthur Schmidt
Samuel Warren Ho M.D
James Anthony Frey II

Officers as of December 31, 2006:

Steven Arthur Schmidt	President
Forrest Gregory Burke	Treasurer
Robert Worth Oberrender	Secretary
Donald Alan Powers	Vice President and Assistant Treasurer

Juanita Valarae Bolland Luis
Susan Lynn Berkel

Assistant Secretary
Chief Financial Officer

Conflict of Interest

The Company's policy requires that members of the BOD, officers and all employees grade 30 or above file a conflict of interest statement each year. The purpose of the statement is to detect any activities or participation on the part of an employee that could possibly be interpreted as a conflict of interest. No exceptions were noted.

Fidelity Bond and Other Insurance

The Company is a named insured under a crime coverage plan purchased by UnitedHealth Group, Inc. The aggregate coverage limit was \$25 million, with retention of \$500,000 per loss as of December 31, 2006. The coverage limit amounts exceed the NAIC recommended minimum coverage range of \$1.25 million to \$1.5 million.

The Company is also protected under various other insurance policies acquired by its Parent. Those policies are:

- Commercial General Liability Policy
- Professional Liability Policy
- Property and Business Interruption Policy
- Workers Compensation/Employers Liability Policy
- Professional Liability and Medical Professional Liability Policy
- Employee Benefit Plan Fiduciary Liability Insurance Policy
- Directors and Officers Liability Policy

The review of the Company's insurance policies indicates insurance coverage has been purchased and is in force covering hazards to which the Company is exposed as of the examination date. All affiliated companies are covered as named insureds under policies purchased by the Parent.

Officers', Employees', and Agents' Welfare and Pension Plans

PCWA has no employees during the examination period. All services are performed by its affiliates, under the Management and Administrative Services Agreement and Cost Reimbursement Agreement.

COPORATE RECORDS

The Articles of Incorporation, Bylaws, Certificate of Registration, and minutes of the BOD and committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present.

ACTUARIAL REVIEW

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim

liabilities as of December 31, 2006. The claim liabilities were determined to be within a reasonable range. The review included examining the Company's reserving philosophy and methodologies to determine the reasonableness of the claim liabilities; verifying that claim liabilities include provisions for all components noted in SSAP No. 55, Paragraphs 7 and 8; reviewing historical paid claims and loss ratios; checking the consistency of the incurred-paid data from the Company's system with the figures reported in the 2006 NAIC Annual Statement; reviewing the calculation for the provision of refund for risk sharing under Medicare Part D; and estimating claims unpaid for the valuation date of December 31, 2006. One issue was noted in the review. (See Instruction No. 1.f.)

REINSURANCE

PCWA has a reinsurance agreement with an affiliate, PacifiCare Life Assurance Company since January 1, 2003. Under the agreement, PacifiCare Life Assurance Company agreed to indemnify PCW for losses exceeding its retention level of \$400,000 per member per year, with a lifetime cap of \$2,000,000. In return, PCWA agreed to pay a fixed amount of premium per month to PacifiCare Life Assurance Company for the risk assumed. The fixed amount of the premium is amended annually as necessary. The reinsurance agreement was terminated on December 31, 2006.

SPECIAL DEPOSITS

The OIC requires the filing of the Underwriting of Indemnity Calculation of Funded Reserve form pursuant to WAC 284-07-050(8). The Company initially calculated the required minimum special deposit at \$4.10 million. A number of errors were included in the calculation. The Company re-calculated the minimum deposit which increased the minimum deposit to \$4.88 million pursuant to WAC 284-44-330 and WAC 284-44-340. (See Instruction No. 1.e.)

The Company met the special deposit requirement with various securities with a total fair market value of 6.1 million. The securities are held in a special deposit account by the Company's custodian, Bank of New York, pursuant to RCW 48.44.030.

ACCOUNTING RECORDS AND INFORMATION SYSTEM

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) basis and adjusts it to Statutory Accounting Practice (SAP) basis for NAIC Annual Statement reporting. The Company was audited annually by Ernst and Young, LLP for 2003 to 2005, and Deloitte and Touche, LLP for 2006. The Company received unqualified opinions for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no material exceptions were noted.

The management of PCWA is sufficiently knowledgeable of the information system process. System development, acquisition, and maintenance controls were evaluated to gain assurance

that appropriate internal controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the internal controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The Company's information system department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, written recovery plan.

SUBSEQUENT EVENTS

An Administrative Service Agreement was entered on January 1, 2007 between ACN Group, Inc., and PCWA. ACN Group, Inc., is to provide administrative services and other general business operations to PCWA. This agreement is for a period of 12 months and automatically renews annually.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of the Company as of December 31, 2006:

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Four-Year Reconciliation of Surplus
Analysis of Changes in Financial Statements Resulting from the Examination

PACIFICARE OF WASHINGTON, INC.
Assets, Liabilities, Capital and Surplus
As of December 31, 2006

	<u>BALANCE PER COMPANY</u>	<u>ref.</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Assets				
Bonds	\$89,417,756			\$89,417,756
Cash and short-term investments	93,810,763			93,810,763
Investment income due and accrued	1,012,508			1,012,508
Premiums and considerations:				
Uncollected premiums and agents' balances	8,302,476	2	(\$959,157)	7,343,319
Amounts recoverable from reinsurers	54,982			54,982
Current federal and foreign income tax recoverable	847,080			847,080
Net deferred tax asset	2,257,577			2,257,577
Receivables from parent, subsidiaries and affiliates	150,047	5,6	\$72,914,631	73,064,678
Health care and other amounts receivable	1,943,656			1,943,656
Total Assets	<u>\$197,796,845</u>		<u>\$71,955,474</u>	<u>\$269,752,319</u>
Liabilities, Capital, and Surplus				
Claims unpaid	\$36,192,490			\$36,192,490
Accrued medical incentive pool and bonus amounts	73,349			73,349
Unpaid claims adjustment expenses	900,994			900,994
Aggregate health policy reserves	7,418,749			7,418,749
Aggregate health claim reserves	279,995			279,995
Premiums received in advance	7,766,557	2	(\$959,157)	6,807,400
General expenses due or accrued	1,987,939			1,987,939
Amounts withheld or retained for the account of others	1,494			1,494
Amounts due to parent, subsidiaries and affiliates	4,784,949	4	8,854,868	13,639,817
Liab. for amounts held under uninsured plans	4,566,678			4,566,678
Total Liabilities	<u>63,973,194</u>		<u>7,895,711</u>	<u>71,868,905</u>
Gross paid in and contributed surplus	104,456,000	1	(24,000,000)	80,456,000
Aggregate write-ins for other than special surplus funds	4,534,195			4,534,195
Unassigned funds (surplus)	24,833,456	1,4,5,6	88,059,763	112,893,219
Total Capital and Surplus	<u>133,823,651</u>		<u>64,059,763</u>	<u>197,883,414</u>
Total Liabilities, Capital and Surplus	<u>\$197,796,845</u>		<u>\$71,955,474</u>	<u>\$269,752,319</u>

PACIFICARE OF WASHINGTON, INC
Statement of Revenue and Expenses
For the Year Ended December 31, 2006

	<u>BALANCE PER COMPANY</u>	ref.	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	760,744			760,744
Net premium income	\$522,139,160			\$522,139,160
Change in unearned premium reserves	(7,418,749)			(7,418,749)
Total revenues	<u>514,720,411</u>		0	<u>514,720,411</u>
<u>Hospital and Medical:</u>				
Hospital/medical benefits	347,690,145	3	(3,605,347)	344,084,798
Other professional services	4,272,892			4,272,892
Emergency room and out-of-area	17,721,449			17,721,449
Prescription drugs	36,658,998			36,658,998
Incentive pool, withhold adjustments and bonus amounts	(667,909)			(667,909)
Subtotal	<u>405,675,575</u>		<u>(3,605,347)</u>	<u>402,070,228</u>
Net reinsurance recoveries	720,205			720,205
Total hospital and medical	404,955,370		(3,605,347)	401,350,023
Claims adjustment expenses	8,491,901	3	3,605,347	12,097,248
General administrative expenses	44,226,420	4,5	(9,513,103)	34,713,317
Total underwriting deductions	<u>457,673,691</u>		<u>(9,513,103)</u>	<u>448,160,588</u>
Net underwriting gain or (loss)	<u>57,046,720</u>		<u>9,513,103</u>	<u>66,559,823</u>
Net investment income earned	8,131,897			8,131,897
Net realized capital gains or (losses)	(900,714)			(900,714)
Net investment gains or (losses)	<u>7,231,183</u>		0	<u>7,231,183</u>
Aggregate write-ins for other income or expenses				
Net income or (loss) before FIT	64,277,903		9,513,103	73,791,006
Federal and foreign income taxes incurred	21,568,513			21,568,513
Net Income (Loss)	<u>\$42,709,390</u>		<u>\$9,513,103</u>	<u>\$52,222,493</u>
<u>CAPITAL AND SURPLUS ACCOUNT</u>				
Capital and surplus prior reporting period	\$99,971,252			\$99,971,252
Net Income (Loss) from above	42,709,390		\$9,513,103	52,222,493
Change in net deferred income tax	(552,064)			(552,064)
Change in nonadmitted assets	1,195,073			1,195,073
Surplus adjustments:				
Paid in		1	(24,000,000)	(24,000,000)
Dividends to stockholders	(9,500,000)			(9,500,000)
Aggregate write-ins for gains or (losses) in surplus to prior years resulting from examination adjustments		1,4,6	78,546,660	78,546,660
Net change in capital and surplus	<u>33,852,399</u>		<u>64,059,763</u>	<u>97,912,162</u>
Capital and surplus end of reporting period	<u>\$133,823,651</u>		<u>\$64,059,763</u>	<u>\$197,883,414</u>

PACIFICARE OF WASHINGTON, INC.
Four Year Reconciliation of Surplus
For the Years Ended December

	<u>12/31/2006</u>	<u>12/31/2005</u>	<u>12/31/2004</u>	<u>12/31/2003</u>
Capital and surplus, prior reporting year	<u>\$99,971,252</u>	<u>\$86,537,889</u>	<u>\$45,422,752</u>	<u>\$47,492,689</u>
Net income or (loss)	52,222,493	42,709,545	53,544,088	(3,408,197)
Change in net deferred income tax	(552,064)	(2,392,057)	3,767,653	(2,726,462)
Change in nonadmitted assets	1,195,073	115,875	21,803,396	4,064,722
Change in surplus notes		(3,000,000)	(43,000,000)	
Capital changes:				
Paid in			5,000,000	
Surplus adjustments:				
Paid in	(24,000,000)			
Dividends to stockholders	(9,500,000)	(24,000,000)		
Aggregate write-ins for gains or (losses) in surplus to prior years resulting from examination adjustments	<u>78,546,660</u>			
Net change in capital and surplus	<u>97,912,162</u>	<u>13,433,363</u>	<u>41,115,137</u>	<u>(2,069,937)</u>
Capital and surplus, end of reporting period	<u><u>\$197,883,414</u></u>	<u><u>\$99,971,252</u></u>	<u><u>\$86,537,889</u></u>	<u><u>\$45,422,752</u></u>

PACIFICARE OF WASHINGTON, INC.
Analysis of Changes in Financial Statements Resulting from the Examination
For the Year Ended December 31, 2006

	<u>BALANCE PER</u> <u>COMPANY</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>	<u>ref.</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>	<u>TOTAL</u>
Capital and Surplus, December 31, 2006 Per Annual Statement					\$133,823,651
<u>ASSETS</u>					
Uncollected premiums and agents' balances	8,302,476	7,343,319	2	959,157	
Receivables from parent, subsidiaries and affiliates	150,047	73,064,678	5,6	(72,914,631)	
<u>LIABILITIES</u>					
Premiums received in advance	7,766,557	6,807,400	2	(959,157)	
Amounts due to parent, subsidiaries and affiliates	4,784,949	13,639,817	4	8,854,868	
<u>CAPTIAL AND SURPLUS</u>					
Gross paid in and contributed surplus	104,456,000	80,456,000	1	(24,000,000)	
Unassigned funds (surplus)	24,833,456	112,893,219	1,4,5,6	88,059,763	
<u>STATEMENT OF REVENUE AND EXPENSES</u>					
Hospital/medical benefits	347,690,145	344,084,798	3	3,605,347	
Claims adjustment expenses	8,491,901	12,097,248	3	(3,605,347)	
General administrative expenses	44,226,420	34,713,317	4,5	9,513,103	
Surplus adjustments: Paid in		(24,000,000)	1	(24,000,000)	
Aggregate write-ins for gains or (losses) in surplus to prior years resulting from examination adjustments	0	78,546,660	1,4,6	<u>78,546,660</u>	
Change in surplus					<u>64,059,763</u>
Capital and Surplus, December 31, 2006 Per Examination					<u>\$197,883,414</u>

NOTES TO THE FINANCIAL STATEMENTS

The Company has no special consents, permitted practices or orders from the state of Washington. There were six examination report adjustments.

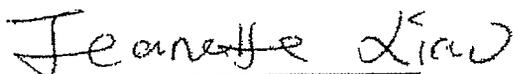
1. PCWA misclassified an extraordinary dividend in the 2005 NAIC Annual Statement in the amount of \$24,000,000. The Company reduced "Unassigned funds (surplus)" instead of "Gross paid in and contributed surplus". At the time of approval, the Company had an accumulated negative amount of "Unassigned funds (surplus)". An examination reclassification adjustment, debiting "Gross paid in and contributed surplus", and crediting "Unassigned funds (surplus)" is reflected in the preceding financial statements. (See Instruction No. 1.a.)
2. PCWA included an entry twice in recording "Premium received in advance" in the 2006 NAIC Annual Statement in the amount of \$959,157. An examination adjustment debiting, "Premium received in advance" and crediting, "Uncollected premiums and agents' balances in course of collection", is reflected in the preceding financial statements. (See Instruction No. 1.d.)
3. PCWA misclassified "Claim adjustment expenses" in the 2006 NAIC Annual Statement in the amount of \$3,605,347. An examination adjustment debiting, "Claim adjustment expenses" and crediting, "Hospital/medical benefits", is reflected in the preceding financial statements. (See Instruction No. 1.f.)
4. PCWA paid a management fee to PHPA based on 9.19% of net premiums not on actual costs. Management fees paid during the examination period were \$198,481,345. The actual cost as stated by the Company was \$207,336,213. An examination adjustment debiting, "Unassigned funds (surplus)" in the amount of \$9,209,498 for prior year adjustments, crediting, "Amounts due to parent subsidiaries and affiliates" in the amount of \$8,854,868 and crediting, "General administrative expenses" in the amount of \$354,630 for the current year adjustment, is reflected in the preceding financial statements. The tax effect is not considered in the examination adjustment. (See Instruction No. 4.)
5. PCWA paid royalty fees for year 2006 in the amount of \$9,158,473. An examination adjustment debiting, "Receivables from parent, subsidiaries and affiliates" and crediting, "General administrative expenses" is reflected in the preceding financial statements. The tax effect is not considered in the examination adjustment. (See Instruction No. 5.)
6. PCWA paid royalty fees for years 1999 through 2005 in the amount of \$63,756,158. An examination adjustment debiting "Receivables from parent, subsidiaries and affiliates" and crediting, "Unassigned funds (surplus)" is reflected in the preceding financial statements. (See Instruction No. 5.)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and staff of PacifiCare of Washington, Inc., during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Supervising Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Lichiou Lee, ASA, MAAA, Health Actuary; Shiraz Jetha, FSA, FCIA, MAAA, Health Actuary; Kathy Hicks, CPA, Financial Examiner; Ann Kauffman, CPA, Financial Examiner; Friday Enoye, Financial Examiner; Tony Quach, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Jeanette Jiangtao Liao, CPA, CFE
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
COUNTY OF KING }

Jeanette Jiangtao Liao, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of her knowledge and belief.

She attests that the examination of PacifiCare of Washington, Inc., was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Jeanette Liao
Jeanette Jiangtao Liao, CPA, CFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me on this 11th day of August, 2008.

Colleen Jansen
Notary Public in and for the
State of Washington.



Exhibit R-5

MIKE KREIDLER
STATE INSURANCE COMMISSIONER



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)	No. G06-4
)	
The Financial Examination of)	FINDINGS, CONCLUSIONS,
PACIFICARE OF WASHINGTON, INC.)	AND ORDER ADOPTING REPORT
)	OF
)	FINANCIAL EXAMINATION
A Registered Health Care Service Contractor.)	

BACKGROUND

An examination of the financial condition of **PACIFICARE OF WASHINGTON, INC.** (the Company) as of December 31, 2002, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of registration as a health care service contractor. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings and instructions was transmitted to the Company for its comments on September 21, 2005. The Company's response to the report is attached to this order only for the purpose of providing convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners work papers, and submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 16 of the report.

CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **PACIFICARE OF WASHINGTON** and to order the Company to take the actions described in the Instructions section of the report. **The Commissioner** acknowledges that the Company may have implemented the

PACIFICARE OF WASHINGTON
Order Adopting Examination Report
February 13, 2006
Mailing Address: P.O. Box 40255 • Olympia, WA 98504-0255
Street Address: 5000 Capitol Blvd. • Tumwater, WA 98501

Instructions prior to the date of this order. The Instructions in the report are an appropriate response to the matters found in the examination.

ORDER

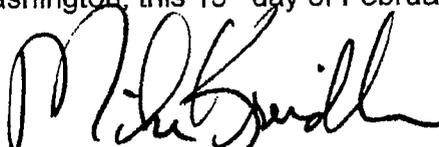
The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions contained in the examination report on pages 1-5.

1. The Company is ordered to comply with RCW 48.31C.060 and the requirements of Solicitation Permit No. 276 as required by RCW 48.06.180, pursuant to RCW 48.44.015, to obtain OIC's written approval of payments on surplus notes. Instruction 1, Examination Report, page 2.
2. The Company is ordered to correct all deficiencies relating to the safeguarding of securities and to execute a revised or amended custodial agreement pursuant to NAIC Annual Statement Instructions and the NAIC Accounting and Procedures Manual, as required by WAC 284-07-050(2). Adherence to the NAIC Financial Condition Examiners Handbook is included in this requirement. Instruction 2, Examination Report, page 4.
3. The Company is ordered to comply with RCW 48.12.070 and produce records, books and other information that are reasonably necessary to ascertain the financial condition of the Company. Instruction 3, Examination Report, page 4.
4. The Company is ordered to correctly classify all transactions as required by RCW 48.44.095, WAC 284-07-050, and the NAIC Annual Statement Instructions. Instruction 4, Examination Report, page 5.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 13th day of February, 2006.



MIKE KREIDLER
Insurance Commissioner

Exhibit R-6

STATE OF WASHINGTON

Phone (360) 725-7000
www.insurance.wa.gov

MIKE KREIDLER
STATE INSURANCE COMMISSIONER



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)

No. 08-111

The Financial Examination of)
PACIFICARE OF WASHINGTON, INC.)

) FINDINGS, CONCLUSIONS,
) AND ORDER ADOPTING REPORT
) OF FINANCIAL EXAMINATION
)

A Domestic Health Care Service
Contractor.

BACKGROUND

An examination of the financial condition of **PACIFICARE OF WASHINGTON, INC.** (the Company) as of December 31, 2006, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of registration as a health care service contractor. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and recommendations was transmitted to the Company for its comments on July 10, 2008. The Company's response to the report is attached to this order only for the purpose of a more convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and the submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 15 of the report.

PACIFICARE OF WASHINGTON, INC.
Order Adopting Examination Report
August 13, 2008

1

Mailing Address: P. O. Box 40255 • Olympia, WA 98504-0255
Street Address: 5000 Capitol Blvd. • Tumwater, WA 98501



Exhibit R-6
Page 1

CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **PACIFICARE OF WASHINGTON, INC.**, and to order the Company to take the actions described in the Instructions section of the report. The Commissioner acknowledges that the Company may have implemented some of the Instructions prior to the date of this order. The Instructions in the report are appropriate responses to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions contained in the examination report on pages 1-4.

1. The Company is ordered to file an accurate statement of its financial condition, transactions, and affairs in compliance with RCW 48.43.097, which requires the filing of its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions. Instruction 1, Examination Report, page 3.
2. The Company is ordered to keep and maintain sufficient detail records in accordance with RCW 48.03.030(1) and RCW 48.44.145(2). Instruction 2, Examination Report, page 3.
3. Pursuant to RCW 48.31C.050(1)(a-d) and SSAP No. 70, paragraph 8, the Company is ordered to reimburse affiliate transactions based on actual costs incurred by its affiliate. Instruction 3, Examination Report, page 3.
4. Pursuant to RCW 48.31C.070 and RCW 48.31C.050(1)(d), the Company is ordered to maintain accounts and records of each affiliate so that transactions clearly and accurately disclose the nature and details, including such accounting information as is necessary to support the reasonableness of the charges or fees at cost. Instruction 3, Examination Report, page 3.

5. Pursuant to RCW 48.31C.050(1)(a-c) and SSAP No. 70, paragraph 8, the Company is ordered to discontinue paying royalty fees either directly or indirectly and to seek reimbursement from PHPA for all royalty fees paid. Instruction 4, Examination Report, page 4.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 13th day of August, 2008.



MIKE KREIDLER
Insurance Commissioner

Exhibit R-7

FINAL BILL REPORT

SHB 1792

C 179 L 01

Synopsis as Enacted

Brief Description: Creating the holding company act for health care service contractors and health maintenance organizations.

Sponsors: By House Committee on Financial Institutions & Insurance (originally sponsored by Representatives Benson and Hatfield; by request of Insurance Commissioner).

House Committee on Financial Institutions & Insurance
Senate Committee on Labor, Commerce & Financial Institutions

Background:

The Insurer Holding Company Act requires that businesses obtain prior approval from the Office of the Insurance Commissioner (OIC) to acquire a domestic insurance company. For the acquisition to be approved, the acquiring party must file certain information with the OIC. This information includes the business and financial history of the acquiring party; the source, nature, and amount of the acquisition price; and any plans that will result in a material change in the business or corporate structure of the acquired company. The commissioner must approve the proposed acquisition within 60 days of receiving a complete application and after holding a public hearing on the proposed acquisition.

The Holding Company Act also requires that companies within a holding company system file a registration statement with the OIC. The registration statement includes detailed financial information about the insurance company; the identity and relationship of every member of the insurance holding company system; and material transactions between affiliates in the holding company system and the insurance company.

Every registered insurance company is also required to report to the OIC all dividends and other distributions to shareholders. The dividend report must be filed at least five business days after dividends are declared, and at least 15 business days before the company pays the dividend. After receiving the report, the commissioner makes a determination to verify the insurer's financial ability to declare the dividend. If the commissioner finds a company's surplus inadequate, the commissioner may order the company to stop payment of the dividend.

There are three types of health carriers in Washington: (1) disability insurers, which are traditional insurance companies that reimburse policyholders for covered health care expenses; (2) health care service contractors (HCSCs), which are organizations that provide health care services through a provider network to enrollees who have contracted with the HCSCs; and (3) health maintenance

organizations (HMOs), which are organizations that provide health care services to enrollees on a prepaid basis (generally monthly). All health carriers are regulated by the OIC as provided in state law. The OIC does not apply the Insurance Holding Company Act to HCSCs or HMOs, only to traditional insurance companies.

Summary:

A Holding Company Act for health care service contractors (HCSCs) and health maintenance organizations (HMOs) is established.

Any entity that desires to acquire an HCSC and an HMO created under the laws of another state and doing business in Washington must file a pre-acquisition notification with the Office of Insurance Commissioner. The commissioner determines the form and the information necessary for the pre-acquisition notification. The commissioner approves or denies acquisitions based on prescribed standards and procedures.

Any entity that desires to acquire a domestic HCSC or an HMO must send a statement detailing the acquisition to the Insurance Commissioner and the HCSC or HMO to be acquired. The statement filed with the commissioner includes various items such as the financial backgrounds of the individuals or businesses filing the statement, the source of the finances needed for the acquisition, fully audited financial statements for the preceding five years, any plans for liquidating or selling the assets of the domestic HCSC or HMO, and information on investments and securities. The commissioner must approve or deny the acquisition based on prescribed standards and procedures.

Every holding company system must keep its registration statement current. The HCSCs and HMOs that do business in Washington, but are domiciled in another state, do not have to file annual registration statements if the state of domicile has similar registration requirements. The registration statement contains current financial information, outstanding agreements and contracts, transactions not in the ordinary course of business, and the identity and relationship of every member of the holding company system.

The Insurance Commissioner regulates transactions within the holding company system. The commissioner may seek court orders enjoining violations of the act, seek civil and criminal penalties, and suspend, revoke, or refuse to renew registration. The commissioner has the authority to make rules and issue orders under the act.

Votes on Final Passage:

House: 94
Senate: 46

Effective: May 7, 2001

Exhibit R-8

FORM B

**HEALTH CARRIER HOLDING COMPANY SYSTEM
ANNUAL REGISTRATION STATEMENT**

**Filed with the Insurance Commissioner
of the State of Washington**

BY

PACIFICARE OF WASHINGTON, INC.
7525 SE 24th, Suite 200
Mercer Island, WA 98040

Dated: May 13, 2003

Name, Title, Address and Telephone Number of Individual to Whom
Notices and Correspondence Concerning this Statement Should be Addressed

Susan L. Berkel
Chief Financial Officer
PacifiCare of Washington
5995 Plaza Drive
MS: CY20-182
Cypress, CA 90630
(714) 226-3130

FORM B

ITEM 1. IDENTITY AND CONTROL OF REGISTRANT

- a. Name: PacifiCare of Washington, Inc.
(the "Registrant")
- b. Home and Principal Executive Office Address: 7525 SE 24th, Suite 200
Mercer Island, WA 98040
- c. Date on which Registrant became part of health care holding company system: October 11, 1985
- d. Method by which control of Registrant was acquired and is Maintained:

The Registrant was incorporated on October 11, 1985, as a wholly owned subsidiary of PacifiCare Operations, Inc. formerly known as PacifiCare Health Systems, Inc. ("PHS"). Effective March 31, 1999, PacifiCare Operations, Inc. merged with and into its affiliate, PacifiCare Health Plan Administrators, Inc. ("PHPA"), whereby PHPA survived. PHPA, a wholly owned subsidiary of PHS, formerly known as N-T Holdings, Inc., is now the direct parent company of the Registrant.

ITEM 2. ORGANIZATIONAL CHART

The organizational chart of PHS, which lists the present identities of and interrelationships among all affiliated persons within the insurance holding company system, as of August 1, 2002, is attached hereto as Exhibit A and incorporated herein by this reference. Unless otherwise noted, control over all entities identified on Exhibit A is maintained by 100% ownership or control of all of the voting securities. Each entity is a corporation. In all cases the organizations are corporations and they are domiciled in the states of their incorporation with the exceptions of those corporations incorporated in Delaware or in Indiana, which are domiciled in California.

ITEM 3. THE ULTIMATE CONTROLLING PERSON

- a. Name: PacifiCare Health Systems, Inc.
- b. Home Office Address: 5995 Plaza Drive
Cypress, California 90630
- c. Principal Executive Office Address: 5995 Plaza Drive
Cypress, California 90630
- d. Organizational Structure: A Delaware corporation
- e. Principal Business: A managed health care organization
- f. Information on persons owning ten percent or more of any class of voting security:

As of February 28, 2003, Capital Group International, Inc. located at 11100 Santa Monica Boulevard, 15th Floor, Los Angeles, California 90025 owns 4,383,600 shares of common stock (12.1%) of PHS. No other person owns 10% or more of any class of PHS' voting stock.

- g. Court information in connection with reorganization or liquidation: Not Applicable

ITEM 4. BIOGRAPHICAL INFORMATION

The biographical information for the executive officers and the directors of PHS, the ultimate controlling person, are attached hereto as Exhibit B and incorporated herein by this reference.

ITEM 5. TRANSACTIONS AND AGREEMENTS

The following is a complete description of all the agreements in force, relationships subsisting, and transactions currently outstanding or which have occurred during the calendar year of 2002 between the Registrant and its affiliates:

- (a) **Loans, other investments, or purchases, sales or exchanges of securities of the affiliates by the Registrant or of the Registrant by its affiliates:**

PHS loaned the Registrant \$40,000,000 on June 24, 1996, then made an additional loan to the Registrant of \$21,500,000 on September 30, 1996 to increase the Registrant's tangible net equity. Subordinated surplus notes made by the Registrant and held by PHS evidence these loan

transactions. \$46,000,000 is currently outstanding on the subordinated surplus notes, and no principal or interest payments were made on the subordinated surplus notes in 2002.

(b) **Purchases, sales or exchanges of assets:** None

(c) **Transactions not in the ordinary course of business:** None

(d) **Guarantees or undertakings for the benefit of an affiliate which result in an actual contingent exposure of the registrant's assets to liability, other than insurance contracts entered into in the ordinary course of the registrant's business:** None

(e) **All management agreements, service contracts and all cost-sharing arrangements:**

Effective January 1, 1999, the Registrant entered into a Management and Administrative Services Agreement PHPA, whereby PHPA provides comprehensive management and administrative services for the Registrant's operations, subject to the ultimate control and direction of the Registrant's Board of Directors. The fees associated with this Agreement during the 2002 calendar year were \$9,539,984.

(f) **Reinsurance agreements:**

A. The Registrant and PacifiCare Life Assurance Company (PLAC), a wholly owned subsidiary of PHPA entered into Reinsurance Agreement Number 9098-201, renewed effective January 1, 2000 pursuant to which the Registrant ceded and PacifiCare Life Assurance Company reinsured certain obligations of the Registrant under its member Services Agreements. This policy continues in effect.

B. The Registrant and PLAC, a wholly owned subsidiary of PHPA entered into Reinsurance Agreement Number 8098-202, renewed effective January 1, 2000 pursuant to which the Registrant ceded and PLAC reinsured certain obligations of the Registrant for PacifiCare of Oregon Members residing in the State of Washington. The total payments made in 2002 for both reinsurance agreements noted in this section 5(f)(A) and (B) is \$653,439.

(g) **Dividends and other distributions to shareholders:** None.

(h) **Consolidated tax allocation agreements:**

The Registrant and PHS entered into an Income Tax Allocation Agreement effective November 1, 1998, which remains in effect. Pursuant to this agreement, PHS will file a U.S. consolidated federal income tax return each year and PHS will allocate income tax liability to the Registrant.

(i) **Any pledge of the Registrant's stock or of the stock of any subsidiary or controlling affiliate, for a loan made to any member of the insurance holding company system:**

In April 2002, PHS executed an amendment to the Amended and Restated Credit Agreement, dated August 20, 2001 (the "Credit Agreement"), by and among PHS, the banks, financial institutions, and other institutional lenders from time to time party thereto (the "Lenders"), and Bank of America, N.A., as administrative agent ("BofA"), Registrant's parent, PHPA, pledged 100% of the common stock of Registrant to BofA, for the benefit of the Lenders, to secure the obligations of the PHS under the Credit Agreement. The amendment was entered into to extend the maturity date of the Credit Agreement to January 3, 2005. The Insurance Commissioner of the State of Washington was notified on December 14, 2001 of the transaction.

ITEM 6. LITIGATION OR ADMINISTRATIVE PROCEEDINGS

(a) There are no criminal prosecutions or administrative proceedings by any governmental agency or authority to which the ultimate controlling person, its directors or executive officers were parties that may be relevant to the trustworthiness of any party thereto.

(b) There are no proceedings that may have a material effect upon the solvency or capital structure of the ultimate controlling person.

ITEM 7. STATEMENT REGARDING PLAN OR SERIES OF TRANSACTIONS

Transactions entered into since the filing of the prior year's annual registration statement are not part of a plan or series of like transactions, the purpose of which is to avoid statutory threshold amounts and the review that might otherwise occur.

ITEM 8. FINANCIAL STATEMENTS AND EXHIBITS

Attached to this Statement and incorporated hereby by this reference are the following financial statements and exhibits:

- Exhibit A: Organizational Chart of PHS
- Exhibit B: Biographical Information of Directors and Executive Officers of PHS
- Exhibit C: PHS's Form 10-K Annual Report for fiscal year ending December 31, 2002
- Exhibit D: Notice of Annual Meeting of Shareholders of PHS held on June 13, 2002, and accompanying proxy statements
- Exhibit E: 2002 PHS Annual Report to Shareholders



ITEM 9. FORM C REQUIRED

See attached Form C.



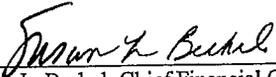
SIGNATURE AND CERTIFICATION

Signature

Pursuant to the requirements of RCW 48.31C.040, the Registrant has caused this registration statement to be duly signed on its behalf in the Cypress and State of California on the 13th day of May 2003.

(Seal)

PACIFICARE OF WASHINGTON, INC.,
a Washington corporation



Susan L. Berkel, Chief Financial Officer

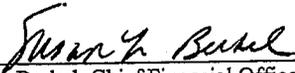
Attest:



Joseph S. Konowiecki, Secretary

Certification

The undersigned deposes and says that she has duly executed the attached registration statement dated May 13, 2003, for and on behalf of PacificCare of Washington, Inc.; that she is the Chief Financial Officer of such company, and that she is authorized to execute and file such instrument. Deponent further says that she is familiar with such instrument and that the facts therein set forth are true to the best of her knowledge, information and belief.



Susan L. Berkel, Chief Financial Officer

Exhibit R-9

Baker Chronology

07-12-07 RFI #K014c, the Examiner asks questions about individual expense items included in Company's spreadsheet used to explain costs as recorded on the UIE in the Annual Statement.

Company's Response, "These are direct expenses of PHPA, which is out of the scope of this audit. These expenses are used for the allocation % calculations only."

(See Attachment 6)

07-12-07 RFI # K014d, We asked the Company the following:

(1) Why it would not provide support for the actual costs of services received from the parent and to explain the reasoning because they were incurred directly by PHPA on behalf of PCW, OIC's request for the support was outside the scope of this exam.

(2) Why for the years 2003 thru 2006, the Company had not recorded actual expense.

Company Response: "Because the finance and accounting functions were being transitioned throughout 2006, these issues predate the current staff involved in the accounting for this agreement.

(See Attachment 7)

08-03-07 In the Company's comparison of actual expense vs. estimated expenses the Company is still identifying royalty fees as Management Contract Fees.

08-09-07 Conference Call with Corporate Financial Management. We asked for a conference call because we were past our budgeted completion date for field work but still had not received documentation for actual expenses. We were told by the Company that expenses incurred by affiliates on behalf of PCW were "outside our scope". We asked for an explanation of "outside our scope". The Company stated that the information was not outside our scope. We asked what made up the amount for "Management Contract Fees" Tom Lindquist, Financial Manager, stated that they were royalty fees that PCW paid to PacifiCare Life and Health Insurance Company. This was the first time in two examination periods covering year 1999 through 2006 that anyone in the Company identified payment of royalty fees. (See Attachment 8)

Conference Call Regarding UIE Expenses

Date and Time: August 09, 2007 at 9:00 am

The individuals in attendance are marked with an "*". "X" means the person did not attend.

From the OIC:

- * Carl Baker, Supervisor of the Health Team
- * Jeanette Liao, EIC
- * Kathy Hicks, Examiner

From the Company:

* Tom R Lindquist	952-992-5791	UnitedHealthcare	Dir, Finance
* Andrea Dawson	952-992-7464	UnitedHealthcare	Mgr. Finance
* John E. Burch	714-226-3873	UnitedHealthcare	Dir, Accounting
X Jane Knous (tentative)	714-226-3095	UnitedHealthcare	VP, Finance
* Ross Vernadahl	952-992-4484	UnitedHealthcare	Dir, Finance
* Karie Besore	952-992-4422	UnitedHealthcare	Sr. Financial Analyst
* James Nakamura	714-226-3523	UnitedHealthcare	Sr. Financial Analyst
* Rebeca de la Torre	916-567-2311	UnitedHealthcare	Project Director
* Lori Cottingham	512-347-2732	UnitedHealthcare	Compliance Consultant

OBJECTIVES

We called the meeting to reiterate that additional items are needed in order to complete an examination of the **actual** expenses that **should have** appeared on the 2006 *Underwriting and Investment Exhibit*. (UIE) (Page 14 of the 2006 Annual Statement.)

Per Carl, our objective is to obtain support for the actual expenses incurred in 2006. We need sufficient detail in order to determine if they are fair and reasonable. As of today, we still do not have a clear understanding from where the expenses are coming. We have used up our budget and do not have the information needed to complete the exam.

Carl later asked what "outside our scope" meant. (The Company did not respond to RFI K014c, IIA 4 & 5, IID 1 & 2 because it deemed that our questions about expenses incurred by affiliates on behalf of PCW were outside of the scope of our exam.) A person from the Company said that as far as he was concerned, this information was not

outside our scope. (The person did not directly address my question but since they stated that it was in our scope I passed in pursuing any further clarification, CMB)

Kathy described the detail that would typically be required for *salaries and wages*. As a starting point, we would need a payroll summary report for the year with gross wages less employee deductions to arrive at net pay. Employer deductions should be summarized. A reconciliation of source documentation to a W-3 transmittal or FUTA Form 940 report would be needed. From here, the allocation amongst affiliates should be described.

COMPANY'S RESPONSES

Refer to the "Preliminary Revised" Comparison of Actual Expenses on Contract Company vs. Management Fees Paid that was e-mailed to us prior to the meeting. The document outlines the actual expenses for 2006 (as of 08-09-07). The Company's answers to some of our questions are written on the document.

Carl asked what made up *Management Contract Fees*. Tom Lindquist explained that they were royalty fees that PCW paid to PacifiCare Life and Health Insurance Company (PLIC). He said that they were calculated based on 1.75% of premiums. (Later that day, he provided the calculation.) (Note that a related question was asked in the meeting on 06-06-07 and in RFI K014a, 3c. The Company was not forthcoming with an explanation and would only say that an amount was allocated to the UIE on Line 18. *Group service and admin fees based on management's discretion.* The Company denies paying royalty fees in RFI's K006, K006a, RFI K016a, Sample #3.d. Per Linda Spaulding, the Master License Agreement application was denied by the OIC.)

SEE
ATTACHED

Carl questioned the Company on whether or not PHPA's employees were still doing work for PCW. The Company said that during the first 6 months of 2006, the people that worked on PCW operations were employed by PHPA. For the second 6 months, most of the staff became employees of UHS. "UnitedHealth assumed PacifiCare employees."

The Company appears to be willing to get us the information that we need. One employee during our teleconference said that he didn't believe that our requests were out of the scope of our exam. (The statement is a retraction to the Company's position taken on RFI K014c, IIA 4 & 5, IID 1 & 2.) People on the other side of the phone line stated that they will work on our Action Items below and acknowledged the need to expedite the responses.

ACTION ITEMS DISCUSSED (Also, included in RFI K027 sent on 08-09-07);

1.) The Company believes that it can provide the following to us today;

- a.) G/L detail for all expenses on the attached "Preliminary Revised" Comparison of Actual Expenses on Contract Company vs. Management Fees Paid.

b.) Calculation of the *Management Contract Fees* of \$9,027,502. Per Tom Lindquist, these are royalty fees paid to PLIC. They are based on 1.75% of premiums.

2.) As soon as the Company can, it will provide;

- a.) The revised 2006 *Underwriting and Investment Exhibit* using the actual figures.
- b.) Refer to "*Preliminary Revised*" *Comparison of Actual Expenses on Contract Company vs. Management Fees Paid*. Provide supporting documentation for each line item. Explain how the chargebacks from corporate are derived and how they are allocated to each company and then to each line on the UIE.

MEETING ADJOURNED.