

SPECIAL REPORT ON EXAMINATION

OF

HEALTHNOW NEW YORK INC.

AS OF

DECEMBER 10, 2003

DATE OF REPORT

JUNE 7, 2004

EXAMINER

ROBERT W. MCLAUGHLIN, CFE, CIE

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

George E. Pataki
Governor

Gregory V. Serio
Superintendent

December 10, 2003

Honorable Gregory V. Serio
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the provisions of the New York Insurance Law and acting in accordance with the directions contained in Appointment Number 22035 dated March 13, 2003, annexed hereto, I have made an examination into the condition and affairs of HealthNow New York Inc., a non-profit health service corporation licensed pursuant to Article 43 of the New York Insurance Law. The following report, as respectfully submitted, deals with the findings concerning the manner in which HealthNow New York Inc. conducts its business practices and fulfills its contractual obligations to policyholders and claimants.

Whenever the designations "HealthNow" or "the Plan" appear herein without qualification, they should be understood to mean HealthNow New York Inc.

1. SCOPE OF EXAMINATION

A review of how HealthNow New York Inc. conducts its business practices and fulfills its obligations to policyholders and claimants was performed. Such review included a review of board governance procedures prior to and subsequent to the separation of the employment service of HealthNow's former President and Chief Executive Officer in February 2003.

The primary purpose of this report is to assist HealthNow New York Inc.'s management in addressing areas where improvements in corporate governance could be implemented. The performance dates of this review are January 1, 1998 through December, 10, 2003. This report's comments chiefly involve matters that depart from New York laws, regulations and rules or those which are deemed to require an explanation or description from the Plan.

2. EXECUTIVE SUMMARY

The results of this examination revealed certain operational deficiencies, including deficiencies related to the board governance of the Plan during the examination period. The most significant findings of this examination include the following:

- The Plan's board committees and the President and CEO conducted much of the core governance of the Plan without the prior approval oversight of the full board of directors.
- Failure to adequately document discussion of potential conflicts of interest at the Board of Directors level.
- HealthNow entered into contracts with providers wherein certain HealthNow directors were also directors or officers of such providers. Such contracts were effected without a majority vote of HealthNow's board of directors.
- Frequent use of "Executive Sessions" at such meetings in which little or no minutes of such proceedings are maintained.

- Board and Nominating Committee minutes of meetings indicated that, with few exceptions, potential board members were presented for consideration primarily by the Chairman of the board or the former President and CEO. Also, the review of minutes indicated little discussion was held relative to board member criteria qualifications.
- Limited oversight and Board of Directors approval of executive compensation paid to the Plan's officers and key employees prior to 2003.
- Little evaluation of board member and senior management performance in achieving identified goals and objectives of the Plan.
- Failure to adequately monitor and document the cost vs. benefits to the Plan and its parent company, New York Care Plus Holding Company, Inc. (now known as HealthNow Systems, Inc.) under its business relationship with Xerox Corporation.
- Failure to submit its Excess Benefit and Compensation Limit Plan (SERP) and amendments to its defined pension plans and 401(k) plans to the New York Insurance Department for approval prior to implementation.

The examination findings are described in greater detail in the remainder of this report.

3. BOARD GOVERNANCE

A. Board Oversight of Delegated Corporate Powers

A review of HealthNow's board and committee meetings, conducted during the period under review, noted that the Plan's board committees and the President and CEO conducted much of the core governance of the Plan without the prior approval oversight of the full board of directors in all cases. Examples of limited oversight of delegated powers on the part of the board included limited review of disclosed conflicts of interest by members the board, lack of performance evaluations of both the members of the board of directors and senior management, officer compensation and other matters as noted in this report.

Article IV, Section 1 of the HealthNow New York Inc. by laws states,

“Powers and Duties. The property, business, and affairs of the Corporation shall be managed by a Board of Directors. In the management and control of the property, business, and affairs of

the Corporation, the Board of Directors may exercise all of the powers of the Corporation except such as may be otherwise conferred by law or these By-laws or the Corporation's Certificate of Incorporation."

It is recommended that the Plan's board of directors comply with Article IV, Section 1 of its by-laws and maintain management and control of the property, business and affairs of the corporation. It is further recommended that all delegation of such board management and control of the property, business and affairs of the corporation should be appropriately monitored by the board of directors.

During the later part of the examination period in 2003, the Plan increased the number and length of its of the Board of Directors and Committees meetings, and began a comprehensive review of its governance procedures.

B. Interested Directors and Officers

During the examination period, HealthNow entered into contracts with providers and vendors in which certain HealthNow directors were also directors, officers or employees of such providers or significant vendors. Interested directors included Directors Boyle, Castiglia, Metcalf, Rickard and Woerner.

Director Boyle, during the examination period, was also CEO of St. Peter's Health Care Services of Albany, NY. St. Peter's Health Care Services includes St. Peter's Hospital, a large hospital provider in the Albany, NY area.

It was noted that Chairman Castiglia, during the examination period, was also Chairman of the Board of the Catholic Health System (CHS), a network of hospital and providers within

the Buffalo, NY area. CHS is also affiliated with Catholic IPA, a large Buffalo, NY area IPA network.

Director Metcalf, M.D., during the examination period, was also Chairman of the Board of Highgate Medical Group, a significant provider group in the Buffalo, NY area.

Director Rickard, prior to his appointment to the HealthNow board of directors, was Group President & Corporate Senior Vice President (now retired) of Xerox Corporation. It is noted that Director Rickard, prior to his appointment to the HealthNow board of directors was the Xerox representative who signed the preliminary agreement relative to the HealthNow/Xerox business alliance agreement on the part of Xerox Corporation, which is discussed later in this report. Such agreement called for the naming of a Xerox representative to be appointed to the HealthNow board of directors.

Director Woerner, during the examination period, was also Chairman and CEO of Health Care Resources, a home health provider in the Rochester, NY area.

Such contracts were effected without a majority vote of HealthNow's board of directors.

Section 715 of the Not-for-Profit Corporation law states in part,

“(a) No contract or other transaction between a corporation and any one more of its directors or officers, or between a corporation and any other corporation, firm, association or other entity in which one or more of its directors or officers are directors or officers, or have a substantial financial interest, shall be either void or voidable for this reason alone or by reason alone that such director or directors or officer or officers are present at the meeting of the board, or of a committee thereof, which authorizes such contract or transaction, or that his or their votes are counted for such purpose:

(1) If the material facts as to such director's or officer's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the board or committee, and the board or committee authorizes such contract

or transaction by a vote sufficient for such purpose without counting the vote or votes of such interested director or officer; or

(2) If the material facts as to such director's or officer's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the members entitled to vote thereon, if any, and such contract or transaction is authorized by vote of such members.

(b) If such good faith disclosure of the material facts as to the director's or officer's interest in the contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the members entitled to vote thereon, if any, and such contract or transaction is authorized by vote of such members."

It is recommended that the Plan comply with the provisions of Section 715 of the New York Not-for-Profit Corporation Law with regard to effecting contracts or transactions with providers and other entities in which certain HealthNow directors are also directors or officers of such providers or other entities.

C. Home Health Agencies – Proposal Procedures

A review was made of the Plan's evaluation of prospective participation of Home Health Care agencies within the Rochester, NY metropolitan area, including a Home Health Care agency owned by one of HealthNow's directors, Louise L. Woerner. It was noted that HealthNow was not able to provide certain information relative to the procedures used in determining the fee schedules for home health care agencies within the Rochester, NY area.

It is recommended that the Plan, in the future, maintain within its files, detail information relative to the procedures used in determining the fee schedules for all of its participating home health care agencies.

D. Conflict of Interest Procedures

The examination review revealed that certain directors were engaged in outside business practices that have, at least, the appearance of potential conflicts with their roles as directors of the Plan. During the examination period, conflict of interest statements were submitted to the

Plan's internal audit section and reviewed in conformity with the Plan's policy. However, not all of the Plan's potential conflicts of interest were identified or noted in the Board or Committee minutes of meetings.

A review of the Plan's existing Conflict of Interest forms, signed by the Plan's board members and officers indicates that such form should be enhanced to provide for additional disclosure of conflicts including disclosure of a medical practice in New York State, disclosure of family members that work for, or have a connection with providers of health care services, disclosure of filer or family member of filer as a supplier of services to the Plan or member of the HealthNow holding company system, and disclosure of filer or family member are owners of a corporation whose aggregate sales to (1) hospitals, (2) licensed medical professions and (3) facilities of health service, hospital service and medical expense indemnity corporations exceed 5% of its total sales.

It is recommended that HealthNow enhance its conflict of interest forms for its directors, officers and key employees by including such additional disclosure items as indicated above or other items as necessary. It is further recommended that the Plan enhance its review of such conflict of interest statements and require more comprehensive documentation to support a determination that conflicts do not exist.

E. Board Member Nomination Process

It was noted that a review of the Board and Nominating Committee minutes of meetings indicated that, with few exceptions, potential board members were presented for consideration primarily by the Chairman of the board or the former President and CEO. Also, the review of minutes indicated little discussion was held relative to board member criteria qualifications.

Article IV, Section 4 of the HealthNow New York Inc. by-laws states in part,

“Filling of Vacancies. Any vacancy on the Board of Directors shall be filled promptly by a majority vote of the remaining directors.”

It is recommended that the entire board of directors become more involved in the recruitment of potential members of the board, including setting the criteria qualifications for such potential board members.

F. Executive Compensation

A review of the minutes of meetings of the HealthNow New York Inc. board of directors and committees indicated that there is a need for more enhanced documentation of board oversight over executive compensation.

Article VI, Section 4 of the Plan's by-laws states in part,

*“**Compensation of Officers.** Officers who are full-time employees of the Corporation shall receive reasonable compensation for their services, the compensation of the President and Chief Executive Officer to be determined by the Executive Committee and the compensation of all other officers to be determined by the President and Chief Executive Officer with the advice and consent of the Executive Committee.”*

It was noted that although reports may have provided to the board during “Executive Session”, no specific approval of the former President and CEO's specific compensation was noted in the minutes of meetings of the board of directors. Although the board may have been aware of the Executive Committee's approval of the former President and CEO's salary and other compensation, there were no compensation amounts specifically approved by the board included in the board minutes for the years reviewed.

The review indicated limited other executive compensation paid to the Plan's officers and key employees discussion in the minutes of Board of Directors meetings prior to 2003. During 2003, the board minutes reflected enhanced review and approval of officer compensation.

It is recommended that the Plan's board of directors continue to approve a specific amount relative to the President and CEO's salary and other compensation. It is also recommended that the Plan's board of directors maintain approval governance over compensation paid to senior level officers and compensation approval governance in excess of a pre-established monetary threshold for other officers. It is further recommended that such board approved salary and other compensation, relative to such officers, be specified by individual officer and included within the board's minutes of meetings.

G. Board Member/Senior Management Performance Evaluation

A review of the minutes of meetings of HealthNow's board of directors indicated very little evaluation of board member and senior management performance in achieving identified goals and objectives of the Plan. It is noted that the board has recently entered into discussion relative to such lack of evaluation process. Such lack of evaluation process pertaining to the goals and objectives of the Plan may have led to the recent rift between certain members of the board and the former President and CEO.

It is recommended that the Plan develop a performance evaluation process relative to board members and senior management in order to determine that the goals and objectives of the Plan are met.

H. Minutes of Meetings – Use of “Executive Session”

A review of the minutes of meetings of HealthNow's board and committees revealed the frequent use of “Executive Sessions” at such meetings in which little or no minutes of such proceedings are maintained.

Article VII, Section 3 of the Plan's by-laws states in part,

“Each committee...shall keep a record of all its proceedings...”

It is recommended that the HealthNow board and committees comply with Article VII, Section 3 of its by-laws and limit the use of “Executive Session” in its meetings whereby little or no minutes of such proceedings are maintained.

I. Board Meeting Notices

Article V, Section 3 of the HealthNow New York Inc. by-laws states,

“Notice of Meetings. Unless otherwise prescribed by law, notice of the time, place, and purposes of any meeting of the Board of

Directors shall be delivered either personally or by mail, facsimile, or courier service to each Director at each Director’s address or facsimile number as it appears upon the records of the Corporation or, in the event it does not so appear, to his last known post office address or facsimile number, at least three (3) days prior to the meeting.”

A review of the notices of meetings for the board meetings held in 2003 by HealthNow, New York Inc. revealed that delivery of notices to directors relative to the January 30, 2003 board meeting was evidenced as being received within the three day time frame – a time frame not prescribed in the Plan’s by-laws. Also, no evidence was included within the Plan’s files as to such notices having been delivered within such time frame to certain directors for the May 22, 2003 and August 18, 2003 board meetings.

It is noted that the above notice of meeting procedures did not appear to contribute to any of HealthNow’s directors not attending such meetings.

It is recommended that the Plan comply with Article V, Section 3 of its by-laws relative to the delivery of notice of meeting time-frame requirements and that the Plan maintain adequate evidence of the delivery of notice of meeting to each of its directors within its files.

J. Non-Director Appointments to Board Committees

During the examination period, HealthNow's board of directors appointed non-director individuals, including outside investment advisors and HealthNow non-board member officers and staff to serve on its Board Committees. Such appointments of non-board members to Board Committees are not specifically included in the Plan's by-laws.

Article VII, Section 2 of the HealthNow New York Inc. by-laws states in part,

“Section 2. Powers and Duties of Committees. Each such committee shall have powers and duties as shall be fixed by these By-laws or by resolution of the Board of Directors. To the extent provided in these By-laws, each committee shall have and may exercise all the powers and authority of the Board of Directors in the management of the business, property, and affairs of the Corporation...”

Inasmuch as the Board Committees maintain the powers as noted in Article VII, Section 2 of the Plan's by-laws, and inasmuch as the Committees may invite guests, including staff to meetings as needed, it is recommended that the Plan limit its Committee members to members of its elected board of directors.

4. JOINT VENTURE WITH XEROX CORPORATION

On June 8, 1999, the Plan, New York Care Plus Holding Company, Inc. (now known as HealthNow System, Inc.) and Xerox Corporation (Xerox) entered into a business alliance agreement in which Xerox and HealthNow agreed to work together to create a set of business document or business processes to improve customer communications. In addition, the alliance projected that Xerox would be provided a set of repeatable document or business solutions that could be marketed to other healthcare industry companies.

As part of HealthNow's responsibilities under the agreement, HealthNow agreed to recognize Xerox Business Services (XBS) as its preferred vendor for the procurement of all document-related services and to acquire XBS services and utilize XBS products. The agreement called for HealthNow to purchase such services from XBS at specified annual amounts. The

agreement also called for HealthNow to pay an investment recovery fee to XBS in the event that XBS' invoices to HealthNow did not reach specified levels as per the contract.

During the period covered under the contract, HealthNow, as of mid September, 2003, had paid approximately \$8M to XBS with a remaining commitment to XBS estimated at approximately \$4.5M. In addition, HealthNow, in 2000, paid an investment recovery fee (as defined above) of \$112,000 to XBS pursuant to the contract.

The agreement also called for Xerox to pay HealthNow a commission of 2% relative to any repeatable document solutions developed and re-marketed as an outcome of the joint venture. To date, the joint venture has not produced any marketable repeatable document solutions, which have resulted in any commissions to be paid to HealthNow.

In light of the above significant expenditures made to Xerox and \$ 0 commissions earned by HealthNow pursuant to its joint venture with Xerox, it is recommended that HealthNow reconsider the continuance of its joint venture business alliance with Xerox Corporation.

5. RETENTION OF BOARD CONSULTANTS/LAW FIRMS

It is noted that, during the examination period, certain members of the board of directors, without the full board's knowledge, engaged a consulting firm and two law firms relative to board and senior management matters. Inasmuch as such consultant and law firms were retained for the purpose of advising the full board and/or investigating specific director and senior management complaints on behalf of the board of directors, it would appear appropriate for the full board to determine whether such consultant and law firms should be retained as well as the scope of the engagement.

It is recommended that, in the future, HealthNow's board of directors approve the retention of those consulting and law firms which have been retained for the purpose of advising the board of directors as well as the scope of such engagements.

6. OFFICER/EMPLOYEE BENEFIT PLANS

It was noted that the Plan, at the time of the examination had not submitted its Excess Benefit and Compensation Limit Plan (SERP) and amendments to its defined pension plans and 401(k) plans to the Superintendent of Insurance for approval prior to implementation.

Prior to the examination date, the Plan had submitted its SERP for approval. However, as of the examination date, such SERP had not been approved. During the examination, upon being informed that such amendments to its defined pension plans and 401(k) plans needed to be approved by the Superintendent of Insurance, the Plan indicated that it would send such amendments to the Superintendent of Insurance for approval.

Section 4312(b) of the New York Insurance Law states, in part,

“No such corporation shall grant any pension to any officer, director or trustee thereof or to any member of his family after death, except that such corporation may, in pursuance of the terms of the retirement plan adopted by the board of directors of such corporation and approved by the superintendent, provide for any person who is a salaried officer or employee of such corporation, a pension payable at the time of his retirement by reason of age or disability, ”

It is recommended that the Plan, in the future, comply with the requirements of Section 4312(b) of the New York Insurance Law and submit all unapproved retirement plans, 401(k) plans, SERP agreements and any amendments to such plans and agreements for approval to the Superintendent of Insurance prior to implementation.

7. PROMPT PAYMENT INTEREST

The Plan reported prompt pay interest of \$615,976 on 14,971 claims in its June 30, 2003 quarterly statement and \$697,763 on 19,977 claims in its September 30, 2003 quarterly statement. Both interest payment amounts are relatively high compared to the number of claims reported.

According to the Plan's examination response to an examination inquiry relative to the June 30, 2003 reported interest payment amount, the Plan indicated the following:

1. An accrual of \$120,000 for interest estimated to be owed to members for denied emergency room services claims. Such amount had not been paid as of June 30, 2003.
2. Interest that may have been paid on non-insured business, i.e. ASO business.
3. Interest may have been paid on adjustments based on retroactive rate agreements.

In addition, the Plan indicated that the interest payments are higher than those reported by its competitors – although less than for a comparable period in 2002 when, according to the Plan, a computer error relative to payments made on adjusted claims resulted in overpayments.

The Plan has indicated that it is conducting an internal audit review of prompt payment interest payments in order to determine the cause of the relatively large amount of interest payments on a relatively low number of affected claims.

It is recommended that the Plan continue to review its procedures relative to the payment of claims beyond the forty-five (45) day limitation and interest thereon as set forth by Section 3224-a of the New York Insurance Law and report the results of such review to this Department.

8. LEVEL PREMIUM RATING

A review of the Plan's level premium rating program revealed that the Plan did not maintain signed group remittance contracts which contained the level premium rating methodology for all groups receiving level premium rates.

It is recommended that the Plan maintain signed copies of a Department approved rider or group remittance contracts with all groups receiving level premium or guaranteed rates.

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following is a summary of the comments and recommendations made in the body of this report:

<u>ITEM NO.</u>	<u>PAGE NO.</u>
A.	
<u>Board Governance</u>	
It is recommended that the Plan's board of directors comply with Article IV, Section 1 of its by-laws and maintain management and control of the property, business and affairs of the corporation.	4
It is further recommended that all delegation of such board management and control of the property, business and affairs of the corporation should be appropriately monitored by the board of directors.	4
It is recommended that the Plan comply with the provisions of Section 715 of the New York Not-for-Profit Corporation Law with regard to effecting contracts or transactions with providers and other entities in which certain HealthNow directors are also directors or officers of such providers or other entities.	6
It is recommended that the Plan, in the future, maintain within its files detail information relative to the procedures used in determining the fee schedules for all of its participating home health care agencies.	6
It is recommended that HealthNow enhance its conflict of interest forms for its directors, officers and key employees by including such additional disclosure items as indicated in the body of the report or other items as necessary.	7
It is further recommended that the Plan enhance its review of such conflict of interest statements and require more comprehensive documentation to support a determination that conflicts do not exist.	7

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It is recommended that the entire board of directors become more involved in the recruitment of potential members of the board, including setting the criteria qualifications for such potential board members.	8
It is recommended that the Plan's board of directors continue to approve a specific amount relative to the President and CEO's salary and other compensation.	9
It is also recommended that the Plan's board of directors maintain approval governance over compensation paid to senior level officers and compensation approval governance in excess of a pre-established monetary threshold for other officers.	9
It is further recommended that such board approved salary and other compensation, relative to such officers, be specified by individual officer and included within the board's minutes of meetings.	9
It is recommended that the Plan develop a performance evaluation process relative to board members and senior management in order to determine that the goals and objectives of the Plan are met.	9
It is recommended that the HealthNow board and committees comply with Article VII, Section 3 of its by-laws and limit the use of "Executive Session" in its meetings whereby little or no minutes of such proceedings are maintained.	10
It is recommended that the Plan comply with Article V, Section 3 of its by-laws relative to the delivery of notice of meeting time-frame requirements and that the Plan maintain adequate evidence of the delivery of notice of meeting to each of its directors within its files.	11

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	11
It is recommended that the Plan limit its Committee members to members of its elected board of directors.	
B. <u>Joint Venture with Xerox Corporation</u>	12
It is recommended that HealthNow reconsider the continuance of its joint venture business alliance with Xerox Corporation.	
C. <u>Retention of Board Consultants/Law Firms</u>	13
It is recommended that, in the future, HealthNow's board of directors approve the retention of those consulting and law firms which have been retained for the purpose of advising the board of directors as well as the scope of such engagements.	
D. <u>Officer/Employee Benefit Plans</u>	14
It is recommended that the Plan, in the future, comply with the requirements of Section 4312(b) of the New York Insurance Law and submit all unapproved retirement plans, 401(k) plans, SERP agreements and any amendments to such plans and agreements for approval to the Superintendent of Insurance prior to implementation.	
E. <u>Prompt Payment Interest</u>	15
It is recommended that the Plan continue to review its procedures relative to the payment of claims beyond the forty-five (45) day limitation and interest thereon as set forth by Section 3224-a of the New York Insurance Law and report the results of such review to this Department.	
F. <u>Level premium rating</u>	15
It is recommended that the Plan maintain signed copies of a Department approved rider or group remittance contracts with all groups receiving level premium or guaranteed rates.	

Respectfully submitted,

Robert W. McLaughlin, CFE,CIE
Principal Insurance Examiner

STATE OF NEW YORK)
)SS.
)
COUNTY OF ERIE)

ROBERT W. MCLAUGHLIN, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Robert W. McLaughlin

Subscribed and sworn to before me

this _____ day of _____ 2004.

Appointment No. 22035

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Robert McLaughlin

as a proper person to examine into the affairs of the

HEALTHNOW NEW YORK INC.

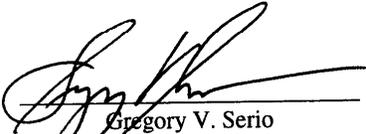
and to make a report to me in writing of the said

Company

with such information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal
of this Department, at the City of New York.

this 13th day of March, 2003



Gregory V. Serio
Superintendent of Insurance

