



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

JUL 03 2006

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Report Number: A-07-05-00192

Mr. Kent Marquardt, Chief Financial Officer
Premera Blue Cross
7001 220th SW, MS 349
Mountlake Terrace, Washington 98043

Dear Mr. Marquardt:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General (OIG) final report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by Premera Blue Cross for Fiscal Years 1996 Through 2004." A copy of this report will be forwarded to the HHS action official noted on the next page for his review and any action deemed necessary.

The HHS action official will make final determination regarding actions taken on all matters in the report. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports are made available to the public to the extent information contained therein is not subject to exemptions of the Act that the Department chooses to exercise (see 45 CFR part 5).

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, extension 274, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-05-00192 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Patrick J. Cogley", written over a large, stylized flourish.

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Mr. RJ Ruff
Regional Administrator, Region X
Centers for Medicare & Medicaid Services
2201 Sixth Avenue, MS 40
Seattle, Washington 98121

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF PENSION COSTS
CLAIMED FOR MEDICARE
REIMBURSEMENT BY PREMERA
BLUE CROSS FOR FISCAL YEARS
1996 THROUGH 2004**



Daniel R. Levinson
Inspector General

July 2006
A-07-05-00192

Office of Inspector General

<http://oig.hhs.gov>

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Notices

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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

Premera Blue Cross (Premera) administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services until the contractual relationship was terminated effective September 30, 2004.

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and Medicare contracts.

The Medicare contracts require contractors to allocate or separately calculate pension costs. The separate calculation method must be used if there is a material difference between the results of the two methods.

OBJECTIVE

Our objective was to determine the allowability of pension costs that Premera claimed for Medicare reimbursement for fiscal years (FYs) 1996 through 2004.

SUMMARY OF FINDING

Premera did not claim all pension costs that were allowable for Medicare reimbursement for FYs 1996 through 2004 because it did not claim pension costs in accordance with the Medicare contract. Therefore, Premera underclaimed \$36,923 of allowable pension costs.

RECOMMENDATION

We recommend that Premera revise its Final Administrative Cost Proposals to claim allowable CAS pension costs of \$36,923 for FYs 1996 through 2004.

AUDITEE'S COMMENTS

Premera concurred with our recommendation. Premera's response is included in its entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We commend Premera for its action to address the recommendation.

INTRODUCTION

BACKGROUND

Premera

Premera Blue Cross (Premera) administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective September 30, 2004.

Medicare

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with the Cost Accounting Standards (CAS) 412 and 413; and (2) funded as specified by part 31 of the Federal Acquisition Regulations (FAR).

Beginning in fiscal year (FY) 1988, CMS incorporated specific segmentation language into Medicare contracts that requires contractors to use either an allocation method or a separate calculation method to identify and claim pension costs for Medicare reimbursement. Under the allocation method, the contractor determines total plan CAS pension costs and allocates a share to Medicare. Under the separate calculation method, the contractor separately identifies the pension cost components for the Medicare segment. The separate calculation method must be used if its result is materially different from that of the allocation method.

Regulations

The Medicare contracts address the determination and allocation of pension costs. The contracts state: “The calculation of and accounting for pension costs charged to this agreement/contract are governed by the FAR and CAS 412 and 413.”

The FAR 31.205-6(j) addresses allowability of pension costs and requires plan contributions to substantiate pension costs assigned to contract periods.

The CAS 412 regulates the determination and measurement of pension cost components. It also regulates the assignment of pension costs to appropriate accounting periods.

The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of pension costs claimed by Premera for Medicare reimbursement for FYs 1996 through 2004.

Scope

We reviewed pension costs claimed for Medicare reimbursement on Premera's Final Administrative Cost Proposals (FACP) for FYs 1996 through 2004. Achieving the objective did not require that we review Premera's overall internal control structure. However, we did review the internal controls relating to the pension costs claimed for Medicare reimbursement to ensure that pension costs were allowable in accordance with the CAS and funded in accordance with the FAR.

We performed fieldwork at Premera's office in Mountlake Terrace, WA, during December 2004 and June 2005.

Methodology

In performing our review, we used information that Premera's actuarial consulting firm provided. The information documented Premera's methodology to separately calculate Premera's CAS pension costs. The information also included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined Premera's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s.

We identified Premera's CAS pension costs for the total company and for the Medicare segment. We also determined the extent to which Premera funded CAS pension costs with contributions to the pension trust fund and accumulated prepayment credits. Using this information, we calculated CAS pension costs that were allowable for Medicare reimbursement for FYs 1996 through 2004. The calculations were based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. The CMS Office of the Actuary calculated the allocable CAS pension costs based on Premera's historical practices and on the results of our segmentation review "Review of Pension Segmentation Requirements at a Terminated Medicare Contractor, Premera Blue Cross" (A-07-05-00191). Appendix A contains details of the pension costs and contributions.

We performed our review in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATION

ALLOWABLE PENSION COSTS NOT CLAIMED

Premera did not claim \$36,923 of pension costs that were allowable for Medicare reimbursement for FYs 1996-2004.

Medicare reimburses its portion of contractors' annual pension costs. In claiming costs, contractors are to follow cost reimbursement principles contained in the FAR, the CAS, and the Medicare contracts. Premera based its claim only on a separately computed CAS pension cost for the Medicare segment. However, Premera did not claim pension costs from indirect operations.

We calculated the allowable pension costs based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. We compared allowable CAS pension costs with the pension costs claimed on Premera's FACPs, as shown in the table below.

Pension Costs Claimed Variance

Fiscal Year	OIG	Premera	Difference
1996	\$19,223	\$8,729	\$10,494
1997	12,243	0	12,243
1998	13,518	0	13,518
1999	26,837	0	26,837
2000	24,594	0	24,594
2001	31,392	122,794	(91,402)
2002	158,333	166,516	(8,183)
2003	262,935	231,531	31,404
2004	274,159	256,741	17,418
TOTAL	\$823,234	\$786,311	\$36,923

For FYs 1996 through 2004, Premera claimed pension costs of \$786,311 for Medicare reimbursement; however, allowable CAS pension costs were \$823,234. As a result, Premera did not claim \$36,923 of allowable pension costs. The underclaim occurred primarily because it did not claim allowable indirect pension costs.

RECOMMENDATION

We recommend that Premera revise its FACPs to claim allowable CAS pension costs of \$36,923 for FYs 1996 through 2004.

AUDITEE'S COMMENTS

Premera concurred with our recommendation. Premera's response is included in its entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We commend Premera for its action to address the recommendation.

APPENDIXES

**STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1996 THROUGH 2004**

Date	Description	Total Company	Other Segment	Medicare Segment
1995	CY Allocable Cost	1/	\$0	\$28,435

1996	Contributions	<u>2/</u>	0	0	0
8.50%	Discount For Interest	<u>3/</u>	0	0	0
01/01/1996	Present Value Contributions	<u>4/</u>	0	0	0
01/01/1996	Prepayment Credit	<u>5/</u>	1,360,975	1,360,975	0
01/01/1996	Present Value Of Funding	<u>6/</u>	1,360,975	1,360,975	0
01/01/1996	CAS Funding Target	<u>7/</u>	1,360,975	1,360,975	0
01/01/1996	Percentage Funded	<u>8/</u>		100.00%	0.00%
01/01/1996	Funded Pension Cost	<u>9/</u>		1,360,975	0
	Allowable Interest	<u>10/</u>		0	0
	CY Allocable Pension Cost	<u>11/</u>		1,360,975	0
	FY Allocable Pension Cost	<u>12/</u>		1,020,731	7,109
	Medicare LOB* Percentage	<u>13/</u>		1.22%	95.23%
	FY Allowable Pension Cost	<u>14/</u>	\$19,223	\$12,453	\$6,770

1997	Contributions		\$320,000	\$320,000	\$0
8.50%	Discount For Interest		(14,808)	(14,808)	0
01/01/1997	Present Value Contributions		305,192	305,192	0
01/01/1997	Prepayment Credit		1,444,505	1,444,505	0
01/01/1997	Present Value Of Funding		1,749,697	1,749,697	0
01/01/1997	CAS Funding Target		1,444,505	1,444,505	0
01/01/1997	Percentage Funded			100.00%	0.00%
01/01/1997	Funded Pension Cost			1,444,505	0
	Allowable Interest			0	0
	CY Allocable Pension Cost			1,444,505	0
	FY Allocable Pension Cost			1,423,623	0
	Medicare LOB Percentage			0.86%	94.15%
	FY Allowable Pension Cost		\$12,243	\$12,243	\$0

1998	Contributions		\$945,031	\$945,031	\$0
8.50%	Discount For Interest		(74,035)	(74,035)	0
01/01/1998	Present Value Contributions		870,996	870,996	0
01/01/1998	Prepayment Credit		793,112	793,112	0
01/01/1998	Present Value Of Funding		1,664,108	1,664,108	0
01/01/1998	CAS Funding Target		1,664,108	1,664,108	0
01/01/1998	Percentage Funded			100.00%	0.00%
01/01/1998	Funded Pension Cost			1,664,108	0
	Allowable Interest			52,441	0
	CY Allocable Pension Cost			1,716,549	0
	FY Allocable Pension Cost			1,648,538	0
	Medicare LOB Percentage			0.82%	96.04%
	FY Allowable Pension Cost		\$13,518	\$13,518	\$0

*Line of business.

**STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1996 THROUGH 2004**

Date	Description	Total Company	Other Segment	Medicare Segment
1999	Contributions	\$5,240,471	\$5,240,471	\$0
8.50%	Discount For Interest	(410,544)	(410,544)	0
01/01/1999	Present Value Contributions	4,829,927	4,829,927	0
01/01/1999	Prepayment Credit	0	0	0
01/01/1999	Present Value Of Funding	4,829,927	4,829,927	0
01/01/1999	CAS Funding Target	3,128,852	3,128,852	0
01/01/1999	Percentage Funded		100.00%	0.00%
01/01/1999	Funded Pension Cost		3,128,852	0
	Allowable Interest		188,383	0
	CY Allocable Pension Cost		3,317,235	0
	FY Allocable Pension Cost		2,917,064	0
	Medicare LOB Percentage		0.92%	96.75%
	FY Allowable Pension Cost	\$26,837	\$26,837	\$0

2000	Contributions	\$6,515,669	\$6,515,669	\$0
8.50%	Discount For Interest	(493,038)	(493,038)	0
01/01/2000	Present Value Contributions	6,022,631	6,022,631	0
01/01/2000	Prepayment Credit	1,845,667	1,845,667	0
01/01/2000	Present Value Of Funding	7,868,298	7,868,298	0
01/01/2000	CAS Funding Target	3,480,470	3,480,470	0
01/01/2000	Percentage Funded		100.00%	0.00%
01/01/2000	Funded Pension Cost		3,480,470	0
	Allowable Interest		98,429	0
	CY Allocable Pension Cost		3,578,899	0
	FY Allocable Pension Cost		3,513,483	0
	Medicare LOB Percentage		0.70%	99.18%
	FY Allowable Pension Cost	\$24,594	\$24,594	\$0

2001	Contributions	\$4,640,084	\$4,640,084	\$0
8.50%	Discount For Interest	(359,728)	(359,728)	0
01/01/2001	Present Value Contributions	4,280,356	4,280,356	0
01/01/2001	Prepayment Credit	4,583,685	4,577,027	6,658
01/01/2001	Present Value Of Funding	8,864,041	8,857,383	6,658
01/01/2001	CAS Funding Target	4,583,685	4,577,027	6,658
01/01/2001	Percentage Funded		100.00%	100.00%
01/01/2001	Funded Pension Cost		4,577,027	6,658
	Allowable Interest		0	0
	CY Allocable Pension Cost		4,577,027	6,658
	FY Allocable Pension Cost		4,327,495	4,994
	Medicare LOB Percentage		0.61%	100.00%
	FY Allowable Pension Cost	\$31,392	\$26,398	\$4,994

**STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1996 THROUGH 2004**

Date	Description	Total Company	Other Segment	Medicare Segment
2002	Contributions	\$29,800,000	29,774,467	\$25,533
8.50%	Discount For Interest	(2,003,288)	(2,001,572)	(1,716)
01/01/2002	Present Value Contributions	27,796,712	27,772,895	23,817
01/01/2002	Prepayment Credit	4,836,349	4,699,519	136,830
01/01/2002	Present Value Of Funding	32,633,061	32,472,414	160,647
01/01/2002	CAS Funding Target	5,678,190	5,517,543	160,647
01/01/2002	Percentage Funded		100.00%	100.00%
01/01/2002	Funded Pension Cost		5,517,543	160,647
	Allowable Interest		49,252	1,434
	CY Allocable Pension Cost		5,566,795	162,081
	FY Allocable Pension Cost		5,319,353	123,225
	Medicare LOB Percentage		0.66%	100.00%
	FY Allowable Pension Cost	\$158,333	\$35,108	\$123,225

2003	Contributions	\$11,100,000	\$11,100,000	\$0
8.50%	Discount For Interest	(852,715)	(852,715)	0
01/01/2003	Present Value Contributions	10,247,285	10,247,285	0
01/01/2003	Prepayment Credit	7,168,190	6,937,586	230,604
01/01/2003	Present Value Of Funding	17,415,475	17,184,871	230,604
01/01/2003	CAS Funding Target	7,168,190	6,937,586	230,604
01/01/2003	Percentage Funded		100.00%	100.00%
01/01/2003	Funded Pension Cost		6,937,586	230,604
	Allowable Interest		0	0
	CY Allocable Pension Cost		6,937,586	230,604
	FY Allocable Pension Cost		6,594,888	213,473
	Medicare LOB Percentage		0.75%	100.00%
	FY Allowable Pension Cost	\$262,935	\$49,462	\$213,473

2004	Contributions	\$7,500,000	\$7,500,000	\$0
8.50%	Discount For Interest	(581,094)	(581,094)	0
01/01/2004	Present Value Contributions	6,918,906	6,918,906	0
01/01/2004	Prepayment Credit	7,623,084	7,397,521	225,563
01/01/2004	Present Value Of Funding	14,541,990	14,316,427	225,563
01/01/2004	CAS Funding Target	7,623,084	7,397,521	225,563
01/01/2004	Percentage Funded		100.00%	100.00%
01/01/2004	Funded Pension Cost		7,397,521	225,563
	Allowable Interest		0	0
	CY Allocable Pension Cost		7,397,521	225,563
	FY Allocable Pension Cost		7,282,537	226,823
	Medicare LOB Percentage		0.65%	100.00%
	FY Allowable Pension Cost	\$274,159	\$47,336	\$226,823

**STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1996 THROUGH 2004**

FOOTNOTES

- 1/ We obtained the 1995 allocable pension cost from our prior audit (report number A-07-97-01205).
- 2/ We obtained total company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. The amounts shown for the other segment represent the difference between the total company and the Medicare segment.
- 3/ We subtracted the interest that is included in the contributions deposited after January 1 of each year to discount the contributions back to their beginning-of-the-year value. For purposes of this appendix, we computed the interest as the difference between the present value of contributions at the valuation interest rate and actual contribution amounts.
- 4/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. For purposes of this appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year.
- 5/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit may be carried forward, with interest, to fund future CAS pension costs.
- 6/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured as of January 1 of each year.
- 7/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of Federal Acquisition Regulations (FAR) 31.205-6(j)(3)(i).
- 8/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Because any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(a)(7), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.
- 9/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.

**STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1996 THROUGH 2004**

- 10/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, would accrue in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest pursuant to FAR 31.205-6(j)(3)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days of the end of the quarter.
- 11/ The calendar year (CY) allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.
- 12/ We converted the CY allocable CAS pension costs to a Federal fiscal year (FY) basis (October 1 through September 30). We calculated the FY pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 13/ The Medicare line-of-business (LOB) percentages, for the segment and indirect operations, are based on information provided by Premera Blue Cross.
- 14/ We computed the FY allowable Medicare pension cost as the FY allocable pension cost multiplied by the Medicare LOB percentages.



Atlanta ■ Washington

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May 9, 2006

VIA FEDERAL EXPRESS

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
Office of the Inspector General
Office of Audit Services
Region VII
U.S. Department of Health & Human Services
601 East 12th Street
Room 284A
Kansas City, MO 64106

Re: Response to draft report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by Premera Blue Cross for Fiscal Years 1996 Through 2004" (Report Number A-07-05-00192)

Dear Mr. Cogley:

On behalf of Premera Blue Cross (hereinafter "Premera"), Powell Goldstein LLP as its outside counsel hereby submits Premera's response to the above-referenced report (hereinafter "Draft Report"). In the Draft Report, the OIG asserts that Premera did not claim all pension costs that were allowable for Medicare reimbursement for FYs 1996 through 2004. (Draft Report at 3.) Therefore, Premera underclaimed \$36,923 of allowable pension costs. (Draft Report at 3.)

The OIG recommends that Premera revise its Final Administrative Cost Proposals to claim allowable CAS pension costs of \$36,923 for FYs 1996 through 2004. (Draft Report at 3.) Premera accepts the OIG's recommendation and will incorporate the adjustment in the final resolution of the final administrative cost proposals accordingly.

Sincerely,

W. Bruce Shirk

For POWELL GOLDSTEIN LLP

WBS/pjt

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
Office of the Inspector General
Office of Audit Services
Region VII
U.S. Department of Health & Human Services
May 9, 2006
Page 2

cc: Jamie Insley, Esq. *(Via Federal Express)*
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