

**Northern Mariana Islands Retirement Fund
Investigative Report on the
Hawaii Pacific Medical Referral Contract
Dated August 1, 2001**



EXECUTIVE SUMMARY

Northern Mariana Islands Retirement Fund Investigative Report on the Hawaii Pacific Medical Referral Contract Dated August 1, 2001

Report No. M-02-07, August 19, 2002

Summary

This report presents information gathered relative to the administrative services agreement of Hawaii Pacific Medical Referral (HPMR) with the Northern Mariana Islands Retirement Fund (NMIRF). OPA is currently conducting an audit of various issues related to HPMR's contract. During the course of the audit, the Office of the Public Auditor (OPA) has identified a number of procurement issues which it believes need to be reported promptly and separately from the audit. This compilation of information contains OPA's analysis of certain procurement issues identified.

The objectives of OPA's compilation are: (1) to determine the procurement process utilized to solicit, award, and issue the administrative services contract to HPMR, and (2) to determine if the process followed in selecting, awarding, and negotiating the contract, and the terms contained therein, comply with applicable procurement regulations.

Results of Compilation

This procurement was administered by the NMIRF, and was processed under the competitive sealed proposals method in the NMIRF's Procurement Regulations (NMIRF-PR). In establishing the NMIRF-PR, the Board of Trustees adopted the CNMI Procurement Regulations (CNMI-PR), with modifications on the government officials involved in the procurement process.

On May 11, 2000, the NMIRF released an RFP for utilization review services. The RFP requested proposals from interested and qualified individuals and firms to review medical claims for the Government Health and Life Insurance Trust Fund (GHLITF) program. The Investment Committee of the NMIRF Board of Trustees was tasked to review the proposals submitted by two firms. After evaluating the background, administrative services, management team, client references and the like, the Committee found, on August 30, 2000, Hawaii Western Management Group or HWMG (an off-island-based company) to be the more experienced of the two firms. Nearly a year later, the contract was awarded to HPMR on August 1, 2001.

OPA's analysis of the HPMR procurement identified the following issues:

- Whether NMIRF can independently administer its own procurement function given that its enabling legislation has not specifically set forth such authority, and no delegation of authority from the Procurement and Supply (P&S) Director exists;



- Whether award of a contract to a party who had not responded to the RFP, HPMPR instead of HWMG, violated applicable procurement regulations;
- Whether the scope of contract services with HPMPR deviated significantly from the utilization review service sought in the solicitation, and the effect of any deviation on compliance with the applicable procurement regulations;
- Whether NMIRF followed proper selection procedures given that the final terms of the contract appear to have been negotiated after the selection of HWMG; and
- Whether the payment structure set forth in the HPMPR contract is permissible under the applicable procurement regulations.

As OPA had previously advised NMIRF in 1997, it is OPA's position that the NMIRF does not have authority to administer its own procurement since its enabling legislation does not specifically set forth such authority, and there has been no delegation of authority from the P&S Director as required in the absence of statutory authority.

Aside from the issues associated with the authority of the NMIRF to independently administer its own procurement, there are additional issues with respect to the manner of the procurement, the selection of the contractor and the contract terms that call into question the validity of the contract. The fact that the proposer and the contractor are different entities does not appear compliant with the CNMI-PR. The differences between the RFP's scope of work, HWMG's proposal and the HPMPR contract contravene the spirit of equal and fair negotiation and do not appear consistent with the CNMI-PR.

In addition, the negotiation of the final price and contract terms after selection without permitting the alternative proposer to amend its proposal also does not appear to comply with the CNMI-PR. Finally, the compensation mechanism contained in the HPMPR contract does not appear compliant with the CNMI-PR.

Section 1-107 of the CNMI-PR states that "No government contract shall be valid unless it complies with these regulations." While any one of the issues raised above would call into question the validity of the NMIRF-HPMPR Administrative Services Agreement, together the deficiencies noted indicate significant deviation from the CNMI-PR. Given the legal nature of these issues, OPA defers legal determination to the Attorney General's Office.

Please note that this compilation of information has been issued as an investigative report. It was not conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and, therefore, should not be considered an audit report.



A copy of this report is available at the Office of the Public Auditor

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August 19, 2002

Mr. Vicente C. Camacho
Chairman, Board of Trustees
Northern Mariana Islands Retirement Fund
P.O. Box 501247 CK
Saipan, MP 96950

and

Mr. Karl T. Reyes
Administrator
Northern Mariana Islands Retirement Fund
P.O. Box 501247 CK
Saipan, MP 96950

Dear Messrs. Camacho and Reyes:

**Subject: Investigative Report on the Hawaii Pacific Medical Referral Contract
Dated August 1, 2001 [Report No. M-02-07]**

This report presents information gathered relative to the administrative services agreement of Hawaii Pacific Medical Referral (HPMR) with the Northern Mariana Islands Retirement Fund (NMIRF). The Office of the Public Auditor (OPA) is in the process of conducting an audit of various issues related to the NMIRF's issuance of the contract to HPMR. In conducting the HPMR audit, OPA has identified a number of procurement issues which it believes need to be reported quickly. This compilation of information contains OPA's analysis of the procurement issues identified.

Please note that such compilation has been issued as an investigative report. It was not conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States, and therefore should not be considered an audit report.

OPA provided the NMIRF a copy of the draft report in this matter on June 20, 2002. While this report is not considered an audit and therefore not held to the formal 30-day comment period, OPA provided the NMIRF seven days to comment on the draft report. OPA did not receive a response to the draft report from the NMIRF until July 16, 2002. OPA also received a letter from HPMR dated July 5, 2002, addressing one of the issues raised by the draft report. OPA has reviewed the comments provided by the NMIRF and HPMR and responds to them herein. A

copy of the NMIRF's July 16, 2002 letter is attached as Exhibit "B". A copy of HPMR's July 5, 2002 letter is attached as Exhibit "A".

NMIRF Response

The NMIRF responded to the draft report by first questioning the report's form (compilation instead of an audit) and purpose, and the standards applied in the report.

OPA Comment

While this compilation of information is not an audit and therefore not conducted in accordance with Government Auditing Standards, it is consistent with OPA's statutory mandate under 1 CMC §2304(a) "to specially act to prevent and detect fraud, waste, and abuse in the collection and expenditure of public funds." HPMR's contract involves expenditure of public funds as the CNMI Government Health and Life Insurance Trust Fund's (GHLITF) operations are partly funded by the government's share of insurance premiums.

As stated above, OPA is conducting an audit on the arrangement between the NMIRF and HPMR. While conducting the audit work, OPA identified various issues regarding the procurement of the HPMR contract that appeared inconsistent with the procurement regulations. OPA separated out the procurement issues for analysis from the ongoing HPMR audit due to the continuing nature of the identified procurement violations. OPA has reviewed these issues, and has prepared this report to provide to the Office of the Attorney General based on its mandate in 1 CMC §2304(b) to "conduct audits and *investigations*, when necessary, relating to programs and operations involving expenditure of public funds." (Emphasis added). A compilation or investigation report rather than a formal audit report was prepared because the issues were treated as an investigation and separated out from the original HPMR audit, due to the extensive length of time it takes to prepare an audit, the continuing nature of the identified violations, and to forward the identified issues to the Office of the Attorney General in an expedient manner.

OPA does not take enforcement action on this matter as that is beyond its jurisdiction. This report serves simply to gather information and to provide notice to the Office of the Attorney General regarding an apparent violation of CNMI procurement law.

BACKGROUND

On January 30, 2001, OPA released an audit report (AR-01-01) on health insurance payments to Megaplus International CNMI, Inc. OPA began the initial Megaplus investigation in April 1996, and completed follow-up investigative work in January 2000. One of OPA's audit recommendations to the NMIRF was to expedite the hiring of a utilization review specialist, either on a contract or employment basis, for the GHLITF program.

On May 11, 2000, the NMIRF issued a Request for Proposal (RFP) for utilization review services. The RFP requested proposals from interested and qualified individuals and firms in the review of medical claims for the GHLITF program. Two firms responded to the RFP. The

NMIRF Board of Trustees, at its regular meeting held on September 22, 2000, unanimously voted to award the contract to Hawaii Western Management Group (HWMG). On September 25, 2000, the Board sent an award letter to HWMG informing it of the NMIRF's decision.

On March 16, 2001, Mr. Arnold Baptiste¹ formed Hawaii Pacific Medical Referral (HPMR) to handle third party administrative services to various Pacific Island nations. Mr. Baptiste was listed in the Articles of Incorporation obtained by OPA as HPMR's sole director, officer and shareholder.

GHLITF through the NMIRF subsequently entered into a three-year Administrative Services Agreement with HPMR², effective on August 1, 2001, for a monthly fee of \$7.29 per GHLITF member. In addition to this fee, the Contractor will be paid thirteen percent of all off-island paid claims, as well as a one time setup fee of \$40,000. The contracted fees³ differ from the fees set forth in the HWMG proposal.⁴

OPA has received various requests to review and comment on the third party administrator arrangement with HPMR. One such request was a May 1, 2002 request from Senator Ramon Guerrero for OPA to conduct an audit/investigation of the Administrative Services Agreement between GHLITF and HPMR.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of OPA's compilation are: (1) to determine the procurement process utilized to award and issue the administrative services contract to HPMR, and (2) to determine if the process followed in selecting and awarding the contract, and the terms contained therein, comply with the applicable procurement regulations.

To accomplish our objectives, OPA reviewed and evaluated the contract document file and other pertinent documents available; interviewed various officials and personnel at the NMIRF responsible for these matters; obtained copies of corporate filings from the office of the CNMI Registrar's of Corporations and the State of Hawaii's Department of Commerce and Consumer Affairs regarding the corporate structure of the parties involved; reviewed the applicable laws regarding the NMIRF's procurement authority and procedures; and reviewed comments from HPMR and the NMIRF on the draft report issued in this matter.

¹ Mr. Baptiste passed away in June 2002 in Hawaii.

² As discussed earlier and noted later in this report, HPMR did not submit a proposal; HWMG did.

³ Section 3 of the contract on page 3 provides for amendment of the fees upon approval by GHLITF. This raises procurement issues that OPA has not addressed.

⁴ The HWMG proposed quote contained a one-time setup charge of \$50,000, administrative fees of 10 percent of paid claims for referrals to Hawaii/Guam/Mainland USA, case management fees of \$125 per hour, and administration fees for services in the CNMI of \$8.00 per member monthly.

RESULTS OF COMPILATION

Summary

This procurement was administered by the NMIRF, and was processed under the competitive sealed proposals method in the NMIRF's Procurement Regulations (NMIRF-PR). The Investment Committee of the NMIRF Board of Trustees was tasked to review the proposals submitted by two firms. After evaluating the background, administrative services, management team, client references and the like, the Committee found, on August 30, 2000, HWMG (an off-island-based company) to be the more experienced of the two firms. Nearly a year later, the contract was awarded to HPMR on August 1, 2001.

OPA's analysis of the HPMR procurement identified the following issues:

- Whether NMIRF can independently administer its own procurement function given that its enabling legislation has not specifically set forth such authority, and no delegation of authority from the P&S Director exists;
- Whether award of a contract to a party who had not responded to the RFP violated the applicable procurement regulations;
- Whether the scope of contract services with HPMR deviated significantly from the utilization review service sought in the solicitation, and the effect of any deviation on compliance with the applicable procurement regulations;
- Whether NMIRF followed proper selection procedures given that the final terms of the contract appear to have been negotiated after the selection of HWMG; and
- Whether the payment structure set forth in the HPMR contract is permissible under the applicable procurement regulations.

1. The Procurement Process

The procurement of utilization review and other administrative services for GHLITF was administered by the NMIRF, and processed under the competitive sealed proposals method contained in the NMIRF-PR. On May 11, 2000, the NMIRF released an RFP for utilization review services. The RFP requested proposals from interested and qualified individuals and firms to review medical claims for the GHLITF program. Based on NMIRF records, two firms submitted proposals: a local firm established on February 1, 2000 and an off-island firm founded in 1989.

The Investment Committee of the NMIRF Board of Trustees was tasked to review the proposals submitted by the two firms. After evaluating the background, administrative services, management team, client references and the like, the Committee found HWMG (the off-island based firm) to be the more experienced at handling the GHLITF utilization review services. The

Board's report, dated August 30, 2000, stated that because of its vast networking system and broad client base, HWMG had secured discounts, averaging 30 percent in 1997 and 1998, for off-island medical referral programs it managed. Based on the various services, experience, fees, network and affiliates, within Hawaii and outside Hawaii including the Philippines, the Committee felt that HWMG was the more experienced firm, and that it was adequately staffed and fully equipped to handle, review, and process claims. Therefore, the Committee recommended that the NMIRF Board award the utilization review services contract to HWMG.

On September 25, 2000, the NMIRF sent an award letter to HWMG informing that firm of its decision, and stating that an NMIRF designee would be contacting Mr. Arnold Baptiste, Sr., identified as Founder and Chairman of HMAA/HWMG, to negotiate the terms and conditions of the final contract agreement.

2. The NMIRF's Procurement Authority

OPA first raised questions concerning the NMIRF's legal authority to independently procure group life insurance for the Commonwealth in a June 11, 1997 letter to the NMIRF Administrator. In that letter, OPA referenced Section 1-105 of the CNMI Procurement Regulations (CNMI-PR) and advised that the NMIRF was required to comply with the CNMI-PR except to the extent that procurement functions had been delegated to the Fund under those regulations. In a September 8, 1997 letter, the NMIRF replied that its Board of Trustees had voted on August 29, 1997 to continue to administer its own procurement policy. OPA responded to the NMIRF on October 1, 1997 stating that the Division of Procurement and Supply (P&S) must administer the NMIRF's procurement functions until such time as the P&S Director delegates, in writing to the NMIRF, the authority to handle its own procurement.

1 CMC 2553(j) assigns responsibility for procurement and supply in the Commonwealth to the Department of Finance. This is a fairly broad statement with respect to the coverage of the Department of Finance's jurisdiction and is based on Article X, Section 8 of the CNMI Constitution which gives the Department of Finance control over expenditures of public funds.

When the NMIRF issued the RFP for utilization review services on May 11, 2000, the CNMI-PR, published on September 15, 1990, in Volume 12, No 9 of the Commonwealth Register were in effect. Section 1-105 of the applicable CNMI-PR states that the regulations: "apply to every expenditure of public funds, irrespective of source." 1 CMC §8315 permits the NMIRF to adopt rules and regulations: "as necessary for the exercise of the fund's powers, performance of its duties and administration of its operations." The law is unclear as to whether the NMIRF is intended to have the power to independently administer a procurement system.

Nevertheless, Volume 11, No. 11 of the Commonwealth Register contains the public notice of the NMIRF Board of Trustees' adoption of the CNMI Procurement Rules and Regulations applicable to the NMIRF, with the following modifications:

8.1 All references in the Commonwealth Procurement Regulations to the Chief⁵ of Procurement and Supply, Director of Finance, Officer with Expenditure Authority, and other executive branch officials shall be deemed to refer to the Administrator of the Retirement Fund. All references to the Governor shall be deemed to refer to the Board of Trustees of the NMI Retirement Fund. All references to the Attorney General shall be deemed to refer to the legal counsel to the Retirement Fund. Procurement appeals may be made to the Public Auditor as provided in the Commonwealth Procurement Regulations.

On the other hand, § 2-201 of the CNMI-PR states that:

All purchases under sections 3-104, 3-105, 3-108 shall be centralized through the P&S Director. However, upon approval by the Secretary, the P&S Director may delegate, in writing, other procurement functions and responsibilities to public agencies upon satisfying the following requirements: (a) the procurement regulations have been duly adopted pursuant to the procedures required for adopting official business of such agencies; (b) the agency has adequate staff capability necessary to carry out the functions of the P&S Director; and (c) the agency shall certify to the P&S Director that it is in compliance with (a) and (b) above.

Even though a December 2, 1996 memorandum from the Secretary of Finance to the P&S Director authorized certain government entities, including the NMIRF, to administer procurement functions in accordance with CNMI-PR § 2-201, OPA found no evidence that the Director of P&S delegated *in writing* procurement functions to NMIRF as required by CNMI-PR §2-201. OPA therefore again restates its concerns to NMIRF, previously expressed in June and October of 1997, regarding the authority of the NMIRF to independently adopt procurement regulations.

NMIRF Response

The NMIRF provided an extensive analysis of its position that the NMIRF has authority to independently administer its own procurement. Such analysis is available for review in “Exhibit B.” OPA does not make any determination on the position stated by the NMIRF.

OPA Comment

While the authority of the NMIRF to independently administer its own procurement is an issue for consideration, it is not the determinative factor regarding the validity of the procurement with HPMR. This is particularly so considering that the NMIRF adopted the CNMI-PR in all aspects other than the modifications contained in section 8.1 quoted above with respect to processing procedures.

⁵ Section 106 of Executive Order 94-3 changed the titles of Chief of Procurement and Supply and Director of Finance to Director of Procurement and Supply and Secretary of Finance, respectively.

The more significant issues concerning the validity of the procurement do not have to do so much with what office processed the paperwork and who signed the documents but rather the terms contained in the contract with HPMR and whether they are in conformity with the procurement regulations, be they CNMI Procurement Regulations or the NMIRF procurement regulations.

However, it is important to note that in May 2001, a revised version of the CNMI-PR was adopted in the CNMI Commonwealth Register. The language contained in Volume 11, No. 11 of the Commonwealth Register where the NMIRF adopted the CNMI-PR does not reference adoption of any subsequent amendments. In addition, given that the RFP in this matter was issued before the adoption of the revised CNMI-PR, the old regulations would control in any event. As such, the analysis contained in this opinion utilizes the earlier version of the CNMI-PR.

By raising this matter, OPA sought to bring to attention an issue that has been raised in the past and remains unclear. OPA forwards the comments of the NMIRF on this issue to the Office of the Attorney General and will defer to the Attorney General to make a final determination regarding this matter given that the Attorney General's Office has the authority to interpret Commonwealth laws.

3. Proposer Different from Contractor

Although HWMG responded to the RFP, NMIRF awarded the Administrative Services Agreement to Hawaii Pacific Medical Referral (HPMR). When asked for the reason behind this inconsistency, GHLITF officials provided OPA a written explanation on the relationship between Hawaii Management Alliance Association (HMAA), HWMG and HPMR.

The explanation stated that HMAA is a not-for-profit mutual benefit society owned by its members and established in 1989 by Mr. Arnold M. Baptiste. After organizing HMAA, Mr. Baptiste established three for-profit corporations including HWMG to facilitate the day-to-day operations of the mutual benefit society. Also, HWMG provides third party administrative services to HMAA as well as to the Pacific Island governments of American Samoa and the Republic of the Marshall Islands.

On March 16, 2001, HPMR, a Hawaii for-profit corporation, was formed to handle third party administrative services for the various Pacific Island nations. Subsequently, contracts with American Samoa and the Republic of the Marshall Islands were transferred from HWMG to HPMR.

Corporate filings from the State of Hawaii indicate that Mr. Baptiste is the incorporator, sole director and sole officer of HPMR. According to the explanation provided by GHLITF and various corporate filings from Hawaii and California, HWMG is a California company owned by the Baptiste family. Mr. Baptiste is a director and the Executive Vice President of HWMG, with Arnold Baptiste Jr. as the Chief Financial Officer and various other individuals filling the remaining roles of directors and officers.

The NMIRF's justification for selecting HWMG repeatedly referenced HWMG's extensive experience in the field, its resources, and its large number of clients. The NMIRF selected HWMG in part because of the various agreements it had with off-island providers for service discounts. On the other hand, HPMR did not exist at the time of the proposer selection, and may not have even been established at the award date. While HWMG responded to the solicitation, HPMR did not.

HPMR and NMIRF Responses

Both HPMR and the NMIRF responded to the concerns raised by OPA in the draft report. HPMR provided additional information in a letter to OPA dated July 5, 2002. The letter stated that:

HPMR was created to handle all Pacific Island Nation Third Party Administration (TPA) business. HMAA, HWMG and HPMR were all operated by Arnold Baptiste, Sr., or his sons Arnold Baptiste, Jr. and Marc Baptiste. The management and claims processing staff of HWMG who worked on Pacific Islands Nation TPA services all transferred from HWMG to HPMR, and the same computer system is used. Existing HWMG Agreements for TPA services with Pacific Island Nations were assigned from HWMG to HPMR. In essence all of the extensive experience, resources and clients from HWMG had in regard to Pacific Island Nation TPA services were transferred to HPMR.

The NMIRF also commented on this issue in its response to the draft report stating that prior to contracting with HPMR, the NMIRF had carefully considered the issue and "was satisfied that it was properly contracting with *an entity established by the proposer* to handle services specifically for the Micronesian region, which would include GHLIF." (Emphasis added) The NMIRF also stated that if the contract had not been signed with HPMR, the NMIRF would have approved an assignment of the contract. It also noted that all staff and systems originally proposed to handle the work had been transferred to HPMR.

OPA Comment

The initial explanation and the supplemental information provided by both HPMR and the NMIRF regarding HPMR's relationship to HWMG do not resolve OPA's concern regarding the identity of the contractor. While there may have been a sound reason for HWMG to reorganize itself, the fact remains that HWMG and not HPMR responded to the RFP.

The NMIRF states that it felt it was contracting with an entity established by the proposer and therefore felt that it could issue the contract to HPMR. However, HPMR was not established by the proposer. It was established by Mr. Baptiste individually. If HWMG had established HPMR and was the sole shareholder or even if the corporate structure of HPMR mirrored that of HWMG and there was sufficient documentation showing the transfer of assets from one company to another, there may have been stronger justification for the issuance of the contract

to HPMR. However, this was not the case. HPMR is essentially Mr. Baptiste as he is the sole shareholder and holds all executive and board positions.

When deciding whether to proceed with issuing the contract to HPMR, the NMIRF may have considered many of the same issues it had reviewed earlier when making the responsibility determination on HWMG. However, a significant difference between the corporate structure of HPMR and HWMG is the decision-making authority. With HPMR, it rests with a single individual. With HWMG, there was a board made up of various individuals. Mr. Baptiste's recent passing highlights the significance of the difference in the corporate structures. The NMIRF's failure to award the contract to an entity that responded to the solicitation in this situation does not appear to be in conformity with the CNMI-PR.

4. Contract Terms and Conditions Differed Substantially from the RFP

The RFP, issued by the NMIRF on May 11, 2000, sought proposals for reviewing medical claims for the GHLITF program. The RFP's scope of work stated that prospective vendors must demonstrate the ability to screen service providers for: (1) claims for services or items not covered under the GHLITF benefit plan; (2) claims for services determined to be medically unnecessary; (3) claims on outpatient services rendered in connection with in-patient stay; (4) duplicate claims, and; (5) incorrect or fictitious cost reports. It further added that vendors must submit a utilization review plan describing procedures established for appeal of an adverse determination and descriptions of the various computer-generated reports deemed necessary to assist management in formulating policy decisions including statistical data required for actuarial studies.

OPA's review of HPMR's Administrative Services Agreement indicates it encompasses more than what is stated in the RFP scope of work. The contract states that HPMR will receive, adjudicate, verify, and pay or deny all claims for benefits. Under its contract, HPMR will also utilize enrollment materials and supplies that GHLITF needs to administer the plan. It will respond to plan participants with respect to questions regarding benefits, claims and other non-plan administrator duties. The contract further states that HPMR will use its best effort to negotiate, secure and maintain discount medical service contracts with all major hospital facilities and medical providers in as many specialties as is practicable in Hawaii and Guam for providing medical treatment to CNMI patients. HPMR's contract extended beyond what was solicited in the RFP's scope of work.

The documentation reviewed provides no indication that NMIRF provided the other proposer an opportunity to amend its proposal to include a broader scope of services.

NMIRF Response

The NMIRF denies that the contract contains services that exceeds those in the solicitation. It acknowledges that the terms in the RFP and the contract are not identical in language, but argues that they both contain services that are essentially the same. It admits that they did not really know what was involved in "utilization review" when it solicited the service and argues that the

contract only spells out in more detail what is entailed in the “utilization services” it sought in the RFP.

Furthermore, the NMIRF notes that both respondents to the RFP offered similar services at similar prices and therefore it was unnecessary to provide opportunity for amendments to the alternative proposer because the competitive basis of the solicitation was not compromised. It states that it selected HPMPR because HPMPR had negotiated contracts in place with providers, and that there was a perceived conflict of interest between the alternative proposer and GHLIP.

OPA Comment

The RFP and the two proposals in this matter are framed in fairly general terms. OPA acknowledges that it is difficult to concretely compare the services solicited and those offered by the two parties. However, it is clear that the RFP did not contain any language regarding negotiated contracts with providers.

Section 3.106(6) of the applicable procurement regulations states:

As provided in the request for proposals, discussions may be conducted with responsible offerors who submit proposals determined to be reasonably susceptible of being selected for award for the purpose of clarification and to insure full understanding of, and responsiveness to, solicitation requirements. Offerors shall be accorded fair and equal treatment with respect to any opportunity for discussion and revision of proposals and such revisions may be permitted after submission and prior to award for the purpose of obtaining the best and final offers.

The RFP in this matter did not contain the requisite language notifying respondents of the possibility of negotiations. As such, the negotiations with HMPR were not in conformity with the RFP. In addition, the price in the contract and that contained in HWMG’s proposal are not the same. Therefore, an amendment to the initial offer was made by HPMPR.

Even if the possibility of negotiations had been properly noticed in the RFP, there would have to have been either a finding by the review committee that the alternative proposal was not “reasonably susceptible of being selected for award” or the opportunity provided to the alternative proposer to revise its price. NMIRF’s response to OPA indicates that there was some concern regarding a “possible conflict” with respect to the alternative proposer. However, neither the procurement records we obtained nor the NMIRF response to OPA indicates that a definitive finding was made thereby eliminating the alternative proposer from possible award, and the attendant opportunity to negotiate. If they were not eliminated from possible award, there is no indication that they were provided an equal and fair opportunity to amend their proposal through negotiation, as required by section 3.106(6).

Furthermore, OPA notes that the RFP states that the term of the service contract to be awarded shall not exceed one year but may be extended on a month-to-month basis not to surpass six months. The contract awarded to HPMPR was for a three-year period.

5. Negotiation of Final Terms After Selection of the Contractor

On September 25, 2000, the NMIRF sent an award letter to HWMG informing it of the decision to accept HWMG’s proposal and advising that an Administrator designee would contact HMAA/HWMG to “negotiate the terms and conditions of the final contract agreement.”

The CNMI-PR in effect at the time of issuance of the RFP, selection, and award of the contract provide, in Section 3-106 (5), that “[t]he Request for proposals shall state the relative importance of price and other evaluation factors.” The evaluation criteria in Section IV.A.2 of the RFP stipulates that cost would represent 40 percent of the evaluation criteria. It appears from the various documents including the NMIRF’s letter of September 25, 2000, HWMG’s proposal, and the contract eventually awarded to HPMR, that cost was not determined until after contract award. As such, it appears that the NMIRF did not select the contractor in compliance with the CNMI-PR and the RFP.

OPA’s review of the Administrative Services Agreement showed differences in rates between those indicated in HWMG’s proposal and those reflected in the final contract awarded to HPMR:

Details	HWMG’s Proposal	HPMR’s Contract	Difference
One time setup charge	\$50,000.00	\$40,000.00	\$10,000.00
Administration fee for off-island paid claims	10% of paid claims	13% of paid claims	\$2,695.00 ⁶ per month
Case management fee for off-island cases	\$125 per hour	No charge	Proposed fee was eliminated from final agreement.
“On-island” administration fee	\$1,344,000 ⁷ per year based on \$8 per member per month	\$1,224,720 ⁶ per year based on \$7.29 per member per month	\$119,280.00 per year

NMIRF Response

The NMIRF responded to this issue by providing additional procurement history information for the RFP. It explained that the NMIRF was led to believe by the Legislature that an appropriation of \$1,000,000.00 would be made to fund the utilization review contract. However, after the RFP was issued and a contract was ready to be awarded, no appropriation was made. The NMIRF stated it was thus in the position of having made an award without funding. As such, the NMIRF had to negotiate with the awardee to a level that was supportable under the GHLIF program without the additional funding. The NMIRF also commented that it found the draft

⁶ This amount was calculated based on projected off-island monthly payment of \$89,823.50 (\$718,588 off-island payments as of 4/30/02 divided by 8 months) multiplied by 3 percent (13% less 10%).

⁷ This is based on the 14,000 estimated number of GHLIF’s members and dependents.

version of the above chart to be “very deceptive as it fails to take into account the cost of the separate case management fee that was negotiated out of the final contract.”

OPA Comment

OPA’s original version of the above chart had a “—“ mark in the column titled “difference”. OPA has amended the chart to provide clearer language that the case management fee for off-island cases was removed.

Although it is not entirely clear, it appears that the NMIRF is stating in its response that it selected HWMG based on the price presented in the proposal. However, changes in funding circumstances required the NMIRF to later go back and renegotiate the price prior to award of the contract. This position is somewhat confusing given that the board selected HWMG on September 22, 2000 and three days later issued the intent to award letter notifying HWMG that the NMIRF would contact it to “negotiat[e] the terms and conditions of the final contract agreement.” As such, the language in the letter seems to indicate that a final agreement had not been reached prior to selection.

Nevertheless, regardless of the time line of the change in circumstances that prompted the change in terms, the fact remains that HWMG submitted a proposal with one set of terms and that a contract was issued with an alternative set of terms with respect to price. OPA recognizes that the price arrived at in the contract was substantially lower than that included in the HWMG proposal. However, as stated in the above section entitled “Contract Terms and Conditions Differed Substantially from the RFP”, if the terms were to change from the proposal submitted, then the other proposer should have also been granted an opportunity to negotiate a different price unless it was excluded from the range considered “reasonably susceptible for award.”

6. Payment Terms and Pertinent Provision of the CNMI Procurement Regulations

CNMI-PR Section 3-401, as adopted by the NMIRF in Volume 11, No. 11 of the Commonwealth Register, reads as follows⁸:

1. Use of a *cost-plus-a-percentage-of-cost* and percentage of construction cost methods of contracting *are prohibited*.
2. Government contracts shall utilize a *firm fixed price* unless the use of a cost reimbursement contract is justified under paragraph 3.
3. A cost reimbursement contract may be used when the Chief determines in writing which is attached to the contract that:

⁸ As stated above in the section entitled “The Procurement Process”, the issue of the authority of the NMIRF does not affect the analysis of the proper payment terms for the contract. This is because, regardless of whether or not the Fund properly adopted its procurement regulations, the regulations mirror the CNMI-PR except for the signature and approval authorities. In addition, the analysis would focus only on the September 15, 1990 version of the CNMI-PR because that is the only version adopted by the NMIRF and the RFP was issued prior to the May 24, 2001 amendment date of the CNMI-PR.

- (a) uncertainties in the work to be performed make the cost of the performance too difficult to estimate with the degree of accuracy required for a firm fixed price contract;
- (b) use of a cost reimbursement contract is likely to be less costly to the government than any other type due to the nature of the work to be performed under the contract.

(Emphasis added)

Appendix B of HPMR's Administrative Services Agreement provides a fee schedule indicating that the Contractor will be paid \$7.29 per member monthly. In addition, the Contractor will be paid thirteen percent for all off-island paid claims.

In the draft report OPA stated that this arrangement appears to be a cost-plus-a-percentage-of-cost arrangement prohibited by §3-401 of the CNMI-PR.

NMIRF Response

The NMIRF responded to the draft stating:

1. That the fee arrangement with HPMR is not a cost plus percentage of cost arrangement because NMIRF is not paying HPMR "a fee for a service, then [paying] an amount on top of that set fee that is a percentage of that set fee," and
2. That the fee negotiated with HPMR provides significant savings due to the structure for off-island claims.

The NMIRF explains that the contract has two components: on-island services and off-island services, each with separate fee arrangements. The on-island component has a flat fee per member, while the off-island component involves a separate fee based on a percentage of off-island claims paid. The NMIRF argues that the arrangement is not cost-plus-percentage-of-costs but rather two different and separate types of fee arrangements.

The NMIRF then argues that paying a percentage of costs for off-island claims was reasonable because of the discounts realized in the HPMR contracts with off-island providers. As such, the NMIRF explains that it negotiated the flat fee for members on-island and the fee plus percentage of claims paid for off-island costs. The NMIRF also points out that it negotiated the initial proposal of \$8.00 per member down to \$7.29 per member per month.

OPA Comment

The NMIRF's position does not resolve the problems associated with the fee arrangement. Under the argument presented by the NMIRF, the on-island component might qualify as a firm fixed price arrangement, but the off-island service would be questionable because the procurement regulations still do not permit the NMIRF to pay a percentage of claims. The CNMI regulations effective at the time of the issuance of the RFP in §3-401, as quoted above, state that "[g]overnment contracts shall utilize a *firm fixed price* unless the use of a cost

reimbursement contract is justified under paragraph 3.” (Emphasis added) This allows for only two forms of fee arrangements, a firm fixed price or a reimbursement arrangement. The off-island service fee arrangement with HPMR is neither.

The Federal Acquisition Regulations define a firm fixed price contract in section 16.202-1 as one which “provides for a price that is not subject to any adjustment on the basis of the contractor’s cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss.” It is a bargain that provides a fixed amount of compensation without a formula for varying the price upon uncertain contingencies. (Formation of Government Contracts, Cibinic & Nash, Third Edition pg. 1080.)

Payment of a percentage of claims paid is not a reimbursement arrangement. It is even questionable whether the fee per member constitutes a “firm fixed-price” as the price to the government will fluctuate depending on the number of members involved. Such an arrangement does not provide a not-to-exceed limitation amount and does not enable the Government to know how much its maximum financial obligation will be under the contract.

However, even if the on-island fee passes scrutiny, the off-island fee of a percentage of claims paid out of the funds of GHLIF is certainly not a firm-fixed price or a cost reimbursement arrangement. It does not provide a fixed amount of compensation. There is no predictable way for the NMIRF to determine how many claims may be processed during any given month since they are based upon the health of the fund members.

The current CNMI-PR do allow alternative methods of payment, but they were not authorized under the regulations in place at the time of the RFP and have not been adopted by the NMIRF. The regulations that are applicable to this procurement, as explained above, are the September 1990 CNMI-PR . The NMIRF commented that it had realized savings through the fee arrangement. OPA does not discount the economic sense of its position; unfortunately however it does not excuse the lack of compliance with the provisions in the CNMI-PR.

Conclusion

The procurement was administered by the NMIRF and was processed under the competitive sealed proposals method in the applicable CNMI Procurement Regulations. As OPA had previously advised NMIRF in 1997, it is OPA’s position that the NMIRF has no authority to administer its own procurement since its enabling legislation does not specifically set forth such authority, and there has been no delegation of authority from the P&S Director as required in the absence of statutory authority.

Regardless of the issues associated with the authority of the NMIRF to independently administer its own procurement, there are additional issues with respect to the manner of the procurement, the selection of the contractor and the contract terms that call into question the validity of the contract. The fact that the proposer and the contractor are different entities does not appear compliant with the CNMI-PR. The differences between the RFP’s scope of work, HWMG’s

proposal and the HPMP contract contravene the spirit of equal and fair negotiation and do not appear consistent with the CNMI-PR. The negotiation of the final price and contract terms after selection without permitting the alternative proposer to amend its proposal also does not appear to comply with the CNMI-PR. Finally, the compensation mechanism contained in the HPMP contract does not appear compliant with the CNMI-PR.

Section 1-107 of the CNMI-PR states that “No government contract shall be valid unless it complies with these regulations.” While any one of the issues raised above would call into question the validity of the NMIRF-HPMP Administrative Services Agreement, together the deficiencies noted indicate significant deviation from the CNMI-PR. Given the legal nature of these issues, OPA defers legal determination to the Attorney General’s Office.

Sincerely,



Michael S. Sablan, CPA
Public Auditor

cc: Governor
Lt. Governor
Thirteenth CNMI Legislature (27 copies)
Secretary of Finance
Special Assistant for Management and Budget
Attorney General
Press Secretary
HPMP
Media

07-18-02 16:41 CRF-CNMI RETIREMENT FUND

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P11/12



July 5, 2002

Michael Sablan, CPA
Office of the Public Auditor
Commonwealth of the Northern Mariana Islands
P.O. Box 501399
Saipan, MP 96950

Subject: Draft Compilation Report on the Hawaii Pacific Medical Referral
(HPMR) Contract Dated August 1, 2001

Dear Mr. Sablan,

Thank you for the opportunity to respond to the draft report above. We also appreciate the extension you allowed us in our response time due to the passing of Mr. Arnold Baptiste Sr.

After carefully reviewing the report we find only one point which we feel that additional information may help to clarify, that is, the issue of the proposer being different from the contractor. Your report is correct in stating that the response to the RFP was made by HWMG, yet the contract was with HPMR.

CNMI GHLITF issued the RFP, which HWMG responded to in mid-2000. On August 29, 2000, CNMI GHLITF notified HWMG of their intent to contract.

A decision was then made by HWMG in early 2001 that all of the Pacific Island Nation Third Party Administration (TPA) business would be transferred out to a new corporate entity formed exclusively to handle that line of work. This new entity was HPMR. HMAA, HWMG and HPMR were all operated by Arnold Baptiste, Sr., or his sons Arnold Baptiste, Jr. and Marc Baptiste. The management and claims processing staff of HWMG who worked on Pacific Island Nation TPA services all transferred from HWMG to HPMR, and the same computer system is used. Existing HWMG Agreements for TPA services with Pacific Island Nations were assigned from HWMG to HPMR. In essence all of the extensive experience, resources and clients HWMG had in regard to Pacific Island Nation TPA services were transferred to HPMR.

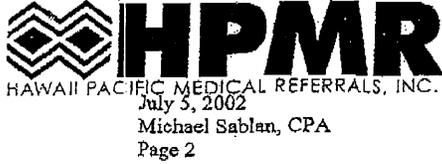
737 Bishop Street, Suite 1800 Honolulu, HI 96813 • Phone (808) 585-0161 • Fax (808) 585-0171

07-12-02 16:47 TO:CRF-CNMI RETIREMENT FUND

FROM:6703225095

P01

07-18-02 16:42 CRF-CNMI RETIREMENT FUND ID= P12/12
7-18-02: 4:54PM:HPMR CNMI :6703225095
7-18-02: 5:06PM:HPMR :585-0171 # 2/ 2



When the CNMI GHLITF contract was finally issued in August 2001, it was executed by HPMR, which had by then completed its spin-off from HWMG. HPMR had the same ability to provide all of the TPA services outlined in the HWMG RFP response when the contract was awarded in August 2001.

The Board of Directors and leadership of CNMI GHLITF were all fully informed about this transfer process. They knew that all the key elements which they used to award the bid to HWMG were still in place with HPMR. They did not give any indication that there would be an issue with continuing the contracting process with HPMR rather than HWMG.

I hope this assists in the completion of your report. Please feel free to contact me via phone or email at tcannon@hawaii.rr.com if you have any questions.

Sincerely,

Thomas G. Cannon
Vice President & COO

cc: Mr. Vincente Camacho, Chairperson
CNMI GHLITF

07-18-02 16:37 CRF-CNMI RETIREMENT FUND ID= P02
1272 28 7/17/02 Q



Northern Mariana Islands
RETIREMENT FUND
"Investing For The Future Financial Security Of Our Members"

16 July 2002

Mr. Michael S. Sablan
Public Auditor
Office of the Public Auditor
2nd Floor, J.E. Tenorio Bldg
Gualo Rai, Saipan, MP 96950

RE: Draft Compilation Report on the Hawaii Pacific Referral Contract
Dated August 1, 2001

Dear Mr. Sablan,

Initially, please allow us to state for the record that NMIRF questions the Draft Report regarding this matter, in its entirety. It was our understanding that OPA had been asked to audit the contract between HPMR and the Fund; however, your letter states this is not an audit and therefore generally accepted auditing standards were not used. This begs the question, then, as to what standards were applied to the investigation and compilation of this report. We would appreciate, and are most certainly entitled to, a through explanation of the intended purpose of this investigation and report.

NMIRF's Procurement Process

OPA's letter states it first questioned NMIRF's authority to independently administer its own procurement in 1997. NMIRF was created in 1980, given authority to develop its own rules and regulations and has administered its own procurement from inception. In 1989, NMIRF formally published in the Commonwealth Register its intent to adopt, with modifications, the CNMI's procurement regulations. OPA and all other governmental entities that might have raised concerns, including the Attorney General's Office and DOF, were silent.

NMIRF's enabling statute, by virtue of the language used, specifically repeals any power DOF had regarding managing trust and retirement funds for the Commonwealth, and all such power became vested in the NMIRF (compare 1 CMC 2553(d) to 1 CMC 8315). While DOF may have been initially charged

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with virtually all financial responsibilities for the Commonwealth, Public Law 6-17, codified into the Retirement Fund Act, changed that and all such responsibility and control over trusts and retirement funds were removed from DOF. Both the Retirement Fund and the Group Health and Life Insurance Trust Fund were specifically established as trusts, and therefore DOF should have no measure of control, be it financial or otherwise, over either.

NMIRF adopted CNMI-PR with appropriate modifications in 1989, prior to publication of the Procurement Regulations that OPA believes apply to all agencies, including NMIRF. The Procurement Regulations of 1990 came well after NMIRF's Enabling legislation, NMIRF's own Rules and Regulations and subsequent adoption by NMIRF of the CNMI Procurement Regulations. As such, OPA's analysis, if taken as valid (which NMIRF certainly does not), would be an attempt to usurp NMIRF's statutory authority by asserting that Department of Finance's regulations take priority over those of the NMIRF. We believe OPA's reasoning, and ultimate conclusion to be flawed. It would require legislation, not regulation, to restore to DOF any responsibility or control over trust or retirement assets.

The CNMI Legislature, in creating the Retirement Fund, had the foresight to establish the retirement system as a Trust Fund. As such, the accessibility to the funds is strictly controlled by and limited to a Board of Trustees with very specific fiduciary duties. Rarely, if ever, is the power or expenditure over trust funds delegated to other than a trustee, or board of trustees, or a qualified agent or custodian. DOF does not qualify as any of these.

In general, procurement approval by an entity not familiar with a trust, its operations, assets and the associated fiduciary responsibility would be inappropriate and highly irregular. Likewise, procurement approval by an entity without such fiduciary responsibility for those funds would also be inappropriate and highly irregular. Legal title to Fund assets is vested in the Board, not the Government or DOF, and as such, only the Board can expend or divest any assets. Further, control over procurement being vested in DOF is inconsistent with the broad language used by the Legislature in creating the NMIRF and giving the Trustees control over all aspects of Fund management.

On Page 4 of its letter OPA asserts "the law is unclear as to whether NMIRF is intended to have the power to independently adopt a procurement system". The drafters of Public Law 6-17, and its resulting codification into statute, had the foresight to use very specific terminology, which when taken in plain meaning, leaves no question as to the intent. To determine the Fund's authority and ability to administer its own procurement, without interference from other governmental entities, one need but look to and read the Retirement Fund Act. To illustrate this point, we would call OPA's attention to specific sections of the Act. We believe a simple reading of these sections, combined with readily available definitions of key terms, renders the Fund's authority easily discernable.

8313 (f) – Board means Board of Trustees provided for as the governing body responsible for the direction and operation of affairs and business of the Fund.

8313 (b) – Agent means one who is engaged by the Board to render service.

8314 (a) – ALL powers vested in the Fund shall be exercised by the Board.

8315 Board of Trustees: Powers and Duties

(a) - to establish, maintain and operate the program;

(b) - establish internal organization and management;

(e) - to employ, retain or contract with individuals or organizations for their services as qualified managers or specialists;

(f) - adopt rules & regulations as necessary for the exercise of powers and performance of duties and administration of operations;

(j) - to authorize expenditures in accordance with provisions of this part;

(o) - to do any and all other things necessary to the full and convenient exercise of above powers.

8316 (b)(3) – [Administrator] To keep the Board advised on needs of the Fund and approve demands for payment within the purposes and amount authorized by the Board.

8316 (c) – The costs and expenses of administration of the Fund shall be paid out of the Fund.

8421 – All functions ... with respect to administration of GHLIP are transferred to NMIRF.

8421 (1) – Legislature finds a need to ensure the program is administered in a fiscally sound and professionally accountable manner.

8423 – NMIRF shall serve in a fiduciary capacity and as fiscal and administrative agent.

8424 – establishes GHLITF to be held in trust and administered by NMIRF. The Trust Fund is to be administered in accordance with the policies set forth in Rules and Regulations promulgated by NMIRF. All contributions shall be collected & held in the Trust Fund. The Administrator of NMIRF shall have expenditure authority over the Trust Fund.

Note the lack of any reference to Department of Finance or any authority of DOF over any facet of management of NMIRF or GHLITF. Further, if DOF were capable of handling these types of matters, why did the Legislature transfer GHLITF from DOF to NMIRF stating a need to ensure sound fiscal management? If the Legislature intended DOF to continue financial management, surely they would have said so, or not transferred the Program at all.

Taking specific terms used in the Act, and corresponding definitions for those terms, it appears quite clear that the Legislature intended the Fund to be autonomous and to remove any financial control over the Fund, including procurement, from DOF. For example, the following key terms with definitions and synonyms simply taken from Webster's Dictionary:

Govern(ing) (§8313(f)): to exercise continuous *sovereignty* over; to control and direct the making of administration and policy; to prevail or have decisive influence; to control, direct, or strongly influence the actions and conduct; to *exercise authority*; to rule, reign, overrule, administrate, execute, render, command, head, *administer*, control, direct, manage, regulate, dominate;

Operate (§8315(a)): to cause to function; to perform a function; exert power or influence; to follow a course of conduct; to produce an appropriate effect; *handle, run, carry on, manage, direct* ;

Power (§8315): command, control, domination, jurisdiction, *governance*, rule, *authority*, management, right or prerogative of determining;

Duty (§8315): obligation, charge, commitment, burden, assignment, chore, function, objective, task, purpose {also, accountability, answerability, liability};

Employ (retain or contract) (§8315(e)): engage, hire, *contract (for), obtain, procure*, retain, secure, acquire, gain, have.

Procure: to get possession of; obtain; bring about; achieve; acquire; annex; gain; obtain; secure.

NMIRF cannot sufficiently stress that the specific terminology chosen by the Legislature in creating the Fund leads to only one logical conclusion: The NMIRF has authority to operate without interference, including procuring, on its own ("employ, retain or contract"), again without interference, necessary services and goods, as the case may be.

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Definitions and clauses used in the CNMI-PR further reinforce the position that NMIRF has the statutory authority to handle its own procurement. In Section 1-201 (13) the Official with Expenditure Authority is defined as the official who may expend funds under the Planning and Budgeting Act or under any annual appropriation act. The Fund is not subject to the Planning and Budgeting Act, has the authority to prepare and maintain, and does prepare and maintain, its own budget, does not receive an annually appropriated budget, and has its own statutorily designated expenditure authority. CNMI-PR Section 1-201 (15) refers to "procurement" as buying ... *acquiring* of goods and services, *including all functions pertaining to obtaining said goods and services*. NMIRF was given the specific authority to do this in 1 CMC §8315.

Notwithstanding the above, and notwithstanding the fact that NMIRF in no way concedes to any of OPA's arguments or assertions, or portions thereof, concerning NMIRF procurement, we will address OPA's contentions regarding the delegation of procurement authority from DOF to NMIRF.

Initially, it should be clarified that NMIRF did not "independently adopt a procurement system" of its own, it adopted the CNMI's, in total, merely substituting those with the statutory authority and responsibility and fiduciary duty for the trust assets in place of those with no such authority or duty.

The 1996 Memorandum from the Secretary of DOF specifically confirmed that NMIRF and GHLITF had been "delegated their own procurement functions", and unequivocally stated that P&S "may not actively participate in the procurement functions of those agencies... without approval of DOF". The Secretary's statement could easily be construed to mean that he, or a predecessor, had read the law, and understood that the law itself delegated this authority to NMIRF, as is clear from the Retirement Fund Act. One can assume that the reference to "without DOF approval" refers to agencies whose statutes did not remove such authority from DOF. In this Memorandum, however, P&S was instructed to provide delegation agreements to the referenced entities, but apparently failed to do so. It is entirely possible that a reading of the law led them to the conclusion that such an agreement between DOF and NMIRF was not necessary, nor would it be binding since DOF's financial responsibility over trust and retirement fund assets had been removed by virtue of the Act. In any event, if the clarity of the statute is lost on a reader, the Secretary's Memorandum, unequivocally stating that procurement authority had been delegated to NMIRF, should be more than adequate proof of said written delegation. Notwithstanding the fact that P&S failed to comply with the Secretary's instruction to provide the written agreement, the delegation, while completely unnecessary since NMIRF had its own authority and DOF's had been repealed by the Retirement Fund Act, was, in fact, made in writing by the Secretary.

Contract Terms and Conditions with HPMR

OPA contends that the contract with HPMR goes beyond the scope of work for the RFP that was issued for utilization review services. Again, the Fund disagrees. While we would agree that the contract language and the RFP language are not identical, they essentially refer to the same or similar services. The Fund, not necessarily being expert in these types of matters, prepared the Scope of Work to the best of its ability, based upon what the Fund thought it needed. Upon receiving the responses to the RFP, the Fund realized that there is often much more involved in the "utilization review" process than was initially known. As such, the contract that was negotiated specified each and every function that the Fund was seeking to be performed, even though those specific functions may not have been fully spelled out in the RFP itself. The scope of the final contract was more fully developed through the questions and answers that ensued between respondents and the NMIRF during the period in which proposals were being submitted in response to the RFP.

Both of the timely responses to the RFP encompassed very similar services at a somewhat similar price, and both respondents offered to provide all of the services encompassed in the resulting contract with HPMR. HPMR did, indeed, offer an advantage that the other respondent did not propose, that being the discounted contracts with medical service providers that HPMR already had, and existing negotiations with others. As part of its proposed services the other respondent offered to "negotiate rates with major medical facilities in Guam, Hawaii and California". The advantage to the selection of HPMR was that little to no waiting would be required to begin realizing the savings that would result from such contracts. As such, both proposals being virtually identical in the scope of services offered, no opportunity for amendments was necessary or required, and no noncompetitive basis existed. In addition, a potential conflict was detected in the response from the respondent other than HPMR, as this company also provided a home healthcare service, which is utilized by GHLIP patients. This potential conflict was taken into consideration in determining the awarding of the contract.

Negotiation of Final Terms

Contrary to OPA's assertion that it appears the Fund did not consider cost as a significant factor, thereby selecting HPMR outside compliance with NMIRF's procurement regulations, cost was most definitely a factor. OPA's contention, however, is understandable since it lacks much of the background of this situation and the process through which GHLITF went in its selection. That background is offered here.

Prior to issuance of the RFP for these services, the Fund had estimated the start-up and first year expenses for the services being sought. Since the Legislature failed to appropriate operating funds to GHLITF upon its transfer to

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NMIRF, the Fund approached the legislature for an appropriation of \$1,000,000.00 to fund a utilization review process, since GHLITF's budget was woefully inadequate to fund such a venture. The Legislature gave the impression, and led NMIRF to believe, that such an appropriation would be forthcoming. After the RFP was issued and a contract ready to be awarded, however, no appropriation had been made. Several months later, it became very evident that no funds were forthcoming. NMIRF, having already awarded the contract, was placed in the position of negotiating with the awardee to a level that was supportable under the Group Health Program itself without additional funding.

HPMR was very gracious and willing to make some financial concessions to benefit the Program. The HPMR off-island portion of the proposal called for an administrative fee based on a percentage of claims, and a set hourly fee for case management services. Additionally, as part of Hawaii law, an excise tax of just over 4% is charged to all businesses, similar to the CNMI's BGRT. This cost is normally passed on to the customer and HPMR reflected this tax in its initial proposed contract. NMIRF objected to separate charges for administrative and case management fees and specific payment of this tax and therefore the parties negotiated a set percentage that encompassed all off-island services at a rate that was determined to be reasonable and beneficial to the Program based on calculations of estimated anticipated claims costs. As a side note, the chart on Page 7 of OPA's letter is very deceptive as it fails to take into account the cost of the separate case management fee that was negotiated out of the final contract.

Payment Terms

Again, there is much OPA fails to take into account as it asserts that the HPR contract appears to be a cost-plus-a-percentage-of-cost arrangement. First of all, in order to be such an arrangement, NMIRF would have to pay HPMR a set fee for a service, then pay an amount on top of that set fee that is a percentage of that set fee. The contract is not structured in this way.

The HPMR contract was segregated into and encompasses two separate facets: on-island services and off-island services. Initially, (as was proposed by both respondents to the RFP) a setup fee was paid to HPMR to allow them to integrate the Group Health Program into its systems, and establish whatever other functions were necessary to accommodate GHLIP's 13,000 plus membership. This setup fee was a one-time fee only, with no additional funds to be provided by NMIRF for any future integrations, upgrades, etc.

Since the off-island claims would be subject to processing under HPMR's discounted contracts with providers, resulting in a lower dollar amount being payable by the Program, it is to GHLIP's benefit to pay HPMR based on a percentage of the amount of claims actually paid. The Program had realized significant savings due to this structure for off-island claims. However, no such

discounts are anticipated for on-island services, therefore, it is not in the Program's best interest to pay a fee based on a percentage of claims paid. With this in mind, NMIRF negotiated a flat fee per member for on-island services. The initial proposal of \$8.00 per member, although not specifically stated, assumed that NMIRF would be paying the Hawaii excise tax of approximately 4%. As previously stated, NMIRF objected to this and negotiated the removal of this from that flat fee. Based on various calculations of estimated claims and costs per member, the resulting \$7.29 figure was agreed upon.

Proposer Different from Contractor

HPMR has provided a response to OPA's concern regarding the awarding of the contract to HPMR, rather than HWMG, the company that actually proposed to provide services. This issue has been discussed with OPA more than once. It is believed that OPA's continued concern likely results from a fundamental lack of understanding of the relationship between HMAA, HWMG and HPMR. A copy of HPMR's response is attached for OPA's reference.

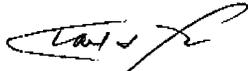
NMIRF considered this issue carefully in executing the contract with HPMR, and, based on proper documentation and explanations provided by HMAA/HWMG/HPMR, at the time of contracting, as to the nature of those relationships, was satisfied that it was properly contracting with an entity established by the proposer to handle services specifically for the Micronesian region, which would include GHLITF. Had the contract not been executed as it now exists, NMIRF would have given its approval for assignment of the contract and the contract would have been assigned to HPMR, as there was no valid reason for objection to such assignment. As was stated to NMIRF officials at the time, and has been stated in HPMR's attached response, all staff and systems that were originally proposed by HWMG for handling GHLITF were transferred to HPMR. At the time, HWMG decided that to better and more effectively serve its Micronesian clients, it would establish a separate, but associated, entity solely for that purpose.

Based on the foregoing, NMIRF asserts, unequivocally, that it complied with all of its procurement policies and that the resulting contract is not in violation of any of those policies or regulations. Further, NMIRF, also as detailed above, disputes the statement that "differences between the RFP's Scope of Work, HWMG's proposal and the HPMR contract contravene the spirit of competitive solicitation". These are OPA's erroneously perceived differences, which appear to result from a lack of detailed investigation and understanding into the process NMIRF undertook in securing these crucial services.

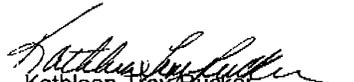
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Please feel free to call on us should you have any questions.

Sincerely,



Karl T. Reyes
Administrator



Kathleen Troy Rucker
Legal Counsel

Attachment