

Pajaro Valley Unified School District

Insurance Vendor Selection:

Are There Options?

Summary

The Santa Cruz County Grand Jury investigated the Pajaro Valley Unified School District (PVUSD) processes for vendor selection. The investigation was prompted by public concern and a newspaper article regarding potential conflicts of interest related to health insurance consulting and vendor selection. The investigation found PVUSD selection processes to be transparent and followed state-mandated procedures. However, the current contract for Medical, Dental and Vision Consulting Services considered only one vendor bid. It appears that PVUSD relies heavily on that one contractor, Keenan & Associates, to provide insurance services across a wide range of roles, including consultant, broker, and administrator of insurance pools, each of which is separately compensated. The Grand Jury recommends process improvements to increase the choice of competing vendors, provide more thorough contract review, and ensure a more comprehensive accounting of total costs.

Definitions

- **AD&D Insurance:** Accidental Death & Dismemberment insurance.
- **BeLiEF JPA:** Benefits Liability Excess Fund Joint Powers Authority. A group of self-funded public school districts and community colleges, including PVUSD, that have joined together for Stop-Loss insurance coverage.
- **COE:** Santa Cruz County Office of Education.
- **JPA:** Joint Powers Authority. JPAs can be formed by public entities that wish to join together and leverage their purchasing power. For example, school districts can join with each other, under a JPA, to collectively fund or purchase insurance coverage in a specific area.
- **KPPC:** Keenan Pharmacy Purchasing Coalition used by PVUSD to provide employee prescription benefits.
- **Nor Cal ReLiEF JPA:** Northern California Regional Liability Excess Fund Joint Powers Authority. A large group of member school districts, including PVUSD, that have joined together for leverage in obtaining property and liability insurance coverage.
- **PEPM:** Per employee per month.
- **PMPM:** Per member per month.
- **PO:** Purchase Order. An accounting document prepared and approved for all purchases.
- **PVUSD:** Pajaro Valley Unified School District.
- **SACS:** Standardized Account Code. The California Department of Education implemented a uniform way for school districts to report their revenues and expenditures. Since the 2003-2004 school year, all districts use SACS in their financial reporting.
- **SAFER JPA:** Schools Association For Excess Risk JPA. Provides excess property and liability insurance. The Nor Cal ReLiEF JPA is a member of the SAFER JPA.

- **SAWCX II JPA:** School Alliance for Workers' Compensation Excess II. SAWCX II is a JPA that provides excess workers' compensation protection.
- **Self-Insurance Fund:** A dedicated fund used by self-insured employers to pay claims directly.
- **Stop-Loss Insurance:** An insurance policy sometimes used by self-insured employers to protect themselves against unexpectedly high claims.
- **Warrant:** The standard accounting term for payments.

Background

Questions were raised by an earlier Grand Jury concerning the budget review process, conflicts of interest regarding vendor selection, and dollar amounts and types of purchases which should be submitted for PVUSD Board of Trustees approval. These issues were addressed in PVUSD's response to the Santa Cruz County 2006-2007 Grand Jury Final Report with Responses.^[1]

More recently, there have been persistent, yet unsubstantiated, rumors regarding a potential conflict of interest with the selection of health insurance vendors. A 2009 newspaper article reported that a PVUSD trustee was concerned about a perceived conflict of interest with the PVUSD insurance consultant, who was also an insurance vendor.^[2]

Employee benefits are the second largest portion of the overall PVUSD budget after salaries. According to the Second Interim 2010-11 PVUSD SACS report, expenditures for employee benefits are \$47.2 million of the total \$182.7 million Operating Budget for fiscal year 2010-2011.^[3] \$26.3 million of these benefits are for Health and Welfare alone.^[4] PVUSD medical costs have tripled over the last 14 years, while dental and vision costs have remained relatively flat.^[5]

Scope

Grand Jury members reviewed PVUSD Board Meeting packets and minutes, PVUSD budgets, PVUSD purchasing procedures, PVUSD Board bylaws, several PVUSD audit reports, web content related to insurance vendors that had contracted with PVUSD, and lawsuit documents filed in Alameda County (Alameda County Superior Court Case No. RG04183334). This is a class action lawsuit against one of the PVUSD vendors, Keenan & Associates, that alleges various improper business practices relating to the brokerage of insurance for public schools and community colleges. The Grand Jury conducted interviews with employees of the County Office of Education (COE), PVUSD Administration, and the PVUSD Board of Trustees. PVUSD purchase order (PO) history and warrants (payments) were reviewed. This work was performed to determine if there were any apparent improprieties or conflicts of interest regarding insurance vendor selection.

Investigation

The investigation initially focused on whether a conflict of interest existed within PVUSD, regarding the choice of health insurance vendors. The scope of the investigation was subsequently expanded to examine the dominance of one vendor, playing a role across almost all PVUSD insurance needs, in more detail. The reliance on a single vendor also triggered a closer examination of the PVUSD bid process and level of contract review.

In initial interviews at the COE, it was learned that districts within the county select their own vendors, subject to the State of California Public Contract Code Section 20111(a), which requires school district governing boards to competitively bid for services that exceed \$50,000 (adjusted annually for inflation).^[6] The COE does not control contracts awarded by individual districts; however, a financial audit by an independent firm of Certified Public Accountants is required annually.^[7] During these audits, the accountants may request documentation on selected contracts.

PVUSD Board meeting minutes,^[8] Board packets^[9] and related newspaper articles were reviewed for any mention of contracts regarding health insurance. At the August 26, 2009, Board meeting, a contract for Keenan & Associates to provide Medical, Dental and Vision Consulting Services was submitted for approval. The Board packet documented that requests had been sent to five prospective vendors. Keenan & Associates was the only vendor to send a proposal prior to the submittal deadline. Another proposal was received after the deadline and was returned unopened.^[12] A Santa Cruz Sentinel article reported that the contract was discussed at the Board meeting, but it was tabled at the request of one of the trustees who was concerned that in acting as both as a District consultant and insurance vendor, Keenan & Associates had a conflict of interest.^[2] The official Board meeting minutes document that the contract approval was deferred, to clarify concerns of potential conflict of interest.^[13]

Keenan & Associates made a presentation to the Board, clarifying the services they provide to schools, on October 14, 2009.^[14] The contract with Keenan & Associates was eventually approved at the Board meeting on October 28, 2009. The cover page in the Board packet clarified that the consultant, Keenan & Associates, would be acting exclusively in an advisory and consultative capacity.^{[15] [16]}

Upon further review by the Grand Jury, the agreement with Keenan & Associates revealed several clauses which clearly authorize Keenan & Associates to provide brokerage services in addition to consulting services. In Section 2 of the agreement, the Brokerage Services option has been accepted. In Section 3, it states that Keenan shall procure and maintain Workers' Compensation and General Liability coverage. In Exhibit B of the agreement, Keenan & Associates has exclusive authority and right to negotiate with insurance carriers covering Prescriptions, Short and Long Term Disability, Life and AD&D (Accidental Death & Dismemberment). In Exhibit C, it states Keenan shall receive commissions from the insurance carriers and/or other vendors for the placement of insurance coverage.^[16]

At this point the investigation was expanded to look at the services provided by Keenan & Associates. This company focuses on providing insurance, employee benefits, and financial services for California schools and community colleges.^[17] Their insurance services include consulting, brokering, and managing numerous JPA's (Joint Powers Authorities). Public entities join JPA's like SAWCX II (Schools Alliance for Workers' Compensation Excess) JPA^[18] or Nor Cal ReLiEF (Northern California Regional Liability Excess Fund) JPA,^[19] to collectively purchase insurance and other products as a large pool. Keenan & Associates forms and manages these JPA's and provides the brokerage services. They also have a division, Keenan Financial Services, that provides retirement financial solutions for school employees, such as SERP (Supplemental Early Retirement Program) and Futuris (trust fund for post-employment benefits).^[20]

The Grand Jury did Internet research on Keenan & Associates, and discovered some material on blogs^{[21] [22]} and the Alameda County website for the Superior Court of California.^[23]

While the blog content could be biased, it did lead the Grand Jury to the court documents for case No. RG04183334 on the Alameda County website. On November 2, 2004, the County of Santa Clara filed a complaint against several insurance brokers, including Keenan & Associates.^[24] The complaint has been amended a number of times over the years. The fourth version of the complaint was filed on July 12, 2006. At that time, it was a class action lawsuit, with a list of plaintiffs including San Francisco Community College District, San Francisco Unified School District, Tuolumne Joint Powers Authority, and the People of the State Of California, by and through San Francisco City Attorney Dennis Herrera. Keenan & Associates was the only remaining defendant left in the complaint by that time.^[25]

The fourth version of the amended complaint alleges Keenan has “represented itself as a sophisticated and trustworthy insurance business expert,” but has engaged in “secret fee agreements,” “undisclosed kickbacks,” “bid-rigging,” “improper steering,” and “anti-competitive practices.”^[25] Overall, the complaint alleges that Keenan & Associates abuses its position of trust, as an advisor to public entity clients and JPA's, to maximize the undisclosed compensation they receive as a broker from carriers and vendors to whom they steer insurance business. The allegations conclude that the carrier and vendor recommendations made by Keenan & Associates may not be in the best interest of their public entity clients. The alleged undisclosed broker compensation received from carriers and vendors prevents clients from verifying whether they are getting the best deal or understanding the impact to their premiums. It should be noted that everything in the Fourth Amended Complaint must be treated as unproven allegations only.

On August 24, 2010, one of the plaintiffs, the San Francisco City Attorney, settled out of court and is no longer part of the case, which is now in its seventh year. At the time of this report there are 779 documents filed under the Register of Actions in the case, and it has not yet gone to trial.

This lawsuit was discussed in a front page article in the September 22, 2005, issue of The Recorder, a provider of California legal content. The article stated “Santa Clara County is suing several top insurance brokerage firms, claiming they have duped customers out of millions through secret ‘kickbacks’ and other ‘lucrative’ service deals and are ‘steering’ clients towards insurers that are offering brokers undisclosed commissions, funded through insurance premiums.”^[26]

A letter posted on the Internet from the Capistrano Unified Education Association (a teachers’ Union) dated May 19, 2009, asked the Capistrano Unified School District Board of Trustees to rescind their selection of Keenan & Associates, citing issues surrounding the previously mentioned lawsuit, the need to use objective criteria to evaluate service proposals, and the appearance of impropriety.^[27]

The next step in the investigation was to request vendor-related financial documents from PVUSD. They responded promptly, by directing us to their website where this information was located. The website contains detailed budget information,^[28] bidding policies,^{[29] [30]} and conflict of interest policy.^[31] In response to the Grand Jury request for vendor information, PVUSD created new public web pages with purchase order^[32] and vendor payment (warrant) histories.^[33]

The Grand Jury also reviewed PVUSD audit reports. The Grand Jury observed that the three JPA's noted in the audit reports were also JPA's mentioned in the lawsuit, as examples where Keenan & Associates allegedly engaged in deceptive business practices.^[25] These independent audits were performed by Vavrinek, Trine, Day & Co., LLP, Certified Public Accountants, in Palo Alto.

Table 1. Participation in Keenan managed JPA's noted in PVUSD audits.

	2006 Audit ^[34]	2007 Audit ^[35]	2008 Audit ^[36]	2009 Audit ^[37]	2010 Audit ^[38]
SAFER JPA	X	X	X	X	X
SAWCX JPA			X	X	X
BeLiEF JPA			X	X	X

The SAFER (Schools Association For Excess Risk) JPA provides excess property and liability insurance coverage, and provides an umbrella that includes the Nor Cal ReLiEF JPA mentioned previously.^[39] The SAWCX II (School Alliance for Workers' Compensation Excess II) JPA provides excess workers' compensation insurance. The BeLiEF (Benefits Liability Excess Fund) JPA is used for excess medical insurance.^[38]

After reviewing information requested from PVUSD, the Grand Jury scheduled interviews with PVUSD administrators and learned that PVUSD does not purchase health insurance from insurance vendors, or via brokers like Keenan & Associates. Instead, their health and workers' compensation benefits are paid from a self-insurance fund up to a certain level. An actuarial analysis determines the size of the annual contributions needed to maintain the fund to pay claims.^[40]

PVUSD "Fund 67" Self-Insurance Fund 2010-2011 Budget

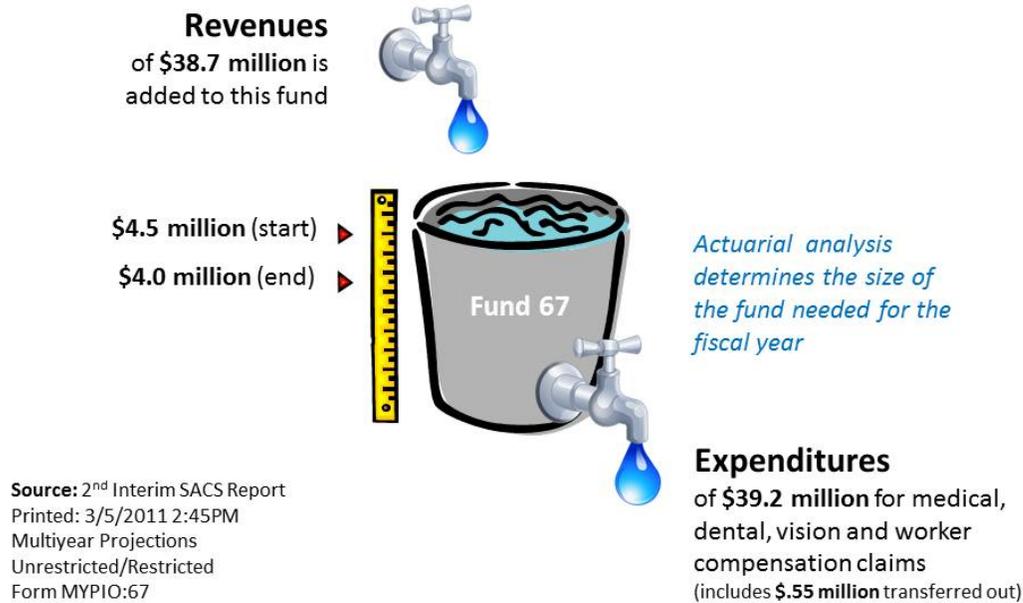


Figure 1. Illustration of PVUSD Self-Insurance Fund.

For the current fiscal year (2010-2011), according to the Second Interim SACS Report, PVUSD estimates it will add \$38.7 million to the fund. The beginning balance is \$4.5 million (which has an audit adjustment applied). The ending balance is \$4.0 million. The estimated expenditures from this fund are \$39.2 million for medical, vision, dental, and workers' compensation claims (includes administration and a transfer out amount of \$0.55 million).^[41] An earlier report, when the budget was adopted, details the breakdown of expenditures. At \$32.7 million, medical is the largest portion.^[42]

PVUSD pays large claims, above \$285,000, with stop-loss excess insurance through the BeLiEF (Benefits Liability Excess Fund) JPA. Members in this JPA include other self-funded public school districts and community colleges. Keenan & Associates created and manages the BeLiEF JPA.^[43] The cost for this stop-loss protection is currently \$1.7 million per year.^[44]

A copy of the latest Keenan & Associates Stewardship Report^[43] clearly indicates that the overall relationship with Keenan & Associates goes beyond acting "exclusively in an advisory and consultative capacity between vendors such as Coastal Healthcare and Blue Cross" as stated in Board Agenda Backup Item 12.3, dated October 28, 2009.^[16]

Purchase orders reports, available from PVUSD website, were reviewed, to better understand the extent of the business relationship with Keenan & Associates. In addition to the purchase order for the Medical, Dental and Vision Consulting Services contract, purchase orders were also noted if they:

- Were made out directly to Keenan & Associates for other services.

- Were made out to other vendors and Keenan & Associates received indirect compensation.
- Were made out to other vendors that were related in some way to Keenan & Associates.

Table 2 shows selected purchase orders and amounts to be paid to Keenan and Associates for insurance and workers' compensation services.

Table 2. Selected purchase orders directly to Keenan & Associates in the 08/11/2010 Board Meeting Purchase Order Report.^[44]

<i>Purchase Order</i>	<i>Vendor</i>	<i>Amount</i>	<i>Description</i>
110755	Keenan & Associates	\$49,000	Insurance Consultant services
110756	Keenan & Associates	\$1,720,000	Stop-Loss protection plan 2010 (BeLiEF JPA)
110636	Keenan & Associates	\$41,000	Life insurance premiums 10-11
110754	Keenan & Associates	\$195,000	Keenan Workers Compensation 2010-2011

As stated in the Keenan Stewardship Report,^[43] Keenan receives:

- A consulting fee of \$1.76 PEPM for Medical, Dental and Vision.
- A JPA Management Fee of 3% premium for the BeLiEF JPA stop-loss protection. If there is any indirect broker compensation (as alleged in the lawsuit) it was not disclosed in the Stewardship report.
- A commission of 14% for the placement of term life and AD&D insurance and ongoing service responsibilities, via MetLife.

Table 3 shows purchase orders for services paid to other vendors for which it is known Keenan receives other compensation.

Table 3. Selected purchase orders to other vendors, for which it is known Keenan receives other compensation, in the August 11, 2010, Board Meeting Purchase Order Report.^[44]

Purchase Order	Vendor	Amount	Description
110757	KPPC ^[45]	\$55,000	KPPC Agency Coalition Billing
110760	Chiropractic Health Plan	\$242,000	Chiropractic Health Plan of CA
110753	UNUM Provident	\$660,000	Short/Long Term Disability Coverage

As stated in the Keenan Stewardship Report,^[43] Keenan receives:

- Coalition Management Fee of \$0.80 PMPM for KPPC.
- Commission of \$0.50 PEPM for the “Chiropractic Carve Out program.”
- Commission of 10% for the placement of long and short term disability insurance from Unum.

Table 4 includes purchase orders for other related Keenan & Associates products and services.

Table 4. Selected purchase orders to JPA's and other products related to Keenan & Associates in the August 11, 2010, Board Meeting Purchase Order Report.^[44]

Purchase Order	Vendor	Amount	Description
110906	SAWCX II ^[18]	\$151,154	SAWCX II Member Contribution
110509	Nor Cal ReLiEF ^[19]	\$726,523	Insurance Coverage
Various	United of Omaha	\$2,894,069 (<i>subtotal</i>)	SERP ^[46] Installments

The Grand Jury was not able to determine what, if any, indirect compensation Keenan & Associates receives for the items in the table above. Keenan & Associates manages the SAWCX II and Nor Cal ReLiEF JPA's, and SERP is a Keenan product. There were no disclosures for these items in the Keenan Stewardship report. The lawsuit alleged that Keenan & Associates

obtains insurance for JPA's such as SAWCX II and Nor Cal ReLiEF but does not disclose indirect compensation received from insurance carriers.

Keenan & Associates has had a contractual relationship with PVUSD since November 2003. The Grand Jury explored the bidding process behind the last Medical, Dental and Vision Consulting Services contract with Keenan & Associates. According to PVUSD, there are only a handful of vendors in California that are qualified to provide the kind of insurance consulting services they require. Bid requests were sent to five prospective vendors. There was a period of two weeks for vendors to respond. The only bid received prior to the stipulated deadline was from Keenan & Associates, with a second bid returned unopened because it arrived thirty (30) minutes late.

PVUSD is in compliance with all bidding regulations and policies. State law and PVUSD policies stipulate minimum requirements for the bidding process for services. As mentioned previously in this report, Public Contract Code 20111(a) specifies a bid threshold, above which competitive bids shall be sought through advertisement. This threshold is revised every year and communicated by the State Superintendent of Public Instruction. In 2009, this threshold had increased to \$76,700.^[47] PVUSD Board Policy section AR 3311(a) describes the method for obtaining services, and section AR 3311(b) stipulates bids must be advertised for a minimum of two weeks.^[21]

Near the end of the investigation, additional interviews were held with PVUSD trustees, one of whom pointed out that clause 4-D in the Medical, Dental and Vision Consulting Services contract with Keenan & Associates offers some protection to PVUSD against conflict of interest. This clause states:

Keenan shall comply with all applicable state and/or federal laws and regulations regarding disclosure of compensation. We embrace industry efforts for transparency and believe that it is important that clients have access to information that may be relevant to their choice of insurance products, including cost of such insurance and services, and, the compensation that may be directly or indirectly paid to Keenan in connection with the products or services that are selected. If you have any questions regarding any of these items or desire additional information, you may contact your Keenan account representative to discuss this matter in more detail.^[16]

Trustees appear to have relied heavily on information and recommendations provided by the administration when reviewing the contract. The PVUSD trustees and administrators interviewed were not aware of the class action lawsuit brought against Keenan & Associates. As of the writing of this report, these allegations have not been resolved and the case has not yet gone to trial.

Keenan & Associates appears to be a professionally-run company with a solid understanding of the insurance market. They also appear to provide a comprehensive set of solutions to satisfy their customers' needs.

The Grand Jury made contact with an executive from Keenan & Associates at the end of the investigation. The executive stated that Keenan & Associates' objective is to assist their clients

to find the best insurance products and services at the best price. The executive also added that any commissions they receive when acting as a broker are consistent with industry practices.

Findings

- F1.** The Grand Jury found no evidence of any conflict of interest between PVUSD insurance related vendors and PVUSD employees or trustees.
- F2.** It appears that the PVUSD Board of Trustees has relied heavily on the administration for information and recommendations on vendor selection and contract approval.
- F3.** During the initial interviews, PVUSD Board of Trustees and administrators appeared to be unaware of ongoing litigation concerning Keenan & Associates.
- F4.** The services that Keenan & Associates provide PVUSD go beyond an advisory and consultative capacity for health benefits to also include brokering a wide variety of insurance, prescription management, early retirement planning and administration of several JPA's.
- F5.** Even though PVUSD requested proposals from five qualified vendors for Medical, Dental and Vision Consulting Services, and followed California Code and district purchasing policies, the process does not appear to encourage multiple bids.
- F6.** The Medical, Dental and Vision Consulting Services contract discloses that Keenan & Associates receives direct compensation from PVUSD and indirect compensation from brokered vendors, which is a conflict in that it diminishes the incentive for Keenan & Associates to always recommend vendors offering PVUSD the best deals.

Recommendations

- R1.** PVUSD Board of Trustees should act more independently of the administration when reviewing and approving significant contracts and vendors.
- R2.** PVUSD should include in their purchasing process an Internet background check on prospective vendors, relating to litigation or other issues.
- R3.** PVUSD should review their purchasing process and identify possible changes that would increase the number of qualified bids.
- R4.** PVUSD should consider the nature of the issues raised in the Fourth Amended Class Action Complaint to determine if they apply to their district. Following that, they should exercise clause 4-D in the Medical, Dental and Vision Consulting Services contract, to review both total direct and indirect compensation received by Keenan & Associates and the potential impact to PVUSD's overall costs.

Commendations

The Grand Jury requested budget information, purchasing policies and spending records from PVUSD. They responded with links to existing information on their website and added new detailed purchase order and payment history content at:

<http://www.pvUSD.net/info/public-notice/PurchaseOrdersReport.html>

<http://www.pvUSD.net/info/public-notice/WarrantReports.html>

This PVUSD website contains a large amount of detailed information and historical data. It is an excellent example of transparency for which they should be commended.

Responses Required

<i>Respondent</i>	<i>Findings</i>	<i>Recommendations</i>	<i>Respond Within/ Respond By</i>
PVUSD Superintendent	F3-F6	R2-R4	60 Days September 1, 2011
PVUSD Board of Trustees	F2-F3	R1	90 Days October 1, 2011

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Site Visits

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