

August 19, 2003

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative cited as the "Voluntary Health Plan Arbitration Act of 2004" (File No. SA2003RF0028).

Background

The Department of Managed Health Care (DMHC) is responsible for licensing and regulating health care service plans, also known as health maintenance organizations (HMOs) and some preferred provider organizations (PPOs). The California Department of Insurance (CDI) regulates the remainder of the health insurance market. The products regulated by CDI include PPOs and varied health insurance products such as disability health insurance and short-term intermittent products.

Existing law requires health insurers to arrange for the provision of medically necessary care where the health care service is a benefit provided under the contract. Existing law also allows health insurers to require that enrollees agree to binding arbitration to settle claims as opposed to litigation.

Major Provisions

This measure would enact the Voluntary Health Plan Arbitration Act of 2004, which would prohibit HMOs from requiring, as a condition of plan membership, that potential enrollees agree to binding arbitration or any other dispute procedure that requires enrollees to waive the right to a trial in court. The same prohibition would apply to all contracts for health or disability insurance, including PPOs.

Under this measure, enrollees could voluntarily agree in advance to binding arbitration. In such cases, disputes between health insurers and enrollees would be

subject to new arbitration procedures. These procedures, would place additional responsibilities on DMHC, including the following:

- Establish and maintain a panel of arbitrators.
- Develop an electronic randomized procedure to ensure that a neutral arbitrator is assigned to the enrollee and the health insurer within 15 days of the reported dispute.
- Develop procedural safeguards and enforce the provisions. This would include having health insurance businesses report to DMHC all decisions and settlements of arbitrations and litigations with enrollees within 30 days of completion.

Fiscal Effects

We estimate that if the measure is approved by the voters it would have the following fiscal effects on state and local government.

Increased Administrative Cost to DMHC

This initiative would result in increased administrative costs to DMHC. To pay for these new costs to DMHC, the amount of the fees that health insurers pay to the state might have to be increased.

These increased administrative costs would result from establishing a pool of qualified arbitrators and creating a process for assigning arbitrators to settle disputes among enrollees and various health insurance businesses. The department would also have to establish procedural safeguards appropriate for these types of arbitration proceedings. The department estimates annual ongoing costs of \$250,000 associated with performing these responsibilities. The DMHC estimates it would incur one-time costs of up to \$210,000 to (1) hire a consultant to develop the initial procedures and ensure that safeguards are in place, and (2) develop an automated process to randomly select and assign arbitrators to disputes.

Effects on State and Local Health Insurance Contracts

The state and local governments contract with health insurers for health insurance for their employees and their families and retired state employees. The state also contracts with health insurers to provide coverage to certain low-income persons in the Medi-Cal and Healthy Families programs. Some, but not all, of these contracts currently require patients to agree to binding arbitration in order to receive health care coverage.

It is likely that the state and local governments would experience an increase in health care costs if there were a reduction in the use of binding arbitration to settle disputes between health insurers and enrollees. This is because litigation typically costs

more than arbitration. The magnitude of the increased costs is unknown and would depend on a variety of factors, including the number of enrollees who would choose to have disputes with their health insurers settled in court, compared to continuing to use binding arbitration. If for example, this measure resulted in increased health care costs for current and former state employees and their families by 1 percent, then state costs could increase by around \$5 million annually.

Other Fiscal Effects

This measure could result in increased state costs to the court system to the extent that individuals pursue litigation instead of binding arbitration to resolve disputes with health insurers.

Summary

This measure would have the following fiscal effects:

- Increased administrative costs to DMHC of up to \$210,000 (one-time) and \$250,000 (ongoing).
- Unknown increase in state and local government costs to the extent that enrollees in various health insurance products use litigation, instead of binding arbitration to resolve disputes with their health insurers.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Steve Peace
Director of Finance