December 15, 2009

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 09-0073) relating to the imposition and collection of taxes, fees, or assessments on community hospitals.

BACKGROUND

Medi-Cal: California's Medicaid Program

Medi-Cal Funding and Administration. The U.S. Centers for Medicare and Medicaid Services (CMS) administers the federal Medicaid Program. In California, this federal program is administered by the state Department of Health Care Services as the California Medical Assistance Program and is known more commonly as Medi-Cal. This program provides health care benefits to low-income persons (primarily families with children and the aged, blind, or disabled) who meet certain eligibility requirements.

The costs of the Medicaid program are generally shared between states and the federal government based on a set formula. (In some cases, the state's share may be provided by local governments.) The share paid by the federal government is known as the federal medical assistance percentage, or FMAP. In general, the FMAP for Medi-Cal has been set at 50 percent. However, a 2009 federal law, the American Recovery and Reinvestment Act, temporarily increased the FMAP for Medi-Cal to about 62 percent through December 31, 2010, after which time the federal and state shares will revert to a 50-50 split absent any further changes in federal law.

Medi-Cal Hospital Funding. About 400 California hospitals receive some of their funding through Medi-Cal, with the level and type of support they receive generally depending on whether they are operated by public agencies (such as counties) or private firms. The Medi-Cal Program currently spends more than $9 billion for hospital

inpatient and outpatient services. Private and certain public hospitals (also known as district hospitals) receive Medi-Cal funding primarily through support from the state General Fund and matching federal funds. Certain other public hospitals participating in Medi-Cal, however, do not rely as heavily on state General Fund support. These hospitals certify that they have spent money on services provided to Medi-Cal and uninsured patients, and then are reimbursed by the federal government for part of their costs, generally at the state's FMAP rate.

Charges on Medicaid Providers

Provider Charges Are Used to Leverage Federal Medicaid Funds. Federal Medicaid law permits states to levy various types of charges—including taxes, fees, or assessments—on Medicaid providers. A number of different types of providers can be subject to these charges, including hospitals that provide inpatient and outpatient services. A number of states impose such charges and use the proceeds to draw down additional federal funds that are used for (1) support of their Medicaid programs and (2) to offset some state costs. In order to leverage these federal funds, these charges must meet certain requirements and be approved by the federal CMS. Currently, 43 states, including California, impose these types of charges on their Medicaid providers.

Recent State Legislation Imposes a Fee on Hospitals. Recent state legislation, Chapter 627, Statutes of 2009 (AB 1383, Jones), imposes a fee on certain hospitals based on a period ending December 31, 2010 to provide additional funding to hospitals and support children's health coverage. The fee, which is estimated to generate as much as $2 billion annually in revenues and potentially draw down more than $2 billion annually in additional federal funding, would not go into effect unless it was approved by CMS. Under the terms of the legislation, the authority to collect the fee would expire January 1, 2013, unless extended in a future law enacted by the Legislature and Governor.

The legislation creates a new special fund, called the Hospital Quality Assurance Revenue Fund, into which all proceeds of the fee must be deposited. The monies in the new fund would generally be used to provide additional funding for hospitals and reimburse administrative costs of the program. The legislation also earmarks $80 million dollars each quarter to pay for health coverage for children.

Children's Health Care Coverage in California

Children from low-income families in California can receive health care coverage from a variety of state and local programs. Medi-Cal is the largest single provider of children's health care coverage and is estimated to cover about 30 percent of California's children. Other state programs, such as the Healthy Families Program and California Children's Services, also provide health care coverage for eligible children. Children's Health Initiatives and other programs provide coverage at the local level primar-

ily for children who are not eligible for state programs. These local programs are funded by local governments, non-profit foundations, and other funding sources.

PROPOSAL

This measure does not impose any new taxes, fees, or assessments on hospitals, or extend the existing charges imposed under Chapter 627. However, it would amend the State Constitution to prohibit the Legislature from imposing and collecting any such charges on community hospitals for the purpose of obtaining additional federal funds unless a series of requirements are met. The measure defines a community hospital as a general acute care hospital licensed by the state that is not operated or funded by the federal government. The specific restrictions that would be placed in the Constitution are described below.

Federal Funding Related Requirements

The measure prohibits the imposition and collection of charges by the state on community hospitals for the purpose of obtaining additional federal funds unless the following federal matching requirements are met:

- ***Required Federal Matching Level.*** The measure states that every $45 generated by a tax, fee, or assessment that would be used to increase Medi-Cal reimbursements to community hospitals would have to be matched with $55 in federal funds.
- ***Medicaid Payments Generally Limited.*** Under the terms of this measure, charges of the type discussed above only could be imposed by the state on community hospitals for Medicaid payments for hospital services covered under the program if they did not exceed the amount for which federal funding is available. In other words, payments to hospitals from the revenues of such hospital charges might not be allowed unless they were drawing down federal matching funds.
- ***Hospital Charges Generally Limited.*** This measure places limits in state law on the rate of any charges that could be imposed on community hospitals for the purposes discussed above. Specifically, under this measure, the rate charged by the state to community hospitals could not exceed the amount for which federal funding is available. In other words, the measure places a ceiling on charges to community hospitals tied to the amount for which federal funds are available.

How Proceeds and Related Funds Could Be Spent

Funds Available Only for Administration, Hospitals, and Children's Coverage. The measure specifies how any proceeds from such charges on community hospitals would be spent. The proceeds including all interest earned and the amount provided by the federal government would be placed in a trust fund and be subject to an annual state audit. The proceeds would have to first be spent on:

- State administration of such charges on hospitals.
- Payments to hospitals licensed to a county, city and county, or the University of California.
- Health care coverage for children in low-income families. At least 10 percent but no more than 15 percent of the proceeds would have to go for this purpose.

The remainder of the proceeds, including any interest earned on the funds as well as additional federal funding obtained, would be used to provide increased reimbursements to community hospitals.

Proceeds Exempt from Proposition 98 Calculation. Proposition 98, a constitutional amendment adopted by voters in 1988 and amended in 1990, establishes a set of formulas that are used to annually calculate a minimum state funding level for K-12 education and the California Community Colleges. In many cases, additional state General Fund revenues result in a higher Proposition 98 requirement. This measure amends the Constitution to specify that the proceeds of any charges imposed on community hospitals for the purposes discussed above shall not be considered in calculating the Proposition 98 funding level required for schools.

Maintenance of Existing Funding for Hospital Services

The measure prohibits the use of any funding from these types of charges on community hospitals to replace existing funds for hospital services provided to Medi-Cal patients. The measure defines existing funding for hospital services as the amount of state General Fund expended from appropriations by the Legislature for Medi-Cal patients in the fiscal year in which the fee was enacted or in the preceding fiscal year, whichever is greater. The measure specifically exempts funds deposited into the Hospital Quality Assurance Revenue Fund created by Chapter 627, from being counted as existing funding for hospital services.

FISCAL EFFECTS

This measure could have significant fiscal effects on the state and local governments, particularly counties. However, these fiscal effects cannot be estimated at this time because they largely depend on future federal and state actions. For example, it is unknown whether the Legislature and Governor will enact any charges on community hospitals of the type that would be subject to the restrictions set forth in this measure. It is also unknown whether federal authorities would approve any such charges enacted for the purpose of drawing down additional federal funds. We discuss some specific potential effects of this measure below.

Potential Effect on Implementation of Recently Enacted Hospital Fee

This measure could affect the implementation of the recently enacted hospital fee under Chapter 627. In order for the state to collect the proceeds from the fee established by Chapter 627, the requirements of this measure might have to be met. Some provisions in this measure could conflict with Chapter 627. For example, it is possible that the proceeds earmarked for children's coverage could exceed the amount allowed under this measure, or 15 percent of proceeds. The federal matching requirements for hospital payments discussed above may also create a conflict. The exact fiscal effects of these potential conflicts are unknown and would heavily depend on future actions by the federal government and the state.

Thus, this measure could affect the ability of the state to impose and collect revenues related to hospital charges and additional federal reimbursements. This could have a further impact on local government finances, particularly counties.

Requirements to Maintain Funding for Hospital Services

As noted earlier, this measure would not allow the state to use money from charges on community hospitals to offset reductions in funding for hospital services. If federal authorities approve the proposed Chapter 627 fee, and it was in effect at the time this initiative were to pass, these new requirements to maintain funding levels for hospitals may apply immediately upon the enactment of this measure. These requirements could also be triggered in the future by the future enactment of these types of charges on community hospitals.

The requirement to maintain funding for hospital services could create greater pressures for additional state General Fund spending than would otherwise occur. The exact fiscal effect of this provision on the state is unknown and would depend upon a number of factors, including the future availability of various existing sources of funding for hospital services.

Summary

In summary, depending on future state and federal actions, this measure could result in the following major fiscal impacts:

- This measure could affect the ability of the state to impose and collect revenues related to hospital charges and additional federal reimbursements. This could have a further impact on local government finances, particularly counties.
- In some situations, this measure could result in greater pressures for additional state spending than would otherwise occur.

Sincerely,

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Mac Taylor
Legislative Analyst

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Michael C. Genest
Director of Finance