LAO
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January 3, 2012

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Dawn McFarland
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 11-0081) that would require certain nonprofit hospitals to provide a minimum amount of charity care, generally defined as the provision of health care without reimbursement.

Background

General Care Acute Hospitals. A general acute care hospital (hereinafter referred to as a "hospital") is a health facility with a governing body that has overall administrative and professional responsibility for the facility and a medical staff that provides 24-hour inpatient care, including the following services: medical, nursing, surgical, anesthesia, laboratory, radiology, pharmacy, and dietary. According to the state Office of Statewide Health Planning and Development (OSHPD), there were 352 hospitals in California in 2010. This does not include hospitals operated by the federal government, such as Veterans Administration hospitals.

Two Broad Categories of Hospitals: Public and Private. Hospitals fall into two broad categories: public and private. A public hospital is operated by the State of California, a county, a city, the University of California, a local health district or authority, or any other political subdivision of the state. A private hospital is typically operated by a corporation (both for-profit and nonprofit). In California, about 82 percent of hospitals are private hospitals and about 18 percent of hospitals are public hospitals. Public hospitals deliver a large percentage of the medical care provided to the uninsured and low-income persons in California.

Public hospitals are mainly funded with federal, state, and/or local government funds. Under California law, counties bear the ultimate responsibility to provide medical care to all incompetent, poor, and indigent persons, and those persons incapacitated by age, disease, or accident unless such persons are relieved by their own means, relatives, friends, or by state hospitals or other state or private institutions. In order to meet this obligation, some local government entities directly operate public hospitals.

We note that some hospitals may receive specific designations based on the type of care they specialize in providing or how critical their existence is to maintaining access to care in a region. For example, children's hospitals specialize in providing care to patients under the age of 18 and Medicare Critical Access Hospitals (MCAH) are federally certified hospitals that meet requirements generally to ensure that there is access to care in rural areas. (Medicare is a federally funded program to provide health care to persons over 65 years of age and certain younger persons with disabilities.)

Two Broad Categories of Private Hospitals: For-Profit and Nonprofit. For taxation purposes, there are two broad categories of private hospitals: for-profit and nonprofit. Of the private hospitals in California, about 30 percent are for-profits and about 70 percent are nonprofits. The for-profit hospitals pay corporate income taxes to the state. Nonprofit hospitals are exempt from state corporate income taxes and local sales and property taxes. The tax exemptions are intended to allow nonprofit hospitals to use the funds that would have been paid in taxes to provide patient care, invest in their facilities and equipment, and implement other measures that would be beneficial to their delivery of healthcare services.

Defining Charity Care. Currently, there is no uniform definition for charity care either in federal or state statute. However, charity care is generally considered to be care provided for which payment is not expected and patients are not billed.

No Required Amount of Charity Care. There is currently no federal, state, or local requirement on the *amount* of charity care that nonprofit California hospitals must provide in order to maintain their nonprofit and tax-exempt status. However, all hospitals are required, under state law, to offer reduced rates to uninsured and underinsured patients that may have low or moderate incomes, and to establish policies that state the qualifications patients must meet in order to be eligible for free medical care and discounted payments. These policies vary from hospital to hospital.

Health Insurers Purchase Services From Hospitals. Broadly speaking, health insurance can be defined as a system for the advance financing of medical expenses through payments made by persons, businesses, or state and local government entities, into a common fund to pay for an agreed upon set of health services, goods, and medical supplies. Generally, health insurers negotiate rates with hospitals for the services they purchase on behalf of their enrollees, and may pay for them based on discounted rates, per diem rates, or other arrangements.

State and Local Governments Purchase Health Insurance. State and local governments purchase health insurance for their employees and for beneficiaries of government health programs. For example, the California Public Employees' Retirement System (CalPERS) purchases health insurance on behalf of government employees, retirees, and their families. In addition, the state purchases health insurance for beneficiaries of such programs as Medicaid. (Medicaid, known as Medi-Cal in California, is a joint federal and state program that provides medical goods and services to qualified, low-income persons and families.)

PROPOSAL

This measure would require certain nonprofit hospitals to provide a minimum amount of charity care, impose new data reporting requirements on certain nonprofit hospitals, impose new administrative responsibilities on the Attorney General (AG) and give the AG authority to oversee and enforce the provisions of the measure. This measure goes into effect January 1, 2013, and is repealed on December 31, 2017, unless extended by future statute.

Measure Defines Charity Care

This measure defines charity care as the unreimbursed cost to a nonprofit hospital for: (1) *directly* providing health care services or items to needy patients (defined as those with no medical coverage or high medical expenses whose family income is no more than 350 percent of the federal poverty level—currently about $78,000 for a family of four); (2) *indirectly* providing health care services or items to needy patients through other nonprofit or public outpatient clinics, hospitals, or health care organizations; and (3) *directly* providing specific community benefits for low-income families (defined as families with income no more than 200 percent of the federal poverty level—currently about $45,000 for a family of four), including vaccination programs or chronic illness prevention programs, that reduce community health care costs.

Certain Nonprofit Hospitals Required to Provide Minimum Amount of Charity Care

Required Minimum Charity Care Amount Set at 5 Percent of Net Revenues. This measure imposes a requirement on nonprofit hospitals, unless exempted by the measure, to provide an amount of charity care (as defined by the measure) equal to at least 5 percent of their net patient revenues. Hospitals to which this measure applies must meet this requirement in order to continue to qualify as a nonprofit corporation and maintain tax-exempt status within the state.

Hospitals Exempted From Charity Care Requirement. This measure exempts specified categories of nonprofit hospitals from the 5 percent charity care requirement. Specifically, the measure does not apply to nonprofit hospitals that are part of an integrated nonprofit health system or part of a safety-net nonprofit health system as defined by the measure. Additionally, children's hospitals, MCAHs, and certain other hospitals are exempted. Altogether, about 36 percent of the state's nonprofit hospitals are exempted from the requirements of the measure.

Excusal From Compliance. Should a nonexempt, nonprofit hospital determine that complying with the charity care requirement would result in a less than 1 percent profit margin in a fiscal year, it may petition the AG to be excused from compliance with the charity care requirement for that fiscal year. The AG may excuse compliance if it agrees that fulfilling the minimum 5 percent charity care requirement would result in a less than 1 percent profit margin for a nonexempt, nonprofit hospital.

New Data Reporting Requirements for Nonprofit Hospitals

Hospitals Must Report Amounts of Charity Care. This measure requires nonexempt, nonprofit hospitals to file an annual report to the AG that includes the amount of charity care provided in the previous fiscal year. In lieu of this report, a nonprofit hospital can elect to include

this information in the annual community benefits plan, currently required by state law, to be filed with OSHPD and the AG.

New Oversight Responsibilities for the AG

Establish Requirements for Data Reporting and Collection. The measure makes the AG responsible for determining the rules for reporting and collecting hospital data on charity care. Through an interagency agreement, OSHPD and the AG are required to establish a reporting and collection system, adopt regulations related to data reporting and collection, and collect annual reports from all nonexempt, nonprofit hospitals. With assistance from OSHPD, hospital data from these reports along with the reports themselves shall be made publicly available.

Assess Penalties for Failure to Report Charity Care. This measure allows the AG to assess civil penalties against a nonprofit hospital that fails to meet the reporting requirements for data collection established by the AG. The penalty may not exceed $1,000 for each day a report is past due, up to a maximum of $300,000. Nonprofit hospitals may petition the AG for a reconsideration of the assessment. The AG will determine the regulations governing the review, acceptance, and denial of such petitions.

Enforce Charity Care Requirement. The AG may bring any action available under the law against a nonprofit hospital for violating this measure. Civil actions may include, but are not limited to, assessing a civil penalty or revoking a hospital’s status as a nonprofit corporation.

Supervise Noncompliant Hospitals. This measure allows the AG to supervise nonprofit hospitals that fail to comply with the 5 percent charity care requirement. Specifically, the AG may appoint any person to serve as its representative on the Board of Directors of a noncompliant hospital that has not been excused from compliance.

Conduct Charity Care Compliance Reviews as Requested. Any patient, state taxpayer, or nonprofit hospital may request the AG to review the charity care data submitted by a nonprofit hospital to ensure that the hospital has satisfied the requirements of this measure. For any review granted, any patient, state taxpayer, or nonprofit hospital may ask the AG for its opinion regarding the charity care data.

The AG May Assess Fees to Cover the Costs of Activities. This measure allows the AG to assess reasonable fees on nonprofit hospitals to cover its administrative costs to implement the measure. For example, nonprofit hospitals petitioning the AG for excusal from the charity care requirement may be assessed a fee to cover the AG’s administrative and processing costs. Additionally, the AG may assess fees on filers of requests to review hospitals’ charity care data in amounts that would cover its costs.

FISCAL EFFECTS

State Agency Administrative Costs

Potentially Significant Cost Increases for AG, Offset by Fees. This measure imposes uncertain, but potentially significant, administrative, processing, oversight, and enforcement workload increases on the AG. This increased workload would result in potentially significant

costs to the AG. However, under the measure, these costs are fully reimbursable from fee-based (non-General Fund) sources.

Minor Fiscal Impact on OSHPD to Perform New Duties. This measure does not give OSHPD the authority to assess fees to cover its administrative costs to implement the measure. Existing OSHPD staff and resources may be able to absorb the workload resulting from implementation of this measure in 2012-13. However, while costs for the ensuing years may not be absorbable, they are likely to be minor.

Indirect Impacts on State and Local Finances

Fiscal Impacts Depend on Hospitals' Responses to Measure. The measure could result in both costs and savings to state and local governments, depending on how the hospitals subject to the measure responded to it. Our analysis finds that most of the nonprofit hospitals subject to the measure would have to increase the amount of charity care they provide in order to meet its requirements. In effect, this measure would require these hospitals to provide more uncompensated care than they currently provide in order to maintain their nonprofit and tax-exempt status under state law.

To offset the additional costs of providing greater amounts of charity care, hospitals subject to the measure could employ a mix of different strategies. For example, hospitals may opt to try to reduce their personnel costs and their maintenance and operations costs. As another example, hospitals may opt to reduce or eliminate certain low-profit medical services or services where they typically incur losses. Hospitals may also opt to increase the rates they charge to purchasers of hospital services, such as health insurers, where possible. Some nonprofit hospitals may ultimately opt to convert to for-profit status should they decide they cannot meet the measure's minimum 5 percent charity care requirement.

Individual hospitals may respond differently to this measure and implement the strategies we described here, other strategies, or a combination of strategies in order to meet the measure's requirements and maintain their revenues at a level that will allow them to continue to provide services. The nonprofit hospitals' responses, which could vary widely, would largely determine the nature and extent of the measures impact on state and local government finances. Below, we discuss the major potential fiscal impacts on the measure based on our evaluation of some of the most likely responses of nonprofit hospitals to the measure's charity care requirement.

Potential Costs to the State and Local Governments Due to Potentially Increased Health Insurance Rates. As mentioned above, some nonprofit hospitals may opt to offset the additional financial burden of a 5 percent minimum charity care requirement by increasing, where allowable, the rates they charge to purchasers of their health care services. For example, hospitals might increase the rates they charge to health insurers. In turn, insurers could pass these increased rates through to their subscribers in the form of increased premiums. To the extent this occurred, there could potentially be increased costs, at least in the millions of dollars annually through 2017, to state and local governments in the form of higher health insurance premium costs for CalPERS, Medi-Cal, and other government-funded healthcare.

Potential Savings for Public Hospitals. Although exempted from the requirements of this measure, there potentially could be indirect fiscal impacts to public hospitals and hence to the government entities that fund them. To the extent that nonprofit hospitals would be providing greater amounts of charity care as a result of the measure, public hospitals, which provide a large percentage of the care in California for uninsured patients, could be relieved of some of their burden for caring for this population. This could result in savings, at least in the low millions of dollars annually through 2017, for mainly local governments which bear the ultimate responsibility in California for providing care to indigents. The degree of savings ultimately would depend upon how many uninsured people shift from a public to a nonprofit hospital for their care.

To the extent that this measure increases the availability of charity care provided by hospitals, and more uninsured persons are provided with medical care, including preventive care, it could lower costs for treating this population in the future. For example, blood pressure screening can lead to early treatment that prevents the costly complications associated with high blood pressure, such as heart disease. The responsibility for treating these complications would likely fall on public hospitals and to the degree they are avoided, the public hospitals would not have to bear these costs.

Fiscal Summary

Based on our analysis of some of the most likely responses to this measure by the nonprofit hospitals subject to the measure, it would at least have the following fiscal impacts:

- Potential increased costs to state and local governments, at least in the millions of dollars annually through 2017, associated with potentially increased premiums for government-purchased health insurance.
- Potential local government savings, at least in the low millions of dollars annually through 2017, from uninsured persons accessing health care services at certain nonprofit hospitals instead of at government-funded, public hospitals.

Sincerely,

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Mac Taylor
Legislative Analyst

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Ana J. Matosantos
Director of Finance