DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: April 28, 2010
POSITION: Oppose
SPONSOR: California Nurses Association

BILL NUMBER: SB 1240
AUTHOR: E. Corbett
RELATED BILLS: SB 1351 (2008), AB 1131 (2005)

BILL SUMMARY: Local Health Care Districts: Operation of Facility

This bill imposes new regulations on contracts between health care districts and other entities which are contracted to operate health facilities owned by the health care district. It requires (1) that any revenue generated by a facility being operated by the contracted entity may only be used to benefit a hospital within the jurisdiction of the district; (2) the hospital and the operating entity must undergo an annual independent financial audit; and (3) that in the case of the subsequent sale of any district assets, any losses incurred by the operating entity may not be used as a credit against the purchase price of the facility, among other provisions. These provisions are to apply to all existing and future contracts, unless there has been "full performance" by both parties to the contract prior to January 1, 2011. These provisions do not apply to nonprofit corporations that operate general acute care hospitals that are owned by the health district where the district is the nonprofit corporation's sole corporate member.

FISCAL SUMMARY

This bill may result in a minor workload increase for the Office of Statewide Health Planning and Development (OSHPD), through its Cal-Mortgage Loan Insurance Program. Any additional staff costs can be absorbed in the existing support budget.

The bill does not specify if the health care district is obligated to pay for the independent financial audit of the hospital and/or the operating entity. If the health care district is obligated to pay for this audit the Commission on State mandates may determine that this would create a state reimbursable mandate for which the bill makes no appropriation.

This bill has a potential for significant costs to the Health Facility Construction Loan Insurance Fund. This bill would also reduce the incentives for an effective private operating entity to assume the operation and maintenance of a health facility owned by a district. Health care districts operating financially struggling facilities will have limited options and may shut down these facilities causing them to default on loans insured by Cal-Mortgage and healthcare services in the community will be reduced. As of March 1, 2010, the Cal-Mortgage Program insured 137 loans for approximately 100 facilities for an insured loan risk of $1.74 billion, through the Health Facility Construction Loan Insurance Fund. If one of these facilities defaults on their loan due to financial duress, this could result in a loss of tens of millions of dollars to the fund.

COMMENTS

The Department of Finance opposes this bill for the following reasons:

- This bill would impose similar regulatory restrictions on a health care district's ability to transfer assets as did SB 1351 (Corbett, 2008) which was vetoed. In his veto message, the Governor stated that he did not support imposing additional restrictions on health care districts that are already subject to

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several regulations and are governed by locally-elected board members that are held accountable by their communities.

- This bill would limit the discretion of the district's governing board in determining whether transferring or leasing district assets serve the best interests of the residents of the community they represent. The Legislature has balanced local discretion with the state's interests in protecting vital health care assets by enacting several safeguards, such as requiring the State Attorney General to review asset transfers and, in some cases, requiring voter approval. By this detailed regulation of specific elements in health care districts' contracts, SB 1240 disrupts the existing balance between protecting state interests and preserving local discretion.

- This bill would reduce the incentive for an effective private operating entity to assume the operation and maintenance of a struggling district operated facility, thus increasing the chances that the facility will close. This could result in defaults on loans insured through the Cal-Mortgage Program, which could cost the Health Facility Construction Loan Insurance Fund tens of millions of dollars. In addition, healthcare services in the community could be reduced

- This bill proposes retroactive application which could violate State law. The provisions of SB 1240 are to apply to contracts which were entered into prior to its effective date of January 1, 2011 but are not fully performed as of that date. This would appear to violate the California Constitution's prohibition of laws that impair contractual obligations, and is likely to result in litigation.

- This bill may result in a state reimbursable mandate for which the bill makes no appropriation.

ANALYSIS

A. Programmatic Analysis

Under current law, until January 1, 2011, a health care district is authorized to transfer ownership, at fair market value, of any part of its assets to one or more corporations to operate and maintain the assets. Before the district transfers 50 percent or more of the district's assets to one or more corporations, in sum or by increment, the elected board must, by resolution, submit to the voters of the district a measure proposing the transfer. Transfers of district assets, under current law, can be made to both for profit or nonprofit corporations. After January 1, 2011, existing law changes these provisions to restrict these transfers only to nonprofit corporations.

This bill would impose additional specific conditions on contracts between districts and other entities to operate one or more health facilities owned by the district:

- Specifically provides that no assets of the district shall be used for the benefit of any person or entity other than a hospital within the jurisdiction of the district;

- Provides that the hospital and the operating entity must undergo an independent fiscal audit, which must be made public; and

- Provides that, in the case of a subsequent sale of the hospital facility or other assets of the district to the operating entity, any losses incurred by the entity may not be used as a credit against the purchase price of the facility or other district assets.

These provisions would apply to all existing and future contracts, unless there has been full performance by both parties to the contract prior to January 1, 2011.

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Discussion: According to the author, health care districts are formed when citizens take the extraordinary step to assess themselves in order to provide hospital and other health care services in their community. Many struggle to maintain their fiscal viability and some decide to contract with larger private health care systems to manage their hospitals. The author believes that, in too many cases, these relationships end with assets being transferred out of the district to the benefit of the contracting private health system. The author cites as examples of this a 2007 agreement between the Eden Township Healthcare District Sutter Health, under which Sutter obtained a right of first refusal to purchase San Leandro Hospital, and the right to first deduct their operating losses from the purchase price, and an agreement between Marin Healthcare District and Sutter Health, under which the author states that $90–$200 million was transferred from Marin General Hospital to Sutter over a two-year period.

The bill is sponsored by the California Nurses Association, and supported by the AFL-CIO and the California Labor Federation, among others. Supporters believe the bill is necessary to keep private contracting entities from taking local assets and transferring them to outside of the district. The bill is opposed by the California Hospital Association which argues that existing law already provides adequate protections and public review prior to a district entering into a major contract. Furthermore, it argues that district hospitals, like all hospitals, face intense market pressures; often, contracting with a health care system is what a district must do in order to sustain the operations of a hospital, and often these agreements require the movement of assets between operating organizations. Health care districts face a rapidly changing and competitive marketplace. As local governments, they must follow the Brown Act, The Public Records Act, the Political Reform Act, public contracting laws, and other statutory restrictions which hamper their ability to effectively and efficiently operate. These struggling hospitals also must make costly investments to meet the state's seismic safety standards for hospitals by 2013. Private nonprofit corporations can often successfully meet these substantial challenges due to having less “red tape”. In addition, by forcing the nonprofit corporation dealing with the district to use all the revenue earned by operation of the facility only for the benefit of a hospital within the district, this severely reduces the incentive for a third party to enter into any form of operating agreement with the district. This could lead to more district owned facilities closing down and defaulting on their construction loans.

B. Fiscal Analysis

The OSHPD, through its Cal-Mortgage Loan Insurance Division, administers the Cal-Mortgage Program, which provides, without cost to the State, a loan guarantee program for health facility construction, improvement, and expansion loans to nonprofit corporations and political subdivisions of the state. The principal method of financing these loans is through tax exempt project revenue bonds issued by state or local agencies. Health and Safety Code Section 129200 established the Health Facilities Construction Loan Insurance Fund (HFCLIF) as a continuously appropriated fund. The HFCLIF is the initial source of funds to pay all costs and expenses relating to loan defaults. As of March 1, 2010, the OSHPD insured approximately 135 loans to nonprofit health facilities throughout California for approximately $1.7 billion, roughly $12.5 million per loan.

SB 1240 may adversely impact the Cal-Mortgage program. Districts having operational and/or financial difficulty often attempt to salvage healthcare services for the community by leasing or affiliating with other hospital systems or management entities, thereby avoiding bankruptcy. Limitations in this bill would make it difficult for districts to find entities willing to operate their fledgling facility since there is no incentive to do so and all financial risk is diverted to the contracted entity. A district unable to secure an operating contract with a private entity will be much more likely to default on their loans and close the facility. For entities with Cal-Mortgage insurance backing their bonds, such a default will result in a loss to the HFCLIF as it is the initial source of funds to pay all costs and

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expenses relating to loan defaults - resulting in potential losses to the HFCLIF of tens of millions of dollars.

Also, the bill does not specify if the health care district is obligated to pay for the independent financial audit of the hospital and/or the operating entity. If the health care district is obligated to pay for this audit the Commission on State mandates may determine that this would create a state reimbursable mandate for which the bill makes no appropriation.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2010-2011	FC	2011-2012	FC	2012-2013	Fund Code
4140/Stwd Hth Pln	SO	No		------------------- No/Minor Fiscal Impact -------------------					0001
4140/Stwd Hth Pln	LA	No		--------------------- See Fiscal Summary ---------------------					0518

Fund Code	Title
0001	General Fund
0518	Health Facility Const Loan Insurance Fd