Fiscal Note & Local Impact Statement

122 nd General Assembly of Ohio

BILL: **Am. Sub. H.B. 242** DATE: **April 30, 1997**

STATUS: **As Passed by the Senate** SPONSOR: **Rep. Van Vyven**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Requires the Attorney General to review transfers of assets of certain nonprofit health care entities to for-profit entities**

State Fiscal Highlights

STATE FUND	FY 1997	FY 1998	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Unlikely, but potential gain of up to $10.0 million	- 0 -
Expenditures	Potential increase of up to $200,000	Potential increase of up to $200,000	- 0 -

- Although unlikely, but there is a potential increase in revenues of up to $10.0 million from civil penalties.
- Although it may not be necessary, a $200,000 potential increase in expenditures is highlighted in the event that special counsel is needed.
- Substantial reparations of forgone taxes would accrue to charitable foundations – yet to be established.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 1997	FY 1998	FUTURE YEARS
Counties			
Revenues	Potential minimal gain	Potential minimal gain	- 0 -
Expenditures	Potential increase	Potential increase	- 0 -
Other Political Subdivisions			
Revenues	-0-	-0-	- 0 -
Expenditures	Potential increase	Potential increase	- 0 -

- Increases county expenditures, when civil or criminal action is brought before the respective Courts of Common pleas or the Franklin County Court of Common Pleas.
- Could increase revenue from criminal penalties.
- Allows recognition of significant effects on Ohio communities as charitable donors.

Detailed Fiscal Analysis

Under the provisions of the bill the Attorney General (AG) would be required to review the proposed transfer of assets from certain nonprofit health care entities (including insurers and hospitals) to a for-profit entity for approval or disapproval, after the receipt of a notice and other documents required by the bill.

In determining whether to approve or disapprove a proposed transaction, the Attorney General would be required to consider all of the following: (1) the fairness of the transaction to the nonprofit health care entity; (2) whether the nonprofit entity exercised due diligence in deciding to agree to the transaction; (3) the procedures used by the nonprofit entity in making its decision; (4) whether the transaction will result in a breach of fiduciary duty; (5) whether the nonprofit health care entity will receive full and fair value for charitable or social welfare assets; (6) whether the proceeds of the transaction will be used consistent with the nonprofit health care entity's original purpose; (7) whether the Attorney General has received sufficient information from the nonprofit entity to make a determination under the bill; and (8) any other criteria the Attorney General considers necessary to determine if the nonprofit entity will receive full and fair market value for its assets as required in rules adopted by the Attorney General.

In order for the Attorney General to review these transactions, the bill requires nonprofit entities to provide the Attorney General's office with all the information the Attorney General may require. Under current law, the Attorney General has no authority to compel such entities to comply with its requests, making court action the only avenue to secure such information. In addition, all documents secured through this means must remain confidential. In an on going transaction by Blue Cross and Blue Shield of Ohio, the Attorney General's office recently secured Controlling Board approval to engage outside counsel for legal representation in a pending court case to secure such documents. (The current budget is $100,000.) The bill would potentially eliminate the need for such requests by the Attorney General's office.

According to a May 1996 report of the American Medical News, there were 63 Blue Cross and Blue Shield Affiliates nationwide, with an enrollment of 63 million people. In Ohio, these affiliates vary in size of enrollment and in the volume of premiums generated, from the former Blue Cross of Central Ohio now Central Benefits Mutual with 43,000 subscribers to Blue Cross and Blue Shield of Ohio, the largest in the state, with an enrollment of 1.5 million Ohio residents and annual premiums of $2.0 billion, according to a May 1996 Wall Street Journal report on corporate earnings. There are currently 13 nonprofit HMOs in the state and approximately 156 nonprofit hospitals in the state that could be subject to the bill's provisions.

According to the Attorney General's office, there have been nine conversions of nonprofit entities to for-profit entities since October 1995 involving hospitals, HMO's and Blue Cross and Blue Shield plans. In addition, there are currently five such conversions pending in Ohio. A spokesperson for the Attorney General's office says this bill would result in a minimum increase in the workload of the office and that the office has adequate staff to handle the review of such transfers, resulting in no increased costs to the state. The spokesperson further states that all reviews would be handled in-house, thus not requiring the services of independently qualified experts, and therefore, they do not expect to bill nonprofit health care entities for the costs of the experts, as permitted by the bill. LBO requested a clarification from the Attorney General's office as to the likelihood of future special counsel contracts similar to the above stated contract.

The spokesperson for the Attorney General's office stated that by requiring notification of such transactions, they would have access to the necessary information with which to conduct a review, eliminating the need to resort to the action that necessitated the contract for special counsel. However true, LBO anticipates that the Attorney General's office may require such services on occasion and assumes two such contracts per fiscal year, hence the potential increase in expenditures to the state of approximately $200,000. We have however not taken into account the likelihood of the Attorney General's valuation being contested by the parties involved which also could result in litigation, or the converting entities appealing the decision of the Attorney General, which would require further court action.

The bill authorizes the AG to institute and prosecute a civil or criminal action to enforce provisions of the bill in the common pleas court of the county where the nonprofit health care entity is domiciled, or in the Franklin County Court of Common Pleas. In addition to any civil remedies, the court could rescind the transaction, grant injunctive relief, assess a civil penalty of up to $10 million, or any combination of those remedies. Although highly unlikely that any prudent individual would allow a case to result in such a judgement, we cannot discount the possibility of one such occurrence, hence the potential increase in revenues to the state. LBO believes also that, if this ever happens, that it will be a one-time occurrence that will reverberate in the industry, thus further reducing the likelihood of another such award. Hence the estimate for FY 1998 only. Revenues from such awards are deposited in the General Revenue Fund. In addition, the bill imposes a felony 3 penalty on anyone found guilty of entering into a transaction with a nonprofit entity without the approval of the AG, and anyone found guilty of receiving improper compensation of any kind relating to the transfer of assets of a nonprofit health care entity to a for-profit entity. By seeking court action in the common pleas court and prosecuting a felony level offense, there would likely be an increase in expenditures by counties. Fine revenues imposed by the courts could increase revenues to counties thus offsetting some of the potential increase in expenditures.

The bill, by requiring that the AG determine that the proceeds of the transaction will be used consistent with the nonprofit health care entity's original charitable purpose will position Ohio communities to adequately evaluate their course of action, as charitable donors. The public's stake in these conversions is substantial in that they represent not only a fundamental change in the structure of the health care system, but also the re-deployment of charitable assets. While for-profit enterprises may prove valuable in terms of increasing competition, there is the resultant risk as well. Not-for-profit health care entities are community-owned institutions and the products of substantial community investment - in terms of charitable contributions, taxes foregone and volunteer time. They have provided services and access to them in response to community need, and profits are invested back into the community through expanded service.

Studies demonstrate that distinct behavioral differences exist between the for-profit and not-for-profit institutions - with the not-for-profit sector providing the vast majority of teaching, research, education, and technological development, as well as a greater breadth and intensity of services (i.e. ICUs, neonatal units, burn centers, children's hospitals, etc.), and the majority of care for chronic illnesses and indigent populations. An investor-owned and operated sector will look different by virtue of ownership, structure and accountability. The changes that will accompany such a transformation will reflect the difference between investor interests and community interests.

The bill further requires that proceeds of an approved transaction be dedicated to existing or new charitable foundations. We assume that the amounts to be dedicated will be equal to that portion of the nonprofit health care entity's value that is attributed to any reduction in taxes and other social benefits received by virtue of the entity's status as a nonprofit health care entity. The potential amounts that could accrue to these charitable foundations is difficult to estimate, as they can only be determined on a case by case basis based on the outcome of the valuation process outlined in the bill. What follows thus, is a limited example of the requirements and outcomes in a few select states including Ohio. In California, the State Department of Corporations required Blue Cross of California to fund two public foundations with $3.3 billion in its bid to convert. In Virginia, the legislature required Trigon Blue Cross Blue Shield to donate $175 million to the state general fund. And very recently, the Ohio Attorney General reached a settlement with a former Blue Cross plan in Columbus (now Central Benefits Mutual) requiring the company to establish a charitable foundation with $5.1 million to provide preventive health care services to the indigent in 29 central Ohio counties.

The bill also brings to mind other issues that are not specifically referenced. These are, (1) how these conversions in general will impact on the insurance tax base administered by the Department of Insurance; and (2) the potential for violation of antitrust laws. The tax issues could generate additional state and local revenue, with a movement from charitable to for profit status, but current insurance code is likely to minimize that effect.

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