CALIFORNIA ASSOCIATION of PUBLIC HOSPITALS AND HEALTH SYSTEMS

May 26, 2020

The Honorable Holly Mitchell, Chair
Senate Budget and Fiscal Review Committee
State Capitol, Room 5019
Sacramento, CA 95814

The Honorable Phil Ting, Chair
Assembly Committee on Budget
State Capitol, Room 6026
Sacramento, CA 95814

Subject: May Revision Concerns

Dear Chair Mitchell and Chair Ting:

On behalf California's 21 public health care systems and the millions of patients they serve, I am writing express several concerns we have identified in the Governor's May Revision. Public health care systems already have serious apprehensions about their financial stability in the medium- to long-term, given the dramatic costs related to the COVID-19 response, a significant loss of revenue due to postponed essential health care, and the historical underfunding of public health care systems. The May Revision would further undermine public health care systems by cutting several essential funding sources across Medi-Cal managed care, pharmacy, and Proposition 56. Taken together, these cuts would total an estimated annual loss of $343 million for public health care systems. While we recognize the difficult decisions that both the Administration and Legislature will have to make in order to balance the State Budget, given the extraordinary deficit, we would implore you not to make these cuts at the expense of the health care safety net. We urge the Legislature to prioritize maintaining critically needed funding sources to ensure that public health care systems are not further crippled; fulfill the hospital industry's $1 billion request for the current budget year; and backfill lost realignment revenues so that essential safety net county services can continue.

Background

As you know, California's public health care systems are the core of the state's health care safety net, delivering high-quality care to more than 2.85 million patients annually, regardless of ability to pay or insurance status. Most patients seen in public health care systems are either Medi-Cal beneficiaries or remain uninsured. Statewide, public health care systems provide nearly 40 percent of all hospital care to the uninsured, and 35 percent of all hospital care to Medi-Cal enrollees in the communities they serve. Public health care systems also operate over half of the state's top-level trauma and burn centers, and train half of all physicians in the state.

Since the beginning of this pandemic, public health care systems have been on the front lines of California's response efforts, working alongside local public health departments and emergency personnel to prepare for the anticipated surge of cases, freeing up space within their facilities, and converting non-clinical spaces into patient care settings. As they always have, public health care systems are caring for many of the state's most vulnerable patients, including low-income essential frontline workers, individuals who are living without a home, and those with other complex social and medical needs, among others.

Proposed May Revision Cuts & Impact to Public Health Care Systems
As described above, the May Revision includes several proposed cuts that, when taken together, would total a loss of roughly $343 million annually for public health care systems, and could have potentially damaging effects. Now, when the health care safety net is nearing a breaking point, is simply not the time to allow these cuts to move forward.

Our specific concerns are discussed in further detail below.

1. Medi-Cal Managed Care Cuts: The May Revision proposes to cut Medi-Cal managed care rates by a total of $869 million ($274 million in General Fund) taking effect during 2020-21. To implement these savings, the State proposes two sets of cuts: one for the 18-month period from July 2019 to December 2020, and a separate set for January 2021 and beyond.

   For the entire 18-month period from July 2019 to December 2020, the State would reduce rates by 1.5%, or the maximum allowed by federal regulation without submitting a revised rate certification. The May Revision also proposes a complementing risk corridor program for plans for this period.

   For rate years beginning after January 2021, the May Revision proposes to implement a variety of "acuity, efficiency, and cost containment adjustments," in order to achieve savings in managed care. As part of these changes, starting in January 2021, DHCS would limit inpatient Medi-Cal managed care payments to fee-for-service APR-DRG rates for private and district hospitals.

   From the combined impact of these cuts, CAPH estimates that public health care systems would receive $106 million less in 2020-21, and $87 million less annually in following years, as a result of lower managed care rates and lower supplemental rate range payments that public health care systems receive (which are dependent on the overall size of managed care rates). We are also concerned that limiting inpatient payments to fee-for-service rates would discourage capitation at the provider level, and could set a negative precedent in the future.

2. Medi-Cal Pharmacy Carve Out: The May Revision maintains the policy to transition all Medi-Cal services provided under the pharmacy benefit out of managed care into fee-for-service, by January 2021. We estimate that this proposal could cost public health care systems nearly $240 million annually, based on the combined impact of lower reimbursement in fee-for-service for 340B drugs, which is limited to acquisition cost, and lower supplemental rate range payments due to the smaller overall managed care rates once pharmacy costs are removed. Because of the significant financial harm, and concerns about the State's readiness to assume these responsibilities, we request the Legislature adopt Trailer Bill Language ("TBL") delaying implementation Medi-Cal Rx until January 1, 2022 and upon the Department's attestation of operational readiness.

3. Proposition 56 Supplemental Payment Cuts: The Administration proposes to trigger a cut of Proposition 56 supplemental payments, starting July 1, 2020, absent the State receiving further federal stimulus funding. Proposition 56 had allowed for certain Medi-Cal supplemental payments to physicians and family planning providers, as well as payments for value based services and developmental screenings, among other areas. The Governor proposes to shift nearly all ($1.2 billion) of the Proposition 56 payments, to support general growth in the Medi-

Cal program, which would result in a total decrease of $2.2 billion to Prop 56. We estimate that this change would likely result in an annual loss of $20 million for public health care systems.

4. Elimination of PPS Carve-Out Payments for FQHCs
   The Administration proposes to eliminate federally qualified health centers (FQHC) prospective payment system (PPS) carve out payments for dental and pharmacy services, beginning January 2021. The State expects this would result in a decrease of $100M ($50M in General Fund); however, it is unclear how the State determined this amount. CAPH is concerned that this policy may force FQHCs that offer pharmacy services, and receive reimbursement outside of PPS, to adjust their scope of services for their PPS rate or stop offering pharmacy services altogether. Typically, PPS scope changes have been unfavorable for FQHCs, resulting in lower PPS rates.

COVID-19 Financial Strains

With dramatic costs related to the COVID-19 response, and a significant loss of revenue, public health care systems already have grave concerns about their financial ability to continue to carry out their mission and maintain their levels of care to Medi-Cal and uninsured patients, let alone having to grapple with additional funding cuts.

Collectively, public health care systems estimate they will incur roughly **$3.5 billion dollars** in new costs and lost revenue between March and August 2020, due to the COVID-19 response. In large part, these costs stem from significant investments such as:

- Expanding surge capacity, including procuring new equipment, supplies, infrastructure, and bringing on new frontline health care workers;
- Purchasing new equipment and services for increasing the provision of telehealth; and
- Preserving access by cancelling non-essential procedures and surgeries, in preparation for anticipated surges.

Because of these dire circumstances, the hospital industry statewide requests $1 billion in the current year's budget, in order to help shore up critical hospital infrastructure and maintain vital capacity as this crisis persists.

Insufficient Federal COVID-19 Funding

Public health care systems are also prioritizing efforts to draw down and secure all available COVID-19 federal funding sources, including allocations for health care providers under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Federal Emergency Management Agency (FEMA) funding, and the pursuit of funding along with the California Hospital Association through an emergency 1115 waiver. However, given the magnitude of our experience, even the aggregate of these possible funding sources will likely fall short in enabling us to maintain essential services and fulfill our safety net role.

Financial Impact on Counties

As you know, a number of public health care systems receive support from their county under typical circumstances. However, the pandemic has substantially reduced county coffers as well, as sales and other taxes dry up. California's counties estimate a loss of $3.3 billion in local tax revenue over two years. As public health care systems provide the non-federal share for a significant portion of the care they provide to their Medi-Cal and uninsured patients, their efforts may be further crippled as fewer local dollars are available to serve as a match for federal funds. As county funding erodes, public health care systems could face a twice over threat of declining local support and a reduced ability to finance federal support. As a result, we have joined with our county partners to request that the Governor

prioritize backfilling these revenue losses so that counties can effectively continue their frontline response efforts and avoid the impending decimation of safety net services in our communities.

Prior Financial Challenges

As outlined in a prior letter, public health care systems were already facing extraordinary financial threats and uncertainty prior to the COVID-19 pandemic. As described above, public health care systems self-finance a significant portion of the care they provide to their Medi-Cal patients – an increasingly challenging and unsustainable model for these systems to maintain, as it creates an inherent gap between costs incurred and payments received.

Since 2005, California has utilized 1115 Medicaid waivers to support public health care systems financing. Over the past 15 years, waivers have become a funding source on which public health care systems have come to rely. Each 5-year waiver has leveraged PHS' ability to finance the non-federal share, simultaneously helping to sustain them and perpetuating the structural deficit issue described above. Waivers have also challenged and enabled public health care systems to achieve significant delivery system transformation through performance-based programs aimed at improving patient outcomes and targeted care coordination efforts for their most vulnerable patients.

California's current 1115 Medicaid Waiver, *Medi-Cal 2020*, totals $2.4 billion annually across public health care system programs, and expires in December 2020. The Center for Medicare & Medicaid Service's (CMS) refusal to allow California to continue the existing structure of 1115 waivers resulted in the development of specific CalAIM proposals and other opportunities for alternative supplemental payments that are managed care based.

As you know, CalAIM, which would could have established a potential transition for public health care systems from some waiver programs, has been formally withdrawn in the May Revision. The Department of Health Care Services is now seeking an extension of California's existing 1115 Medicaid waiver through 2021. However, it is unclear how CMS will respond to this request. If public health care systems lose waiver funding without alternatives in place, they could be forced to significantly curtail services, and some could shutter entirely.

Public Health Care Systems' Ongoing Role

Weakened or shuttered public health care systems could hinder the realization of the goal of a re-opened economy in California. As residents begin engaging with one another more directly and frequently, we are likely to witness future spikes of COVID-19 cases. Knowing this, Governor Newsom made clear that hospitals must maintain their capacity to surge when needed, as a predicate for a re-opened economy. Many hospitals will be able to recoup some level of losses through resuming elective procedures; however, many public health care systems do not achieve substantial margins in the first place.

Public health care systems must also maintain their role in addressing health disparities, a longstanding problem that has risen to greater public consciousness as a result of disproportionate COVID-19 mortality among black and Latino communities. Public health care systems have long served a diverse, low-income patient population who are at greater risk for health disparities and poor health outcomes. Because of this patient population, public health care systems have developed tailored methods to reduce disparities – another example of the kind of effort that could have to be dramatically scaled back due to budgetary cuts.

Balancing the State Budget on the backs of the health care safety net would be especially draconian in the midst of this pandemic, and could greatly reduce access to services for low-income and uninsured patients in our communities. As the budget process moves forward, we urge the Legislature to prioritize the health care safety net. We remain committed to partnering with you, the Governor, and federal officials to find creative solutions to ensure the viability of the safety net during COVID-19 and beyond.

Thank you for your consideration. We would be pleased to discuss our position with you and answer any questions you may have. Please contact Kelly Brooks-Lindsey, our Sacramento representative, at 916-272-0011 if you would like more information.

Sincerely,

Erica B. Murray
President and CEO
California Association of Public Hospitals and Health Systems

cc: The Honorable Members of the Senate Budget and Fiscal Review Committee
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