AUGUST 13, 2024

Proposition 34: Restricts Spending of Prescription Drug Revenues by Certain Health Care Providers. Initiative Statute.

PRESENTED TO:

Senate Committee on Health
Hon. Richard Roth, Chair

Assembly Committee on Health
Hon. Mia Bonta, Chair

LEGISLATIVE ANALYST'S OFFICE

LAO Role in the Initiative Process

Fiscal Analysis Prior to Signature Collection

- State law requires our office to work with the Department of Finance to prepare a joint impartial fiscal analysis of each initiative before it can be circulated for signatures. State law requires that this analysis provide an estimate of the measure's fiscal impact on the state and local governments.
- A summary of the estimated fiscal impact is included on petitions that are circulated for signatures.

Analyses for Qualified Measures

- State law requires our office to provide impartial analyses of all statewide ballot propositions for the statewide voter information guide. This analysis includes a description of the proposition and its fiscal effects.

Background

Medi-Cal Covers Prescription Drugs Through Medi-Cal Rx

- Before 2019, Medi-Cal paid for the cost of prescription drugs in different ways.
- In 2019, the state adopted a single approach called "Medi-Cal Rx." Medi-Cal Rx likely saves the state money because Medi-Cal pays for drugs at more discounted prices.
- Medi-Cal Rx is not reflected in state law, but it is the approach used to pay for drugs in Medi-Cal.

Federal Program Provides Discounts on Drugs

- Under this program, drug makers provide discounts on their drugs to qualifying hospitals, clinics, and other providers. Eligible providers are public or private nonprofits that focus on serving low-income people.
- Providers tend to earn net revenue as a result of the program. They do so by charging payors of health care (such as private health plans and government programs) more than the cost to provide the drugs. As an exception, state law bans providers from charging Medi-Cal more than the discounted price of the drug.
- The program is intended to allow eligible providers to increase services and serve more low-income patients. Federal and state law, however, does not directly restrict how providers spend their revenue from federal drug discounts.

Health Care Entities in California Must Be Licensed

- Licensed entities must follow certain rules. For example, they cannot engage in conduct that is unprofessional, dishonest, or harmful to public health or safety.
- An entity that violates these rules can face penalties, including losing its license (which means the entity can no longer operate as a health care entity).

Proposal

Restricts How Certain Entities Spend Revenue From Federal Discounts

- Requires entities to spend at least 98 percent of their net federal drug discount revenue earned in California on health care services provided directly to patients ("direct patient care"). As the figure below shows, these rules apply only to entities that meet certain conditions ("affected entities").
- Requires affected entities to report how much revenue they earned in California and nationwide from the federal drug discount program and how they spent this revenue. This information would help the state determine compliance with the new rules. The state would charge fees on affected entities to cover its enforcement costs.
- Affected entities that do not submit timely and accurate information would be deemed to be engaging in conduct that is unprofessional, dishonest, or harmful to public health or safety.

Restrictions Only Apply if Four Conditions Are Met

Proposition 34's Restrictions Apply to a Health Care Entity if It:

- Participates in the federal drug discount program.
- Has (or has ever had) a license in California to operate as a health plan, pharmacy, or clinic, or has had certain contracts with Medi-Cal or Medicare.
- Has a ten-year period where it spent more than $100 million on purposes other than direct patient care.
- Owns and operates (or has previously owned and operated) multifamily housing units with at least 500 violations with a severity level of "high."

Proposal

(Continued)

Establishes Penalties for Violating Rules

- As the figure below shows, there would be four penalties for violating the new rules. All four penalties would apply if affected entities spend less than 98 percent of their net federal discount revenue on direct patient care.
- The penalties also would apply if the affected entities engage in conduct that is unprofessional, dishonest or harmful to public health or safety.

Proposition 34 Establishes Four Penalties

For Ten Years:

- Entity loses California tax-exempt status.
- Entity loses license.
- Entity cannot receive state and local government contracts or grants.
- Entity's leaders cannot serve leadership roles in a California health plan, pharmacy, or clinic.

Adds Medi-Cal Rx to State Law

- Medi-Cal Rx would be added to state law.
- Because Medi-Cal Rx already is in effect, there would be no change to the current approach Medi-Cal uses to pay for drugs.

Fiscal Effects

Has Limited Statewide Effects

- Likely few entities would meet the conditions described in the figure on page 3. The exact number of affected entities, however, is not known.
- Because few entities would be affected, the proposition's statewide fiscal effect would be limited.

Increases State Enforcement Costs, Paid by New Fees

- Increases state costs to enforce the new restrictions, likely in the millions of dollars annually.
- State would cover cost by charging fees on affected entities.

Could Have Other Fiscal Effects

- Some affected entities could increase spending on direct patient care to comply with the restrictions. If this increase results in more spending on Medi-Cal patients, there could be savings to the state. This would depend on what health care services are provided.
- Affected entities would have to pay fees and report to the state annually. Some entities might change their operations to avoid these requirements. For example, they could stop participating in the federal discount program. To the extent this results in fewer federal discounts to the Medi-Cal program, there would be state costs.
- Were an affected entity to violate the restrictions or engage in bad conduct, it would face penalties (such as the loss of its tax-exempt status and its health care licenses for ten years). These penalties could put it out of business. This could affect state tax revenue, state spending on Medi-Cal, or spending on other state and local government programs. The fiscal effect would depend on which affected entities face penalties.