



## PROPOSITION 34

### Restricts Spending of Prescription Drug Revenues by Certain Health Care Providers. Initiative Statute.

## ANALYSIS OF MEASURE

### BACKGROUND

#### Drug Coverage in Medi-Cal

*Medi-Cal Pays for Prescription Drugs for Low-Income People.* Medi-Cal is a federal-state program that provides health coverage for low-income people. This coverage includes the cost of prescription drugs.

*Medi-Cal Has a New Approach to Pay for Drugs.* 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.

*New Approach Is Not in State Law.* Medi-Cal Rx is not reflected in state law, but it is the approach used to pay for drugs in Medi-Cal.

#### Federal Drug Discount Program

*Federal Program Provides Discounts on Drugs to Certain Health Care Providers.* Under a federal program, drug makers provide discounts on their drugs to hospitals, clinics, and other providers. To qualify for these discounts, providers must meet certain rules. Eligible providers are public or private nonprofits that focus on serving low-income people. (These public and private nonprofits generally are exempt from paying taxes on their revenue.)

*Providers Tend to Earn Revenue From Federal Discounts.* Providers tend to earn net revenue from the federal drug discount 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. However, providers generally do not earn net revenue on these drugs in Medi-Cal. This is because state law bans providers from charging Medi-Cal more than the discounted price of the drug.

***Providers Decide How to Spend Revenue.*** According to the federal government, the intent of the federal drug discount program is to allow eligible providers to increase services and serve more low-income patients. Providers can do so by spending their net revenue on services to patients. Federal and state law, however, does not directly restrict how providers spend their revenue from federal drug discounts.

## State Licensing

***Health Care Entities Must Be Licensed.*** Health care entities must be licensed to provide services in the state. Several departments license health care entities, such as the Department of Managed Health Care (for most health plans) and the Department of Public Health (for hospitals, clinics, and certain other kinds of facilities).

***Licensed Entities Must Follow Certain Rules.*** 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.*** Proposition 34 creates new rules about how certain health care entities spend revenue from the federal drug discount program. Specifically, the entities would have to spend at least 98 percent of their net revenue earned in California on health care services provided directly to patients (“direct patient care”). As Figure 1 shows, these rules apply only to entities that meet certain conditions (“affected entities”).

Figure 1

### 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.”

***Requires Affected Entities to Report Annually to the State.*** Proposition 34 requires affected entities to report certain information to the state each year (annually). The affected entities would have to report how much revenue they earned in California and nationwide from the federal drug discount program and how they spent this revenue. The state would use this information to help determine compliance with the new rules. The proposition allows the state to charge fees on affected entities to cover its enforcement costs. Under Proposition 34, affected entities that do not submit timely and accurate information would be engaging in conduct that is unprofessional, dishonest, or harmful to public health or safety.

***Establishes Penalties for Violating Rules.*** As Figure 2 shows, Proposition 34 establishes 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.

Figure 2

### **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's Approach to Pay for Drugs to State Law.*** Proposition 34 adds Medi-Cal Rx to state law. Because Medi-Cal Rx already is in effect, the proposition does not change the current approach Medi-Cal uses to pay for drugs.

## **FISCAL EFFECTS**

***Has Limited Statewide Fiscal Effects.*** Under Proposition 34, likely few entities would meet the conditions described in Figure 1. The exact number of affected entities, however, is not known. Because few entities would be affected, the proposition's statewide fiscal effect (described below) would be limited.

***Increases State Enforcement Costs, Paid by New Fees.*** Proposition 34 would increase state costs to enforce the new restrictions. These costs likely would be in the millions of dollars annually. The state would cover this cost by charging fees on affected entities.

***Could Have Other Fiscal Effects.*** Proposition 34 could have other uncertain fiscal effects, such as:

- ***Savings From Increased Spending on Direct Patient Care.*** Some affected entities could increase spending on direct patient care to comply with Proposition 34. 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.
- ***Costs From Fewer Federal Drug Discounts.*** 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.
- ***Fiscal Effects From Violating Rules.*** Were an affected entity to violate Proposition 34's 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.

## **YES/NO STATEMENT**

A **YES** vote on this measure means: Certain health care entities would have to follow new rules about how they spend revenue they earn from a federal drug discount program. Breaking these rules would result in penalties (such as not being able to operate as a health care entity), generally for a ten-year period.

A **NO** vote on this measure means: These new rules would not go into effect.

## **SUMMARY OF LEGISLATIVE ANALYST'S ESTIMATE OF NET STATE AND LOCAL GOVERNMENT FISCAL IMPACT**

- Increased state costs, likely in the millions of dollars annually, to enforce new rules on certain health care entities. Affected entities would pay fees to cover these costs.

## **BALLOT LABEL**

**Fiscal Impact:** Increased state costs, likely in the millions of dollars annually, to enforce new rules on certain health care entities. Affected entities would pay fees to cover these costs.