Madera Community Hospital and St. Agnes/Trinity Health

Second Supplemental Report
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Background

This supplemental report responds to points raised in a recent letter (Letter, 11/18/2022) from Trinity Health to California Supervising Deputy Attorney General Emilio Varanini with regards to previously proposed Competitive Impact Conditions related to the proposed transaction involving Madera Community Hospital (Madera) and St. Agnes/Trinity Health (of Michigan).

This report provides additional data and analyses related to points raised in the Letter.

In addition, this report offers the following recommendation:

> ***It is recommended that Madera will limit prices for out-of-network emergency services rendered to patients covered by commercial health plans to no more than 250% of the Medicare (Prospective Payment System) Traditional Fee for Service (FFS) rates, as determined by the Centers for Medicare & Medicaid Services (CMS).***

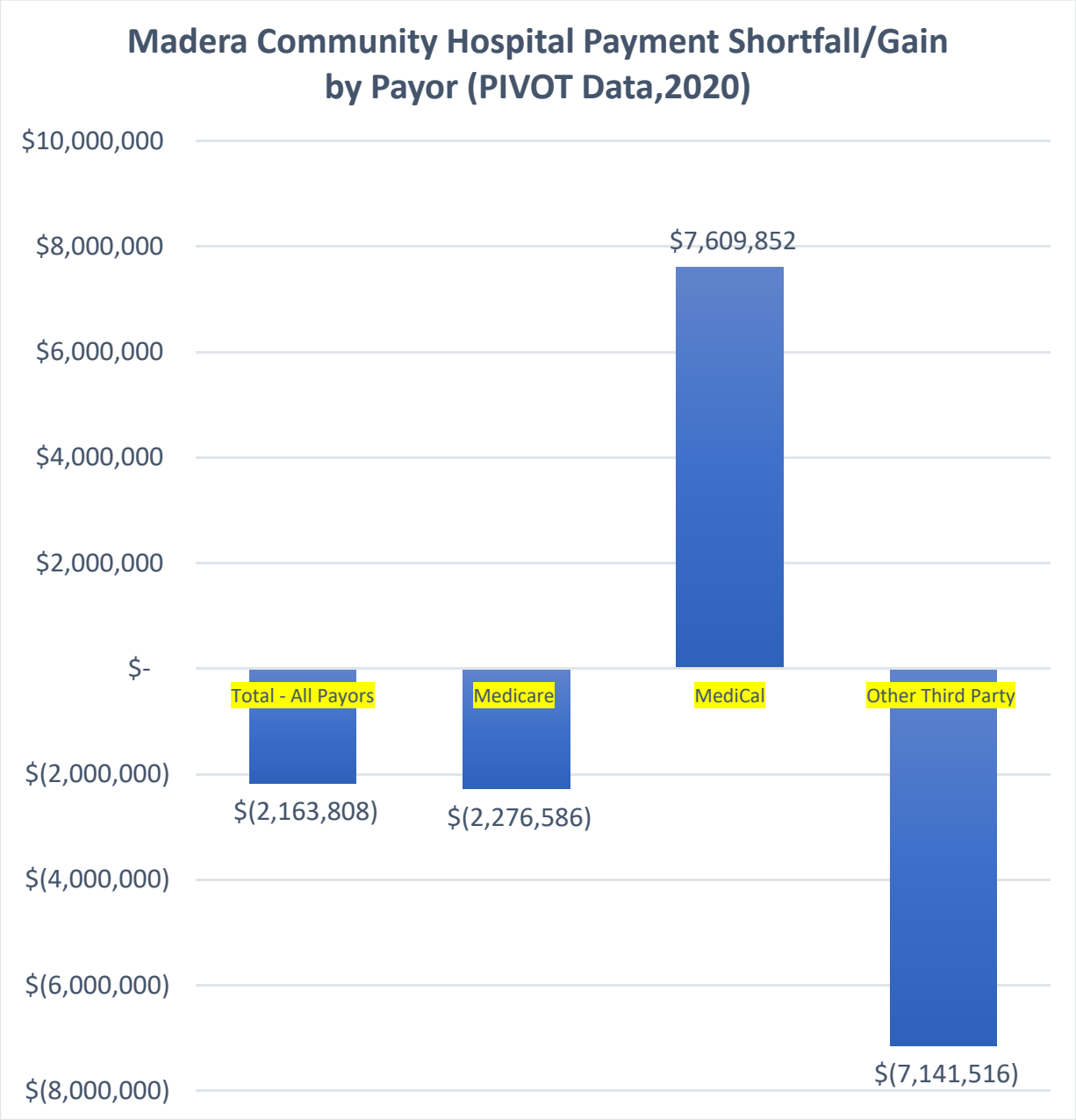
Data and Analyses

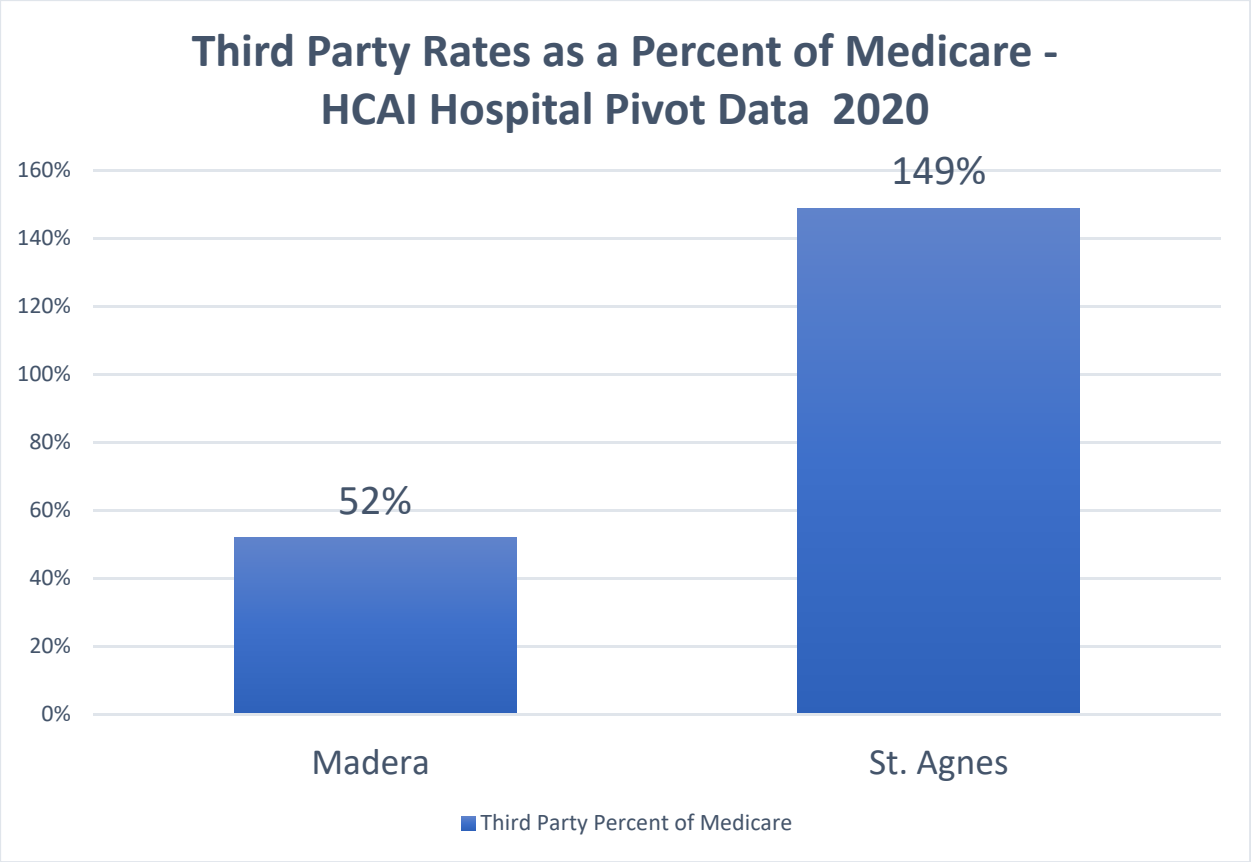
Commercial payors have a variety of incentives to contract with providers when constructing their preferred provider networks. Price is one consideration, but it is not the only one. Commercial health plans need to construct preferred provider networks that meet both market and regulatory requirements. From a market and marketability perspective, health plans prefer (all else equal) the broadest provider network possible. This makes the products that they are selling—access and coverage for health services—more accessible and thus more attractive and more marketable. From a regulatory perspective, health plans face regulations regarding network adequacy which also can affect network construction and the bargaining dynamics between health plans and providers.

An out-of-network emergency services price cap would only apply to emergency services. The cap would not affect other, non-emergency services. While an emergency services price cap limits prices for emergency services if a plan's member uses an out-of-network provider for emergency services, the health plan must also consider the options and costs of ensuring that their members have on-going, adequate access to non-emergency services. As a result, health plans will negotiate contracts based on a wide range of factors including price terms. The Letter implies that a price cap on out-of-network emergency services would provide health plans an overwhelming incentive to not contract with Madera so that they could benefit from

the price cap. This conclusion ignores the need to assure access to all hospital services not only emergency services and that Madera is the only acute care general hospital in Madera County.

Additional analysis of the California Department of Health Care Access and Information's (HCAI) most recent hospital financial data (2020) presented below indicates that Madera's financial losses, unlike many other hospitals as referred to in the Letter, are concentrated largely within the commercial payor category and that Madera's commercial rate is well below both Medicare FFS rates and St. Agnes Medical Center commercial rates. According to HCAI data, Madera's commercial rate is below Medicare FFS rates and St. Agnes's commercial rate is approximately 150% of Medicare.





Under our current system, public policy and associated regulations require all hospitals with emergency departments to treat and stabilize all patients that come to their emergency departments, regardless of their insurance status. This provides a public health benefit by ensuring immediate access to needed emergency services. As a result, our hospital system in the United States, while largely private, has evolved into a shared public-private emergency system. This is important background in developing a benchmark to both limit excessive price increases that result from excessive market concentration as would occur should this transaction be approved while at the same time recognizing the financial implications of this public health role/requirement placed on hospitals.[1]

In addition, under the current structure and market conditions, most U.S. hospitals generate most of their payment gains (excess of net revenue over expenses) from commercial payors. On average, market prices for the commercial sector are approximately 150% of underlying

[1] Melnick and Fonkych, Regulating Out-of-Network Hospital Emergency Prices: Problem and Potential Benchmarks, Health Affairs Blog, MARCH 23, 2020 https://www-healthaffairs-org.libproxy1.usc.edu/do/10.1377/forefront.20200320.866552/.

costs, averaged across all patients. This average does not distinguish between emergency and non-emergency patients.

For this report, additional analyses were conducted to simulate the potential impact of raising the out-of-network cap on commercial prices to 250% of Medicare rates. It should be noted that many contracts between hospitals and commercial health plans in California include price terms that include per-diem rates as well as a percentage of Medicare as benchmarks.

Madera reported $14.212 million in total expenses for third party payors for their 2020 filing and net patient revenue of $7.07 million resulting in a payment shortfall of $7.14 million. A cap on out-of-network patient charges would apply only to patients that use the hospital if it were to become out-of-network. Assuming that Madera would retain 50% of their in-network volume if the hospital were to become out-of-network for all commercial payors,[2] the cap would apply to 2,442 patients (4,883 baseline total patients multiplied by .5). If Madera charged up to the proposed cap of 250% of Medicare, the hospital's net revenue would equal $16.97 million while at the same time expenses would decline due to reduced volume. Assuming that marginal costs for the reduced volume is 50%, expenses would fall from $14.212 million to $10.66 million, resulting in a payment gain of $5 million and net revenue equal to 160% of costs.

Based on this analysis, it is recommended that the cap on out-of-network prices for commercial emergency patients be set at 250% of Medicare FFS rates. This benchmark caps Madera's out-of-network hospital emergency prices at 160% of Madera's own actual costs and thus guarantees the hospital a 60% profit margin for its emergency services based on its own costs while limiting the potential for excessive market disruption.

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[2] Glenn Melnick, PhD, Katya Fonkych, PhD, An Empirical Analysis of Hospital ED Pricing Power, The American Journal of Managed Care, March 2020, Volume 26, Issue 03.