

Adverse impact notification sent to Joint Commission on Administrative Rules, House Committee on Appropriations, and Senate Committee on Finance (COV § 2.2-4007.04.C): Yes Not Needed

If/when this economic impact analysis (EIA) is published in the *Virginia Register of Regulations*, notification will be sent to each member of the General Assembly (COV § 2.2-4007.04.B).



Virginia Department of Planning and Budget Economic Impact Analysis

12 VAC 5-221 – Virginia’s Rules and Regulations Governing Cooperative Agreements
Virginia Department of Health
Town Hall Action/Stage: 4439/7332
July 13, 2017

Summary of the Proposed Amendments to Regulation

Pursuant to Chapter 741 of the 2015 Acts of the Assembly¹, the State Board of Health (Board) proposes to promulgate a regulation that will govern any mergers between hospitals/hospital systems in Southwest Virginia that are approved under the Virginia Cooperative Agreements Act. Specifically, the Board proposes to set definitions and a fee schedule. The Board also proposes to outline procedures for the Commissioner’s requests for information, the Commissioner’s review of applications and ongoing monitoring of, and annual reporting for, approved cooperative agreements. This regulation will replace an emergency regulation that went into effect January 18, 2016 and that expires January 16, 2018.

Result of Analysis

Costs likely outweigh benefits for this proposed regulatory action.

Estimated Economic Impact

In 2015, the General Assembly passed the Cooperative Agreements Act (the Act) which amended the authorizing legislation for the Southwest Virginia Health Authority. The Act authorizes the Southwest Virginia Health Authority to receive and review applications for cooperative agreement for mergers between hospitals, hospital centers or health care providers

¹ <http://leg1.state.va.us/cgi-bin/legp504.exe?151+ful+CHAP0741>

who would otherwise be competitors in the market place. The Act also sets out criteria for assessment of such applications. By statute, both the Southwest Virginia Health Authority and, later in the process, the Commissioner of the Virginia Department of Health (VDH), must consider whether a proposed cooperative agreement will result in:

“a. Enhancement of the quality of hospital and hospital-related care, including mental health services and treatment of substance abuse, provided to citizens served by the Authority, resulting in improved patient satisfaction;

b. Enhancement of population health status consistent with the regional health goals established by the Authority;

c. Preservation of hospital facilities in geographical proximity to the communities traditionally served by those facilities to ensure access to care;

d. Gains in the cost-efficiency of services provided by the hospitals involved;

e. Improvements in the utilization of hospital resources and equipment;

f. Avoidance of duplication of hospital resources;

g. Participation in the state Medicaid program; and

h. Total cost of care.”

The Southwest Virginia Health Authority and, later in the process, the Commissioner must also evaluate any disadvantages attributable to any reduction in competition likely to result from any proposed cooperative agreement. Pursuant to the Act, these entities must assess factors that include, but are not limited to:

a. The extent of any likely adverse impact of the proposed cooperative agreement on the ability of health maintenance organizations, preferred provider organizations, managed health care organizations, or other health care payors to negotiate reasonable payment and service arrangements with hospitals, physicians, allied health care professionals, or other health care providers;

b. The extent of any reduction in competition among physicians, allied health professionals, other health care providers, or other persons furnishing goods or services to, or in competition with, hospitals that is likely to result directly or indirectly from the proposed cooperative agreement;

c. The extent of any likely adverse impact on patients in the quality, availability, and price of health care services; and

d. The availability of arrangements that are less restrictive to competition and achieve the same benefits or a more favorable balance of benefits over disadvantages attributable to any reduction in competition likely to result from the proposed cooperative agreement.

The Act authorizes the Southwest Virginia Health Authority to recommend approval of proposed cooperative agreements to the Commissioner only if “*it determines that the benefits likely to result from the proposed cooperative agreement outweigh the disadvantages likely to result from a reduction in competition from the proposed cooperative agreement.*” According to the Act, upon receipt of the Southwest Virginia Health Authority’s recommendation, the Commissioner may request additional information from applicant parties that he deems necessary to assess whether the benefits of a merger will outweigh its costs. The Commissioner of VDH has 45 days after receipt of the Southwest Virginia Health Authority’s recommendation to approve or reject an application for cooperative agreement, but that approval window may be extended an additional 15 days if the Commissioner requests additional information from the applicants. That 15 days starts once all requested information is received and the application is deemed complete. If an application is approved, the Act requires the Commissioner to provide ongoing supervision of the cooperative agreement to ensure compliance and allows the Commissioner to revoke the cooperative agreement if, at any time in the future, it no longer meets the requirements of the Act. The Act also allows any party to a cooperative agreement to terminate participation in the agreement but requires that party to file a notice of termination with the Commissioner within 30 days after termination.

The Act allows both the Southwest Virginia Health Authority and VDH to charge fees for their costs of evaluating applications; the act specifies that the Southwest Virginia Health Authority may not charge more than \$50,000 and VDH may not charge more than \$75,000. Additionally, VDH may charge ongoing, annual fees not to exceed \$75,000 for their ongoing supervision.

The Act explicitly states that: “*(a)ctivities conducted pursuant to cooperative agreements approved and supervised by the Commissioner are immunized from challenge or scrutiny under the Commonwealth’s antitrust laws. It is the intention of the General Assembly that this chapter shall also immunize cooperative agreements approved and supervised by the Commissioner from*

challenge or scrutiny under federal antitrust law". While the Act will apply to any cooperative agreement applications received in the future, it was specifically written to allow consideration of a proposed merger between Wellmont Health System and Mountain State Health Alliance which, between them, own and operate 11 hospitals in southwestern Virginia and northeastern Tennessee.

Pursuant to the Act, the Board promulgated an emergency regulation that became effective January 18, 2016 and now proposes this regulation to replace the emergency regulation which will expire January 16, 2018. Both the emergency regulation, and this replacement regulation, enumerate the statutory factors to be considered during application evaluation, and set fees for both evaluation of an application and for ongoing supervision of any approved cooperative agreements. In addition to including requirements in the Act, the Board at its discretion proposes to include regulatory language that states what additional information the Commissioner may request from applicants for cooperative agreements. This discretionary language seems to be geared towards allowing the Commissioner to get more specific information about the commitments made by the parties in their applications as well as more specific demographic information. Under this language, the Commissioner may, for instance, request specific healthcare workforce information to help assess the impact of any merger on that workforce. To the extent that this proposed regulatory language gives greater certainty to applicants as to what information they might be expected to provide, it will likely be beneficial.

Applicants are required to pay \$50,000 for initial application with provision for a refund if application evaluation does not cost \$50,000 and provision for additional fees to be assessed (up to a \$75,000 total) if costs exceed \$50,000. Parties to any approved cooperative agreements will also be subject to an annual fee of \$20,000 due when their annual report must be filed with the provision that additional fees up to a \$75,000 total may be charged if VDH's costs exceed \$20,000. Board staff reports that VDH's cost thus far for evaluating the application currently before them exceed \$87,000 and further report that, if the application is approved, they expect VDH's annual costs for supervision to exceed \$75,000 each year. Given this, it is likely that, at least for these applicants, fee costs for application and for ongoing supervision will be \$75,000.

In addition to the fees assessed by VDH, various parties have incurred, or will likely incur, various other costs. The parties to the current application likely have incurred quite large

costs for lawyers and consultants to help them prepare their applications and guide them through the application process. These parties likely have also incurred costs for searching out, preparing and providing additional information to both the Southwest Virginia Health Authority and the Commissioner. Additionally, VDH has already incurred costs in excess of the fees they are allowed to recover for application evaluation and anticipate incurring costs in excess of allowable fees for ongoing supervision if the current application is approved. Health care consumers are likely to incur additional costs for health care services, and may also have fewer health care services available to them in the future as the health care systems consolidate and eliminate duplicative services, if the application is approved. Health insurance carriers and businesses in southwestern Virginia that self-insure for health care are likely to experience a loss in bargaining power, and a concomitant increase in fees for services, if the application is approved. Competitors to these two health care systems may also incur costs if the merger is approved (details of possible costs are laid out in the *Effects on the Use and Value of Private Property* section below).

Finally, both the parties to the current application and the Commonwealth are likely to incur very large costs for defending the proposed merger against anti-trust litigation if the cooperative agreement is approved. Although it was the intention of the General Assembly to immunize parties to cooperative agreements from federal anti-trust scrutiny, the Federal Trade Commission (FTC) has registered strong objections to approval of the cooperative agreement.² Their objections send a strong signal that it is likely they will pursue anti-trust litigation if the merger is approved. Any future applications approved under this proposed regulation may also be subject to costs associated with federal anti-trust litigation if the FTC reaches an opposing opinion to the Southwest Virginia Health Authority, as they have in this case, as to whether the benefits of a merger outweigh its costs under the factors set forth in the Act.

All of these costs would be weighed against any benefits that might accrue on account of cooperative agreements. For instance, Wellmont Health System and Mountain States Health Alliance assert that they will commit \$140 million over ten years “pursuing specialty services”

² The FTC’s initial comment can be found on its website here: https://www.ftc.gov/system/files/documents/advocacy_documents/submission-ftc-staff-southwest-virginia-health-authority-virginia-department-health-regarding/160930wellmontswvastaffcomment.pdf and the a supplementary comment can be found on VDH’s website here: <http://www.vdh.virginia.gov/content/uploads/sites/96/2016/11/FTC-Staff-Supplemental-Submission-to-Virginia-1-13-17.pdf>.

such as addiction recovery services and mobile health crisis management teams.³ Even in cases where benefits might outweigh costs under strict consideration of the factors laid out in the Cooperative Agreement Act, those benefits would likely not be large enough to outweigh all costs laid out above.

Businesses and Entities Affected

Board staff reports that this regulation, and its authorizing legislation, will likely affect Wellmont Health System and Mountain State Health Alliance as well as any competitors to these two health care systems. Health care consumers within localities served by the Southwest Virginia Health Authority and health insurance carriers that serve that area will also likely be affected. Businesses, particularly businesses that self-insure, and Medicaid and Medicare payers (the state and federal governments) may also be affected. The Virginia Department of Health will also be affected. Board staff reports that approximately 258,000 health care consumers, 3,253 physicians, 11 hospitals and at least eight health insurance carriers will be affected.

Localities Particularly Affected

Localities within the Southwest Virginia Health Authority will be particularly affected by this proposed regulation. These localities include the Counties of Lee, Scott, Wise, Buchanan, Dickerson, Russell, Tazewell, Smyth and Washington as well as the cities of Norton and Bristol.

Projected Impact on Employment

Cooperative agreements approved under this proposed regulation may lead to current health care services in southwestern Virginia being consolidated with duplicative services being eliminated to lower costs. To the extent that this happens, there will likely be fewer jobs available within the consolidated businesses

Effects on the Use and Value of Private Property

These proposed regulatory changes may affect the use and value of any hospitals that may be awarded cooperative agreements as well as their competitors. Current applicants for cooperative agreements anticipate that their proposed merger will increase their available revenues. If they are correct, the value of these businesses would increase.

³ The parties report that these potential investments would not be possible without the merger. Given that additional cost savings under the merger that would allow these investments would likely have to result from consolidation and elimination of duplicative services, it is likely that the benefits of these proposed investments would likely be offset by costs incurred by health care consumers on account of services being eliminated. Board staff reports that the parties have committed to not cutting services for five years if their application is approved.

The effects of the merger proposed by current applicants on competitors to those applicants would likely be dictated by the actions of the applicants. The FTC estimates that the applicants would control over 70% of the health care marketplace in southwestern Virginia post-merger. Such a market position would give the merged company tremendous control over prices in the marketplace... they would likely be price makers at that point. Given this, if the merged company values increasing market share over short and intermediate term profits⁴, they may lower their prices temporarily to drive competitors out of the market place. If, on the other hand, the merged company prefers to increase profits immediately, their competitors may benefit from also being able to charge more for any given service because the “market” price has been driven up by the merged company.

Real Estate Development Costs

These proposed regulatory changes are unlikely to affect real estate development costs in the Commonwealth.

Small Businesses:

Definition

Pursuant to § 2.2-4007.04 of the Code of Virginia, small business is defined as “a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than \$6 million.”

Costs and Other Effects

Small businesses in the categories of affected entities listed above may incur costs if any cooperative agreements are approved via the criteria set forth in this proposed regulation and its authorizing legislation. Health insurance carriers and self-insured businesses may also experience a loss in bargaining power, and corresponding increases in health care costs, due to increased market share concentration that decreases competition.

⁴ DPB recognizes that the applicants are nonprofit entities. The term “profit” in this use has the normal economic meaning of revenues minus costs.

Alternative Method that Minimizes Adverse Impact

Within the parameters of Chapter 741, there are likely no alternative methods that would reduce adverse impacts for small businesses.

Adverse Impacts:**Businesses:**

Businesses that apply for approval of cooperative agreements will incur fees not exceeding \$75,000 for initial review of their cooperative agreement applications and would likely incur annual fees of \$75,000 per year that would defray the costs of state supervision and annual review if their applications are approved. These applying businesses will also likely incur significant other costs associated with the application process. These costs will likely include lawyer and consultant fees as well as copying and other costs associated with supplying the Commissioner of VDH with supplemental information that may be requested under the rules of this proposed regulation.

Other businesses in southwestern Virginia, especially health insurance carriers and businesses that self-insure for health care, may incur higher health care costs associated with decreased bargaining power in a health care market with less competition if cooperative agreements are approved.

Localities:

Localities in the Commonwealth that are in the affected geographical area will likely incur the same increased health costs as other health care consumers.

Other Entities:

Health care consumers in Southwestern Virginia will likely see increased prices for health care if cooperative agreements that limit market competition are approved under this proposed regulation. VDH will likely incur costs for reviewing cooperative agreements, and for supervising them if they are approved, that exceed the \$75,000 that they are allowed to charge applicants and holders of cooperative agreements. If the cooperative agreement application between Wellmont Health System and Mountain States Health Alliance is approved, and the FTC brings an anti-trust suit because of the merger, the Commonwealth would likely incur large costs for defending that approval in court.

Legal Mandates

General: The Department of Planning and Budget has analyzed the economic impact of this proposed regulation in accordance with § 2.2-4007.04 of the Code of Virginia (Code) and Executive Order Number 17 (2014). Code § 2.2-4007.04 requires that such economic impact analyses determine the public benefits and costs of the proposed amendments. Further the report should include but not be limited to: (1) the projected number of businesses or other entities to whom the proposed regulatory action would apply, (2) the identity of any localities and types of businesses or other entities particularly affected, (3) the projected number of persons and employment positions to be affected, (4) the projected costs to affected businesses or entities to implement or comply with the regulation, and (5) the impact on the use and value of private property.

Adverse impacts: Pursuant to Code § 2.2-4007.04(C): In the event this economic impact analysis reveals that the proposed regulation would have an adverse economic impact on businesses or would impose a significant adverse economic impact on a locality, business, or entity particularly affected, the Department of Planning and Budget shall advise the Joint Commission on Administrative Rules, the House Committee on Appropriations, and the Senate Committee on Finance within the 45-day period.

If the proposed regulatory action may have an adverse effect on small businesses, Code § 2.2-4007.04 requires that such economic impact analyses include: (1) an identification and estimate of the number of small businesses subject to the proposed regulation, (2) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the proposed regulation, including the type of professional skills necessary for preparing required reports and other documents, (3) a statement of the probable effect of the proposed regulation on affected small businesses, and (4) a description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed regulation. Additionally, pursuant to Code § 2.2-4007.1, if there is a finding that a proposed regulation may have an adverse impact on small business, the Joint Commission on Administrative Rules shall be notified.

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