LAO

70 YEARS OF SERVICE

December 18, 2013

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 13-0042) that would cap total annual compensation for executives at nonprofit hospitals at the level of compensation received by the President of the United States (currently set at $450,000).

BACKGROUND

Two Broad Categories of Hospitals: Public and Private. Hospitals generally fall into one of two broad categories: public or private. A public hospital is operated by the state of California, a county, a city, the University of California, a local health district or authority, or any other political subdivision of the state. A private hospital is typically operated by a corporation (either for-profit or nonprofit). In California, about 80 percent of hospitals are private hospitals and about 20 percent of hospitals are public hospitals. Relative to private hospitals, public hospitals tend to deliver a disproportionately large percentage of medical care to uninsured and low-income persons in California. Public hospitals are mainly funded with federal, state, and/or local government funds.

Two Broad Categories of Private Hospitals: For-Profit and Nonprofit. For taxation purposes, there are two broad categories of private hospitals: for-profit and nonprofit. Of the private hospitals in California, about 30 percent are for-profit and about 70 percent are nonprofit. The for-profit hospitals pay corporate income taxes to the state. Nonprofit hospitals are exempt from state corporate income taxes and local sales and property taxes. The tax exemptions for nonprofit hospitals are intended to allow them to use the funds that would have been paid in taxes to provide patient care, invest in their facilities and equipment, and implement other measures that would be beneficial to their delivery of health care services, such as providing charity care. Charity care is generally considered to be care provided for which payment is not expected and patients are not billed.

Executive Compensation at Nonprofit Hospitals. A recent study published in the *Journal of the American Medical Association Internal Medicine* found that nonprofit hospital Chief

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Executive Officers (CEOs) nationwide earned almost $600,000 on average in 2009; although, earnings ranged from less than $50,000 to over $3 million. The CEOs managing nonprofit teaching hospitals and managing nonprofit hospitals in urban areas were paid more than other CEOs. As of 2011, it is estimated, based on tax filings, that there were a few hundred nonprofit hospital executives in California earning annual compensation above $450,000.

PROPOSAL

This measure would impose a cap on compensation for executives at nonprofit hospitals, impose new data reporting requirements on nonprofit hospitals, impose new administrative responsibilities on the Attorney General (AG), and give the AG authority to oversee and enforce the provisions of this measure. This measure would go into effect on January 1, 2015.

Caps Executive Compensation at Nonprofit Hospitals

Executive Compensation May Not Exceed President of the United States' Compensation. This measure imposes a cap on total annual compensation paid to nonprofit hospital executives at the level of compensation received by the President of the United States. Currently, this level of compensation is $450,000 per year. "Executives" are defined under this measure to include individuals whose primary responsibilities are executive, managerial, or administrative, such as CEOs or chief financial officers, for example. "Total annual compensation" capped by this measure includes, but is not limited to, wages, salary, paid time off, bonuses, incentive payments, lump-sum cash payments, loan forgiveness, housing payments, travel, meals, reimbursement for entertainment or social club memberships, the cash value of housing or automobiles, scholarships or fellowships, the cash value of stock options or awards, and payments or contributions to severance. Total annual compensation does not include the cost of health insurance or disability insurance, or contributions to health reimbursement accounts.

New Data Reporting Requirements for Nonprofit Hospitals

Nonprofit Hospitals Must Report Levels of Executive Compensation. This measure requires nonprofit hospitals to file an annual report to the AG that includes the names, positions, and total annual compensation of the ten executives who received the greatest level of compensation and the five former executives who received the greatest level of severance compensation in the given year. This report must include a breakdown of the wage and nonwage compensation provided, identify all entities that contributed to the compensation, and identify the amounts of the contributions. This information must also be made publically available on a website and on request from any member of the public.

New Oversight Responsibilities for the AG

Establish Requirements for Data Reporting. This measure makes the AG responsible for determining the format that nonprofit hospitals must follow when reporting data on executive compensation.

Enforce Executive Compensation Cap. This measure allows the AG (or any state taxpayer) to bring a civil action against a nonprofit hospital for violating this measure. Civil actions may be brought to assess a civil penalty, revoke a hospital's corporate status as a nonprofit corporation,

and/or revoke a hospital's tax-exempt status under state tax law. This measure allows the AG to assess civil penalties of up to $200,000 for each intentional violation. For violations that are determined to be non-intentional, civil penalties of up to $100,000 for a first offense and up to $200,000 for all subsequent offenses may be assessed.

Supervise Noncompliant Hospitals. This measure allows the AG to supervise nonprofit hospitals that fail to comply with the executive compensation cap. The AG may appoint any person to serve as its representative on the board of directors of any nonprofit corporation that owns, operates, or controls a noncompliant, nonprofit hospital. Nonprofit religious corporations and nonprofit corporations incorporated outside of California are excluded from this provision.

The AG May Assess Fees to Cover the Costs of Implementation and Enforcement. This measure gives the AG the authority to assess reasonable fees on nonprofit hospitals to cover its administrative costs to implement and enforce the measure. These fees will be assessed annually and must be submitted with the annual report from each nonprofit hospital.

FISCAL EFFECTS

Administrative Costs for AG, With Authority to Recover Costs Through Fees Assessed on Nonprofit Hospitals

This measure creates additional workload for the AG to implement and enforce the measure. The increased workload would result in annual costs for the AG in the low millions of dollars. Under the measure, the AG is given the authority to recover costs from fees assessed on nonprofit hospitals.

Other Potential, but Likely Minor, Net Fiscal Effects on State and Local Governments

The cap on executive compensation could have fiscal effects on state and local governments in several different ways. These effects are likely to be relatively minor on net. To the extent the cap on executive compensation reduces the amount of income earned by certain employees of private nonprofit hospitals, state personal income tax revenue collected from these employees would decrease. However, hospitals could respond to the cap on executive compensation in a way that generates additional tax revenue, potentially offsetting the just-mentioned revenue decrease. For example, hospitals could reallocate funds that were previously used to provide compensation above the cap to hire new employees or to increase the salaries of current employees who are under the cap—thereby increasing state personal income tax revenue from these employees. A hospital could also reallocate the funds to increase the amount of charity care provided to uninsured individuals. To the extent this reduces the amount of charity care necessary at public hospitals, this would reduce costs for state and local governments, again potentially offsetting any revenue decrease resulting from the measure.

The impacts of this measure on the amount of charity care provided by private nonprofit hospitals and the salaries provided to employees who are not subject to the cap on compensation are uncertain. While these potential fiscal effects on state and local governments are uncertain, on net, they are likely to be minor.

Summary of Fiscal Effects

This measure would have the following significant fiscal effect:

- State administrative costs in the low millions of dollars annually to enforce the measure, with authority to recover costs through fees assessed on nonprofit hospitals.

Sincerely,

for Mac Taylor
Legislative Analyst

for Michael Cohen
Director of Finance