Great Falls Hospital Merger - 1999 Decision on Requested Modifications

BEFORE THE DEPARTMENT OF JUSTICE
FOR THE STATE OF MONTANA

In the Matter of the Application	)	
by Benefis Healthcare for	)	FINDINGS OF FACT
Modification to the Certificate	)	
of Public Advantage	)	

This matter is before the Department pursuant to Benefis Healthcare's ("Benefis") request for modifications to the July 9, 1996 Certificate of Public Advantage ("COPA") that the Department issued in conjunction with its approval of the consolidation of the two Great Falls hospitals. These findings are issued pursuant to Section 17.2 of the Terms and Conditions of the COPA which provides:

17.2 The Consolidated Hospital may request modifications to or the repeal of any terms and conditions in the COPA that it believes are justified by unforeseen circumstances, changed conditions in the marketplace or other reasons. The Department will grant such requests if it determines that the requested modifications are necessary to promote lower costs, improved access to health care or higher quality health care or, in respect of modifications to Section 1.3, 2.11 or 3.1 of these Terms and Conditions, if the Department determines that the requested modifications are necessary to provide sufficient funding to the Consolidated Hospital to ensure quality health care.

I. BENEFIS'S REQUEST FOR MODIFICATIONS TO THE COPA

On December 18, 1998, Benefis President and CEO Lloyd Smith sent a memorandum to the Department requesting the following modifications to the COPA:

1. Replace the Producer Price Index ("PPI") in the Revenue Cap Model with the Market Basket Inflation Index ("MBI") and recalculate the revenue cap for fiscal years 1997 and 1998 using the MBI;

2. Delay implementation of the cost savings target in the Revenue Cap Model by an additional year, maintaining the mandated savings level at $3.2 million for another year and then increasing the level to $7.3 million effective in year three;

3. Replace the existing Revenue Cap Model with a price control model; and

4. Modify Section 2.15 of the COPA to require employee and physician surveys every three years instead of the present requirement that such surveys be conducted on "an annual basis." See Dec. 18, 1998 Mem. from Lloyd Smith to Beth Baker, Ex. A.

Benefis contends that unless these modifications are approved "there will be diminished access to a lower quality health care" in Great Falls. Id. Letters were submitted to the Department by numerous physicians, other health care providers, and members of the community. Some support Benefis's position that if the existing revenue cap model is not replaced, quality of health care will significantly deteriorate in Great Falls. Others oppose Benefis's request for modifications to the COPA, asserting that the hospital has not maintained high quality health care services, has mismanaged its revenue and spent too much money on unneeded capital improvements, and should not be allowed to change the rules now when many provisions of the COPA were based on arguments and data submitted by the two Great Falls hospitals in seeking approval of the merger.

On February 5, 1999, the Department held a public meeting in Great Falls to discuss with the hospital and the board the progress in achieving the terms and objectives of the COPA and to review the hospital's

proposed modifications. In addition, the public was given opportunity at the meeting to comment on the proposed modifications. The Department also allowed written comments on the proposal, to be submitted by February 26, 1999. At the February 5, 1999 meeting, representatives of Benefis presented arguments in support of Benefis's request for modification of the COPA. In addition to the four proposed modifications set forth in the December 18, 1998 Memorandum of Lloyd Smith, Benefis proposed the following additional modifications to the COPA:

1. Reduce the required savings related to Full-Time Equivalent (FTE) productivity to reflect recent industry increases in FTE levels. According to Benefis, the industry FTE level has increased by approximately .3 - .4 FTEs per Adjusted Occupied Bed (AOB) over the last few years. Benefis contends that this increase should be reflected in the Revenue Cap. The Revenue Cap presently requires 5.5 FTEs per AOB. Benefis requests that this level be adjusted to 5.8 or 5.9;

2. Increase the revenue cap to include expenses associated with Year 2000 (Y2K) compliance;

3. Modify the revenue cap to net interest expense against interest income. Benefis contends this modification is necessary to eliminate the incentive for Benefis to draw down on its reserves rather than using debt financing which Benefis claims would be more prudent and economical; and

4. Develop a simpler outpatient adjustment factor calculation. Benefis argues that the current methodology, although technically accurate, is difficult if not impossible to perform on an ongoing monthly interim basis. Benefis claims that this impedes its ability to efficiently manage its resources.

II. FINDINGS

Pursuant to Section 17.2 of the COPA, the Department makes the following specific findings based upon the application of Benefis, other materials and information submitted by Benefis in support of that application, letters, written public comments and the information presented at the February 5, 1999 public meeting, and the evaluation conducted by the Department's consultants.

A.The Department Denies Benefis's Request to Replace the Existing Revenue Cap With a Price Control Model.

The Department concludes that the revenue cap should remain in place to ensure that Benefis continues to implement the cost reductions and efficiency-related consolidations that it offered as justifications for approving the consolidation. While Benefis has made significant progress toward achieving these cost savings, it concedes that the savings targets set by the COPA have not yet been realized. Accordingly, the Department concludes that continuing compliance with the revenue cap is necessary to ensure full compliance with the purpose and intent of the COPA. The cost savings have and should continue to result in lower prices to consumers. A price control model would be a substantial departure from the regulatory scheme on which the COPA was originally based, and the Department sees no good reason to make such a departure at this early stage in implementation of the COPA.

B. The Department Denies Benefis's Request to Delay Implementation of the Cost Savings Target for an Additional Year.

The cost savings targets included in the Revenue Cap Model are based on projected cost savings that the Great Falls hospitals claimed could be achieved if the consolidation was approved. While Benefis now argues that these targets were too aggressive, the Department is not inclined to alter the savings target schedule that the hospitals offered as a justification for the consolidation and that was one of the key factors in granting the COPA. The savings targets, however, will be modified to reflect the Department's decision to allow additional full time equivalents (FTEs). See infra, Section G.

C. The Department Denies Benefis's Request to Modify the Annual Survey Requirement.

Benefis contends that the COPA requirement of annual physician and employee surveys is unreasonable and that "surveys of this nature" should only be "performed every 3-5 years." After the transition is

complete, the Department agrees that a three-year survey period may be adequate. Based on concerns raised at the hearing and in the written comments, however, the Department concludes that annual surveys are appropriate until such time as the disruption and stress of the consolidation have abated. This is particularly true with respect to employee surveys. As noted in the Department's preliminary findings on Benefis's progress in meeting the objectives of the COPA, good employee relations are vital to quality patient care. Benefis still has significant room for improvement in this area, and annual surveys may help the hospital keep more open lines of communication with its staff. The hospital's concern about the low rate of return could perhaps be better addressed by offering employees more flexibility in filling out the survey forms. According to comments submitted to the Department, employees were not allowed to take the survey forms home or even back to their work stations to complete them.

D. The Department Will Consider Specific Proposals to Develop a Simpler Outpatient Adjustment Factor.

Benefis has not made specific proposals regarding the modification of the outpatient adjustment factor in the Revenue Cap Model. The Department encourages Benefis to work with the Department's healthcare accounting consultant to explore alternatives to the outpatient adjustment formula in the Revenue Cap Model. The Department does not rule out consideration of specific proposals to change or alter this formula, but finds insufficient ground to make changes at this time.

E.It Is Premature to Consider Adjustments to the Revenue Cap to Account for Y2K Expenses Until Such Expenses Have Been Incurred.

Paragraph 4 of the Revenue Cap Model states: "If the Consolidated Hospital sustains additional expense from an extraordinary occurrence . . . for that particular time period, the department may, upon request, increase the Revenue Cap by no more than the extent of such loss, net of insurance recoveries." The Department concludes that this paragraph may be invoked to cover reasonable expenses incurred to remedy the Y2K problem. Paragraph 4, however, is not prospective in application and relief under that paragraph is only appropriate after the expense has been incurred. Accordingly, the prospective relief requested by Benefis is not appropriate at this time.

F.The Department Denies Benefis's Request to Modify the Revenue Cap to Net Interest Expense Against Interest Income.

This issue was raised by Benefis's predecessors when the Department developed and approved the Revenue Cap requirement of the COPA. The Department does not believe that a change to this aspect of the Revenue Cap Model is justified.

G.The Revenue Cap Model Should be Amended to Reflect an FTE Level of 5.71 Per AOB.

Full-time equivalents per adjusted occupied bed (FTE/AOB) is a measurement of a hospital's staffing level, and therefore of the amount of labor cost associated with providing hospital services. Based on projections provided by Benefis's predecessors, the Department established a personnel cost savings target in the COPA that was predicated on a staffing level of approximately 5.46 FTEs per AOB.

Benefis argues that this level of staffing is no longer realistic considering the trend in FTE increases in the industry over the last few years. According to Benefis, the industry-wide trend to increasing staffing levels may be attributed, at least in part, to increased complexity of cases, as well as to increased regulatory requirements.

Based primarily on concerns expressed by the public and Benefis employees relating to the availability and responsiveness of nurses and other patient service staff at Benefis, the Department has reconsidered the FTE requirements incorporated into the COPA's savings targets. The Department finds that, to the extent that a trend to increased staffing levels results from increased complexity of cases, case-mix adjustments already in the COPA revenue cap model provide for some relaxation of the savings target. However, the Department also finds that the initial targets reflected staffing levels in aggressive managed care markets that are not appropriate for Montana.

The statute governing the adoption of the Great Falls COPA requires that the Department consider three factors in approving and supervising cooperative healthcare agreements:

1. That the consolidation is likely to result in lower health care cost than would occur in the absence of a consolidation;

2. That the quality of health care services will likely be maintained after the consolidation; and

3. That the consolidation is likely to result in improved access to health care. See Mont. Code Ann. § 50-4-602. In balancing lower health care costs and quality of care, the Department concludes that a staffing level of 5.71 FTE/AOB will still allow for a significant cost savings while avoiding the type of aggressive staffing reductions that have affected quality of care in some managed care environments. This staffing target of 5.71 FTE/AOB, when incorporated in the COPA's cost savings targets, will translate to an allowable staffing level of 6.10 FTE/AOB with the case-mix acuity level of the patients Benefis cared for in 1998. The Department finds that such a staffing level is a reasonable target, considering the 1998 staffing levels for comparable Montana hospitals (5.9-6.10) and the projected 1998 level for Near West region hospitals (6.24).

In consideration of the change in the FTE standard, the annual expense reduction targets for the COPA are revised as follows:

Year	Original Staffing Related Savings Target	Revised Personnel Related Savings Target	Other Components of Savings (Net)	Revised Total Expense Reduction Target, 1995 Dollars
1997	3,271,378	1,470,400	122,691	1,593,091
1998	4,363,736	1,961,387	2,953,853	4,915,240
1999	4,761,304	2,140,084	3,720,967	5,861,051
2000	4,761,304	2,140,084	3,663,363	5,803,447
2001	4,761,304	2,140,084	3,859,308	5,999,391
2002	4,761,304	2,140,084	4,030,502	6,170,586
2003	4,761,304	2,140,084	4,155,486	6,295,570
2004	4,761,304	2,140,084	4,277,211	6,417,294
2005	4,761,304	2,140,084	4,395,900	6,535,984
2006	4,761,304	2,140,084	4,514,397	6,654,481
2007	4,761,304	2,140,084	4,591,097	6,731,180
2008	4,761,304	2,140,084	4,627,587	6,767,671

Based on Benefis's submissions in support of this modification, the Department expects that Benefis will devote the additional labor resources resulting from this modification, which are equivalent to 74 FTEs, to maintaining increased staffing at the patient level. The Department will continue to monitor Benefis's efforts and progress towards eliminating duplicative administrative costs.

H. The Inflation Index in the Revenue Cap Model Should Be Changed to the HCFA Market Basket Index.

The inflation index specified by the COPA is the Producer Price Index (PPI) for hospitals. Producer price indexes generally measure prices charged at the wholesale level. The Health Care Facility Administration (HCFA) Hospital Market Basket Index (MBI) measures the changes in prices of the goods and services purchased by hospitals. It is an input price index. Labor costs (including clinical, administrative, technical, and general) comprise about 70% of the hospital MBI. Proxies to measure the cost of utilities, supplies, drugs, insurance, etc. make up the remainder of the index.

Through the 1980s, hospital prices increased at a faster rate than the MBI. As Benefis has observed, however, the rate of increase in the hospital PPI has decreased since the adoption of the COPA and has not kept pace with the MBI. The primary purpose of the inflation index in the COPA was "to adjust the

allowable total costs for inflation" because "hospital input costs rise from year to year." COPA at § 1.3(c). The Department concludes that as an "input" index, the MBI provides a better adjustment mechanism for Benefis's cost of doing business in the current period relative to the 1995 base period. Accordingly, the Department concludes that the Revenue Cap for fiscal years 1997 and 1998 should be recalculated using the MBI inflation index. The MBI index should also be used in place of the PPI for future applications of the Revenue Cap Model.

III. CONCLUSION

The COPA expressly anticipates that modification of its terms and conditions may be necessary to meet the objectives of lower health care costs and improved quality of or access to health care services in a changing health care environment. See COPA, § 17. As the health care market in the Great Falls area evolves through increased competition from ambulatory surgery centers, ancillary service providers and other competitors, more extensive modifications to the COPA may be justified. However, in view of the relatively short period since issuance of the COPA and for the reasons set forth above, the Department denies Benefis's request to replace the Revenue Cap Model with a model based on the regulation of price increases. The Department also denies Benefis's other requests for modification except for the requests to change the inflation index and the FTE requirement.

The Department takes very seriously the comments submitted by the public concerning alleged inadequacies in staffing levels and patient care. To the extent financial relief is granted to the hospital by this decision, Benefis has committed to using those resources for health care services that directly benefit hospital patients and healthcare consumers. The Department will continue to monitor Benefis's compliance with that commitment in order to restore community confidence in Benefis's stated mission of providing cost-effective, quality healthcare services to the people of north-central Montana.

DATED this 22nd day of March, 1999.

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Attorney General