

**THE COST AND ADMINISTRATION
OF HEALTH CARE SERVICES
IN VIRGINIA**

**Report of the
Commission to Study Prepaid Health Care
Plans and Costs of Medical, Surgical and
Hospital Services and Insurance Therefor
to
The Governor and The General Assembly of Virginia**



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January, 1972

To: HONORABLE LINWOOD HOLTON, *Governor of Virginia*

and

THE GENERAL ASSEMBLY OF VIRGINIA

I. INTRODUCTION

During the 1971 Special Session of the General Assembly, the operations of Blue Cross and Blue Shield of Virginia attracted national attention as matters concerning the high administrative expenditures of these organizations were revealed in Washington. The General Assembly reacted to these developments by approving the following Resolution:

SENATE JOINT RESOLUTION NO. 20

Creating a commission to study certain organizations such as Blue Cross-Blue Shield and the costs of medical, surgical and hospital services and the rates of insurance therefor.

Whereas, it is essential that the public be protected against unduly large hospital and medical bills and historically this has been done through certain organizations such as Blue Cross and Blue Shield Associations; and

Whereas, recent events have raised serious questions as to whether such plans are being run on an efficient and economical basis and in a manner calculated to restore and maintain the confidence of the public and subscribers thereto; and

Whereas, the rates charged in medical, surgical and hospitalization plans are directly related to medical, surgical and hospital costs; now, therefore, be it

Resolved by the Senate, the House of Delegates concurring, That there is hereby created a commission to investigate and study the operations and administration of all plans providing hospital, medical and surgical services comparable to plans generally referred to as Blue Cross and Blue Shield plans as well as the methods and basis of establishing costs of medical, surgical and hospital services with a view toward recommendations which, if implemented, could operate to stabilize and check the rising costs of health care. The Commission shall, among other matters, consider whether such plans should be placed under the regulatory powers of the State Corporation Commission, whether any of the plans should

continue to enjoy tax exempt status, and what legislative action, if any, is necessary to assure that the public interest is advanced and protected. Upon the conclusion of its work, the Commission shall report to the Governor and General Assembly not later than December one, nineteen hundred seventy-one.

The membership shall be composed of the following: three members of the House of Delegates appointed by the Speaker thereof, three members of the Senate appointed by the President of the Senate and three persons appointed by the Governor who may include among his appointees persons holding any State or local office. The Commissioner of Insurance shall be a member ex officio without vote.

The Commissioner of Insurance shall provide the staff, research and other necessary facilities and services required for the Commission to begin and conclude its work expeditiously and properly. The Commission shall hold such hearings as it deems appropriate. The members of the Commission shall receive no compensation for their services but shall be paid their necessary expenses for which and for such secretarial and other assistance as may be required, there is hereby appropriated the sum of ten thousand dollars to be paid from the contingent fund of the General Assembly. As the text of this Resolution reads, the study Commission which is created thereby is charged with the responsibility of examining not only the administrative operation of plans for future surgical, hospital and medical care, but also those factors which contribute to the costs of health care. It was recognized that a study of the former necessarily requires an examination of the latter.

Pursuant to the terms of the study directive, the Governor appointed to serve on the Commission E. Leo Burton, Roanoke; Robert Carter, Richmond; and Frank A. Schwalenberg, Newport News. The President of the Senate appointed Senators Adelard L. Brault, Fairfax; Henry E. Howell*, Jr., Norfolk; and Edward E. Willey, Richmond. The Speaker of the House of Delegates selected Delegates Junie L. Bradshaw, Richmond; Donald A. McGlothlin, Sr., Grundy; and Richard J. Ryder, Annandale. Senator Willey was elected to serve as Chairman of the Commission and Mr. Bradshaw as Vice-Chairman.

From the outset, the members were aware of the considerable complexity of the matters designated for their deliberation; especially the matter of cost accounting for hospitals and the administration of laws relative to the organizations under scrutiny. Therefore, it was deemed best and proper for subcommittees to be appointed. The Subcommittee to study hospitalization costs would include, in addition to certain members of the Commission, experts in the field of hospital administration and cost accounting. Mr. Schwalenberg was selected by the Chairman to chair this Hospitalization Costs Subcommittee of the Commission. Senator Howell also participated as a member of this Subcommittee. The following gentlemen devoted their time and best efforts as members of the Subcommittee, providing valuable advice, counsel and information to the Commission for which the sincerest expression of appreciation is extended:

Edward L. Brown, Portsmouth; George J. Carroll, M.D., Suffolk; Harold P. Heafner, Jr., D.D.S., Portsmouth; Stuart D. Ogren, Richmond; R. Bruce Prouty, Blacksburg; Roscoe A. Robertson, Roanoke; Frank A.

* Mr. Howell was elected Lieutenant Governor of the Commonwealth during the course of the study and consequently participated no longer in the deliberations of the Commission.

Schwalenberg, Newport News; O. Delk Simpson, Smithfield; George R. Tyler, Richmond; and Frank C. Watters, Falls Church.

The Subcommittee to examine the administration of laws consisted of Senator Brault and Mr. Bradshaw, whose special service is recognized by the other members of the Commission.

Everette S. Francis, Commissioner of Insurance, rendered great assistance to the Commission, being available at all times to advise and relate factual data. To him also a measure of appreciation is accorded.

The Division of Statutory Research and Drafting made staff and facilities available to assist the Commission in the discharge of its duties. Wildman S. Kincheloe, Jr. and Laurens Sartoris were assigned as legal counsel for the duration of the study.

The Commission held numerous meetings and hearings in an attempt to thrash out satisfactory solutions to the problems before it. Public hearings were held for the benefit of representatives of the Blue Cross and Blue Shield organizations in Virginia, stock and mutual insurance companies writing health and accident insurance, the Medicare and Medicaid Programs, health maintenance organizations, hospitals, pharmacists, members of the medical profession, nurses, nursing homes and other providers of health care services.

Based on the testimony heard and the information examined, the Commission reached such conclusions as are contained herein. It is not the feeling of the Commission that our findings are dispositive of all aspects of health care problems, but it is believed that our recommendations, if received and acted upon with favor will facilitate the resolution of the health care crisis.

II. RECOMMENDATIONS

- A. The boards of directors of non-stock corporations operating pursuant to the provisions of Chapter 11 of Title 32 of the Code of Virginia should be reorganized to include majority representation from the consuming public.
- B. Plans for future medical, surgical and hospital care should be required to submit, in addition to the annual detailed audits now required, quarterly financial statements in order that the Commonwealth may be kept informed of the activities of such plans.
- C. Modification of the law of Virginia should be effected to allow for the establishment of health maintenance organizations in Virginia.
- D. Legislation should be enacted to provide for the establishment of certification of need prior to the establishment or extension of hospital facilities.
- E. The Virginia Hospital Association should be requested to proceed with the establishment of a voluntary rate review board to examine the costs and charges of hospitals.
- F. The Commission should be continued in existence to study further matters relating to the cost of health care services and to oversee the activities and performance of providers of health care with a view toward making recommendations for additional improvements if needed.

III. REASONS FOR RECOMMENDATIONS

A. THE BOARDS OF NON-STOCK CORPORATIONS OPERATING PURSUANT TO THE PROVISIONS OF CHAPTER 11 OF TITLE 32 OF THE CODE OF VIRGINIA SHOULD BE REORGANIZED TO INCLUDE MAJORITY REPRESENTATION FROM THE CONSUMING PUBLIC.

The genesis of this Commission was brought about by allegations of administrative misfeasance of duty in the operation of Blue Cross and Blue Shield of Virginia. A major portion of the Commission's time was devoted to examination of the administrative operations of health care plans. It appears that such plans are operated currently in an efficient manner which serves well the public interest.

The paramount concern is the public interest. Plans such as Blue Cross and Blue Shield are created pursuant to a special group of sections of the Code (§ 32-195.1 et seq.) which provide for their establishment as non-stock and thereby non-profit corporations on which no tax or heavy licensing fee in lieu of taxation is levied. This is deemed to be in the public interest as the existence of plans for health services provides the public with a viable alternative to indemnity companies as the source of coverage for health care needs.

Nevertheless, additional control measures are needed to insure the continuing operation of health care plans in the interest of the consuming public. The Blue Cross and Blue Shield plans are creatures of participating physicians and hospitals, respectively. We do not suggest that these participants act selfishly or for their own benefit alone, but it seems reasonable to assume that those who are themselves providers of health care services operate from a professional bias and are not in a position to approach the problems of the plans in the disinterested manner of a non-provider of health care services. In light of this thinking, we recommend the enactment of legislation which will provide for the composition of the membership of the boards of directors for health care plans. For a board to be efficient and well organized it should be small, not in excess of fifteen members. Of these members, a majority should be subscribers to the services of the plan who are in no way connected with providing health care or related services and who are neither officers nor employees of any plan. This recommendation will establish effective consumer representation which will be a "watchdog" for the public against future administrative excess.

B. PLANS FOR FUTURE MEDICAL, SURGICAL AND HOSPITAL CARE SHOULD BE REQUIRED TO SUBMIT, IN ADDITION TO THE ANNUAL DETAILED AUDITS NOW REQUIRED, QUARTERLY FINANCIAL STATEMENTS IN ORDER THAT THE COMMONWEALTH MAY BE KEPT INFORMED OF THE ACTIVITIES OF SUCH PLANS.

The above recommendation is concerned with the internal reorganization of health care plans. Beyond this it is vital that the Commonwealth be kept informed of the financial condition of all plans so that it may detect any unfortunate trends in the operation of plans not in the public interest.

The law requires presently that plans submit detailed annual financial statements to the State Corporation Commission. The Corporation Commission may require additional statements at any time that it deems proper. Our feeling is that more regular statements should be required to be submitted by plans. Pertinent financial data should be furnished on

a quarterly basis so that there will be a readily available source of information for the inspection of financial experts and the public. Thus, no possible impropriety would be allowed to go unnoticed for a period of greater than three months, and prompt action could be taken should such occur.

C. MODIFICATION OF THE LAW OF VIRGINIA SHOULD BE EFFECTED TO ALLOW FOR THE ESTABLISHMENT OF HEALTH MAINTENANCE ORGANIZATIONS IN VIRGINIA.

The health maintenance organization (HMO) concept is relatively new to most Virginians. Simply defined, an HMO is an organization which provides health services to enrollees or subscribers either directly or through arrangements with others, on a per capita payment basis. In theory, it is not unlike Blue Cross and Blue Shield which are not indemnifiers but providers of services. The distinction is that HMO's historically have made arrangements for the hiring of medical staffs and the direct control of hospital facilities and clinics. Through coordinated plans of preventative medical treatment and outpatient services, HMO's have succeeded in significantly reducing the average number of days their subscribers spend in hospital beds. Health care is most expensive when given in hospital facilities and reduction in the days of treatment therein produces considerable savings in the total cost of health care.

The imagination of the federal administration and the Congress has been caught by the HMO concept. Currently pending in the 92nd Congress is H.R. 1, the "Social Security Amendments of 1971," which provides for the establishment of HMO's in conjunction with the Medicare program. Also the President's Health Message (February 18, 1971) endorsed HMO's as the prime new method of organizing health care delivery for quality and economy.

The law of Virginia does not prohibit the establishment of HMO's in Virginia; however, it does not provide for their creation. Consequently those who might wish to operate HMO's in Virginia have been hesitant to do so, although some modest attempts have been made in the western and northern parts of the Commonwealth. We do not feel that the entry into Virginia of HMO's will be a panacea for all the ills of the present health delivery system. We do feel that the law should be modified to permit the licensing of HMO's in order to provide an additional health care option for the consuming public.

D. LEGISLATION SHOULD BE ENACTED TO PROVIDE FOR THE ESTABLISHMENT OF CERTIFICATION OF NEED PRIOR TO THE ESTABLISHMENT OR EXTENSION OF HOSPITAL FACILITIES.

During the course of its deliberations it was brought to the attention of the Commission that in many areas of Virginia there are hospital beds in excess of those needed. This is especially true in the city of Richmond where the highest ratio of hospital beds in relation to population in the nation will exist upon completion of new hospital facilities now contemplated or currently under construction. Hospital beds in excess of those required for the treatment of the public represent an unnecessary cost to the consuming public which must bear the expense of supporting the use of extra beds. In order to promote the financial stability of their institutions the management of hospitals are compelled to make full use of the facilities under their control. Beds are available, so they are filled with patients who not requiring hospital care, but having been admitted to a hospital must be maintained at the same high cost as those who do require such care. Also, with extra beds available there is no incentive for physicians and administrators to discharge patients at the earliest pos-

sible date. Patients in extra beds cause additional cost which must be borne by all members of the consuming public.

Other states have solved this problem by enacting legislation to provide for certification of need prior to the establishment or expansion of hospital facilities. Acting pursuant to such laws, qualified state officials determine in advance the needs of the state and localities and permit the construction of such facilities as are necessary to accommodate the public's needs. It is critical that Virginia enact such legislation. Our examination has led us to the conclusion that the State Board of Health is qualified to determine when and where hospital beds should be provided. Certificate of need legislation will prove to be a key factor in stemming the tide of rising health care costs.

E. THE VIRGINIA HOSPITAL ASSOCIATION SHOULD BE REQUESTED TO PROCEED WITH THE ESTABLISHMENT OF A VOLUNTARY RATE REVIEW BOARD TO EXAMINE THE COSTS AND CHARGES OF HOSPITALS.

Hospital cost accounting and the multiplicity of rates charged for care presented a mystifying quagmire which concerned the Commission from the outset. The sophistication of cost accounting systems varies from institution to institution. There is a wide range of charges made by different hospitals depending upon their location and facilities. In a single hospital, reimbursement for hospital services will vary according to third party contractual agreements for patient care. Generally, Blue Cross, Medicare, Medicaid and certain State hospitalization programs reimburse hospitals on a cost or cost-plus formula rather than the conventional method based on individual charges for the service rendered. These cost and cost-plus agreements generally provide no reward for an efficient operation nor a penalty for a loose operation. As a result, there is no financial incentive on the part of our hospitals to operate in the most efficient manner. Were cost and rates determined prospectively with a single rate charged all patients receiving the same treatment, the hospitals would be forced into operating at peak efficiency in order to avoid sustaining serious losses.

Some states have created rate review boards to oversee hospital costs and charges. Unfortunately, the formation and operation of such boards is costly and requires considerable staffing. We believe that a satisfactory alternative to the Commonwealth's having to become the supervisor of hospital financial administration exists.

The Virginia Hospital Association has conducted an exhaustive study in its own attempt to solve these problems. They have formulated plans for the establishment of a voluntary rate review board to control hospital costs and rates. We believe that the hospitals of Virginia should be given the opportunity to bring about order in their own affairs. If they are able to police their activities it will save the Commonwealth both money and time and preserve the free enterprise aspects of our hospitals. However, the Association should be admonished to appoint effective consumer representatives to such board in order to ensure a balanced approach to the problems with which it will deal. It would be best if a majority of the board's membership consisted of non-providers of health care or related services.

Granted that neither private nor State action can control the reimbursement policies of the federal programs, it still appears that much can be done to improve hospital costing, and, if feasible, who better to accomplish such a deed than those who must live with the results.

F. THE COMMISSION SHOULD BE CONTINUED IN EXISTENCE TO STUDY FURTHER MATTERS RELATING TO THE COST OF HEALTH CARE SERVICES AND TO OVERSEE THE ACTIVITIES AND PERFORMANCE OF PROVIDERS OF HEALTH CARE WITH A VIEW TOWARD MAKING RECOMMENDATIONS FOR ADDITIONAL IMPROVEMENTS IF NEEDED.

The scope and complexity of the problems confronting the Commission prevented thorough examination of every facet thereof. Extremely important areas which require further study if solutions are to be found are coordination of benefits and co-insurance.

While we feel that our recommendations, if implemented, will do much to improve the administration of plans for medical, surgical and health care and stabilize health care costs, further consideration is in order.

This Commission should be continued in existence to continue its study and supervise the carrying out of its recommendations.

Respectfully submitted,

E. E. WILLEY, *Chairman*

JUNIE L. BRADSHAW, *Vice-Chairman*

ADELARD L. BRAULT

E. LEO BURTON

ROBERT CARTER

DONALD A. McGLOTHLIN, SR.

RICHARD J. RYDER

FRANK A. SCHWALENBERG

A B I L L

To amend the Code of Virginia by adding sections numbered 32-195.3:1, 32-195.5:1 and 32-195.8:1 relating to creation by individuals of plans for future hospitalization, medical and surgical services, boards of directors for such plans and filing of statements thereby.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia be amended by adding sections numbered 32-195.3:1, 32-195.5:1 and 32-195.8:1, as follows:

§ 32-195.3:1. Any person or any group of persons may conduct directly or through an agent, who may be either an individual or a non-stock corporation, a plan or plans for furnishing prepaid hospital or medical and surgical or related services, or any combination thereof.

§ 32-195.5:1. Notwithstanding the provisions of § 13.1-220 to the contrary, any plan created pursuant to the terms of this chapter which is a non-stock corporation shall have a board of directors consisting of not more than fifteen members of whom a majority shall be subscribers to such plan who are not providers of health care services and not employees or officers of any such plan. The tenure of office of no board member shall be in excess of eight consecutive years.

As employed herein "provider of health care services" shall include, but not be limited to physicians, dentists, pharmacists, nurses, physical therapists, hospital administrators, employees or stockholders, and other persons furnishing health related services.

§ 32-195.8:1. In addition to the annual statement required by § 38.1-159, the Commission shall require every plan to file on a quarterly basis such further reports, exhibits or statements as it deems necessary to furnish full information concerning the condition, solvency, experience, transactions or affairs of such plan. The Commission shall prescribe the time within which such additional reports, exhibits or statements shall be filed, and may require verification by such officers of the company as it may designate.

A B I L L

To amend and reenact §§ 32-299 and 32-305 of the Code of Virginia, relating to the licensing of hospitals and additions or alterations thereto.

Be it enacted by the General Assembly of Virginia:

1. That §§ 32-299 and 32-305 of the Code of Virginia be amended and reenacted, as follows:

§ 32-299. **Establishment or operation of hospitals prohibited without license.**—(1) No person shall establish, conduct, maintain or operate in this State any hospital as defined in and included within the provisions of this chapter without having a license so to do as provided in this chapter, where such hospital, under regulations of the Board, is required to obtain a license.

(2) No license issued hereunder shall be assignable or transferable.

(3) No person shall establish, conduct, maintain or operate in Virginia any new hospital without first having obtained a license as provided in this chapter; *provided, that no license shall be issued unless, prior to the commencement of construction of such new hospital, the written ap-*

proval of the Board is obtained. Such written approval shall not be issued by the Board until it is satisfied that a public need exists for the establishment of the proposed new hospital. The Board shall act on a request for such written approval within sixty days of application therefor.

(4) No person may continue to operate such an existing hospital unless such operation is approved and licensed as provided herein.

§ 32-305. Alterations or additions to hospitals; additional fees, when necessary; new constructions or operations.—(a) Any person operating a hospital who desires to make any alteration or addition to the building or plant or any material change in any of its facilities ~~may~~, *shall*, before making such change, alteration or addition, request the Board to approve same, provided that nothing contained in this chapter shall be construed as in any way superseding the provisions of any local building code now in existence or hereafter enacted. Thereupon, the Board shall investigate the change, alteration or addition so contemplated to be made and as soon thereafter as reasonably practicable *and after the Board shall have determined the public need for the existence and operation of such change, alteration or addition* notify the licensee that the change, alteration or addition is or is not approved with such recommendations as the Board may care to make.

(b) In case any alterations or additions have the effect if approved ~~before or after being made~~ of placing the licensee in a different category, a supplementary license for the remainder of the license year, after payment of an additional service charge if any be necessary under the scale of charges prescribed by the Board for such cases, must be obtained before beginning operation of the additional facilities or in the new category.

(c) The Board may by its rules and regulations provide for similar consultative advice and assistance, with such limitations and restrictions as deemed proper, as to the construction, or reconstruction, equipment and so forth of any proposed hospital the owner or operator of which is desirous ultimately of making application for a license and the Board may fix reasonable charges for such service, subject to credit on the ultimate license application charge or to the extent it deems proper so to do.

SENATE JOINT RESOLUTION NO. —

To express the sense of the General Assembly relating to the establishment of a voluntary rate review board by the Virginia Hospital Association.

Whereas, the cost of health care has been characterized by a trend of spiraling inflation; and

Whereas, as a part of this vicious trend hospital costs have risen drastically; and

Whereas, it has been reported to the General Assembly of Virginia that there is an unfortunate lack of uniformity among hospitals as to hospital cost accounting, and that such lack of uniformity casts confusion upon attempts to make a Statewide analysis of hospital costs; and

Whereas, no review of the total hospital cost or charge structure has been made in Virginia; and

Whereas, the Virginia Hospital Association has proposed the establishment of a voluntary rate review board, to examine hospital costs and charges; now, therefore, be it

Resolved by the Senate of Virginia, the House of Delegates concurring, That the Virginia Hospital Association is requested hereby to establish forthwith a rate review board to examine hospital costs and charges in an attempt to bring uniformity and economy to such costs and charges. Such board should reflect the interests of the consuming public of the Commonwealth and to this end it is recommended that its membership include a majority of non-providers of health care or related services.

SENATE JOINT RESOLUTION NO. —

To continue the Commission to study the costs and administration of Health Care Services.

Whereas, the General Assembly by the terms of Senate Joint Resolution No. 20 of its nineteen hundred seventy-one special session did create a Commission to study certain organizations formed pursuant to Chapter 11 of Title 32 and the costs of medical, surgical and hospital services; and

Whereas, such Commission did pursue its charge and make its report to this General Assembly; and

Whereas, due to the scope and complexity of those matters studied by such Commission, it was not possible for all aspects to be dealt with in depth; and

Whereas, it is deemed in the best interests of the people of this Commonwealth that further study be devoted to such matters; now, therefore, be it

Resolved by the Senate of Virginia, the House of Delegates concurring, That the above referenced Commission is continued hereby as the Commission to study the Costs and Administration of Health Care Services. The Commission shall continue its investigation and study of the operations and administration of all plans providing hospital, medical and surgical services and the methods and bases of establishing costs of medical, surgical and hospital services with the view toward recommendations which, if implemented, would operate to stabilize the rising costs of health care.

The Commission shall conclude its study and make its report to the Governor and the General Assembly not later than December one, nineteen hundred seventy-three.

The present members shall continue as the members of the Commission, provided that if any member be unwilling or unable to serve, or for any other reason a vacancy occur, his successor shall be appointed in the same manner as the original appointment was made. The Commissioner of Insurance shall be a member *ex officio* without vote and shall provide staff, research and other necessary facilities and services required for the Commission to discharge expeditiously its duties. The members shall receive no compensation for their services but shall be paid their necessary expenses incurred in carrying out their duties for the Commission, for which and for such secretarial and other assistance as may be required there is appropriated hereby the sum of five thousand dollars to be paid from the contingent fund of the General Assembly.

