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California Considers New Restrictions as Health Care Notice Requirements Go Live for Transactions Closing on or After April 1

Health Care Law Brief on **April 1, 2024**

In August 2023, we published a blog post about the California Office of Health Care Access and Information's ("OHCA") proposed cost and market impact review ("CMIR") regulations under the California Health Care Quality and Affordability Act ("Proposed Regulations"). The final CMIR regulations implementing the notice requirements for large health care transactions in California ("Final Regulations") were approved on December 18, 2023. As enacted, all health care entities that meet certain threshold requirements and are a party to a "material change transaction" expected to close on or after April 1, 2024, must provide at least 90 days' advance notice to OHCA. OHCA began accepting notices as of January 1.

Continuing the trend towards greater scrutiny of health care transactions, on February 16, the California Assembly introduced a new bill, AB-3129, which would subject private equity groups and hedge funds to a 90-day notice ***and consent*** requirement for change of control transactions or acquisitions of health care facilities or provider groups that are expected to close on or after January 1, 2025. While the Final Regulations are intended to promote competition in the health care sector, the stated purpose of AB-3129 is to improve the quality and lower the cost of health care.

This blog discusses the scope of the Final Regulations and what to look out for as AB-3129 makes its way through the California legislative process.

Who must provide notice under the Final Regulations?

Under the Final Regulations, only health care entities that meet certain thresholds are required to report to OHCA.

“Health care entity” means any payer, provider, or a fully integrated delivery system, including pharmacy benefit managers (“PBMs”), but not including physician organizations with less than 25 physicians, unless determined to be a high-cost outlier.[1] “Health care entity” also includes any parents, affiliates, or subsidiaries of the foregoing that act in California on behalf of a payer and (i) control, govern, or are financially responsible for the health care entity or are controlled or governed, or (ii) in the case of a subsidiary, are a subsidiary acting on behalf of another subsidiary. It is important to note that “payer” includes Knox-Keene Act health care service plans, third party administrators, management services organizations, and “any other public or private entity, other than an individual, that pays for or arranges for the purchase of health care services on behalf of employees, dependents, or retirees.”[2]

Though largely enacted as proposed, the Final Regulations do reach a slightly narrower subset of related parties as compared with the Proposed Regulations, which would have included in the definition of “health care entity” parents, affiliates, subsidiaries *or other agents* that act not only on behalf of any payor, but also on behalf of any provider, fully integrated delivery system, or PBM.

A health care entity must also meet any of the following materiality thresholds to fall within the scope of the Final Regulations:[3]

1. Has annual revenue of at least $25 million or owns or controls California assets of at least $25 million;
2. Has annual revenue of at least $10 million or that owns or controls California assets of at least $10 million and another health care entity meeting the $25 million threshold above is a party to the transaction;[4] or
3. Is located in a designated primary care health professional shortage area in California, as defined in 42 CFR 5.1 et seq.

What constitutes a “material change transaction” under the Final Regulations?

The Final Regulations broadly define “transaction” to include “mergers, acquisitions, affiliations, and agreements impacting the provision of health care services in California that involve a transfer (sale, lease, exchange, option, encumbrance, conveyance, or disposition) of assets or a transfer of control, responsibility, or governance of the assets or operations, in whole or in part, of any health care entity to one or more entities.”[5]

Subject to certain exceptions, a transaction is a “material change transaction” only if any of the following apply:[6]

1. The proposed fair market value of the transaction is $25 million or more and the transaction concerns the provision of health care services.
2. The transaction is more likely than not to increase annual California-derived revenue of any health care entity that is a party to the transaction by either $10 million or more or 20% or more of annual California-derived revenue at normal or stabilized levels of utilization or operation.
3. The transaction involves the sale, transfer, lease, exchange, option, encumbrance, or other disposition of 25% or more of the total California assets of the submitter(s).
4. The transaction involves a transfer of control, responsibility, or governance, in whole or in part, of the submitter.
5. The transaction will result in an entity contracting with payers on behalf of consolidated or combined providers and is more likely than not to increase the annual California-derived revenue of any providers in the transaction by either $10 million or more or 20% or more of annual California-derived revenue at normal or stabilized levels of utilization or operation.
6. The transaction involves the formation of a new health care entity, affiliation, partnership, joint venture, or parent corporation for the provision of health care services in California that is projected to have at least $25 million in California-derived annual revenue at normal or stabilized levels of utilization or operation, or transfer of control of California assets related to the provision of health care services valued at $25 million or more.
7. The transaction is part of a series of related transactions for the same or related health care services occurring over the past ten years involving the same health care entities or entities affiliated with the same entities.
8. The transaction involves the acquisition of a health care entity by another entity and the acquiring entity has consummated a similar transaction(s), in the last ten years, with a health care entity that provides the same or related health care services.

A transaction directly or indirectly transfers control, responsibility, or governance, in whole or in part if it would:[7]

1. Result in the transfer of 25% or more of the voting power of the members of the governing body of a health care entity, such as by adding one or more members,

substituting one or more members, or through any other type of arrangement, written or oral; or

2. Vest voting rights significant enough to constitute a change in control such as supermajority rights, veto rights, and similar provisions even if ownership shares or representation on a governing body are less than 25%.

We note that the Final Regulations no longer include transactions that would result in the transfer of 25% or more of the governance of the management and policies of at least one health care entity that is a party to the transaction.

Notwithstanding the foregoing, the following are excluded and are not considered "material change transactions":[8]

1. Agreements or transactions involving health care service plans that are subject to review under the Knox-Keene Health Care Service Plan Act.
2. Agreements or transactions involving health insurers that are subject to review by the Insurance Commissioner.
3. Agreements or transactions where a county is purchasing, acquiring, or taking control, responsibility, or governance of an entity to ensure continued access in that county.
4. Agreements or transactions involving nonprofit corporations that are subject to review by the Attorney General.

What should stakeholders look out for with AB-3129?

Under the new AB-3129, private equity groups and hedge funds would be required to provide written notice to the California Attorney General ("AG") 90 days prior to any change of control or acquisition of a health care facility or provider group (or both), and must receive the Attorney General's consent to close.

Applying a "public interest" standard, "[t]he [California AG] may grant, deny, or impose conditions to a change of control or an acquisition … if [it] may have a substantial likelihood of anticompetitive effects or may create a significant effect on the access or availability of health care services to the affected community." Likewise, the California AG may waive notice and approval under specific conditions where the acquisition target is severely financially distressed and waiving the approval process would promote the policy objectives of promoting access to health care and market competition.

In addition, AB-3129 would effectively kill the “friendly PC” model with regard to California physician or psychiatry practices by imposing additional corporate practice prohibitions on private equity and hedge funds and banning certain contractual provisions, including non-competes, non-disparagement clauses, and so-called “revenue-increasing strategies.”

Of note, the proposed definitions are quite broadly drafted, especially “private equity group,” which is defined as “an investor or group of investors who engage in the raising or returning of capital and who invests, develops, or disposes of specified assets.”

Under the lengthy reconsideration and judicial review process proposed by AB-3129, potential deal-killing delays could have a chilling effect on private investment in health care entities operating in California. In addition, new restrictions on contractual arrangements and provisions, specifically with physicians and psychiatrists, could invalidate numerous existing and future “friendly physician” relationships.

Proskauer’s Health Care Group will continue to monitor for developments and new guidance related to the Final Regulations and AB-3129. Subscribe to the Health Care Law Brief to stay up to date.

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[1] 22 CCR §§ 97431(g), 127500.2(k), (p)(6).

[2] Cal. Health & Saf. Code § 127500.2(o).

[3] 22 CCR § 97435(b).

[4] “Revenue” is defined at 22 CCR § 97435(d).

[5] 22 CCR § 97431(p).

[6] 22 CCR § 97435(c)

[7] 22 CCR § 97435(e).

[8] Cal. Health & Saf. Code § 127507(d).

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