

California Health Care Transactions: Finalized Regulations Addressing Notice and Review Requirements from the Office of Health Care Affordability

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On December 18, 2023, California's Office of Administrative Law ("OAL") approved the final regulations implementing the health care transaction reporting requirements of the Office of Health Care Affordability ("OHCA"). The final regulations are codified at 22 C.C.R. § 97431, et seq. OAL made several revisions that narrow the scope of reportable transactions in these final regulations. These regulations took effect on January 1, 2024, and impacted several health care transactions closing on and after April 1, 2024. Members of the health care industry should carefully consider whether OHCA's regulations impact any of their respective transactions that are anticipated to close in 2024 and beyond.

Background

OHCA's transaction notice requirements apply if the transaction meets the following three requirements:

1. At least one party to the transaction is a "health care entity." OHCA's implementing statute defines a "health care entity" to include a "payer, provider, or fully integrated delivery system." Each term is further defined in the statutes and regulations to include a broad range of health facilities, provider organizations, health insurers, and others. The transaction notice requirements may also apply to affiliates of health care entities in certain instances.
2. The health care entity must meet certain thresholds for California assets or revenue. OHCA's notice requirements only apply to: health care entities that have at least \$25 million in California-derived assets or annual revenue; (ii) health care entities with at least \$10 million in California-derived assets or annual revenue when another party to the transaction is a health care entity with \$25 million in California-derived assets or annual revenue; and (iii) health care entities located in a primary care Health Professional Shortage Area ("HPSA") in California.
3. The transaction must constitute a "material change transaction." OHCA's regulations enumerate seven types of transactions that constitute material change transactions, including transactions with a proposed fair market value of at least \$25 million that concern the provision of health care services, transactions involving the sale of 25% or

more of the submitter's total California assets, transaction involving a change of control of the submitter, and others, as addressed in prior analyses.¹

If all three requirements are met, the health care entity must provide OHCA with notice of the transaction at least 90 days before the expected closing date of the transaction. The requirements apply to transactions closing on and after April 1, 2024, so OHCA is prepared to receive notices as of January 1, 2024. The notices will require extensive information and documentation about the transaction and the transaction's potential impact on health care services in California (which we have addressed in prior analyses). OHCA will conduct an initial review of the notices and determine whether to conduct a more intensive Cost and Market Impact Review ("CMIR"), which will open the transaction to public comment. While the regulations establish timelines for OHCA's review process, the review process can take several months and many of the deadlines can be tolled for good cause. The noticed transactions cannot take effect until after OHCA has completed its review of the transaction.

OHCA's notice requirements do not apply to the following types of transactions: (i) transactions involving health care service plans that are subject to review by the Department of Managed Health Care for cost impact or market consolidation under the Knox-Keen Health Care Service Plan Act, (ii) transactions involving health insurers that are subject to review by the California Insurance Commissioner, (iii) transactions where a county is acquiring or taking control of an entity to ensure continued access in that county, and (iv) transactions involving the sale of health facilities by nonprofit corporations that are subject to review by the California Attorney General.

Notable Changes in the Final Regulations Approved by OAL

OAL made several significant changes to the final regulations, as opposed to the latest draft of the regulations submitted by OHCA, which include:

- The definition of "health care entity" no longer includes *affiliates* of providers, fully integrated delivery systems, and pharmacy benefit managers. This significantly narrows the scope of the reporting requirements by removing entities that are affiliated with health care providers but are not themselves providing health care services. The change also removed organizations that contract with payors on behalf of providers, which may exclude certain (but not necessarily all) management service organizations ("MSOs") and related "friendly PC" arrangements that were subject to OHCA's notice requirements under previous drafts of the regulations.
- Location in a mental health HPSA in California is no longer an exception to the asset and revenue thresholds for health care entities to be subject to notice requirements. The asset and revenue thresholds for health care entities are now only exempted if the health care entity is located in a primary care HPSA.
- A transfer of control no longer includes transfers of "25% or more of the governance of the management and policies" of a health care entity, but rather only pertains to 25% or more of the health care entity's assets.
- The final regulations flesh out the factors OHCA will consider when deciding whether to conduct a CMIR, such as the transaction's potential to lower wages or slow wage growth, worsening benefits or working conditions, other degradations of workplace quality, and restriction or reduction in health care services offered by a general acute care or specialty hospital.
- OHCA will no longer consider the transaction's impact on the health care entity's ability to meet OHCA's cost targets when conducting a CMIR.

Takeaways

Companies and organizations that operate within the California health care sector and anticipate being a party to a transaction in 2024 and beyond need to carefully consider whether their transaction will be subject to California's pre-transaction notice requirements. Despite the limited narrowing of the scope of the requirements over the last several months, the requirements still capture a broad range of transactions that may not typically be considered under existing transaction approval laws, including potential application to certain lending transactions and bond issuances if 25% or more of a health care entity submitter's assets are encumbered if other required thresholds are met.

In light of all of the foregoing, participants in the California health care sector should do the following:

- Give serious consideration to closing affected or potentially affected near-term deals before April 1, 2024, if possible.
- Get started on the assessment of your health care deals and the issues discussed above early – expect more front-loaded cost, assessment, investment and lead time.
- Strategize early to try to pre-emptively address OHCA concerns in the notice to try to head off a potentially lengthy CMIR.
- Consider and address early how the parties will handle notice and review, associated costs, potential lengthy delays and scrutiny.
- Monitor any potential changes to the regulations as OHCA's review process kicks in.
- Monitor similar pre-transaction notice laws in other states (California is just one example of varying degrees of state-level health care transaction reporting legislation popping up across the country, which we are also tracking).
- Health care providers and other stakeholders will find a way to navigate this, but early, careful assessment, strategy and follow through is key.

[1] Our analyses of the earlier drafts of the proposed regulations can be found here:

<https://www.polsinelli.com/publications/new-california-legislation-and-law-may-have-serious-impact-on-certain-health-care-deals>

<https://www.polsinelli.com/publications/california-regulators-publish-highly-anticipated-draft-regulations-on-mandatory-pre-transaction-notices-for-health-care-entities>

<https://www.polsinelli.com/publications/office-of-health-care-affordability-appears-to-both-limit-and-expand-scope-of-health-care-transaction-notice-requirements-in-latest-draft-regulations>

<https://www.polsinelli.com/publications/office-of-health-care-affordability-publishes-near-final-regulations-on-health-care-transaction-notice-requirements>