POLSINELLI. What a law firm should be.™

California's AB 3129 Continues National Trend of Scrutinizing Private Equity Investments in the Health Care Industry

The California legislature is considering a bill that could severely impact the ability for private equity companies and hedge funds to operate in the California health care industry. AB 3129, introduced by Assembly Member Jim Wood, would (1) require prior notice and approval by the California Attorney General ("AG") prior to a change of control or acquisition between certain health care entities and private equity groups or hedge funds and (2) limit the ability for private equity companies or hedge funds to exercise managerial authority over physician and psychiatric practices. This bill follows a trend of scrutiny by state and federal enforcement agencies of private equity investments in the health care industry and would add to the existing health care transaction review process by California's Office of Health Care Affordability.[1] AB 3129 is scheduled to be heard by the California Assembly Committee on Health on April 9, 2024. If passed, the new law would take effect as of January 1, 2025.

1. Prior Approval For Health Care Acquisitions

AB 3129 would require a private equity group or hedge fund to notify and obtain written consent from the AG prior to a change of control or an acquisition between the private equity group or hedge fund and a health care facility or provider group. A "health care facility" generally includes facilities where health care services are provided, such as hospitals, clinics, long-term health care facilities, ambulatory surgery centers, treatment centers, laboratories, or physician offices. "Provider group" means (a) a group of ten (10) or more individual providers or (b) a group of between two (2) and nine (9) individual providers with at least $10,000,000 in annual revenue. The applicable providers include individuals providing physician, psychiatric, surgery, or laboratory services to consumers, as well as licensed dentists, optometrists, and pharmacists providing health-related surgery or laboratory services.

The notice must be submitted at the same time any other state or federal agency is notified of the transaction under law or 90 days before the change of control or acquisition, whichever is earlier. The AG may extend the review period by 45 days if necessary to obtain additional information if the proposed transaction is substantially modified, or if the proposed transaction involves a multi-facility or multi-provider health system serving multiple communities. The AG may also extend the review period by 14 days if a public meeting is held to receive public comment on the proposed transaction. The AG may also stay any time period for review pending review by another state or federal agency.

In addition to granting or denying approval of the transaction, the AG would be empowered to impose conditions on the transaction if the transaction would have a substantial likelihood of anticompetitive effects or may create a significant effect on the access or availability of health care services in the affected community. When reviewing transactions, the AG would consider the interests of the public in protecting competitive and accessible health care markets for prices, quality, choice, accessibility, and availability.

AB 3129 would also authorize the AG to grant a waiver of the review process upon written request from a party to the transaction that includes the documents governing the transaction and an explanation of why the waiver is necessary. The waiver would require a finding that the requesting party is in financial distress or at risk of filing for bankruptcy, that the transaction would ensure health care access in the relevant markets, and that the party made commercially reasonable best efforts to elicit reasonable alternative offers that would keep its assets in the relevant markets and that would pose a less severe danger to competition and access to care than the proposed transaction. The AG would have 60 days to grant or deny the waiver.

A private equity group or hedge fund would also be required to provide notice to—but not receive consent from—the AG prior to a change of control or acquisition with a "nonphysician provider" with over $4,000,000 in annual revenue or with a provider consisting of two (2) and nine (9) providers with between $4,000,000 and $10,000,000 in annual revenue. "Nonphysician provider" includes a group of between two (2) and nine (9) individuals who are licensed to treat patients, such as optometrists and nurses, but that does not provide health-related physician, surgery, or laboratory services to consumers.

Parties may petition the AG for reconsideration of a decision within 10 days and the AG must make a determination about the request for reconsideration within 30 days. The bill also provides for a process for judicial review of the AG's determinations.

2. Limitations on Management Services Arrangements

In addition to the notice and consent requirements described above, AB 3129 would also restrict many of the management services arrangements currently used in typical "friendly physician arrangements." First, AB 3129 would forbid private equity groups and hedge funds from "control[ling] or direct[ing]" a physician or psychiatric practice, including through influencing or entering into contracts on behalf of the practice with third parties, setting rates, or influencing policies relating to patient admission, referrals, or provider availability. Second, AB 3129 would bar physician or psychiatric practices from entering into agreements with any entity controlled by a private equity group or hedge fund for the provision of management services in exchange for a fee. Notably, this prohibition does not bar revenue-sharing between the practice and any private equity group or hedge fund. It is unclear at this time exactly what kind of "revenue sharing" arrangement would be permissible under the AB 3129. It is also unclear at this time how AB 3129, if it became law, would be reconciled with other sections of long-standing California law that expressly permit management services agreements with many health care providers, including physicians and psychiatrists, in exchange for a fee. Third, management services agreements, real estate purchase agreements, and asset purchase agreements between physician or psychiatric practices and private equity groups and hedge funds would not be allowed to include non-compete clauses and non-disparagement clauses. The AG would have authority to enforce these restrictions through injunctive relief and other equitable remedies.

Takeaways

AB 3129 would add scrutiny on private equity companies when considering health care investments, amplifying the pressure already imposed by enforcement agencies in California and throughout the country. While not yet law, private equity groups, hedge funds and health care providers who are considering certain transactions and investments in California should monitor AB 3129 throughout the legislative process to see whether the bill continues to progress and how the bill could impact current and future deals as well as growth and investment plans. Such parties should also monitor these developments as it pertains to current management services agreements and those that may be entered into on or after January 1, 2025.

---

[1] Our analyses of the notice requirements of California's Office of Health Care Affordability can be found here:

https://www.polsinelli.com/publications/california-health-care-transactions-finalized-regulations-addressing-notice-and-review-requirements-from-the-office-of-health-care-affordability

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