

Publications

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California Bill Seeks to Expand Scope of OHCA's Review to Private Equity, Management Service Organizations and Others

California is considering an expansion of the types of entities that would comprise "health care entities" as defined by and subject to the review of the Office of Health Care Affordability (OHCA). AB 1415 would require private equity groups, hedge funds and their respective affiliates (including newly created entities) entering into material change transactions with health care entities to provide notice of the transactions to OHCA. Current law only requires the health care entities themselves to provide such notice. The bill would also add certain management services organizations, health systems and entities that "own, operate or control" providers (as defined by OHCA) to the list of health care entities that are subject to OHCA's review. Further, the bill would change the definition of "provider" to "a private or public health care provider" with an expanded list of entity types. The proposed revisions are detailed below:

1. Private Equity Groups, Hedge Funds and Entities Newly Formed to Contract with Health Care Entities Would Be Subject to OHCA's Notice Requirements

AB 1415 would require private equity groups, hedge funds and newly created business entities created for the purpose of entering into agreements or transactions with a health care entity to provide notice to OHCA of transactions or agreements that would transfer ownership or control over a material amount of the assets or operations of the health care entity. While health care entities party to material change transactions are already subject to OHCA's notice requirements, the bill would expand the required disclosures to the private equity groups and hedge funds themselves. The definitions of "private equity group" and "hedge fund" generally include the investment entities managed by fund managers for their investors but exclude the individual investors themselves if they do not participate in the management of the funds. The definition of "hedge fund" specifically excludes entities that solely provide or manage debt financing secured in whole or in part by the assets of a health care facility, including, but not limited to, banks and credit unions, commercial real estate lenders, bond underwriters and trustees. AB 1415's definitions of "private equity group" and "hedge fund" largely mirror the definitions included in last year's AB 3129, which would have required prior notice to and approval of the California Attorney

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General for certain health care investments by private equity groups and hedge funds. ¹

The proposed expansion of OHCA's jurisdiction to private equity groups and hedge funds is likely a response to Governor Newsom's veto of AB 3129 last year, in which the Governor reasoned that it was OHCA's role to review certain health care transactions and that additional, separate processes like those in AB 3129 appeared to be unnecessary and duplicative. Instead of attempting another run at a separate review process aimed at private equity and hedge funds (among others), this time the approach is to expand OHCA itself. Unlike the Attorney General under AB 3129, OHCA does not and still would not have the authority to block transactions, but transactions subject to OHCA's review are not permitted to close until the completion of OHCA's review process, which can be burdensome and lengthy.

2. "Provider" Would Be Defined as a "Private or Public Health Care Provider" and Include a Potentially Non-Exclusive List of Entity Types

OHCA's governing statute defines "provider," one of the sub-categories of "health care entity," with an exhaustive list of entity types. AB 1415 would change the definition to "a private or public health care provider" and states that the definition includes the list of entity types from the original definition (with some additions, described below).

If passed as drafted, the language may create ambiguity over whether certain entities are captured under the definition of "provider." First, the definition does not define the difference between a "private" or "public" provider. Second, it is unclear whether the list of entities is exhaustive. If the list is non-exhaustive, members of the health care industry would have little guidance on whether they constitute a health care entity. This definition would benefit from clarifications in revisions to the bill or OHCA's implementing regulations.

3. Management Services Organizations Would Become Health Care Entities Subject to OHCA's Review

AB 1415 would add management services organizations (MSOs) to the definition of health care entity. MSOs would include any entity that provides administrative services or support for a provider (as defined by statute), not including the direct provision of health care services. Administrative services or support would include, but not be limited to, utilization management, billing and collections, customer service, provider rate negotiation and network development.

This addition could include many types of management arrangements that were previously excluded from OHCA's statute and governing arrangement. The legislature may be targeting "friendly PC" arrangements where MSOs operate all non-clinical business operations of a health care practice, but the addition could also capture arrangements that manage smaller portions of practice operations. For example, the addition may capture arrangements that outsource billing and collections or customer service functions to vendors that otherwise have no influence over the health care operations of their clients.

4. Entities that Own, Operate or Control Entities Listed Under the Definition of "Provider" Would Be Health Care Entities Subject to OHCA's Review

Under AB 1415, entities that own, operate or control the entities listed under the definition of "provider" would become health care entities subject to OHCA's notice and review "regardless of whether it is currently operating, providing health care services, or has a

pending or suspended license.” This addition would expand the notice requirements to a broad range of owners and operators over health care entities that have not otherwise been captured by the current law.

Like the changes to the definition of “provider,” this language creates ambiguities that will benefit from further revision to the bill or OHCA’s regulations. For example, holding companies that own provider entities would become health care entities subject to notice even if they held other assets unrelated to the provision of health care services in California and or included other assets and services lines that do are not health care entity services. The legislature may have intended to capture transactions that occur at a holding company level that do not include the health care entities themselves. If that is the case, arguably some these types of transactions are already captured by OHCA’s regulations, which apply to health care entities that are a “subject of” a material change transaction.

5. Health Systems Would Be Included as Health Care Entities Subject to OHCA’s Review

AB 1415 would add health systems to the enumerated list of providers. “Health system” would mean (1) a hospital system, as defined in subdivision (e) of Section 127371; (2) a combination of one or more hospitals and one or more physician organizations; or (3) a combination of one or more hospitals, one or more physician organizations, or one or more health care service plans or health insurers.

Health systems were likely already captured by current law, which includes health facilities like acute care hospitals. However, the addition of “health system” as a type of health care entity could create further ambiguity. For example, the bill does not define the word “combination” as used in the definition of “health system” and does not appear to apply to a specific legal entity. It may be uncertain whether the definition of health care entity would capture an entity that is a subsidiary of a health system that would not otherwise be considered a health care entity but for its affiliation with the health system. The addition could also expand OHCA’s jurisdiction by potentially pulling in holding companies up the corporate chain from health care entities that do not directly own or operate any health care entity services solely by virtue of its inclusion in the overall “health system.”

Takeaways

AB 1415 demonstrates that California’s interest in reviewing private equity and hedge fund investments as well as MSOs in health care did not end with AB 3129.² It also shows a continued appetite to expand OHCA’s jurisdiction less than a year after its review process has begun. It remains to be seen how the bill may be amended in the legislature to further expand its scope or clarify ambiguities in the current language. If passed, AB 1415 would also require OHCA to revise its implementing regulations. Members of the California health care industry should monitor the developments of AB 1415 to determine if their current operations and anticipated transactions may be subject to OHCA’s expanded jurisdiction and strategize early.

[1] Our prior discussions of AB 3129 can be found here:

<https://www.polsinelli.com/publications/californias-ab-3129-continues-national-trend-of-scrutinizing-private-equity-investments-in-the-health-care-industry>

<https://www.polsinelli.com/publications/california-considers-revisions-to-legislation-on->

health-care-investments-and-regulations-on-ohca-review

<https://www.polsinelli.com/publications/california-legislation-requires-consent-for-investment-funds-in-healthcare>

<https://www.polsinelli.com/publications/governor-newsom-vetoes-ab-3129>

[2] The California Senate is currently considering SB 351, which would revive some of AB 3129's corporate practice of medicine-related restrictions on private equity affiliates providing management services to physicians and dentists. Our analysis of SB 351 can be found here: <https://www.polsinelli.com/publications/california-reintroduces-legislation-restrict-private-equity-health-care-management>.