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Healthcare Alert

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AB-3129 Targets Private Equity Investment in California

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AB-3129 provides oversight authority to the California Attorney General for private equity-backed health care transactions.

What's the impact?

- Private equity groups and hedge funds will be required to provide notice to and obtain approval from the California Attorney General before closing a transaction with health care facilities, provider groups, and providers.

In February 2024, California Assembly Bill 3129 (AB-3129) was introduced with the stated purpose of addressing the impact of private equity-backed health care transactions on the cost, accessibility, and quality of health care services in California.

Under existing law, the Attorney General (AG) of California has the ability to review and approve transactions involving a nonprofit organization that operates or controls a health facility in California. In addition, the enactment of the Health Care Quality and Affordability Act in 2022

created the California Office of Health Care Affordability (OHCA), which oversees and approves transactions in California involving health care entities, as described in our prior client alert.

Although the current laws provide a framework for state oversight over certain health care entities and transactions, the enactment of AB-3129 would expand the state's authority to approve a broader set of entities and transactions in the health care market. This also reflects a national trend of increased scrutiny over private equity involvement in health care. Specifically, AB-3129 would require private equity groups and hedge funds to provide notice to, or obtain approval from, the California Attorney General (AG) before proceeding with transactions with a health care facility, provider group, or provider.

AB-3129 was passed by the California Assembly in May 2024, and the California Senate is set to vote on the bill in August 2024. **If passed, the bill is anticipated to be effective January 1, 2025**.

Requirements Under AB-3129

As currently proposed, AB-3129 will require a "private equity group" or "hedge fund" to provide written notice to, and obtain the written consent of, the AG before a "transaction" with a health care facility, provider group, or a provider . This applies to transactions on or after January 1, 2025—meaning that the statute will apply to any transaction where there is a "material change in the corporate relationship" between the entities on or after January 1, 2025.

AB-3129 instructs the AG, in deciding whether to provide consent or conditional consent to a transaction, to determine "whether the transaction may have a substantial likelihood of anticompetitive effects, including a substantial risk of lessening competition or of tending to create a monopoly, or may create a significant effect on the access or availability of health care services to the affected community."

TRANSACTIONS AND PARTIES SUBJECT TO AB-3129

AB-3129 defines a "transaction" as a direct or indirect acquisition, including lease, transfer, exchange, option, receipt of a conveyance, creation or a joint venture, or any other manner of a purchase, by a private equity group or hedge fund of a "material amount of the assets or operations," or a "change of control," of a health care facility, provider group, or provider doing business in California.

- A "material amount of the assets or operations" means the transaction:
    - Affects more than fifteen percent (15%) of the market value or ownership shares of a health care facility, provider group, or provider; or
    - Involves a hospital.
- A "change of control" is "an arrangement in which a private equity group or hedge fund establishes a change in governance or assumes direct or indirect control in whole or in part

over health care services provided by a health care facility, provider group, or provider." Even if less than fifteen percent (15%) of the market value or ownership shares is affected, if a transaction vests supermajority rights, veto rights, exclusivity provisions, and other provisions that effectively constitute a change in control, it will be deemed a "change of control."

"Private equity group" is defined in the bill as "an investor or group of investors who primarily engage in the raising or returning of capital and who invests, or disposes of specified assets." "Hedge Fund" means "a pool of funds managed by investors for the purpose of earning a return." Comments to earlier versions of the bill by stakeholders raised concerns that the breadth of the bill's definitions of "private equity groups" and "hedge funds" encompassed almost all private investments, not just those traditionally thought of as private equity or hedge funds. In response, clarifications have been made to AB-3129 that these definitions exclude: (1) persons who contribute to a private equity group, but otherwise do not participate in its management or in any change of control of the private equity group or its assets; and (2) entities such as banks, credit unions, commercial real estate lenders, bond underwriters, trustees, and other entities who solely manage debt financing secured by the assets of a health care facility.

CONSENT

AB-3129 requires private equity groups and hedge funds to obtain consent from the AG when entering into a transaction with:

- A "health care facility," which includes settings where services are provided by licensed health professionals other than dentists, including, but not limited to, health facilities (e.g., hospitals and other facilities providing a patient stay of 24 hours or more), outpatient clinics, ambulatory surgery centers, clinical laboratories, and imaging centers; and
- A "provider group," which is a group of:
    - Ten (10) or more licensed health professionals; or
    - Two (2) to nine (9) licensed health professionals that generate a gross annual revenue of $25,000,000 or more.
- A "provider," which is a group of two (2) to nine (9) licensed health professionals, if, in the prior seven (7) years, the private equity group or hedge fund has been involved in a transaction involving a health care facility, provider group, or provider, or related health care services.

NOTICE ONLY

A private equity group or hedge fund is required to provide notice to the AG, but does not need to obtain the AG's consent, for transactions with a "provider" that is not otherwise required to obtain consent, and that meets the following gross annual revenue thresholds:

- For a nonphysician provider, over $4,000,000; or
- For a physician provider, between $4,000,000 and $25,000,000.

TRANSACTIONS NOT SUBJECT TO AB-3129

The requirements of AB-3129 do not apply to the following:

- Transactions that have closed before January 1, 2025;
- Subsequent renewals of transactions occurring on or after January 1, 2025, that do not materially affect the corporate relationship between a private equity group or hedge fund and a health care facility, provider group, or provider;
- Transactions involving groups of two (2) to nine (9) licensed health professionals that generate $4,000,000 or less in annual gross revenue;
- The pledge of assets solely to secure a debt obligation, including security agreements, deeds of trust, indentures, financing statements, and liens;
- An offer of employment to, or hiring of, a provider; and
- Transactions between a health care service plan and another payor that is not under common control or affiliated with a health care facility, provider group, or provider, and that is subject to approval by the California Department of Managed Care.

Based on the current language of the bill, transactions that are subject to OHCA are not clearly exempt from AB-3129's notice and consent process. Stakeholders have raised concerns that this will create the potential for filing and review under both frameworks, which may add costs and administrative burdens for parties, create redundancies between the applications, and lead to potential inconsistencies in oversight decisions.

NOTICE AND CONSENT TIMELINE

A private equity group or hedge fund must provide notice to the AG either at the same time as required by any other state or federal agency pursuant to state or federal law, or otherwise at least ninety (90) days prior to the transaction. The AG is permitted to extend this period by an additional forty-five (45)-day period if:

- An extension is necessary to obtain additional information;
- The proposed transaction is substantially modified after initial notice was provided to the AG; or;
- The proposed transaction involves a multifacility or multi-provider health system serving multiple communities.

Further, if the AG decides to hold a public meeting regarding the proposed transaction, the AG may extend both the initial 90-day review period and the additional 45-day period by fourteen (14) days each.

If the AG does not issue its written determination by the specified periods set forth in the proposed legislation, the parties may proceed and close the transaction.

WAIVER

AB-3129 provides a process for parties to seek a waiver of the AG's review. The AG may grant a request to waive review when all of the following conditions are met:

- A party to the transaction requests waiver by submitting a written description of the proposed transaction, a copy of all relevant documents, an explanation of why waiver should be granted, and any other information;
- The health care facilities, provider groups, or provider's operating costs have exceeded its revenue for three or more years and the party cannot meet its debts;
- The health care facility, provider group, or provider provides substantial likelihood that it will have to file for Chapter 11 bankruptcy absent any waiver;
- The health care facility, provider group, or provider provides substantial evidence that it is at risk of liquidation under Chapter 7;
- The transaction would ensure continued health care access in the relevant markets; and
- The health care facility, provider group, or provider made good faith efforts to reasonably assess and elicit alternative arrangements that would have less anti-competitive effects than the proposed transaction.

Following a party's request for waiver, the AG has forty-five (45) days to evaluate and determine whether to grant, deny, or conditionally grant a waiver.

Additional Limitations and Prohibited Practices

AB-3129 also introduces a codified set of limitations governing the operations and practices of private equity groups and hedge funds that contract with health care providers. These are consistent with existing parameters on lay entities involved in the management of certain professional health care services in California (e.g., physician services), historically imposed and overseen by the applicable state licensing authorities.

Under these limitations, private equity groups and hedge funds are prohibited from entering into an arrangement with a physician, psychiatric, or dental practice that interferes with

professional judgment and health care decision-making of these licensees, or exercises control over the clinical practices, including the following:

- Making determinations about diagnostic tests for particular conditions;
- Determining the need for referrals to, or consultation with, another physician, psychiatrist, dentist, or licensed health professional;
- Being responsible for the ultimate overall care of the patient, including treatment options available to the patient;
- Determining how many patients a physician, psychiatrist, or dentist shall see in a given period of time or how many hours a physician, psychiatrist, or dentist shall work;
- Owning or determining the content of medical records;
- Selecting, hiring, or firing clinical personnel based on clinical competency;
- Making decisions regarding a provider's contractual relationships with third-party payors or other providers;
- Deciding procedures regarding coding and billing; and
- Selecting medical equipment and supplies.

Critics of these statutory restrictions point out that California's longstanding ban on the corporate practice of medicine already prohibits lay entities from owning, controlling, and interfering with clinical practices. Earlier versions of AB-3129 sought to limit all management services arrangements between private equity groups or hedge funds, on the one hand, and health care facilities, provider groups, and providers, on the other hand, in exchange for a fee. However, subsequent amendments to the proposed bill have removed this limitation. Notwithstanding, it will be important to monitor the final language of the statute, the implementing regulations, and further guidance on this aspect, which could have widespread impacts on the way management services are provided in the market.

Additionally, and consistent with the California's general disapproval of non-compete clauses, the proposed bill renders unenforceable any contract in which health care practice working with a private equity group or hedge fund bars any provider, who has been terminated or has resigned from that practice, from working with competing practices. This explicit restriction would not appear to materially change the existing law in California with respect to the enforceability of non-compete covenants.

The AG may seek injunctive relief and other equitable remedies to enforce these enforcement provisions.

Next Steps and Implications of Passage

AB-3129 appears to reflect the California Legislature's apprehension with increased involvement of private investors in the health care space. If passed, private equity groups and hedge funds may need to adjust the projected timeline of their transactions with health care providers to accommodate for AG review under AB-3129 and any related requirements. The Senate will begin considering the bill in August and we will provide a substantive update following the Senate's vote.

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