Now & Next
Healthcare Alert

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Proposed California legislation expands scrutiny of health care transactions

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California's new bills, AB 1415 and SB 763, aim to expand oversight on health care transactions, including MSOs, private equity, and hedge funds, and increase penalties for antitrust violations.

What's the impact?

- AB 1415 expands the types of entities that are subject to the requirements of California's Office of Health Care Affordability (OHCA), specifically to include management services organizations (MSOs), private equity groups, hedge funds, along with a more expansive definition of "provider."
- SB 763 proposes to amend the Cartwright Act to increase penalties for violations that constitute a "conspiracy against trade."

California has recently introduced two new bills—AB 1415 and SB 763 —that would continue to increase the scope and level of scrutiny of certain health care transactions.

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Background of the HCQAA and OHCA

In 2022, California's Health Care Quality and Affordability Act (HCQAA) established the Office of Health Care Affordability (OHCA), which requires certain "health care entities" to provide a notification to OHCA at least ninety (90) days prior to entering a "material change transaction"—through this process, OHCA evaluates the anti-competitive impacts of the transaction. Nixon Peabody's prior client alerts discuss the specific requirements and OHCA process.

Key Provisions of AB 1415

AB 1415 attempts to expand the definition of "health care entity" and within this, codify the inclusion of management services organizations (MSOs), private equity groups, hedge funds, as well as broaden the definition of "provider," thus subjecting additional organizations and transactions to OHCA's requirements.

MANAGEMENT SERVICES ORGANIZATIONS (MSO)

Following the enactment of the HCQAA, OHCA released a series of proposed regulations, which included MSOs within the definition of "health care entity." However, following significant feedback from stakeholders and interest groups, MSOs were removed from the final version of the regulations. Subsequently, OHCA also clarified in its guidance that MSOs were not deemed "health care entities"—accordingly, this meant that transactions only involving the sale of an MSO (and absent the involvement of other health care entities) would not necessitate notice to OHCA.

Now, AB 1415, proposes to capture MSOs within the definition of "health care entity." Specifically, AB 1415 defines a "management services organization" as an entity that offers administrative support to health care providers, excluding direct health care services. This support can include but is not limited to utilization management, billing, collections, customer service, provider rate negotiation, and network development.

Based on the proposed language, in addition to typical MSOs that provide turn-key practice management services, the bill's broad definition of MSO may also capture a range of entities performing administrative functions, such as third-party administrators, health care tech companies, and other vendors. Ultimately, this means that transactions that involve the sale of an MSO (whether private equity-backed or otherwise) may be subject to OHCA. And, without further clarification of what type of administrative service provider constitutes an MSO, a number of administrative vendors may be subject to these requirements.

PRIVATE EQUITY GROUPS AND HEDGE FUNDS

Stakeholders that have followed OHCA also closely watched the proposed passage of AB 3129 in 2024, which would have required private equity groups and hedge funds to obtain consent from

the California Attorney General (AG) before proceeding with certain health care transactions. AB 3129 was ultimately vetoed by Governor Newsom, who indicated in his veto statement that OHCA was created as the responsible state agency to oversee consolidation in the health care market.

Importantly, AB 1415 appears to be California lawmakers' direct response to Governor Newsom's comments. Under the proposed bill, a private equity group, hedge fund, or "any newly created business entity created for the purpose of entering into agreements or transactions with a health care entity" is required to file a pre-transaction notice with OHCA before entering into material change transactions with a health care entity or an entity that owns or controls a health care entity.

AB 1415 mirrors AB 3129's definitions of "private equity group" and "hedge funds."[2] If AB 1415 is enacted, California would be one of the first states to mandate that private equity groups disclose such transactions to a state agency and would be the only state to specifically include hedge funds in its health care transaction review legislation.

Notably, another recent bill, SB 351, is proposing to codify the limitations of California's corporate practice of medicine prohibition, specifically aimed at private equity control of health care companies. SB 351 includes a more limited definition of a "private equity group," primarily focusing on potential interference with clinical decisions and transactions within medical and dental practices in California.

Collectively, these bills highlight California's continued focus on private equity involvement in health care and efforts to impose increased regulatory oversight over these activities in the state.

EXPANSION OF PROVIDER DEFINITION

Under the proposed bill, the definition of "provider" appears to be expanded and more open-ended than the existing regulations. In particular, "provider" would include any private and public health care providers, including acute care hospitals and related organizations, health systems, and any entity that owns, operates, or controls a provider (including nonoperational providers and entities that do not provide health care services). By expanding the definition of "provider" to include entities that own, operate, or control a provider, as well as non-operational providers, AB 1415 would extend regulatory oversight beyond direct care providers to financial

[2] For reference a "private equity group" is defined as an "investor or group of investors" that primarily focus on raising or returning capital and investing, disposing, or purchasing any equity interests in assets either as a parent company or through another entity. Private equity groups do not include individuals or entities that contribute or promise to contribute funds, or those that do not participate in management or control of the group's assets. The proposed bill defines a "hedge fund" as "a pool of funds managed by investors to earn returns, regardless of the strategies used, which includes funds managed or controlled by private partnerships or corporate formations." Hedge funds do not include individuals or entities that only contribute funds without participating in its management or control, or entities that solely manage debt financing secured by the assets of a health care facility.

and management entities, including holding companies, parent corporations, and private equity-backed groups.

AB 1415 also incorporates a new definition of "health system," which includes for-profit and nonprofit systems, as well as combinations of hospitals, physician organizations, and health care plans. This already appears to be accounted for under the existing regulations, and as a result, would not materially change the scope of the regulations.

SB 763 and the Cartwright Act

SB 763, similar to AB 1415, seeks to bolster the state's oversight ability to address issues related to the market consolidation and competition in the health care market by increasing the current criminal penalties and add civil penalties for violations of California's Cartwright Act,[3] which was enacted to prohibit practices that restrain trade, fix prices, and reduce competition.

PENALTY INCREASES UNDER SB 763

Under current California law, any violation of the Cartwright Act is considered a conspiracy against trade. SB 763 proposes the following amendments to the Cartwright Act:

- **Violator (Corporation):** Increases the criminal fines from $1 million to $100 million per violation.
- **Violator (Individual):** Increases the criminal fines from $250,000 to $1 million per violation; and increases the term of imprisonment for a felony violation to 2, 3, or 5 years—currently 1, 2, or 3 years, respectively.
- Adds civil penalties of up to $1 million per violation that courts can impose based on factors such as the nature, seriousness, and persistence of the misconduct.

SB 763 imposes higher penalties for antitrust violations under the Cartwright Act, which may include transactions that involve health care entities. Health care entities could encounter heightened financial and legal risks as they invest in compliance measures. Additionally, market uncertainties created by this bill may lead to hesitation or delays in closing transactions. Although the likely ramifications of this bill are still evolving, its potential strain on deal-making processes is likely to reshape the landscape of future health care transactions. If enacted, California would have amongst the highest monetary penalties against restraints of trade—other states, such as Florida, Illinois, Pennsylvania, and Texas, have a $1 million cap on liabilities for similar conduct. The bill would align those penalties imposed in California to those enforced by the federal government.

[3] Cal. Bus. & Prof. Code Section 16755(a).

Forward Thinking

The combined impact of these bills reflects a continued focus by California state legislators and stakeholders to regulate transactions involving health care entities, as well as the business practices of these entities. Health care entities should continue to monitor these laws to ensure they adequately prepare for the potential increase in time to close and costs associated with the transaction, as well as potential penalties for non-compliance.

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