Published on *The National Law Review* https://natlawreview.com

California's Health Care Transactions Review Law: Preparing for What Comes Next

Article By:

Kathryn F. Edgerton

Deborah A. Daccord

Karen S. Lovitch

California's health omnibus trailer bill SB-184 and the final cost and market impact review (CMIR) regulations (CMIR Regulations), which went into effect on December 18, 2023, have ushered in a significant change in California's health care regulatory landscape with the creation of the Office of Health Care Affordability (OHCA). On January 2, 2024, OHCA began accepting notices of covered transactions through its notice of material change transaction submission portal.

The overarching intention of the law is to address concerns regarding consolidation in California's health care market and how such consolidation may impact cost, access, and affordability of health care for patients. The law requires that a party to a transaction submit a notice to OHCA at least 90 days prior to closing if: (1) the party is a "health care entity"; (2) the health care entity meets certain materiality thresholds; (3) the transaction qualifies as a "material change transaction"; and (4) no exemption applies.

This article describes a basic framework for analyzing whether a pre-closing notice to OCHA is required and provides a brief overview of the process for filing a notice.

1. **Are any of the parties to the transaction "health care entities"?**

The term "health care entity" is defined to include:

- health care service plans;
- health insurers;
- hospitals;
- hospital systems;
- fully integrated delivery systems[1];
- pharmacy benefit managers;
- physician organizations[2] (with greater than 25 physicians, subject to high-cost outlier exception);

- other providers[3] (e.g., ASCs, certain clinics, clinical labs, imaging facilities, and other health facilities); and
- payers[4].

The term “health care entity” also covers “any parents, affiliates, or subsidiaries that act in California on behalf of a payer” and:

- control, govern, or are financially responsible for the health care entity or are subject to the control, governance, or financial control of the health care entity; or
- in the case of a subsidiary, a subsidiary acting on behalf of another subsidiary.

The term “health care entity” does NOT include:

- dentists;
- pharmacies;
- drug manufacturers;
- durable medical equipment suppliers;
- home health agencies; and
- emergency medical transportation.

While the proposed regulations sought to include management services organizations as health care entities, the OHCA ultimately reversed course.

2. **Does the health care entity meet any of the materiality thresholds?**

A health care entity that is a party to a material change transaction (defined below) is subject to the notice requirement only if it:

- has at least $25 million in annual California-derived revenue[5] or controls at least $25 million in California assets;
- has at least $10 million in annual California-derived revenue or controls at least $10 million in California assets and is party to a transaction with any health care entity that has at least $25 million in California-derived revenue or California assets; or
- is located in a designated primary care health professional shortage area in California.

Although the materiality thresholds appear to be straightforward, applying them to real-world scenarios can be challenging. For example, if a transaction is part of a series of related transactions for the same or related health care services occurring over the past ten years involving the same health care entities or entities affiliated with those same entities, then the proposed transaction and its related transactions will constitute a single transaction for purposes of determining the revenue thresholds above.

3. **Is the transaction a “material change transaction” subject to OHCA review?**

A “material change transaction” includes “mergers, acquisitions, affiliations, and agreements impacting the provision of health care services in California that involve a transfer (sale, lease, exchange, option, encumbrance, conveyance, or disposition) of assets or a transfer of control, responsibility, or governance of the assets or operations, in whole or in part, of any health care entity to one or more entities” that meets one of the following requirements:

1. The proposed fair market value of the transaction or series of related transactions is $25 million or more and the transaction concerns the provision of health care services.
2. The transaction is more likely than not[6] to increase annual California-derived revenue of any health care entity that is a party to the transaction by either $10 million or more or 20% or more of annual California-derived revenue at normal or stabilized levels of utilization or operation.
3. The transaction involves the sale, transfer, lease, exchange, option, encumbrance, or other disposition of 25% or more of the total California assets of any health care entity submitting a notice as a party to the transaction.
4. The transaction involves a transfer of control, responsibility, or governance, in whole or in part, of any health care entity submitting a notice as a party to the transaction.[7]
5. The transaction will result in an entity contracting with payers on behalf of consolidated or combined providers and is more likely than not to increase the annual California-derived revenue of any providers in the transaction by either $10 million or more or 20% or more of annual California-derived revenue at normal or stabilized levels of utilization or operation.
6. The transaction involves the formation of a new health care entity, affiliation, partnership, joint venture, or parent corporation for the provision of health care services in California that is projected to have at least $25 million in California-derived annual revenue at normal or stabilized levels of utilization or operation, or transfer of control of California assets related to the provision of health care services valued at $25 million or more.
7. The transaction is part of a series of related transactions for the same or related health care services occurring over the past ten years involving the same health care entities or entities affiliated[8] with the same entities. The proposed transaction and its related transactions will constitute a single transaction for purposes of determining the revenue thresholds in subsection (b) and asset and control circumstances in subsection (c).
8. The transaction involves the acquisition of a health care entity by another entity and the acquiring entity has consummated a similar transaction(s), in the last ten years, with a health care entity that provides the same or related health care services. The proposed transaction and its related transactions will constitute a single transaction for purposes of determining the revenue thresholds in subsection (b) and asset and control circumstances in subsection (c).
9. **Do any exceptions apply?**

The requirement to provide notice of a material change transaction to OHCA does not apply to agreements or transactions:

1. 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-Keene Health Care Service Plan Act of 1975;
2. involving health insurers that are subject to review by the Insurance Commissioner under certain circumstances;
3. where a county is purchasing, acquiring, or taking control, responsibility, or governance of an entity to ensure continued access in that county; and
4. involving nonprofit corporations that are subject to review by the Attorney General.
5. **Can OHCA block a transaction?**

The good news is that OHCA cannot block a transaction. However, it can refer the transaction to the Attorney General for further review of unfair methods of competition, anticompetitive behavior, or anticompetitive effects.

6. **What is the CMIR timeframe?**

A health care entity must provide OHCA notice at least 90 days prior to the closing date of a material change transaction for transactions closing on or after April 1, 2024. If OHCA determines it will not conduct a CMIR, it will notify the submitter within 45 days after the filing of a complete notice. If OHCA determines it will conduct a CMIR, it will notify the submitter within 60 days after the filing of a complete notice. OHCA will toll these time periods if it is waiting for information from the parties or waiting for another agency to complete a review that may impact its determination. OHCA must complete the CMIR within 90 days of the final decision to conduct the CMIR, which may be extended by 30 days. The transaction that triggered the CMIR may not be implemented until 60 days after OHCA issues its final report.

While these dates appear certain at first glance, OHCA has the authority to lengthen the process at various points. For example, the time periods applicable to OHCA's notice regarding whether it will conduct a CMIR depend on the date of submission of a "complete" notice. If OHCA reviews an initial submission and requests additional information because the notice is not "complete," then the timeline will be extended. In addition, as noted, OHCA can toll the time periods while it is waiting for information. Buyers and sellers should determine whether this process applies at the outset of a transaction and plan ahead for lengthier transaction timelines.

7. **What information must be provided to OHCA?**

A health care entity must submit notice through OHCA's submission portal. Note that each health care entity that is a party to the material change transaction must file a notice if it meets the definition of a health care entity and the materiality requirements. A detailed description of the information that must be submitted is provided in the final regulations. Such information includes but is not limited to:

- general information regarding the submitter;
- information about all other parties to the transaction, including ownership type, governance and operational structure, location(s) of operations, and annual revenues;
- description of transaction, including the proposed closing date;
- information about materials submitted about the proposed transaction to other state or federal agencies (e.g., FTC, DOJ);
- description of current services and impact on post-transaction services;
- if a merger or acquisition, information related to other similar transactions closed in the last 10 years;
- description of post-transaction changes to ownership/governance/operational structure, employee staffing levels, city/county contracts; and
- description of any material change transactions planned to occur within 12 months following the notice.

The final regulations also detail the specific documents that must be submitted with the notice, including:

- any notice of the transaction with the FTC;
- current agreements and term sheets with appendices and exhibits related to the proposed material change transaction;
- documentation supporting the valuation of the transaction;
- current organizational chart and proposed chart after the transaction;
- documentation identifying number of patients per county or enrollees per county in the last year;
- certified financial statements for the prior 3 years;

- corporate governance documents; and
- documentation related to the mitigation of potential adverse impact of the transaction on the public.

Buyers and seller should prepare for new levels of disclosure and transparency. The scope of information and documents goes beyond that required with a typical change of ownership filing submitted to a state or federal agency. The presumption is that the information will be made public, but the purchase agreement, contract rates, and other proprietary trade secret information can be redacted or withheld. While these exceptions are comforting to some degree, it is worth noting that the OHCA will be the final arbiter of whether information and documents qualify as proprietary or otherwise confidential.

Takeaways

Before entering into any transaction involving a health care entity with California revenue, buyers and sellers should analyze whether one or both parties must submit notice to the OHCA and, if so, begin preparing for the process at the outset of the transaction.

[1] “Fully integrated delivery system” is defined at California Health & Safety Code (the “Code”) § 127500.2(h).

[2] “Physician organization” is defined at section 127500.2(p) of the Code.

[3] “Provider” is defined at section 127500.2(q) of the Code.

[4] “Payer” is defined at section 127500.2(o) of the Code.

[5] The term “revenue” includes California-derived revenues only. Revenue is generally defined to be the total average annual California-derived revenue received for all health care services by the submitter and all affiliates over the three most recent fiscal years, but the specifics vary by health care entity type.

[6] OHCA stated that it will determine whether an increase is “more than likely than not” based on the financial information submitted with the notice of transaction.

[7] A transfer of control, responsibility, or governance only requires notice if the transaction would directly or indirectly: (i) result in the transfer of 25% or more of the voting power of the members of the governing body of a health care entity, such as by adding one or more members, substituting one or more members, or through any other type of arrangement, written or oral; or (ii) vest voting rights significant enough to constitute a change in control such as supermajority rights, veto rights, and similar provisions even if ownership shares or representation on a governing body are less than 25%.

[8] “Affiliation” refers to “a situation in which an entity (“affiliate”) controls, is controlled by, or is under common control with another legal entity in order to collaborate for the provision of health care services.”