California Lawmakers Target Private Equity and Hedge Fund Investment in Healthcare Entities

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On February 16, 2024, California Assemblymember Jim Wood introduced a draft bill that specifically targets private equity and hedge fund investment, ownership and management of healthcare facilities in the state ("AB 3129" or the "Proposed Bill"). Expanding upon Assemblymember Wood's previously introduced bill, AB 977 (which failed to pass at the end of the 2020 legislative session), AB 3129 would give the California Attorney General ("AG") approval power over an acquisition by or change of control involving (i) a "Private Equity Group" or "Hedge Fund" and (ii) a "Health Care Facility" or "Provider Group" doing business in California. The Proposed Bill also appears to limit the ability of such to engage in practice management. The Proposed Bill discriminates against private equity and hedge funds by imposing substantial restrictions on their ability to invest while imposing no such restrictions on competing investors. If passed by the California legislature by the end of September 2024, the Proposed Bill would go into effect on January 1, 2025, providing very limited opportunity for existing investors to exit the market. Thus, AB 3129's proposed expansion of the AG's review and approval power to include for-profit healthcare entities could have a meaningful chilling effect on the California healthcare market.

Given the pointed focus on particular groups of investors, AB 3129 is likely to receive pushback. Below, we summarize key provisions of the Proposed Bill.

Review and Approval of Material Acquisitions. AB 3129 would require a Private Equity Group or Hedge Fund[1] to provide notice to, and obtain the written consent of, the AG for any direct or indirect acquisition or change of control of a Health Care

[1] The Proposed Bill's definition of "Private Equity Group," defined to mean "an investor or group of investors who engage in the raising of or returning of capital and who invests, develops, or disposes of specified assets," appears overbroad and is likely to capture entities that typically would not fall under the definition of "private equity" (e.g., real estate funds, venture capital funds). Likewise, the Proposed Bill broadly defines "Hedge Fund" to mean "a pool of funds by investors, including a pool of funds managed or controlled by private limited partnerships, if those investors or the management of that pool or private limited partnership employ investment strategies of any kind to earn a return on that pool of funds."

Facility[2] or Provider Group[3] that implicates a "material amount of the assets or operations" of the target entity.[4]

Timeline of Review. Notice must be provided to the AG at least ninety (90) days before the acquisition. The AG may extend this review period by one additional forty-five (45) day period.[5] The AG may further extend these periods in order to hold a public meeting, and may toll any period of review with no limit while *any* other review by a state or federal agency is pending. AB 3129 provides for a limited waiver from review if the parties can demonstrate the existence of certain emergency financial circumstances and that the acquisition or change of control will ensure continued health care access.

AG Consent and Conditional Approval. AB 3129 would empower the AG to reject, approve or conditionally approve a subject acquisition. While the Proposed Bill directs the AG to review an acquisition for anticompetitive effects and any impact on the access or availability of healthcare services to affected communities, it does not detail how the AG will make such a determination, only that the AG is to apply a "public interest" standard, under which standard an acquisition or change of control is not entitled to a presumption of efficiency.

Preventing Market Exits. AB 3129 would apply to any acquisition or change of control entered into on or after January 1, 2025 (the "Effective Date"). Acquisitions or changes of control entered into before the Effective Date are excepted unless the investment undergoes a "material change" after the Effective Date of the Proposed Bill.

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2 Health Care Facility is defined as "a facility, nonprofit or for-profit corporation, institution, clinic, place, or building where health-related physician, surgery, or laboratory services are provided, including, but not limited to, a hospital, clinic, long-term health care facility, ambulatory surgery center, treatment center, or laboratory or physician office located outside of a hospital."

3 Provider Group is defined as (i) a group of providers of 10 or more providers that provide health-related physician, psychiatric, surgery, or laboratory services to consumers; or (ii) a group of providers of two to nine that provide health-related physician, psychiatric, surgery, or laboratory services to consumers that generate annual revenue of $10 million or more.

4 A "material amount" is defined as (1) 20% or more of the target's total assets; (2) a transaction value of $3M or more; or (3) involving a general acute care hospital as defined in Section 1250(a) of the California Health and Safety Code. Notably, AB 3129 adopts the same definition of "material amount" that is currently used in the AG's review of non-profit corporations that operate or control healthcare facilities.

5 The AG may extend the time period if (a) necessary to obtain additional information, (b) there is a substantial modification to the proposed acquisition or (c) the proposed acquisition involves a multifacility or multiprovider health system serving multiple communities.

Restrictions on Practice Management. The Proposed Bill would prohibit a Private Equity Group or Hedge Fund from entering into any arrangement that could be construed to "control or direct" a physician or psychiatric practice, including "influencing or entering into contracts on behalf of that practice." It would also explicitly ban arrangements between a physician or psychiatric practice and a Private Equity Group or Hedge Fund—or an entity under their control, such as a management services organization ("MSO")—where the Private Equity Group or Hedge Fund "manages any of the affairs" of the practice "in exchange for a fee."[6] While these provisions could, as a practical matter, have the effect of prohibiting a Private Equity Group or Hedge Fund from engaging in any form of practice management, the phrase "control or direct" could be read more narrowly as a ban on the *types* of management services an MSO may provide to a physician or psychiatric practice group—as a ban, for instance, on the ability of an MSO to negotiate payor contracts or set rate structures on behalf of the practice. Given how ubiquitous the "friendly physician" structure is in this space and the effectiveness of restrictions set forth by California's corporate practice of medicine rules, the legislature's intent may not be to prohibit these types of arrangements wholesale; nevertheless, these provisions are likely to have a significant financial and operational impact on existing and future practice management arrangements.

Looking Ahead. Fast on the heels of SB 184, AB 3129 is an attempt to grant the AG the authority to scrutinize a particular subset of healthcare investments that have not, through a data-driven determination by the newly established Office of Health Care Affordability ("OHCA"), been identified as posing an appreciable anticompetitive market impact.[7] AB 3129, if passed, could have a material impact on access to needed capital for California healthcare systems and providers by chilling private equity and hedge fund investments. Given the lengthy review timeline and the AG's nearly unrestricted ability to toll its review, affected parties should anticipate significant delays to closing timelines that could have an outsized effect on smaller transactions, particularly given the disproportionately low materiality threshold for notification. Further, the current language of the Proposed Bill ostensibly creates a duplicative review process that may run in parallel to OHCA's review, adding to increased complexity, costs and timelines for affected parties,[8] and provides little opportunity for existing

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[6] The Proposed Bill does not, however, prohibit revenue-sharing between an MSO and a physician or psychiatric practice.

[7] If the Proposed Bill is enacted, the AG would benefit from less than a year of data collected by OHCA in reviewing transactions such as those contemplated by the Proposed Bill; SB 184 captures transactions entered into on or after April 1, 2024.

[8] While OHCA's regulations stipulate that certain transactions under review by other agencies (e.g., Knox Keene plans) are exempt from OHCA's review, including non-profit corporations reviewed by the AG, the Proposed Bill does not purport to carve out transactions subject to OHCA's review.

investors to exit the market before the bill takes effect. AB 3129 is likely to receive significant pushback from industry stakeholders, particularly given its targeted application.

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We will continue to monitor the status of this proposed legislation and similar legislative developments. Please do not hesitate to contact us with any questions.

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