

June 4, 2020

## California Senate Bill 977 – California Legislature Considers Major Expansion of State Approval Requirements Targeting Private Equity and Hedge Fund Acquisitions of Health Care Delivery Assets

California Senate Bill 977 (“S.B. 977”) aims to increase oversight of consolidation and anticompetitive behavior in California’s health care market and would impose new requirements on private investors as well as health care systems seeking to acquire health care facilities or providers. S.B. 977 would also confer broad discretion on the California Attorney General in approving reported transactions based on impacts on access and affordability of health care services. Behind the bill are concerns about acquisition activity in the wake of the COVID-19 pandemic and about consequences of pre-pandemic market concentration of hospital systems and private investment in physician services and in financially distressed health systems.

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This Alert is based on the [amended version of the bill](#) dated May 19, 2020. Although the bill has not passed either legislative chamber, its significant reach merits early awareness.

### The Key Approval Requirement:

S.B. 977 would require a **private equity group** or **hedge fund** to apply for and obtain written consent from California’s Attorney General prior to an **acquisition** between the private equity group, hedge fund or health care system and a **health care facility** or **provider**.

**Covered Buyers** include private equity investors and hedge funds as such, without any pre-existing amount of concentration of health care assets or operations in the state. The bill would apply even though a private equity or hedge fund-related buyer has no hospital or other covered assets in California, in contrast to the state’s regulation of health care systems, which are covered only if they have met or exceed a pre-existing level of presence in the state.

- “*Private equity group*” means an investor or group of investors who engage in the raising or returning of capital and who invest, develop, or dispose of specified assets. The definition is broad enough to encompass *venture capital*.
- “*Hedge fund*” means any pool of funds by investors, including any 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.

### Transactions Covered:

The bill casts a wide net, encompassing direct and *indirect* transactions in assets or voting interests. It covers a variety of transactional structures ranging from sales, leases, and options to acquire assets, to the creation of joint ventures, to transfers altering voting rights including *minority voting interests*.

### Targets Covered:

The bill covers acquisitions of all or part of *health care facilities* and *providers*. Covered health care facilities include hospitals, clinics, laboratories, ambulatory surgery centers, treatment centers and *buildings* where physician, surgical or lab services are furnished. For purposes of the bill, providers include individuals and groups that provide services for which a license under California’s Business & Professions Code Division 2 is required (e.g., physicians, dentists, physical therapists). The bill does not expressly cover health care industry participants that do not furnish health care

services, such as pharmaceutical and medical device companies, health information technology companies and pharmacy benefit managers.

### Approval Standards and Process:

The Attorney General must deny approval unless he finds that the applicant has shown that the transaction will either result in “clinical integration,” meaning that the transaction is substantially likely to reduce costs to the benefit of consumer care or outcomes or to increase quality of care, or that it will increase availability and access of services to an underserved population such as rural consumers, Medi-Cal beneficiaries, or other underserved populations.

Even if the applicant demonstrates the likelihood of these beneficial effects, the Attorney General may still deny approval if there is a substantial likelihood of anticompetitive effects that outweigh these benefits. “Anticompetitive effects” include raising market prices, diminishing quality, reducing choice or diminishing availability or access to hospital or health care services. The review standards differ substantively from federal antitrust review criteria.

Finally, the Attorney General must also apply a “public interest” test to grant or deny approval for a transaction. S.B. 977 directs the Attorney General to find that the transaction protects competitive and accessible health care markets in terms of prices, quality, choice, accessibility and availability of health care services on a local, regional or statewide basis.

The bill does not expressly authorize the AG to impose conditions on an approval but there is ample precedent under the hospital change-of-ownership approval statute for that discretion.

The review timelines are lengthy. The Attorney General is given at least 60 days to act on completed applications, and at several junctures in the process may extend the time for decision to call a public meeting on the proposed transaction or if the parties modify the terms as initially submitted.

Because the bill places the burden of proof on the applicant, an applicant denied approval may proceed with the transaction only by prevailing on appeal against the Attorney General.

### No *de minimis* Transactions or Short-form Approval Process for PE/Hedge Fund Acquisitions:

Although the bill provides a 30-day notice-only process for hospital systems seeking to acquire health care facilities or providers in transactions having less than a \$500,000 value, no similar fast track is provided for PE/hedge fund buyers. Consequently, even the acquisition of a solo physician practice could trigger review and approval.

### Grandfathered Transactions:

Transactions entered into by December 31, 2020 are not subject to the notice-and-approval requirement. However, grandfathered transactions can become subject to notice and approval, triggered by “material changes in corporate relationships” between a private equity group or hedge fund and a health care facility or provider after that date.

### Status of the Bill:

S.B. 977 is progressing through final committee review in the Senate before an up-or-down vote in the Senate; if approved there, the bill will proceed to the Assembly for three committee reviews and readings and final vote. If passed by the Assembly, the bill will go to Gov. Newsom’s desk, likely in September, for signature. We are monitoring its progress closely.