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California Healthcare Transactions Will Soon Hit a Speed Bump

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Effective January 1, 2024, health care entities in California that propose to enter into “material change transactions” will be required to provide advance written notice to the California Office of Health Care Affordability (“OCHA”). This requirement will affect a broad range of industry participants, including medical groups, IPAs, surgery centers, clinics, hospitals, management services organizations, pharmacy benefit managers, that propose to enter into transactions ranging from sales or joint ventures to management arrangements.

I. Pre-Transaction Notification

OCHA was created by SB 184 and charged with promoting access and affordability of health care services in California. On July 27, 2023 OCHA released a proposed Emergency Regulation detailing the process for pre-transaction review of material change transactions. 22 CCR 97431 et seq. (the “Regulation”). The timeline in the Regulation is as follows:

1. Effective January 1, 2024, a submitter must provide OCHA at least 90 days’ advance notice of transactions that will be entered into on or after April 1, 2024. For these purposes, “entering into an agreement or transaction” means the date any party’s rights vest in a binding agreement or all contingencies are met or waived.
2. OCHA then has 60 days to determine whether it will conduct a cost and market review based on its evaluation of whether the transaction is likely to have a risk of a significant impact on market competition, the state’s ability to meet cost targets or costs for purchasers and consumers. OCHA and the submitter may agree to a later date by mutual agreement and the 60-day period can be tolled if OCHA requests additional information.
3. If OCHA determines that it will conduct a cost and market impact review, the submitter has 10 business days to request a review of the determination.
4. OCHA has 90 days to complete a cost and market impact review, which OCHA may extend by one additional 45-day period. It can also toll the period by requesting additional information.
5. Upon completion of the cost and market impact review, OCHA will issue a preliminary report.
6. The parties and the public have 10 business days to submit written comments on the preliminary report.
7. OCHA has 30 days from the close of the comment period to issue its final report unless it extends this time “for good cause shown.”
8. The proposed transaction may not close for 60 days following the issuance of the final report. OCHA

has no ability to block the transaction, but it may refer the matter to other organs of state government (i.e., the Attorney General) for action.

II. Factors Considered in Determination of Whether to Conduct a Review

In determining whether to conduct a cost and market impact review, OCHA may base its decision on:

- A. Whether the transaction may have a negative effect on affordability or accessibility;
- B. Whether the transaction may have a negative effect on cost for payers, purchasers or consumers;
- C. Whether the transaction may lessen competition or tend to create a monopoly;
- D. Whether the transaction directly affects a general acute care or specialty hospital;
- E. Whether the transaction may negatively affect quality of care; and
- F. If the transaction involves an out-of-state party, whether it will affect cost or limit access in California.

III. Definitions

The definitions in the Regulation describe who must submit reports and what transactions require reports. Reports relate to "Material Change Transactions" involving "Health Care Entities."

- A. Health Care Entities include physician organizations. Physician organizations are defined as IPAs, RBOs, Restricted Knox Keene Plans, medical foundations and medical group practices "comprised of" 25 or more physicians. No additional definition of "comprised of" is provided, so it is not possible to determine whether it applies to owners, employees or contractor physicians (or all of them). In addition to physician organizations, health care entities include licensed facilities, pharmacy benefit managers, MSOs and affiliates of any of them.
- B. A Health Care Entity is required to file if:
 - a. It has annual revenue of at least \$25 million or owns or controls California assets of at least \$25 million;
 - b. It has annual revenue of at least \$10 million or owns or controls California assets of at least \$10 million and is involved in a transaction with a \$25 million health care entity; or
 - c. It is located in or serves at least 50% of patients who reside in a health professional shortage area.
- C. Material Change Transactions are nine distinct transaction types, including
 - a. transactions whose value is \$25 million or more;
 - b. transactions that are likely to increase the annual revenue of any health care entity that is a party by \$10 million or 20%;
 - c. transactions regardless of dollar value that involve the sale or other disposition (including encumbrance) of 20% or more of the assets of any health care entity involved in the transaction;
 - d. the terms of the transaction contemplate an entity negotiating or administering contracts with payers on behalf of one or more providers and the transaction involves a management services organization;
 - e. the transaction involves the formation of a new health care entity, affiliation, partnership or joint venture for the provision of health services in California that is projected to have at least \$25 million in annual revenue or control of assets related to the provision of health care services valued at \$25 million or more; or
 - f. the transaction involves a health care entity joining, merging or affiliating with another health care

entity where any health care entity has at least \$10 million in annual revenue.

- D. Revenue means the total average annual California-derived revenue received for all health care services by all affiliates over the three most recent fiscal years. For provider organizations, it is net patient revenue, including capitation, fee for service and shared risk and incentive payments. For MSOs, it is all payments or revenue received for providing administrative or management services, including billing and collection services.
- E. Affiliate refers to a situation in which an entity controls, is controlled by or is under common control with another legal entity in order to collaborate for the provision of health care services.

IV. The Notice

The notice is required to include general information about the parties, the proposed closing date and a description of the transaction, including:

- A. The goals of the transaction;
- B. A summary of terms;
- C. A statement of why the transaction is necessary or desirable;
- D. General public impact or benefits of the transaction, including quality and equity measures and effects;
- E. Narrative description of the expected competitive impacts; and
- F. A description of any actions or activities to mitigate potential adverse impacts of the transaction on the public.

In addition, the submission is required to address expected changes to service offerings (specifically including reproductive health care services); community needs assessments; and potential post-transaction changes to ownership, governance or operational structure, employee staffing levels, wages or benefits, seismic compliance and competition.

The notice is to be accompanied by all current agreements, contact information for individuals responsible for the transaction, a pro forma post-transaction balance sheet, pre- and post-transaction organizational charts, certified financial statements and documents supporting the submitter's responses to the narrative portion of the notice.

V. Confidentiality

All information submitted will be treated as a public record, unless the submitter designates information or documents as confidential and OCHA accepts the designation. However, marked confidential portions of stock purchase agreements (asset purchase agreements are not listed but presumably would be accorded the same treatment), financial documents, contract rates and unredacted resumes are deemed confidential. Other documents for which confidential treatment is requested are to be accompanied by a redaction log that includes a detailed statement of the basis for the request, which will be evaluated and decided by OCHA.

VI. Cost and Market Impact Review

The draft emergency regulation lists the factors to be considered in a cost and market impact review as follows:

- (1) The effect on the availability or accessibility of health care services to the community affected by the transaction, including the accessibility of culturally competent care.
- (2) The effect on the quality of health care services to the community affected by the transaction.
- (3) The effect of lessening competition or tending to create a monopoly which could result in raising prices, reducing quality or equity, restricting access, or innovating less.
- (4) The effect on any health care entity's ability to meet any health care cost targets established by the Health Care Affordability Board.
- (5) Whether the parties to the transaction have been parties to any other transactions in the past ten years.
- (6) Consumer concerns including, but not limited to, complaints or other allegations against any health care entity that is a party to the transaction related to access, care, quality, equity, affordability, or coverage.
- (7) Any other factors OCHA determines to be in the public interest.

VII. Final Thoughts

The submission and review process in the draft regulation is detailed, but it is not possible to know at this juncture how the process will work in practice. Nor is it possible to know how many notices will be submitted, how efficiently OCHA will process them or what percentage of submissions will be determined not to require a cost and market impact review. The proposed Emergency Regulation does not require two or more participants in a transaction to submit together, which could potentially lead to inconsistent determinations or delay. Further, other than portions of documents deemed confidential, it is not possible to know at this point whether requests for confidential treatment will be adjudicated expansively or, in the interest of transparency, narrowly.

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