

# U.S. State Healthcare Transaction Reviews: California

## Healthcare Transaction Reviews Generally<sup>1</sup>

Private investment in U.S. healthcare companies has grown significantly in recent years. U.S. state regulators have taken notice and have recently adopted a number of state healthcare transaction review laws focused on antitrust, quality, access and cost. These laws are intentionally broad and are clearly meant to target healthcare transactions owned by private equity-backed companies, including physician management services organizations.

While the laws vary from state to state, they generally require parties to submit filings to state regulators, including attorneys general, of “material transactions,” which may include, but are not limited to, majority changes of ownership, minority changes of ownership, and joint and collaboration agreements. Additionally, many of the laws specifically target physician practice management organizations.

### Key takeaways from the filing and review processes:

- ▶ There are currently healthcare transaction review laws requiring notice submissions, and in some cases regulatory approval, in over 10 states, with pending legislation in several other states.
- ▶ Preparation of the initial filings and subsequent responses to regulators will lengthen the period between signing and closing and, in some states, will be as long as six months or longer and may include public comment and review periods.
- ▶ The laws are intended to capture transactions that fall below the current threshold set by federal antitrust enforcers and, in many cases, are aimed specifically at private equity. The reporting/filing thresholds vary from state to state and use several metrics, including transaction financial value and the number of healthcare providers implicated in the transaction.
- ▶ Most of the transaction review laws require pre-closing filings and, in some cases, approval. The filings will require detailed information, including transaction financing, anticipated impacts on the company’s operations, commitment to quality of care, and impacts on overall market competition, to name a few.
- ▶ Transaction approval may come with post-closing conditions, monitoring, or reporting obligations.

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<sup>1</sup> The information contained in this document should not be construed as legal advice. A number of the state laws impacting healthcare transactions are new, and regulators are still finalizing the corresponding regulations. Once the regulations are finalized, state regulators will likely interpret the regulations in unanticipated ways, which could lead to unpredictable and complex transaction review periods.

## California Health Care Quality and Affordability Act

<b>Status</b>	Notice required for certain transactions closing on or after April 1, 2024. Finalized regulations effective on December 18, 2023.
<b>Purpose</b>	Require that certain parties <b>submit a notice</b> to the newly established Office of Health Care Affordability (“OHCA”) to enable OHCA to analyze healthcare mergers, acquisitions, affiliations and other transactions involving regulated “health care entities” (“Health Care Entities”) that may impact market competition and affordability.
<b>Impacted Health Care Entities</b>	<ul style="list-style-type: none"> <li>• Ambulatory surgical centers</li> <li>• Clinical laboratories</li> <li>• Community clinics</li> <li>• Specialty clinics (including chronic dialysis clinics and rehab clinics)</li> <li>• Health care service plans</li> <li>• Health insurers</li> <li>• Health systems</li> <li>• Hospitals and HOPD</li> <li>• Imaging centers</li> <li>• Pharmacy benefit managers</li> <li>• Physician practices with 25 or more physicians or otherwise considered “high-cost outliers”</li> <li>• Third-party administrators</li> <li>• Parent, subsidiary, or affiliate that acts as an agent on behalf of a payer <b>and</b> that controls, governs or is financially responsible for a Health Care Entity.</li> </ul>
<b>Who Must File</b>	Health Care Entities that: <ul style="list-style-type: none"> <li>• have annual California revenue<sup>2</sup> of at least \$25 million or own or control California assets of at least \$25 million;</li> <li>• have annual California revenue, of at least \$10 million or own or control California assets of at least \$10 million and are involved in a transaction with any Health Care Entity satisfying the above \$25 million threshold; or</li> <li>• are located in a designated primary care health-professional shortage area in California.</li> </ul>
<b>“Material Change” Transactions<sup>3</sup> That Require a Filing:</b>	<p>Regulations require notice by a Health Care Entity to OHCA for transactions that:</p> <ul style="list-style-type: none"> <li>• the proposed fair market value of the transaction is \$25 million or more and the transaction concerns the provision of health care services;</li> <li>• is more likely than not to increase a Health Care Entity’s annual revenue by at least \$10 million or 20% of annual California-derived revenue;</li> <li>• involve the sale, transfer, lease, exchange, option, encumbrance, or other disposition of 25% or more of the total California assets of the submitter;</li> <li>• involve a transfer of control, responsibility, or governance of a Health Care Entity, in whole or in part;</li> <li>• result in an entity contracting with payers on behalf of consolidated/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% of California-derived revenue;</li> <li>• involve 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 or controlled assets;</li> <li>• are part of a series of related transactions for the same or related healthcare services occurring over the past 10 years involving the same Health Care Entities or entities affiliated with Health Care Entities (which will be analyzed as a single transaction); or</li> <li>• involve acquisition of a Health Care Entity by another Health Care Entity where the acquirer has consummated similar transactions within the past 10 years, with a Health Care Entity that provides the same or related healthcare services (which will be analyzed as a single transaction).</li> </ul> <p>“Material change transaction” does not include corporate restructurings (or transactions that involve a Health Care Entity already controlled, directly or indirectly, by all other parties to the transaction) or transactions that are entered into in the ordinary course of a Health Care Entity’s business.</p>
<b>Notice Timing</b>	<p>Minimum of 90 days for a transaction to close, with longer wait times expected.</p> <ul style="list-style-type: none"> <li>• transacting parties <b>must give OHCA 90-day pre-close notice</b> (this must be submitted on office’s portal).</li> <li>• OHCA will notify parties within 45 days of receiving a completed notice if it will not conduct a Cost and Marketing Impact Review (“CMIR”), or a later date if agreed by the parties, and within 60 days if it will conduct a CMIR (which may be appealed within 10 business days). These periods maybe tolled during any time in which OHCA has requested additional information from the parties.</li> <li>• if a CMIR is required, OHCA has 90 days from its final determination that a CMIR will be conducted to complete the CMIR, which may be extended by up to 30 days. Written comments are due within 10 business days of the preliminary report, and final report is due within 15 days of the close of the written comment period, unless OHCA extends for good cause.</li> </ul>

<sup>2</sup> Revenue means the total average annual California-derived revenue received for all health care services by the submitter (see the regs for specific submitter types and additional information) and all affiliates over the three most recent fiscal years.

<sup>3</sup> Transaction includes mergers, acquisitions, affiliations, and agreements impacting the provision of health care services in CA 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.

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<b>Expedited Review</b>	Expedited review may be requested at the time notice is submitted if one of the following conditions exists: <ul style="list-style-type: none"><li>• one or more of the parties to the transaction is in severe financial distress (as defined by the regulations), or there could be a significant reduction in the provision of critical healthcare services within a geographic region or regions.</li></ul>
<b>Content of Notice</b>	The initial notice will require a substantial amount of information, including and supporting documentation on topics such as: <ul style="list-style-type: none"><li>• description of organization, governance, operational structure (including ownership of or by a healthcare entity), tax IDs, etc.;</li><li>• public impact of the transaction, including quality and equity measures;</li><li>• the cost impact to the state and to consumers;</li><li>• post-transaction changes to operations; and</li><li>• copies of documents (definitive agreements, term sheets, balance sheets, certified financial statements, etc.).</li></ul>
<b>Penalties</b>	Transactions may be referred to the CA Attorney General for further review of unfair methods of competition, anticompetitive behavior, or anticompetitive effects.

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## Cal. Corp. Code § 14700, et. seq.

<b>Status</b>	Transactions with effective dates on or after January 1, 2024 require 180 days' pre-closing notice.
<b>Purpose</b>	Require that certain parties <b>submit a notice</b> , which in practice is likely to operate more like a consent, to the California Attorney General ("CA AG") to analyze healthcare mergers, acquisitions, affiliations, and other transactions involving regulated "healthcare entities" ("Healthcare Entities") that may impact market competition and affordability.
<b>Impacted Healthcare Entities</b>	<ul style="list-style-type: none"> <li>• <b>Retail Drug Firms:</b> any person, association, partnership, corporation, or joint venture with one or more business or establishment ("Person") located in California and identified by the North American Industry Classification System ("NAICS") with the retail trade category 45611: <ul style="list-style-type: none"> <li>○ NAICS 45611 includes pharmacies, drug stores, mail order pharmacies, etc.</li> </ul> </li> <li>• <b>Retail Grocery Firms:</b> any Person located in California and identified by the NAICS with the retail trade category 44511 or 455211: <ul style="list-style-type: none"> <li>○ NAICS 44511 includes supermarkets and other grocery stores (except convenience stores);</li> <li>○ NAICS 455211 includes warehouse clubs and supercenters.</li> </ul> </li> </ul>
<b>Who Must File</b>	<p>Both parties to the transaction must file when a transaction involves the direct or indirect acquisition of any voting securities or assets and the transaction:</p> <ul style="list-style-type: none"> <li>• Requires notice under the <b>Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR")</b>; or</li> <li>• Involves more than 20 retail drug firm or retail grocery firm locations in California.</li> </ul>
<b>Content of Notice</b>	<ul style="list-style-type: none"> <li>• If the acquiring party is <b>required to file an HSR notice</b>, the same notice must be provided to CA AG.</li> <li>• If the acquiring party is <b>not required to file an HSR notice</b>, the notice must contain the following information: <ul style="list-style-type: none"> <li>○ Names and addresses of the acquiring parties;</li> <li>○ A report of the nature of any acquiring party's past business operations;</li> <li>○ An informative description of the business, including its corporate structure, governance, or management;</li> <li>○ A list of all individuals who are or have been selected to become directors, executive officers, or will perform such functions;</li> <li>○ The source, nature, and amount of funding, including any corporate stock or loans involved;</li> <li>○ Fully audited financial information of each acquiring party over the past five years and similar unaudited financial information as of 90 days before the written notice;</li> <li>○ Any plans or proposals to liquidate the firms, sell its assets, merge, consolidate, or make any other material change in the business, corporate structure, or management;</li> <li>○ Information required to assess the competitive effects of the proposed transaction, with particular attention given to effects on consumers and patients;</li> <li>○ Information required to assess the economic and community impact of any planned divestiture or store closures.</li> </ul> </li> </ul>
<b>Notice Timing</b>	<ul style="list-style-type: none"> <li>• 180 days' pre-closing notice and filing to CA AG</li> <li>• CA AG can seek an order staying or preliminarily enjoining the transaction if it cannot complete an "evaluation of the competitive effects of the acquisition" within 180 days</li> </ul>
<b>Penalties</b>	<p>Failure to provide the requisite notice may result in:</p> <ul style="list-style-type: none"> <li>• Civil penalties of up to \$20,000 per day for each day of noncompliance;</li> <li>• CA AG may pursue: <ul style="list-style-type: none"> <li>○ Injunctive relief (e.g., enjoining the transaction);</li> <li>○ Attorneys' fees and costs incurred in remedying the violation.</li> </ul> </li> </ul> <p>CA AG may also use the notice, documents, and information disclosed under the notice in a judicial action in state or federal court or an administrative action involving the merger or acquisition.</p>

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