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California Legislature Responds to COVID-19 Crisis with Legislation that Would Require State Approval of Healthcare Mergers and Acquisitions

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By Martin G. Burkett

As healthcare providers around the country struggle to respond to patient needs during the COVID-19 crisis, many are reportedly struggling financially as well. In the past, this scenario has led to an increase in merger and acquisition activity, and many healthcare analysts are predicting an increase in such activity for the second half of the year and into 2021.

In light of this development, the California Legislature is considering a bill that would require the California Attorney General's pre-approval of most healthcare transactions in the state. Specifically, the bill, SB 977 (as amended on May 19), would require that when a healthcare system, private equity group, or hedge fund seeks to acquire or affiliate with a hospital or provider in the state, the parties must obtain the prior approval of the California Attorney General to do so. In addition, for transactions valued at over $500,000 (which is likely to constitute virtually all hospital transactions and many provider group transactions), to gain approval the parties will be required to demonstrate that the transaction will result in "a substantial likelihood of clinical integration, a substantial likelihood of increasing the availability and access of services to

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an underserved population, or both." If the parties cannot demonstrate that these factors outweigh the potential anticompetitive effects of the transaction, SB 977 directs the California Attorney General to deny the transaction.

In addition, the bill would also impose a less burdensome reporting and pre-approval obligation for transactions valued at less than $500,000. For those transactions, the California Attorney General's initial assessment of a proposed deal would be based solely upon the potential competitive effects of the proposed transaction, and would only require the parties to demonstrate the likelihood of enhanced clinical integration and/or the likelihood of increasing the availability of services to the community if the state Attorney General first determines that the transaction raises "substantial competitive concerns." The legislation also makes clear that an offer of employment to a single physician does not constitute a proposed "affiliation" that would require reporting and approval under this new law.

Notably, the obligations that would be imposed on parties under SB 977 would be quite different, and broader, than those under federal law in several material ways. For example, under the federal Hart-Scott-Rodino Act, the obligation to report and seek prior approval of mergers and acquisitions is subject to a $94 million "size-of-the-transaction" threshold. No such limitation exists under SB 977; it applies, in some form or fashion, to almost every transaction. In addition, the Hart-Scott-Rodino Act provides federal regulators with an initial 30 day period to review transactions submitted for approval, while SB 977 would grant the California Attorney General with 60 days, at least for transactions valued at over $500,000. Moreover, perhaps most significantly, under federal law, the starting point for merger analysis is whether the transaction is likely to have anticompetitive effects; the parties have no obligation, in the first instance, to show enhanced benefits in terms of clinical integration and the

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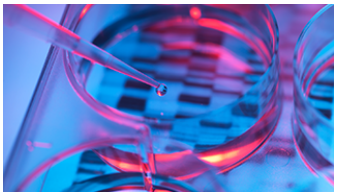

likelihood that the transaction will increase access to care in underserved communities. The California law is quite different in this respect for transactions over $500,000.

The legislation also would direct the California Attorney General to establish a "Health Policy Advisory Board" that would assist the California Attorney General in evaluating and analyzing healthcare markets in California. Membership on this board would include representatives from healthcare systems, healthcare providers, health plans, employers that purchase healthcare services and union representatives, and the Board would be tasked with creating an annual report detailing the state of competition in healthcare in California.

As of the posting of this blog, the California Senate Health Committee has approved SB 977, and the bill is now pending in the state Senate Appropriations Committee. If the California legislation is enacted into law, California would join only a handful of states (including Connecticut and Washington) that currently have express prior notice/prior approval requirements for healthcare transactions. However, given that the COVID-19 crisis has created pressure for the states to ensure greater access to healthcare, other state legislatures may also consider similar legislation as well. Stay tuned.
