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Megan Brubaker
Department of Health Care Access and Information
Office of Health Care Affordability
2020 West El Camino Avenue, Suite 1200
Sacramento, CA 95833
CMIR@hcai.ca.gov

Office of Administrative Law Reference Attorney
Office of Administrative Law
300 Capitol Mall, Suite 1250
Sacramento, CA 95814
staff@oal.ca.gov

SUBJECT: Proposed Emergency Regulatory Action - Promotion of Competitive Health Care Markets; Health Care Affordability: Cost and Market Impact Reviews

Dear Ms. Brubaker and Reference Attorney:

On behalf of our more than 400 hospital and health system members, the California Hospital Association (CHA) thanks the Office of Health Care Affordability (OHCA) and the Office of Administrative Law for the opportunity to comment on the proposed emergency regulations referenced above.

Transfer of Assets; Post-Transaction Revenue

OHCA is statutorily required to promulgate regulations that define the health care transactions that require advance notice to the agency (Health & Safety Code § 127507(c)(3)). Health and Safety Code Section 127507(c)(1) sets forth OHCA's statutory authority to require advance notice:

> (c) (1) A health care entity shall provide the office with written notice of agreements or transactions that will occur on or after April 1, 2024, that do either of the following:
> (A) Sell, transfer, lease, exchange, option, encumber, convey, or otherwise dispose of a material amount of its assets to one or more entities.
> (B) Transfer control, responsibility, or governance of a material amount of the assets or operations of the health care entity to one or more entities.

It is important to note that the above statute sets forth two criteria for a transaction to require notice to OHCA:

- **Transfer**. A ***transfer or other disposition*** of assets ((c)(1)(A)) or a ***transfer*** of control/responsibility/governance of assets or operations ((c)(1)(B)) must take place. That transfer or other disposition may be to one or more entities.

  AND

- **Material amount.** What is transferred must be ***material;*** OHCA must establish the relevant materiality threshold.

However, OHCA has exceeded its statutory authority in subdivisions (c)(2), (c)(5), and (c)(6) of Section 97435 of the proposed regulations. These provisions also violate the necessity, clarity, and consistency standards of the Administrative Procedure Act (subdivisions (a), (b), (c), and (d) of Section 11349 of the Government Code) as explained below.

Several of the notice-triggering criteria in subdivision (c) of Section 97435 do not specify a ***material*** amount of assets or control that must be ***transferred*** (or otherwise disposed of). The criteria don't necessarily require a transfer of *any* assets/control — or, to the extent they do, they don't specify a materiality threshold for the transfer or other disposition. Instead, they require notice based upon post-transaction revenue.

Specifically, subdivision (c)(6) of Section 97435 states that a material change transaction includes circumstances where:

> The transaction involves 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 at normal or stabilized levels of utilization or operation, or transfer of control of California assets related to the provision of health care services valued at $25 million or more.

Broken down, subdivision (c)(6) addresses two different types of transactions:

- The formation of a new health care entity projected to have at least $25 million in annual revenue.
- The formation of a new health care entity that transfers control of California assets valued at $25 million or more.

Whereas the second type of transaction meets the two statutorily required criteria of "transfer" and "material amount," the first type of transaction does not. The first type does not specify a ***material amount*** of assets/control that must be ***transferred*** (or otherwise disposed of).

For example, let's say two hospitals enter into an affiliation to operate a PET scanner. Neither hospital alone has a sufficient patient base to make the PET scanner financially feasible, but together they do. One hospital has some unused space. The other hospital has a couple of radiology technicians it can assign to this space. The space is not transferred; it remains the property of the first hospital (and is not

leased to the new joint venture). The employees are not transferred; they remain employed and paid by the second hospital. The equipment and supplies are obtained by the new joint venture that has obtained a loan. Radiologists staffing the PET scanner will be reimbursed by billing insurance companies or government payers. The expected revenue will be used to pay off the loan, with any extra revenue split evenly between the two hospitals.

At this point, the regulations lack clarity and internal consistency. On the one hand, it may be that there is no "transaction" in this example because there has been no transfer of assets/control.[1] However, the regulations seem to indicate that this example would require notice if the amount of post-transaction annual revenue will be $25 million or more.

Let's now add to this example that the first hospital transfers a few used radiology gurneys (fair market value of approximately $2,500) to the joint venture. There has now been a "transfer" of assets – but the regulations don't specify a materiality threshold. The proposed emergency regulations seem to require notice for this transaction if the joint venture will later earn more than $25 million in annual revenue. However, post-transaction revenue is not the same as a material amount of transferred assets/control. Adding a dollar amount of post-transaction revenue to this criterion does not save it from legal infirmity.

Subdivision (c)(2) of Section 97435 suffers from the same problem. This provision purports to require notice when:

> The transaction is more likely than not to increase annual California-derived revenue of any health care entity that is a party to the transaction by either $10 million or more or 20% or more of annual California-derived revenue at normal or stabilized levels of utilization or operation.

Again, this provision does not specify a ***material amount*** of assets/control that must be ***transferred.*** Instead, it describes post-transaction revenue. It likewise violates the necessity, authority, clarity, and consistency standards of the Administrative Procedure Act (subdivisions (a), (b), (c), and (d) of Section 11349 of the Government Code).

Finally, subdivision (c)(5) of Section 97435 also violates the necessity, authority, clarity, and consistency standards of the Administrative Procedure Act (subdivisions (a), (b), (c), and (d) of Section 11349 of the Government Code). This provision requires notice when:

> The transaction will result in an entity contracting with payers on behalf of consolidated or 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% or more of annual California-derived revenue at normal or stabilized levels of utilization or operation.

Again, this provision focuses on post-transaction revenue rather than a material amount of assets/control to be ***transferred***. For example, let's say a hospital hires a law firm to negotiate a value-based contract for a new service line on behalf of the hospital and its doctors with an

[1] We believe that if there is no transfer of any assets/control, the agreement does not require notice to OHCA, because the definition of "transaction" requires such a transfer.

insurance company. This contract would be considered a "transaction" as defined in Section 97431(p) because it is an agreement impacting the provision of health care services in California that involves a transfer of assets (money to pay the legal fees) of a health care entity (the hospital) to one or more entities (the law firm). The transaction will result in an entity (the law firm) contracting with a payer on behalf of combined providers (the hospital and doctors[2]).

The legislature did not intend for the types of transactions that fall under (c)(6), (c)(2), and (c)(5) to be subject to OHCA notice requirements — this criterion fails to align with its statutory authority in that it does not specify the amount of assets or control that must be ***transferred*** to be considered a "***material***" transaction. It instead focuses on post-transaction revenue.

Expanded Definition of "Health Care Entity"

Health and Safety Code § 127500.2(k) states that: "Health care entity" means a payer, provider, or a fully integrated delivery system." Each of these terms (payer, provider, fully integrated delivery system) is also defined in that statute. However, OHCA has added additional entities to the definition in Section 97431(g)(3) of the proposed regulations, which exceeds its statutory authority. Section 97431(g)(3) states that health care entities:

> (g)(3) Include any parents, affiliates, subsidiaries, or other entities that act as an agent in California on behalf of a payer, provider, fully integrated delivery system, or pharmacy benefit manager, and either:
> (i) control, govern, or are financially responsible for the health care entity or
> (ii) are subject to the control, governance, or financial control of the health care entity, such as an organization that acts as an agent of a provider(s) in contracting with payers, negotiating for rates, or developing networks; or
> (iii) in the case of a subsidiary, a subsidiary acting on behalf of another subsidiary.

Adding parents, affiliates, subsidiaries, and, most importantly, the extremely broad category of "other entities" violates the necessity, authority, and clarity standards of the Administrative Procedure Act (subdivisions (a), (b), and (c) of Section 11349 of the Government Code). If the legislature had wanted these types of entities to be subject to the OHCA regulations, the legislature could have said so. They did not.

Definition of "Revenue"

Section 97435(d) defines "revenue" for the purposes of this regulation. For health plans, insurers, hospitals, long-term care facilities, and risk-bearing organizations, this definition refers back to other state law and the definitions of revenue that these entities are currently required to file with their state regulatory agencies. However, for "other providers or provider organizations," Section 97435(d)(6) of the proposed regulation states that revenue means total revenue received for patient care, as it was "generated or occurred" in California, "rather than when revenue is booked, accrued, or taxed…" The words "generated or occurred" fail to comply with the clarity

[2] Note that physicians are usually not employees of the hospital (in fact, most hospitals are prohibited by California law from employing physicians to provide patient care services). Physicians are independent practitioners who apply for privileges to use the hospital facilities for their patients – for example, to operate on their patients in the hospital's operating room. The hospital does not employ or pay the physician. They are separate legal entities. However, they may both allow the same law firm to represent them.

and consistency standards of the Administrative Procedure Act, as required by Government Code § 11349(b) and (d), as explained below.

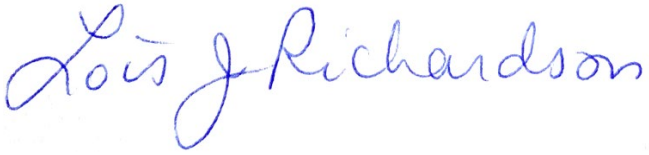
There are two generally accepted methods of accounting for revenue: cash or accrual. Almost every organization of any significant size uses the accrual method. In fact, HCAI regulations require that hospitals and long-term care facilities use the accrual method of accounting, as do regulations promulgated by the Department of Managed Health Care (applicable to health plans and risk-bearing organizations) and the Department of Insurance (applicable to health insurers). In the proposed regulations, it is completely unclear what is meant by "generated or occurred." These are not terms used in the accounting world. HCAI should specify that revenue is determined using the accrual method of accounting, for clarity, to be consistent with how other health care entities will report revenue under these regulations, and to be consistent with other state statutes and regulations, as required by the Administrative Procedure Act.

Conclusion

The California Hospital Association respectfully requests that the Office of Administrative Law decline to finalize the noncompliant provisions in the draft emergency regulations.

I may be reached at (916) 552-7611 if you have any questions.

Sincerely,



Lois Richardson
Vice President & Legal Counsel

cc: Elizabeth Landsberg, Director, Department of Health Care Access and Information
Vishaal Pegany, Deputy Director, Office of Health Care Affordability
Members of the Health Care Affordability Board:
David M. Carlisle, MD, PhD
Secretary Dr. Mark Ghaly
Dr. Sandra Hernández
Dr. Richard Kronick
Ian Lewis
Elizabeth Mitchell
Donald B. Moulds, Ph.D.
Dr. Richard Pan

Attachments:
California Hospital Association comment letters to HCAI dated August 31, 2023 and October 17, 2023.