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Employee Benefit Plan Review

New Filing Requirements for Health Insurer and Third Party Administrator M&A Transactions

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Prior to April 1, 2024, the change in control of a health insurer domiciled outside of, but licensed in, California was subject to a Form A filing with and approval by the insurer's domestic state insurance regulator. In addition, the change in control of a California licensed third party administrator (TPA) was not subject to any California insurance regulatory review and approval regardless of the TPA's state of domicile. That has changed as California has adopted additional filing requirements, as have a number of other states.

In 2022 (applicable to transactions effected after April 1, 2024) the California legislature enacted the Health Care Quality and Affordability Act (the Act), which is overseen by California's Office of Health Care Affordability (the OHCA) within the Department of Health Care Access and Information. Under the Act, the acquisition of an insurer domiciled outside of, but licensed in, California may be subject to an extensive filing, as could the acquisition of a TPA. Not only that, once OHCA's review process is complete, the parties must wait 60 days to close, which may disrupt the typical process of closing acquisitions within days after receiving Form A approval, in the case of health insurers.

As stated in the Act, the legislation is intended to establish a single governmental entity charged with:

- Developing a comprehensive strategy for cost containment, including measuring progress towards reducing the rate of growth in per capita total health care spending and ultimately lowering consumer spending on premiums and out-of-pocket costs, while maintaining quality, access, and equity of care, as well as promoting workforce stability and maintaining high-quality health care jobs.
- Addressing cost increases in excess of health care cost targets through public transparency, opportunities for remediation, and other progressive enforcement actions to achieve cost targets that optimize value in health care spending.
- Referring transactions that may reduce market competition or increase costs to the Attorney General for further review.

This article focuses on how the Act impacts the acquisition of certain "health care entities" (HCEs); in particular, health insurers and TPAs that are either domiciled in California or domiciled elsewhere and licensed in California – yes, in addition to the filing and approval requirements that may exist in the HCE's state of domicile, the transaction could also be subject to OHCA review.

General Applicability

As discussed in greater detail below, determining if the Act applies to an entity involved in a particular transaction is a multi-step process:

- Does the entity meet the definition of an HCE?
- If yes, does the entity satisfy certain revenue thresholds (unrelated to the proposed transaction)?
- Is the proposed transaction one that's regulated by the Act?
- If yes, does the transaction meet certain criteria?

If the answer to each of those questions is yes, the HCE must file a Notice of Material Change Transaction (Notice) with the OHCA, which requirement could apply to the acquiring entity, the target entity and/or the selling entity. The information and documents required to be included with a Notice filing are somewhat similar to a California Department of Insurance (CDI) Form A insurer change in control submission, but are articulated in much greater specificity than in the Form A instructions. In other words, it is a detailed submission.

HCE Criteria

To determine if a Notice filing is required, the first step is to determine if the entity meets the definition of an HCE. If it does, the next question is whether the entity meets the revenue or geographic thresholds.

The definition of an HCE includes health insurers, health care service plans and third party administrators without reference to the entity's state of domicile. Thus, the Act applies to insurers and TPAs domiciled outside of, but licensed and transacting business in, California.

If the entity meets the definition of an HCE, the next question is whether the HCE, itself (not the transaction, in question), meets the Act's revenue or geographic thresholds; namely:

- Does the HCE have annual revenue of at least $25 million or own or control California assets of at least $25 million?
- Does the HCE have annual revenue of at least $10 million or own or control California assets of at least $10 million and is a party to a transaction with an HCE that has $25 million in revenue or California assets?
- Is the HCE located in a designated primary care health professional shortage area in California.

Next, if the entity meets the definition of an HCE and satisfies the revenue criteria, we turn to whether the subject transaction meets the Act's "transaction" definition and, if so, whether the transaction satisfies certain criteria. The required transaction measures are whether it:

- Is a merger, acquisition, affiliation, or agreement;
- Impacts the provision of health care services in California; and
- Involves the transfer of assets by means of a sale, lease, exchange, option, encumbrance, conveyance, or disposition or a transfer of control, responsibility, or governance of the assets of the operations, in whole, or in part, of any HCE to one or more entities.

Below are examples of the types of transactions that could fall within the referenced definition involving a fictitious Insurer A. In our examples, Insurer A is an Arizona domestic health insurer that is also licensed and transacting health insurance in California:

- *Example No. 1:* The acquisition of control of Insurer A could fall within the Act's "transaction" definition even though Insurer A is not domiciled in California and would be the subject of a Form A (change in control) filing in its state of domicile, Arizona.
- *Example No. 2:* The acquisition of Insurer A's business by means of an assumption reinsurance transaction could fall within the Act's "transaction" definition as an acquisition of assets.

As examples nos. 1 and 2, above, meet the "transaction" definition, the next question is whether the transaction, itself, is a "material change transaction" requiring a Notice filing with the OHCA. A transaction meeting any of the following circumstances is a material change transaction:

- The fair market value of the proposed transaction is $25 million or more and concerns the provision of health care services.
- The transaction is more likely than not to increase annual California-derived revenue of any HCE 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.
- The transaction involves the sale, transfer, lease, exchange, option, encumbrance, or other disposition of 25% or more of the total California assets of the submitter(s).
- The transaction involves a transfer of control, responsibility, or governance, in whole or in part, of the submitter.
- The transaction involves the formation of a new health insurer that is projected to have at least $25 million in California-derived annual revenue.
- The transaction is part of a series of related transactions for the same or related health care

services occurring over the past ten years (with thresholds aggregated) involving the same health care entities or entities affiliated with the same entities.

- The transaction involves the acquisition of a health care entity by another entity and the acquiring entity has consummated a similar transaction(s), in the last ten years (with thresholds aggregated), with a health care entity that provides the same or related health care services.

Filing Exemptions

Transactions exempt from the Notice filing include transactions subject to review by the CDI or the California Department of Managed Health Care (DMHC). The acquisition of control of a California domiciled health insurer would be subject to a Form A filing and approval by the CDI and the acquisition of control of a California health care service plan would be subject to a material modification filing and approval by the DMHC. Thus, both of those transactions would be exempt from an OHCA Notice filing unless the CDI or DMHC, as applicable, referred the matter to the OHCA for review, which they each have the ability to do.

This exemption would not, however, apply to the acquisition of a California domiciled (incorporated) and/or licensed TPA as that transaction would not be subject to a CDI filing and approval. Likewise, as the acquisition of Insurer A, above, is similarly not subject to a CDI Form A review, that transaction, too, would not fall within the filing exemption.

Filing Parties

As concerns who is required to file a Notice with the OHCA, if, for example, the acquiror, the seller and the target company meet the definition of an HCE and the transaction is one of the types listed above, it could be all of such entities. In other words, a single transaction may have multiple Notices filed by various parties who are HCEs that meet the threshold requirements.

Timing of the Notice Review

The Act contains a detailed timeline for various aspects of the Notice review. As there is little precedent as to how the OHCA reviews Notices, at this point, it is difficult to say how closely the OHCA will follow the timeline as it can be extended if the filing is not considered to be complete or for good cause. In any event, the statutory timeline is as follows:

- The Notice filing must be submitted 90 days prior to the proposed closing date of the transaction. There is, however, a procedure for an expedited review.
- The OHCA has 60 days after the filing is deemed to be complete, to decide whether to waive or conduct a Cost and Market Impact Review (CMIR).[1]
    - The submitters then have 10 business days to appeal the OHCA's decision to conduct a CMIR.
- If the appeal is denied, the OHCA has 90 days (subject to 30 day extensions) from its decision to conduct a CMIR to issue its preliminary report.
- The public and the submitter(s) have 10 business days after the preliminary report is issued to provide the OHCA with comments.
- Within 15 days following the close of the public comment period (subject to good cause extensions), the OHCA is to issue its final report or refer the matter to the California Attorney General for further review of any anti-competitive behavior.
    - Should the OHCA issue its final report, the transaction cannot be closed until 60 days thereafter.

Conclusion

In sum, the Act contains a number of other important issues pertaining to matters such as the confidentiality of the Notice filings, how revenue is calculated for purposes of determining if certain of the referenced thresholds have been met, the information to be included in a Notice and the criteria forming the basis of the OHCA's review. In addition, as transactions only recently became subject to the Notice filing requirement in April 2024, it is too early to tell how the filing and review process by the OHCA will unfold in real time. ❂

Note

1. The applicable statute states that the OHCA has 60 days to inform the submitter(s) that it will not conduct a CMIR and the regulations reference a 45 day period. See Cal. Health & Safety Code § 127507.2(a)(5); Cal. Code Regs., Title 22, 97440(a)(1).

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