California Legislature Again Seeks to Restrict Private Equity Investments in Healthcare

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Spurred by the Trump administration's deregulatory actions, states appear poised to promulgate bills aimed at regulating healthcare investments, with some states—such as California—explicitly targeting private equity ("PE").[1] On February 12, 2025, California Senator Christopher Cabaldon introduced Senate Bill 351 ("SB 351" or the "proposed bill"), which aims to broaden the state's existing corporate practice of medicine ("CPOM") restrictions, placing limitations on PE's role in practice management. Stakeholders will find the text of the proposed bill familiar: SB 351 revives a portion of last year's controversial Assembly Bill 3129 ("AB 3129") which, despite undergoing extensive revisions, was ultimately vetoed last September by Governor Gavin Newsom.

Looking Back at AB 3129. AB 3129 would have required PE and hedge fund investors to notify and obtain written consent from the state attorney general ("AG") prior to a change of control or an acquisition involving a private equity group or hedge fund and a healthcare facility or provider group.[2] The initial draft of AB 3129 also included expansive restrictions on practice management: it (i) prohibited PE groups and hedge funds from entering into arrangements that would effectively "control or direct" a physician practice, and (ii) created a blanket prohibition of arrangements between a physician and a PE group, hedge fund or entity under their direct control such as a management services organization ("MSO") for which the PE group or hedge fund manages the day-to-day responsibilities of the physician practice in exchange for a fee.

After receiving significant pushback from stakeholders who voiced concerns that the proposed bill would upend existing MSO arrangements, legislators removed the practice management provision. AB 3129, as amended, was approved by the full legislature but vetoed by Governor Newsom: in his veto memo, the governor vocalized his support for efforts to increase regulatory oversight of the state's healthcare system, but cited

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1 On January 21, 2025, Governor Kathy Hochul released the FY 2026 New York State Executive Budget, which seeks to impose a "cost market impact review" for certain "material transactions" involving "health care entities." Connecticut Governor Ned Lamont quickly followed with Governor's Bill 6873, intended to expand the state's review of healthcare transactions, including those that involve PE.

2 For more information on AB 3129, please see our *Debevoise Debrief – California Lawmakers Target Private Equity and Hedge Fund Investment in Healthcare Entities*.

concerns regarding the redundancy of the bill, given the California Office of Health Care Affordability's ("OHCA's") extant authority to review and evaluate healthcare transactions. The governor did not, of course, state his office's position on the broadening of practice management restrictions—those bill provisions had been left on the cutting room floor.

Overview of the CPOM Doctrine and the Potential Impact of SB 351. CPOM is a legal principle that prohibits non-medical persons and entities from practicing medicine to ensure that clinical decision-making is focused on the best interests of the patient. In states that have adopted some form of CPOM, the doctrine may be codified in statutes, established by case law, or promulgated by medical board guidance. California has codified its CPOM prohibition primarily through Business and Professions Code § 2052 (which makes it unlawful for any person to practice medicine without a license) and § 2400 (which states that non-professional entities cannot practice medicine or employ physicians absent an enumerated exception). The statutory prohibition is reinforced by extensive CPOM guidelines promulgated by the Medical Board of California, which has been active in investigating and taking disciplinary action against physicians who enter into improper arrangements. Moreover, California courts have been poised to unwind aspects of the ubiquitous "friendly physician" arrangement: American Academy of Emergency Medicine Physician Group Inc. ("AAEM-PG") recently settled a lawsuit against Envision Healthcare Corporation alleging, among other things, that the MSO exercised undo control over physicians' clinical decision-making in violation of CPOM.[3]

SB 351 includes provisions that, if enacted, would impact PE's role in practice management.[4] Echoing extant CPOM doctrine, the proposed bill prohibits a PE group "involved in any manner with a physician or dental practice . . . including as an investor" from interfering with the professional judgment of healthcare professionals in clinical decision making or having control over responsibilities that fall under the expertise of healthcare professionals, including with respect to: diagnostic testing, referrals, the number of patients seen, patient records, the hiring or termination of clinical staff, the

3 Because the matter settled, the court did not issue a final judgement on the merits of the case; AAEM-PG maintains, however, that the court appeared poised to find certain transfer restrictions and restrictive covenants violative of *CPOM*. *AAEM-PG v. Envision Healthcare Corp.*, No. 18-2, N.D.Cal (2023); see also the AAEM-PG press release.

4 SB 351 borrows the definitions of "Private Equity Group" and "Hedge Fund" from AB 3129. "Private Equity Group" is defined as "an investor or group of investors who primarily engage in the raising or returning of capital and who invests, develops or disposes of specified assets" and does not include "natural persons or other entities that contribute, or promise to contribute, funds to the private equity group, but otherwise do not participate in the management of the private equity group or the group's assets, or in any change in control of the private equity group or the group's assets" and "Hedge Fund" is defined as "a pool of funds by investors, including a pool of funds managed or controlled by private limited partnerships, if those investors or the management of that pool or private limited partnership employ investment strategies of any kind to earn a return on that pool of funds."

selection of medical equipment and supplies, billing procedures and contracts with third-party payors. SB 351 also prohibits the use of non-compete and non-disparagement clauses in any contract involving (i) the management of a physician or dental practice by a PE group or hedge fund, or (ii) the sale of real estate or other assets owned by a physician or dental practice to a PE group or hedge fund; such prohibitions are not readily inferred from existing statutory or case law and would be an expansion of extant CPOM doctrine.[5]

As currently drafted, SB 351 does not appear only *prospectively* applicable (i.e., to arrangements entered into after its effective date): without an explicit grandfather clause, existing arrangements would likely be subject to enforcement. Further, because the proposed bill entitles the AG to injunctive relief and other equitable remedies, the AG will be poised to actively oversee PE involvement in practice management and, in turn, provider groups that find their management arrangements disadvantageous will be better empowered to seek remedy.

Looking Ahead. The fate of SB 351 remains unclear. Because the proposed bill attempts to revive a highly contested and ultimately deleted portion of AB 3129, SB 351 is likely to again incite pushback from stakeholders. Legislators may respond by amending the proposed bill to ensure it will not upend existing MSO arrangements—for example, by allowing an MSO to negotiate payor contracts and set rate structures, by grandfathering existing arrangements, or by providing investors an opportunity to exit the market before the proposed bill takes effect. If SB 351 is approved by the full legislature, there is an outside chance that Governor Newsom would choose to veto, particularly given his lack of support for AB 3129. That said, as we have earlier discussed, the governor's veto of AB 3129 was based on the perceived redundancy of creating two parallel healthcare transaction review processes: his office did not opine on practice management, the subject of SB 351.

SB 351 is likely to receive significant pushback from industry stakeholders, particularly given its targeted application to particular groups of investors. While the proposed bill largely reads as a codification of extant law, if passed, investors should expect increased CPOM enforcement risk, as well as potential financial and operational impacts. We will

[5] The proposed ban of non-competes is consistent with other recently enacted state laws. California has expanded its comprehensive ban on non-competes through two new laws that took effect on January 1, 2024: (i) AB 1076 goes beyond existing law that renders non-compete clauses void and unenforceable, making them illegal; and (ii) SB 699, makes any non-compete agreement void and unenforceable regardless of when the contract was signed or whether it was signed in California. SB 699 further provides for current and former employees (those employed after January 1, 2022) or prospective employees to bring a private right of action to enforce the prohibition on non-compete agreements.

continue to monitor the status of this proposed legislation and similar legislative developments.

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Please do not hesitate to contact us with any questions.

Andrew L. Bab
Partner, New York
+1 212 909 6323
albab@debevoise.com

Jennifer L. Chu
Partner, New York
+1 212 909 6305
jlchu@debevoise.com

Kevin Rinker
Partner, New York
+1 212 909 6569
karinker@debevoise.com

Kim T. Le
Counsel, San Francisco
+1 415 738 5706
kle@debevoise.com

Hannah R. Levine
Associate, New York
+1 212 909 6095
hrlevine@debevoise.com

Mackenzie Mendolla
Associate, New York
+ 1 212 909 6620
mkmendolla@debevoise.com