

Post-Mortem Reflection on SB 977: The Significance of What Could've and Should've Been

In the 2020 legislative session, California attempted to markedly expand the attorney general's (AG) powers to intervene in healthcare acquisitions and changes of control. Senate Bill (SB) 977 would have required AG approval before for-profit healthcare entities could consolidate in California. The passage of SB 977 would have been historic and a massive step in antitrust enforcement in the healthcare industry. Unfortunately, SB 977 failed this session without ever being discussed in the Assembly or the Senate. In this post, we review what SB 977 could have done, why it was significant, and what happened to prevent the passage of this consequential legislation.

What Did SB 977 Propose to Do?

SB 977 was a legislative attempt to curb the trend of unprecedented consolidation of healthcare entities in California. Had it passed, it would have been the most far-reaching healthcare antitrust law in the United States. The bill proposed to require certain healthcare parties to provide written notice and obtain the written consent of the AG prior to engaging in an acquisition or change of control. The AG would have 60 days to review the transaction and either approve or deny the transaction.[\[1\]](#) The table below lays out the parties and transactions subject to SB 977:

	Who/What	Definition
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Buyers	Health care systems	An entity or system of entities that includes or owns three or more hospitals in California, of which at least one is a general acute hospital
	Private equity groups	An investor or group of investors who engage in the raising or returning of capital and who invest, develop, or dispose of specified assets.
	Hedge funds	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.
Sellers	Health care facilities	A facility, nonprofit or for-profit corporation, institution, clinic, place, or building where health-related physician, surgery, or laboratory services are provided
	Health care providers	An individual or group of individuals that provides health-related physician, surgery, or laboratory services to consumers

Transactions	Change of control	An arrangement in which a health care system establishes a change in governance or sharing of control over health care services provided by that health care facility or provider, or in which a health care system otherwise acquires direct or indirect control over the operations of a health care facility or provider in whole or in substantial part
	Acquisition between the entity and a health care facility or provider	The direct or indirect purchase in any manner, including, but not limited to, lease, transfer, exchange, option, receipt of a conveyance, creation of a joint venture, or any other manner of purchase, by a health care system, private equity group, or hedge fund of a material amount of the assets or operations of a health care facility or provider

Notably, the final bill was amended from the original version which would have included a broader scope of parties and transactions. In the original bill, the definition of “provider” included any licensed health care professional, such as nurses, pharmacists, chiropractors, etc. The amended version limited “provider” to “health-related physician, surgery, or laboratory services” only.[\[2\]](#) The original version of the bill also required “affiliations” as a transaction that would require AG approval. “Affiliation” under the original bill meant an “agreement, association, partnership, joint venture, or other arrangement that results in a change of governance or control.”[\[3\]](#) The amended version,

on the other hand, included only a “change of control”, which is a much narrower type of transaction.

Specifically, the bill authorizes the AG to deny consent to a change of control or an acquisition affecting relevant parties, unless the parties demonstrate that:

- The transaction will result in a substantial likelihood of clinical integration[\[4\]](#);
- The transaction will result in a substantial likelihood of increasing or maintaining the availability and access of services to an underserved population; or
- The transaction will result in a substantial likelihood of both of the above.[\[5\]](#)

The bill also authorizes the AG to deny consent to a change of control or an acquisition between parties if there was a “substantial likelihood of anticompetitive effects that outweighed the benefits of a substantial likelihood of clinical integration, a substantial likelihood of an increase in, or maintenance of, services to an underserved population, or both.”[\[6\]](#) A substantial likelihood of anticompetitive effects in providing hospital or health care services includes a “substantial likelihood of raising market prices, diminishing quality, reducing choice, or diminishing availability of, or diminishing access to, hospital or health care services.”[\[7\]](#)

When making the determination whether to grant or deny consent, SB 977 requires the AG to use the “public interest standard.” The bill defines public interest as being in the interest of the public in “protecting competitive and accessible health care markets for prices, quality, choice, accessibility and availability.”[\[8\]](#)

Finally, the bill requires the AG to establish a Health Policy Advisory Board (the “Board”) to evaluate and analyze health care markets in California and provide recommendations to the

AG's office. The Board would be authorized to review the written notifications submitted by the parties to the transaction, in order to provide the AG with information on whether to consent to the change of control or acquisition.

Why Was SB 977 So Important?

Studies show that when hospitals and physician groups consolidate, consumers experience price increases of 20-44% in both inpatient and outpatient services[\[9\]](#) due to higher market concentration and increased market power.[\[10\]](#) Not only does consolidation increase costs, additional research indicates that horizontal mergers are associated with reductions of quality,[\[11\]](#) while vertical consolidation often failed to show the promised quality improvements or efficiencies.[\[12\]](#) Despite the evidence, healthcare consolidation has continued at an alarming rate. In 2018, a study completed by the UC Berkeley's Petris Center showed nearly 95% of hospital markets were highly concentrated.[\[13\]](#)

However, few state AG's receive prior notice of mergers and many healthcare mergers fall under the Hart-Scott-Rodino Act, which leaves antitrust enforcement to the federal government.[\[14\]](#) Prior to the introduction of SB 977, California legislation allows the state AG to intervene in the consolidation of nonprofit health care organizations. Notably, transactions involving only for-profit organizations are omitted and do not require notice or AG approval. For such transactions, the AG has the power to challenge any merger through litigation. While this can be done through federal antitrust law, including the Sherman and Clayton Antitrust Acts, or California's Cartwright Act, relying solely on antitrust litigation to prevent further consolidation and anticompetitive behavior is ineffective. While they have the potential to be highly successful, enforcement cases like the Sutter Health case require an immense amount of time and

resources.[\[15\]](#) As such, legislation provides a quicker and more efficient remedy of blocking anticompetitive behavior before its effects harm consumers.

As existing California merger review authority is limited to transactions involving nonprofit organizations, SB 977 was an important piece of legislation because it attempted to give the state AG enhanced power to review and receive notice of acquisitions and changes of control of essentially all major healthcare entities, including for-profit health care systems, private equity groups, and hedge funds. SB 977 is consequential as it fills in an important gap in existing legislation by requiring AG notice and prior approval in acquisitions of physician practices and clinics by health systems, hedge funds and private equity, which is a big change from current practice.

Additionally, SB 977 also proposed to create new antitrust liability for health care systems with substantial market power when its conduct involved tying or exclusive dealing, or a substantial tendency to cause anticompetitive effects.[\[16\]](#)

The legislation would give the AG additional powers to both police and fine systems for such anticompetitive conduct. Finally, the legislation also proposed to establish the Health Policy Advisory Board, a new agency that would review mergers when requested by the AG and provide assistance to the AG with information on whether to grant or deny consent to the transaction.

Professor Tim Greaney, a Health Law professor at UC Hastings College of the Law, explained that SB 977 was a “major change and major transfer of power to the AG in California. It was a landmark legislation because it gave the AG the power of prior approval of both for profit and nonprofit mergers. It also enhanced the power of the attorney general by giving the office broad discretion by expanding the substantive review beyond antitrust principles to include broader public interest considerations. The justification for this bold move is that

antitrust is more or less a paper tiger when it comes to concentrated health systems. Once they acquire market power, unless they engage in improper conduct to maintain that power, nothing in antitrust law stops them from charging high prices. In short, you can't trust antitrust [litigation] alone to prevent this abuse of power, which is a sound reason for this legislation."

How Did it Fail and What's Next?

Unfortunately, SB 977 failed to pass at the end of the 2020 legislative session. The bill passed the Assembly Appropriations Committee, was read a second time in the Senate, and then ordered to a third reading, which is required to qualify the bill for the floor vote. While SB 977 was read for the third time, it never reached a floor vote and was left to die as the midnight deadline was reached.

There are likely a number of reasons that SB 977 failed to become law. The legislation unquestionably gives the Attorney General a substantial amount of power over healthcare transactions, which gave healthcare entities cause for concern. As such, the bill was strongly opposed by a large number of hospitals, physician groups, and organizations, including the California Hospital Association (CHA), the California Medical Association (CMA), and the American Investment Council, private equity's largest trade and lobbying group. Carmela Coyle, CHA's Chief Executive, said it was a dangerous measure that gave too much power to the Attorney General, and CMA stressed that it was overbroad and could force smaller practices out of business.[\[17\]](#) The opposition of such large and powerful organizations and lobbyists undoubtedly played a role in the bill's failure.

Opponents of SB 977 also argued that the bill could make it harder for smaller healthcare facilities and provider groups

to merge with larger healthcare systems as a last resort if they were going out of business. However, under the antitrust law “failing company doctrine”, mergers that may otherwise not be permissible are allowed to go forward where the firms face imminent bankruptcy and there are no less anticompetitive alternative buyers. While it’s relatively difficult for companies to successfully invoke this defense, it’s hard to see how the regulatory structure of SB 977 creates higher barriers for failing firms. If anything, the broad discretion given to the AG to take into account market conditions would seem to leave ample opportunity to consider the effects of allowing distressed hospitals to merge.

There is a possibility that it will be reintroduced when the California Legislature reconvenes on December 7, for the commencement of the 2021-2022 legislative term. Only time will tell if SB 977 re-emerges in the upcoming legislative term.

The opposition to broadening consolidation review authority is strong, so legislators interested in enhancing the A.G.’s antitrust review will need to leverage the compelling economic evidence of the effect of healthcare consolidation against the loud and influential voices of lobbyists. If reintroduced, the bill will need to be sponsored by a legislator other than the original sponsor Senator Monning, who is leaving the Senate this year after reaching his term limit.

Nonetheless, SB 977 was an unparalleled and commendable attempt at strengthening merger review authority and could foreshadow the future of antitrust legislation governing healthcare entities. It took thirteen years of multiple bills for California to finally pass an all-payers claim database mandate, so while the road ahead may be long, stricter antitrust law in California shouldn’t be written off as a lost cause.

[1] S.B. 977, 2020 Leg., Reg. Sess. (Ca. 2020).

[2] *Id.*

[3] *Id.*

[4] Clinical integration, according to SB 977, means a “showing by the health care system, private equity group, or hedge fund making a change of control with or acquiring the health care facility that there will likely be a reduction in costs to the benefit of consumer care and outcomes or an increase in the quality of care as a result of the acquisition or change of control.”

[5] S.B. 977, *supra* note 1.

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] Richard M. Scheffler, Daniel R. Arnold, Brent D. Fulton, The Sky’s the Limit- Health Care Prices and Market Consolidation in California, California Health Care Found. (2019), <https://www.chcf.org/publication/the-skys-the-limit/#market-concentration>.

[10] Martin Gaynor & Robert Town, Robert Wood Johnson Found., The Impact of Hospital Consolidation—Update (2012), http://www.rwjf.org/content/dam/farm/reports/issue_briefs/2012/rwjf73261.

[11] *Id.*

[12] Marah N. Short & Vivian Ho, Weighing the Effects of Vertical Integration Versus Market Concentration on Hospital Quality, Medical Care Research and Rev. 1 (2019), <https://journals.sagepub.com/doi/pdf/10.1177/1077558719828938>.

[13] *Diagnosis: Opaque Donald Trump Wants Hospitals to be More Upfront About Prices*, THE ECONOMIST (November 21, 2019), <https://www.economist.com/business/2019/11/21/donald-trump-wants-hospitals-to-be-more-upfront-about-prices>.

[14] The Hart-Scott-Rodino Act requires parties to certain large mergers and acquisitions to provide the Federal Trade Commission and the Department of Justice with premerger notice.

[15] Sutter Health was accused of violating California antitrust law by using its market power to increase costs. Sutter Health was sued by self-funded employers and the case was later joined by the state AG, Xavier Becerra. It ultimately settled moments before opening statements were set to begin. More about the Sutter Health case can be found [here](#).

[16] S.B. 977, *supra* note 1.

[17] Chris Cumming, *California Bill to Rein In Private-Equity Health-Care Buyouts Dies*, The Wall Street Journal (2020), <https://www.wsj.com/articles/california-bill-to-rein-in-private-equity-health-care-buyouts-dies-11599250052>.