CLIENT ALERTS & INSIGHTS

California Enacts SB 351: New Restrictions on Private Equity and Hedge Fund Involvement in Physician and Dental Practices

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Key Takeaways

- **Codification of CPOM Restrictions:** SB 351 (effective January 1, 2026) codifies and expands California's corporate practice of medicine/dentistry rules, specifically targeting private equity and hedge fund involvement in physician and dental practices.
- **Limits on MSO/DSO Involvement:** Management companies may not participate in billing, coding, equipment selection or clinical staff oversight and must avoid any influence over clinical judgment or patient care decisions.
- **Restrictive Covenants Curtailed:** Non-compete and non-disparagement clauses in provider employment agreements are unenforceable, with only narrow exceptions for sale-of-business covenants and confidentiality clauses.
- **Compliance Review Required:** Investors, MSOs, and DSOs should closely review contracts, governance structures and compliance programs and revise them to align with SB 351 before the January 1, 2026, effective date.

Background

On October 6, 2025, after multiple rounds of amendments, California Governor Gavin Newsom signed into law Senate Bill 351 (SB 351), a significant measure that strengthens restrictions on the corporate practice of medicine (CPOM) and dentistry (CPOD) in California. Effective January 1, 2026, SB 351 prohibits private equity groups and hedge funds from interfering with professional medical or dental judgment and from exercising control over certain clinical or administrative activities. SB 351 formalizes, through statute, many of the restrictions that previously existed only through case law and regulatory interpretation under California's long-standing CPOM and CPOD prohibitions.

Key Provisions of SB 351

1. Prohibition on Interference with Clinical Judgment

Under SB 351, a private equity group or hedge fund involved in any manner with a physician or dental practice, including as an investor or owner of assets, may not interfere with professional medical or dental judgment, including decisions regarding:

- Determination of appropriate diagnostic testing and treatment options
- Determination of patient referrals and consultations
- Responsibility for patient care management
- Setting physician or dentist schedules, including patient volume or appointment quotas

2. Prohibition on Exercising Control over Clinical and Certain Administrative Operations

Private equity groups and hedge funds are also prohibited from exercising control or being delegated authority over:

- Patient medical record ownership and content
- Hiring, firing or evaluation of physicians and dentists, including allied health staff and medical assistants
- Contracting parameters with third party payers or other providers
- Billing and coding decisions
- Selection and approval of medical equipment or supplies

Importantly, these restrictions apply whether the practice entity was organized as a sole proprietorship, partnership, foundation or corporate entity.

3. Contractual Prohibitions and Enforcement

SB 351 further prohibits certain contractual restrictions, including non-compete and non-disparagement clauses that would prevent physicians or dentists from competing or commenting on practice operations related to care quality or ethical concerns. Limited exceptions exist for legitimate sale-of-business noncompete agreements and confidentiality clauses protecting material nonpublic information, however such exceptions do not apply to provider employment agreements.

Impact on MSOs and DSOs Operating in California

The law has significant implications for private equity backed management services organizations (MSOs) and dental service organizations (DSOs) that partner with licensed professionals to provide administrative services on behalf of a medical or dental practice.

As discussed above, SB 351 imposes limits on the available contractual remedies for private equity backed MSOs and DSOs and renders employee noncompete and non-disparagement clauses unenforceable when used to restrict licensed providers affiliated through “friendly” ownership structures. In addition, MSOs and DSOs are prohibited from determining how many patients a

physician or dentist shall see in a given period of time or how many hours a physician or dentist shall work, which may directly impact how current employment agreements are structured.

Moreover, SB 351 further narrows the scope of permissible "administrative" functions. MSOs and DSOs may not participate in billing, coding or equipment-selection decisions and are restricted from hiring, firing or supervising clinical personnel, including allied health professionals and medical assistants, when those actions are tied to clinical competency or patient care standards.

While SB 351 does not fundamentally alter California's CPOM or CPOD framework, it codifies and expands its reach, signaling greater state oversight of private equity and the involvement of MSOs/DSOs in healthcare delivery. Private equity funds investing in California medical and dental practices and enterprises should anticipate closer examination of their investment structures and the management of the enterprises in which they invest.

Compliance Considerations and Recommended Actions

In light of the above, private equity firms, hedge funds, MSOs and DSOs should consider proactive compliance reviews in preparation for SB 351's January 1, 2026, effective date, including:

- **Review and Update Existing Arrangements:** Evaluate management and administrative service agreements, employment agreements and investment structures (including "friendly" PC/MSO models) to ensure that such agreements do not confer unauthorized control over clinical or billing decisions or otherwise infringe on professional judgment of medical and dental providers.
- **Assess Contractual Provisions:** Revisit non-compete, non-disparagement and confidentiality clauses in existing agreements to confirm they align with the restrictions and exceptions in SB 351. Eliminate provisions that dictate patient volume, productivity quotas or hours worked that could be construed as control over clinical judgment.
- **Audit Operational Functions**: Identify and modify provisions that could be viewed to allow for inappropriate MSO/DSO involvement in billing, coding, payer contracting or equipment selection functions that SB 351 now reserves for licensed professionals.
- **Implement Compliance Training**: Provide education for executives, managers and clinical leadership on SB 351's requirements, particularly around what functions remain permissible for MSOs/DSOs and what must be left exclusively to licensed professionals.
- **Plan for Enforcement Risk**: Anticipate potential state regulatory scrutiny or whistleblower complaints. Consider whether indemnification, disclosure or exit provisions in investment documents need to be updated or modified to account for heightened CPOM enforcement risk.
- **Monitor Guidance**: Track forthcoming regulations, Attorney General opinions and enforcement actions interpreting SB 351, as additional detail may shape compliance expectations before and after January 1, 2026.