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Understanding the Corporate Practice of Medicine Doctrine and the Role of the Management Services Organization

Both California physicians and businesses that wish to do business with them are often confused about the parameters of what California law permits. Where, for example, are the lines defining what decisions physicians, as opposed to unlicensed business managers, must control? What financial relationships are permissible? How much control can management entities assert over medical businesses?

Understanding these questions is essential to structuring medical business and management service entities in accordance with the law. The first section of this article explains the constraints on ownership of medical businesses imposed by the corporate practice of medicine doctrine. The second section of the article details the role of the professional medical corporation, which is the only business entity permitted to provide medical services or employ physicians in California. Finally, the third section reviews the role of the management services organization, and addresses the relationship between management entities and professional corporations under California law.

A. The Corporate Practice of Medicine Doctrine

The corporate practice of medicine doctrine (CPOM) is often regarded as an odd feature of the healthcare law landscape. A product of the Nineteenth Century, CPOM encapsulates the principle that physicians must make decisions autonomously. Although its application varies in the roughly 30 states that follow CPOM, the basic idea is that a business corporation may not practice medicine or employ physicians or other clinical personnel to provide professional medical services.

The rationale underlying CPOM is that physicians, as the only persons licensed to practice medicine, should control clinical decisions; the concern is that, if business entities owned by non-physicians are permitted to control the rendering of care, they will subordinate clinical care to commercial considerations and profits. The objective, therefore, is to prevent non-physicians and non-physician-owned business entities from influencing treatment decisions.

In the states that follow the CPOM, physicians – or other licensed health professionals – may provide medical services only through a professional corporation owned by professionals licensed in that state. California [1] is commonly regarded as among the most aggressive of the CPOM states, which include Arizona [2], Arkansas [3], Colorado [4], Georgia [5], Illinois [6], Indiana [7], Iowa [8], Kansas [9], Kentucky [10], Louisiana [11], Maryland [12], Massachusetts [13], Michigan [14], Minnesota [15], Montana [16], Nevada [17], New Jersey [18], New York [19], North Carolina [20], North Dakota, [21], Ohio [22], Oregon [23], Pennsylvania [24], South Carolina [25], South Dakota [26], Tennessee [27], Texas [28], Washington [29], West Virginia [30], and Wisconsin [31]. Of the remaining roughly 20 states that have not explicitly adopted the CPOM, many have nonetheless issued pronouncements that echo CPOM principles.

The application of the CPOM varies from jurisdiction to jurisdiction. Since physicians are licensed by individual states, the right to practice is typically dependent upon both individual physician licensure in the particular state and compliance by the business entity with the requirements for professional medical corporations in the state.

The CPOM presents a significant constraint to physician business ventures. Specifically, if physicians or other clinical personnel work for entities other than professional medical corporations, they may be exposed to disciplinary risks, as well as to forfeiture of revenues from payors for services rendered. For non-physician business partners, violating the CPOM may also bring both civil and, in extreme cases, potential criminal liability for engaging in medical practice without a license.

In California, the solution for avoiding violations of the CPOM in business ventures in which physicians work with

businesses owned by unlicensed persons is a contractual relationship between the physician entity and the unlicensed business entity. The following sections discuss the requirements for professional medical corporations and management services organizations.

B. The California Professional Medical Corporation

The State of California is generally regarded as an active enforcer of the CPOM. Although there is a general prohibition on the practice of medicine by corporations, the Moscone-Knox Act is the section of the California Corporations Code that establishes the right of physicians to incorporate and operate professional medical corporations (PC's).

In general, lawfully constituted PC's are the only entities in California that may receive payment from patients for physician services and employ or supervise the rendering of services by medical personnel. By law, in California, a PC must be at least 51% owned by a physician or physicians licensed in the state; up to 49% may be owned by specified other types of healthcare licensees, such as registered nurses, physician assistants, and chiropractors. [32] Non-physicians are prohibited from owning any shares of a PC. The PC is the only entity permitted as a care delivery mechanism for physicians; physicians may not deliver medical services via a limited liability company in California.

Professional medical corporations are the only business entities in California that are permitted to enroll in both federal health programs and private payor health plans to receive reimbursement for physician services. The direct receipt of payments for physicians services by entities other than PC's is generally prohibited, and may constitute either the unlicensed practice of medicine or prohibited fee-splitting to the extent that unlicensed business owners share employ or share proceeds with physician "employees."

While professional corporations are not licensed separately from their individual shareholders, they are regulated by the professional licensing boards, for example through the issuance of fictitious name permits, which are required for the PC to operate under any name other than the physician's actual name. The Medical Board of California is typically the regulatory agency that polices medical businesses, in association with local law enforcement, to ensure compliance with CPOM principles. It is essential for physicians to understand the numerous restrictions that apply to the operation of PC's. In addition to state licensing concerns, PC's must be sensitive to other restrictions, including requirements of federal health programs (Medicare/Medi-Cal), marketing restrictions imposed by federal and state law, and numerous other regulatory concerns.

C. The Role of the Management Services Organization

The management services organization (MSO) has emerged as a business vehicle that permits unlicensed persons to provide services to physicians and their professional medical corporations. In its simplest form, an MSO provides basic practice support services to physicians and professional medical corporations via a contractual relationship, commonly known as a management services agreement. These services frequently include activities such as billing and collection, administrative support in certain areas, and electronic data interchange (e.g. electronic billing). Some MSO's provide a broader set of services: the MSO may purchase many of the assets in a medical practice, such as office space or equipment. MSO's can employ office support staff, and assist with a wide range of non-clinical functions. MSO's can also assist in functions such as marketing. Often, MSO's can reduce costs by bringing economies of scale and professional management experience into physician practices, thereby improving operational efficiency and reducing overhead costs.

Based on the CPOM principles articulated above, it is critical to understand the lines between what a physician or PC must control, as opposed to what the MSO may control. For example, it is critical to ensure that, at all times, physicians and/or physician-owned medical corporations control clinical decisions. These include selection, oversight, and termination of all clinical personnel, oversight of treatment options, and choices as to medical equipment and supplies. These and related services may not be delegated to an unlicensed person or to a MSO. While physicians and PC's are free to consult with MSO's in making business decisions, it is essential that ultimate responsibility for decisions remains with the physician. Physicians and PC's need to remember that they will be held accountable to regulators for the conduct of the MSO.

While physicians may elect to contract with MSO's to receive services for fixed fees, in certain circumstances, the MSO may receive percentages of revenues of medical practice in exchange for their services. Indeed, California law specifically recognizes the permissibility of physicians (including PC's) paying unlicensed persons percentages

of gross revenue for services, provided that the payment is reasonably commensurate with the value of the services and not simply a payment for patient referrals.[33]. It is critical to distinguish between gross and net revenue, which is not permitted to be shared between PC's and MSO's. In addition, in many cases, the law may constrain the right of MSO's to receive revenue percentages, such as in cases where the MSO generates patient referrals. Federal health programs, for example, prohibit payment arrangements which amount to payments for the value or volume of patients.

D. Conclusion

Although the corporate practice of medicine doctrine places significant limits upon the operation of medical practices, a wide range of services and business relationships between physicians and non-physicians remain viable. The construct of the contractual relationship between a professional medical corporation and a management services organization is a fundamental building block of such relationships. With appropriate guidance to ensure that the relationship is structured lawfully, physicians and non-physicians can work closely together to build successful and profitable business ventures.

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[1] Cal. B&P Code Section 2400 *et seq*.
[2] Ariz. Rev. Stat. Section 10-2201 *et seq*.
[3] Ark. Code Section 4-29-301 *et seq.*
[4] Colo. Rev. Stat. Section 12-36-134 *et seq.*
[5] Ga. Code Section 33-18-17.
[6] *Carter-Shields, M.D. v. Alton Health Inst.*, 777 N.E.2d 948 (Ill. 2002)
[7] Ind. Code Section 25-22.5-1-2
[8] Iowa Code Section 147.1101 *et seq.*
[9] Kan. Stat. Ann. Section 65-2801 *et seq.*
[10] Ky. Rev. Stat. Ann. Sections 311.560 and 311.565
[11] La. Rev. Stat. Ann. Section 37:1271-101.
[12] Md. Code, Health Occ. Law Sections 14-101 – 14-702.
[13] Mass. Gen. Laws, ch. 112 Section 2-101 and ch. 156A Section 2-101.
[14] Mich. Atty Gen. Op. Nos. 6592 (1989), 6770 (1993).
[15] Minn. Atty Gen. Op. No. 92-B-11 (1955).
[16] Mont. Code Ann. Section 37-3-322.
[17] Nev. Rev. Stat. Chs. 78 and 89.
[18] N.J. Code Section 13:35-6.16(f).
[19] N.Y. Educ. Law Section 6527.
[20] 33 N.C. Att'y. Gen. Bienn. Rep. No. 43 (1955).
[21] N.D. Cent. Code Section 43-17-42.
[22] Ohio Rev. Code Sections 4731 *et seq*. and 1785.02.
[23] *State ex rel. Sisemore v. Standard Optical Co.*, 182 Or. 452, 188 P.2d (1947).
[24] 63 Pa. Cons. Stat. Section 422.1 *et seq*.
[25] *Ezell v. Ritholz*, 188 S.C. 39, 198 S.E. 419 (S.C. 1938).
[26] S.D. Codified Laws Section 36-4-8.1.
[27] Tenn. Code Ann. Section 63-6-201.
[28] Tex. Rev. Civ. Stat. Ann. art. 4495b, Section 3.06 – 3.08 and 5.01
[29] Wash. Rev. Code Ann. Section 18.71.021 and 18.100 *et seq*.
[30] W. Va. Code Section 30-3-15(b).
[31] Wis. Att'y. Gen. Op. No. 39-86 (1986).
[32] California Corporations Code Section 13401.5 *et seq.*
[33] California Business & Professions CodeSection 650.