Illegal Fee-Splitting or Acceptable Business Practice? Court of Appeals Notes "Flexibility" in Section 650 of California B & P Code

Although at first glance *Epic Medical Management, LLC v. Paquette* is a dispute over fees owed by a physician to a management service organization (MSO), the case deserves a closer look for healthcare providers, especially where it intersects with Section 650 of the California Business and Professions Code—namely, the anti-kickback statute therein.

The MSO's fee arrangement: 120 becomes 50-25-75

In *Epic Medical Management, LLC v. Paquette,* the physician had contracted with the MSO to provide management services for the medical practice, including billing and accounting, marketing, office space, equipment, non-physician personnel, and other services. The contract stipulated that the MSO would receive 120% of the costs it incurred each month (but not to surpass 50% of the collected professional revenue and 25% of the collected surgical revenue). However, this formula was not the one adhered to by the parties. Rather, the fee structure used in actuality had the doctor paying the MSO 50% of the revenue for office medical services, 25% of the revenue for surgical services and 75% of the revenue for pharmaceutical services.

The engagement continued at those modified rates for three-and-a-half years, at which point the doctor terminated the agreement. With both parties believing they were owed compensation (the physician because he felt the MSO had not satisfactorily performed its duties; the MSO because it had not been paid for the entirety of the service period), they moved to arbitration.

Arbitration, Section 650, and the enforceability of the parties' fee arrangement

At the arbitration hearing, among other points, the physician attempted to have the contract deemed illegal and unenforceable, citing California Business & Professions Code Section 650 and its prohibition of referrals.

California Business & Professions Code Section 650 (a) provides: "…the offer, delivery, receipt, or acceptance by any person licensed under this division or the Chiropractic Initiative Act of any rebate, refund, commission, preference, patronage dividend, discount, or other consideration, whether in the form of money or otherwise, as compensation or inducement for referring patients, clients, or customers to any person, irrespective of any membership, proprietary interest, or co-ownership in or with any person to whom these patients, clients, or customers are referred is unlawful."

The doctor noted that since some of the MSO's fees were paid for marketing services, any compensation the organization received associated with those patients fell under the purview of a kickback scheme, rendering the underlying agreement illegal.

The MSO had indeed generated occasional referrals to the doctor during the time they'd been affiliated, and although the arbitrator did not completely disagree with the physician's reasoning as it was applied to Section 650, she determined that the referrals represented a small enough percentage of the overall business that if any violation had occurred, it was "technical" and would not undermine the award. She found the doctor had breached the contract between the parties and awarded the MSO the unpaid compensation it sought, albeit compensation based on the formula the parties had exercised over the three-and-a-half years, rather than the formula stipulated in the contract.

The physician moved to vacate the award, again pointing to the illegality of the arrangement under Section 650. Further, he claimed that the arbitrator had overstepped her role when she enforced a formula not memorialized in the contract. Denying the doctor's request to vacate, the trial court confirmed the award, underscoring the arbitrator's interpretation of any potential illegality regarding referrals as "technical" in nature. The court also concluded that the arbitrator had not exceeded her power when she "reasonably" interpreted the contract in light of the parties' own conduct regarding the fee schedule.

Void as a matter of public policy?

The physician appealed to the California Court of Appeals, Second Appellate District, where he argued that state public policy had been transgressed through behavior he categorized as illegal kickbacks. Once again, the arbitrator's determination was upheld: the Court found that the award was not subject to review, based, in part, on the opinion that the "award is not reviewable for illegality in the entirety."

In the words of the Court: "Even assuming, for the moment, that the doctor is correct and that payment to the management company according to the 50-25-75 method constitutes kickbacks for referrals, this does not go to the entirety of the contract. Referral patients were a small percentage of the patients seen while the doctor and management company were operating pursuant to the agreement. The agreement was not a referral agreement, but one for management services, of which referrals played only an incidental part."

Finding that the payments in question were of a type permitted under the Code, the Court cited Section 650 (b): "The payment or receipt of consideration for services other than the referral of patients which is based on a percentage of gross revenue or similar type of contractual arrangement shall not be unlawful if the consideration is commensurate with the value of the services furnished or with the fair rental value of any premises or equipment leased or provided by the recipient to the payer."

The Court found no clear transgression of California public policy, stating: "…subdivision (b) permits *precisely* the arrangement contemplated by the modified agreement – payment to a management company for management services based on a percentage of revenue – as long as the consideration is commensurate with the value of the services furnished (and facilities and equipment leased). Given this flexibility in section 650, there is no absolute prohibition on consideration being paid a management company – even one which occasionally refers patients."

Further, the Court of Appeals confirmed the arbitrator's right to use the un-memorialized compensation formula that the physician and MSO had in fact used, noting that "the arbitrator did not modify the agreement; she concluded that, by their practice, the parties had done so."

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