Preserving Professionalism—MSO Activities Curtailed by Corporate Practice of Medicine Prohibition

General Overview
The corporate practice of medicine prohibition is alive and well, at least according to a recent California Attorney General opinion reiterating that only licensed physicians can practice medicine, and a recent New York federal court case finding a fee-splitting violation by a physician making payment to a management services organization (MSO).

The corporate practice of medicine prohibition generally precludes unlicensed entities from engaging in the practice of medicine, which in many states is defined broadly to include medical decision-making and any activities, including administrative activities, that involve medical judgment. Fee-splitting prohibitions generally place limits on how licensees may use their professional fees, typically prohibiting sharing of professional fees with non-professional or unlicensed entities.

Ban on Corporate Practice of Medicine and Fee-Splitting
The corporate practice of medicine is banned in California by law. First, the practice of medicine in California requires a license. Cal. Bus. & Prof. Code sections 2051—2053. Generally, only natural persons, not corporations, may hold such licenses. Cal. Bus. & Prof. Code sections 2032, 2400. Thus, corporations may not engage in activities that require the exercise of medical judgment unless subject to an exception to the corporate practice of medicine prohibition. The rationale for this ban is to preserve the professional relationship between doctor and patient, which is based on trust and confidence, and which could be destroyed by the divided loyalties and lack of ethical constraints that the imposition of a lay entity could bring.

Similarly, fee splitting is prohibited in New York by law. Physicians may not split their professional fees with non-licensed entities. See New York Education Law sections 6530 and 6531. Likewise, arrangements involving payments based on a percentage of professional fees are also prohibited. See New York Admn. Code, title 10, part 29.1(4).

Such fee-splitting statutes protect the public and the health care system from (i) the corporate practice of medicine, as discussed above, and (ii) fraud and abuse (namely, financial incentives to refer patients to or for certain services).

Prohibitions on the corporate practice of medicine and fee splitting also impact managed care contracts. The corporate practice prohibition requires that these payer contracts be held
in the name of a physician or other licensee, not lay entities like MSOs. Likewise, the fee-splitting prohibition limits the kinds of arrangements that physicians and MSOs may enter by restricting the flow of funds related to the provision of medical services. The California Opinion and the New York case demonstrate these restrictions in the managed care environment.

Many states have corporate practice or fee splitting prohibitions in their statutory or common law, and several states, like California, have both.

The California Opinion

On July 27, the California Attorney General issued an opinion finding a corporate practice of medicine violation when a management services organization contracted with a labor union to select, schedule, secure and pay for radiology diagnostic services ordered by union physicians (the “Opinion”). Although the California Opinion addressed labor unions, a footnote and much of the rationale appears to broaden its application to any lay entity that is responsible for obtaining medical care for its members. This nuance will likely be a topic of some debate.

In the California Opinion, the Attorney General found that a management services organization acting as a broker between diagnostic imaging service providers and payors engaged in the unlicensed practice of medicine, and that no exception to the ban on corporate practice applied. The California Opinion relied on the long-standing rationale that:

* the corporate practice prohibition seeks to preserve the independent judgment of the physician and the relationship of trust between the physician and the patient by ensuring that professional judgment is not distorted by financial concerns;
* only licensed physicians can choose care and perform medical services;
* the business and professional sides of a medical practice cannot be divided (both require the professional judgment of a licensee and division would permit unlicensed persons, not subject to ethical constraints or Medical Board oversight, to engage in conduct not permitted by a licensee); and
* financial arrangements with MSOs are an intrusion into the physician-patient relationship, creating divided loyalties for the licensed professional whose medical judgment may be distorted by financial concerns (precisely the evil that the ban on corporate practice strives to prevent).

The California Opinion reiterated the belief that only the Legislature has the power to reevaluate the long-standing proscription against the unlicensed corporate practice of medicine in California, leaving the door open for a legislative fix.

The New York Case

In a similar result, a federal court in New York affirmed a finding that a radiologist engaged in unlawful fee-splitting when he entered into contracts with management companies and paid them a fixed percentage of receipts for billing services and a fixed dollar amount for each procedure performed. New York regulations prohibit the sharing of fees for professional services other than with another licensee and bar arrangements where money paid for furnishing space, facilities, equipment or personnel services is based on a percentage of the income or receipts from a licensed practitioner’s practice.

This New York case demonstrates that New York’s fee-splitting rules seek to preserve the sanctity of the professional relationship by forbidding financial arrangements with lay entities that are tied to provision of professional services.

Implications for Professionals and MSOs

Essentially, the California Opinion and the New York court case underscore legal limitations on the activities of MSOs. While MSOs may provide certain administrative services under contract, in states with a corporate practice of medicine prohibition, MSO activities that require exercise of professional judgement may constitute violations of law. Similarly, financial arrangements tied to performance of professional services are likely to be unlawful in states with fee-splitting prohibitions. These decisions provide further comfort and ammunition
to professionals who may seek to preserve their role in the medical decision-making process.

These decisions also underscore that non-medical entities should not be made parties to payor contracts, unless exempted by law, because such contracts generally require performance of professional services that cannot be performed by such lay entities. Thus, MSOs and payors with contracts in which an MSO is a named entity should consider revising the contracts to remove the MSO as a party. Likewise, in states with fee-splitting statutes, financial arrangements should be reviewed to determine if they comply with state law limiting arrangements tied to the performance of professional services.

The California Opinion—Detailed Discussion

Background

The Attorney General issued the California Opinion at the request of Assemblyman Martin Gallegos (D), chairman of the California Assembly Health Committee. Gallegos’ request to the Attorney General’s office arose from a letter sent by a Southern California radiologist concerned with the plethora of broker MSOs entering payor arrangements directly with insurance companies, labor unions and other entities, and then buying discounted diagnostic imaging services to meet obligations under the payor contracts. The California Radiology Society had also been seeking guidance in this area for some time.

The radiologist was particularly concerned that MSOs, not physicians, were making decisions regarding appropriate tests, sites and equipment for radiology patients. For example, a broker MSO might determine whether to send a patient for an MRI or for radiation services in response to a physician’s order for care, or whether to use a well-trained MRI specialist to read MRIs, or just to utilize any physician willing to read the tests. MSOs could make such decisions based on price, and without accountability to any licensing board. Such activities by an unlicensed entity may also jeopardize patient care.

The MSO Arrangement

Under the contract between the MSO and the labor union at issue in the California Opinion, the MSO would select a radiology site with the appropriate imaging equipment and qualified operators of the equipment, and select a qualified and duly licensed radiologist to view the films and prepare an interpretive report. In addition, the MSO would pay for the radiology services and profit through payment of a management fee by the labor union.

The Attorney General’s Rationale

Because the Attorney General determined that these activities would require the exercise of professional judgment, a license to practice medicine would be required. If performed by an unlicensed entity, such activities would be the unlawful corporate practice of medicine. As noted above, although the California Opinion addressed labor unions, in a footnote, the Attorney General appears to broaden the application to “any fraternal, benevolent or similar organization that is responsible for obtaining medical care for its members.”

The Attorney General acknowledged that certain of the tasks performed by the MSO could, in isolation, be deemed commercial, not medical, in nature. Nonetheless, based on judicial precedent including Marik v. Superior Court and Painless Parker v. Board of Dental Examiners, the Attorney General found that “in a professional corporation, it is not always possible to divide the ‘business’ side of the corporation from the part which renders professional services; ‘[t]he subject is treated as a whole.’ The Attorney General also noted that because interfacing the business and medical sides of the practice in itself might require medical skills and judgment, a license would generally be required to engage in any of these activities. Moreover, the Attorney General pointed out that division of a medical practice into a business and professional side would be impractical and would allow unlicensed persons to engage in conduct not permitted by a licensee, due to the absence of ethical constraints. Finally, the Attorney General found the financial arrangement with the MSO a further intrusion into the physician-patient relationship, creating divided loyalties for the licensee. This division of loyalties is precisely what the ban on corporate practice strives to prevent.
No Exceptions to the Prohibition Apply

The Attorney General also found that no existing exceptions to the ban on corporate practice of medicine applied here. The Attorney General reiterated that a corporation is not exempt from the prohibition against the unlicensed practice of medicine simply because it is organized as a non-profit corporation.

Section 455

The California Opinion never reached the issue of a violation of Cal. Health and Safety section 455, which prohibits referrals for profit, presumably because the conduct in question was already deemed unlawful under corporate practice prohibition.

California Medical Board CPOM Guidelines

The California Opinion appears to be consistent with January 1999 guidelines addressing the scope of the corporate practice of medicine prohibition issued by the Medical Board of California. In the Medical Board's view, unlicensed practice of medicine occurs where an unlicensed person determines what diagnostic tests are appropriate for a particular condition, or the need for referrals to or consultation with another physician/specialist. The Medical Board further suggests that the corporate practice prohibition is violated where an unlicensed person engages in “business” or “management” decisions such as selecting (hiring/firing as it relates to clinical competency or proficiency) of professionals, physician extenders, or allied health staff; setting the parameters under which a physician will enter into contractual relationships with third-party payers, and approving of the selection of medical equipment.

1 Exceptions exist for such things as philanthropic organizations and California Knox-Keene plans (HMOs), among others.
3 Assemblyman Gallegos had requested an opinion from the Attorney General on the corporate practice of medicine prohibition. Apparently, Assemblyman Gallegos’ request did not concern labor unions, and this limiting language was added at some point in the California Opinion development process for unknown reasons. A footnote was used to broaden the application to fraternal, benevolent and similar organizations responsible for obtaining care for members, but this may not be enough to clarify the application of the California Opinion or to satisfy Assemblyman Gallegos. It is unclear at this time if Assemblyman Gallegos’ office will seek further clarification from the Attorney General’s office.
6 Any fees paid should be commensurate with the fair market value of the services provided.
7 For example, California Knox-Keene plans (HMOs) are subject to an exception to the corporate practice of medicine prohibition.

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