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Ownership of Medical Practices in New York and the Role of Private Investors

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By Francis J. Serbaroli | **July 24, 2018** | **New York Law Journal**

One of the more interesting developments in the ever-shifting dynamics of the health care marketplace is the increasing interest on the part of private investors in developing financial relationships with or even purchasing equity interests in physician practices. For generations, medical practices were mostly small and mostly owned by the physician shareholders who treated their patients at the practices. As the health care marketplace has gravitated to new payment methods and different models of delivering care, there have been more consolidations of physicians into larger medical practices. Depending upon the medical specialty, these large medical practices can be very profitable, hence the interest of private investors in establishing a financial relationship with a practice.

While ownership by nonphysicians of interests in medical practices is legal in a few states, it is still strictly prohibited in New York. Nonphysician investors can invest in business entities that support the nonmedical aspects of a practice, but a medical practice located in New York must at all times be under the ownership and control of physicians licensed to practice medicine in New York.

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Corporate Practice

New York Business Corporation Law (BCL) Section 1507 authorizes a professional service corporation (PC) to issue shares:

... only to individuals who are authorized by law to practice in this state a profession which such corporation is authorized to practice and who are or have been engaged in the practice of such profession in such corporation or a predecessor entity, or who will engage in the practice of such profession in such corporation within thirty days of the date such shares are issued.

Thus, the equity interests of any New York medical PC may be held only by individuals who are licensed to practice medicine in New York and who participate in the subject practice. Any shares issued in violation of BCL Section 1507 are void. In addition, the BCL precludes a shareholder from entering into any voting trust agreement, proxy or any other type of agreement that vests voting power in another person, other than another shareholder or a person who is a New York-licensed physician. In the case of a medical PC, this means that only a licensed physician can be a shareholder or have voting rights.

Similarly, New York Limited Liability Company Law (LLCL) Section 1207(b) requires that each member of a professional limited liability company (PLLC) formed to provide medical services must be licensed pursuant to New York Education Law (Ed. Law) Article 131 to practice medicine in New York. Article 131 permits only individuals to be licensed to practice medicine; it does not permit entities to be licensed to practice medicine. Therefore, the equity interests of any New York medical PLLC may be held only by individuals who are licensed to practice medicine in New York. Furthermore, pursuant to LLCL Section 1207(a), a member of a New York PLLC must provide services to the subject practice at the time such member acquires an equity interest in the PLLC or within 30 days of becoming a member of the PLLC. In other words, absentee ownership of a PC or PLLC is prohibited.

Only a physician licensed to practice medicine may own an equity interest in a New York PC that provides medical services. No other PC or PLLC may own an equity interest in a New York PC that provides medical services. However, a medical PC may be an owner of a medical PLLC. Medical practices may also be formed as professional partnerships or professional limited liability partnerships, but PCs and PLLCs are the more common ownership entities.

In addition to the BCL and LLCL restrictions, New York has a century-old prohibition on the corporate practice of medicine. This prohibition was extracted by the courts from the state's licensing statutes, and is based upon the premise that licenses to practice a profession, such as medicine, are granted to individuals and not corporations. It prohibits any business, partnership or unlicensed individual from employing or contracting with licensed physicians or other medical professionals to provide medical services to patients, or interfering in any way with the free exercise by those professionals of their own medical judgments. See. e.g., *United Calendar Manufacturing v. Huang*, 94 A.D. 2d 176 (App. Div. 2d Dept. 1983).

New York also has a prohibition on splitting fees for professional services by physicians with non-physicians, or with other physicians or licensed medical professionals who are not in a common medical practice such as a partnership, PC or PLLC. Most states have some form of this prohibition, but New York's is unusual in that it is found in both statute and regulation. Ed. Law Section 6530 includes among the definitions of professional misconduct:

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18. Directly or indirectly offering, giving, soliciting, or receiving or agreeing to receive, any fee or other consideration to or from a third party for the referral of a patient or in connection with the performance of professional services;

19. Permitting any person to share in the fees for professional services, other than: a partner, employee, associate in a professional firm or corporation, professional subcontractor or consultant authorized to practice medicine, or a legally authorized trainee practicing under the supervision of a licensee …

Ed. Law Section 6531 authorizes the suspension, revocation or annulment of a health care practitioner's license and other penalties if such professional:

… directly or indirectly requested, received or participated in the division, transference, assignment, rebate, splitting or refunding of a fee for, or has directly requested, received or profited by means of a credit or other valuable consideration as a commission, discount or gratuity, in connection with the furnishing of professional care or service …

The regulations of the Department of Education at 8 N.Y.C.R.R. Section 29.1(b) define as unprofessional conduct:

- Directly or indirectly offering, giving, soliciting, or receiving or agreeing to receive, any fee or other consideration to or from a third party for the referral of a patient or client or in connection with the performance of professional services;

- Permitting any person to share in the fees for professional services, other than: a partner, employee, associate in a professional firm or corporation, professional subcontractor or consultant authorized to practice the same profession, or a legally authorized trainee practicing under the supervision of a licensed practitioner. This prohibition shall include any arrangement or agreement whereby the amount received in payment for furnishing space, facilities, equipment or personnel services used by a professional licensee constitutes a percentage of, or is otherwise dependent upon, the income or receipts of the licensee from such practice, except as otherwise provided by law with respect to a facility licensed pursuant to Article 28 of the Public Health Law or Article 13 of the Mental Hygiene Law.

As unprofessional conduct, fee-splitting is punishable by revocation, suspension or annulment of the practitioner's license, and up to a $10,000 fine for each violation.

Management Service Organizations

With physicians having to see more patients and having less time to devote to the business side of the practice, so-called management service organizations (MSO) for medical practices have proliferated. MSOs offer medical practices the opportunity to outsource much of the practice's back office operations, thereby increasing the productivity of the practice's physicians.

An MSO is commonly a for-profit business corporation that provides the medical practice with a wide range of services and items needed by the practice. These can include office premises, medical and office equipment, and personnel and support services normally required for the operation of a medical practice. MSOs can provide or arrange for nonprofessional personnel such as a receptionist, medical records technicians, billing personnel, accounting services, hazardous waste disposal and janitorial services, telecommunications and information technology, and electricity and utilities. MSOs can also assist in

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physician recruitment, negotiating contracts with third party payors, assuring compliance with Medicare/Medicaid laws and regulations, obtaining professional and general liability insurance, and many other services.

An MSO can be owned by physicians, non-physicians, other corporate entities, or a combination. However, the MSO's contractual relationship with the medical practice must be very carefully structured or it could run afoul of the laws and regulations cited earlier. An MSO makes a considerable financial investment in setting up its operations to support the medical practices it contracts to serve, including purchasing or leasing equipment, setting up billing and electronic medical record systems, hiring employees, and so on. In return, the MSO seeks a long-term contract with the practice and significant control over various aspects of the practice. If the MSO exercises too much control over the practice, it could place itself and the physicians it services in significant legal jeopardy.

Besides potentially violating the BCL and LLCL provisions discussed above, Ed. Law Section 6512(1) makes it a Class E felony to practice or offer to practice or to hold oneself out as being able to provide a licensed profession, or aids or abets an unlicensed person to practice a profession. If an MSO exercises pervasive control over the medical judgments of the physicians or other licensed professionals in the medical practice, the MSO could find itself accused of the unlicensed practice of a profession. Accordingly, not only should the medical PC or PLLC be owned exclusively by New York-licensed physicians, but all physicians, nurses, and other licensed health care professionals providing services to patients should be employed or contracted by the professional entity. The physicians practicing in the professional entity must be free at all times to exercise their own professional judgments in diagnosing and treating the practice's patients. The MSO may not interfere in any way with the licensed professionals' practice of their profession.

When organizing an MSO here are important points to keep in mind. An MSO that sets up a "captive" professional entity, whereby the MSO can remove a physician as the owner of the professional entity and replace him/her with another physician of the MSO's choosing will likely find that, if challenged, the arrangement will not withstand judicial scrutiny. Such an arrangement could be found to violate the provisions of the BCL or LLCL, as well as the prohibition on the corporate practice of medicine, in that it gives the MSO too much control over the medical practice.

The physician practice with which an MSO contracts must not cede control over the practice and its professionals to the MSO. The MSO as a general business corporation may not employ or directly supervise the practice's physicians, nurses or other licensed professionals. The MSO may not interfere with how those licensed professionals practice their professions. The MSO can make recommendations to the leadership of the physician practice regarding staffing, compensation, productivity, treatment or prescription utilization, quality assurance, and other aspects of the practice, but the final decision on all such matters must be made by the practice's physician leadership. Ownership of the practice's accounts receivable, medical records, controlled substances, and other assets directly related to the practice of medicine must remain with the physician owners of the practice.

In drafting the contract between the MSO and the physician practice, the MSO's fees should be structured as a flat fee, or on a fee-for-service or fee-for-item basis, and should be justifiable as representing fair market value for the services and items provided. MSO fees that are based simply on a percentage of the practice's gross or net income can violate the fee-splitting prohibition, can void the MSO agreement, and can constitute professional misconduct for which the physician owners of the practice can be disciplined and fined. While the MSO is not subject to the same professional disciplinary action, it could be at risk of having its contracts with the medical practice voided by the courts, thereby compromising the considerable investment it made in establishing its business.

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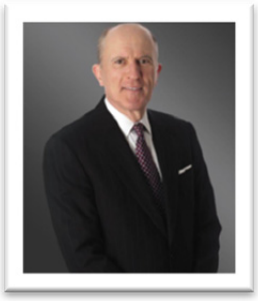

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