

Parent Corporations of Health Care Facilities in New York



In his Health Law column, Francis J. Serbaroli discusses the requirements for parent corporations of licensed health care facilities such as hospitals, nursing homes, diagnostic and treatment centers, ambulatory surgery centers, renal dialysis facilities, and other providers licensed under Article 28 of New York’s Public Health Law. He explains that a parent corporation may be either “active” or “passive”, the limits of a “passive” parent’s role in relation to the licensed provider, and the need for an “active” parent to be licensed under Article 28.

By Francis J. Serbaroli | [September 29, 2020](#) | [New York Law Journal](#)

The health care landscape in New York has undergone dramatic changes over the past few decades. Many formerly independent providers of health care services, including hospitals and physician practices, have merged, been taken over, or have been absorbed into larger systems.

These consolidations have come about in response to a variety of factors including prospects for improved quality of care; integration of clinical and support services; reduced operating costs; stronger negotiating positions with third-party payors; and access to better credit and financing options.

Article 28 Facilities

The typical model for these systems consists of a parent corporation sitting atop one or more facilities licensed under New York Public Health Law (PHL) Article 28 such as hospitals, diagnostic and treatment

centers, ambulatory surgery centers, and nursing homes. Such parent corporations fall into one of two categories: “active” or “passive.”

A “passive” parent normally has little or no ability to take on the central decision-making power to accomplish a system’s goals. Instead, it has a much lesser role, limited to such functions as serving as the corporate member; appointing members of the governing board of the licensed entity; approving amendments to the certificate of incorporation and corporate bylaws; recommending that its subsidiary facilities consider adopting policies and procedures; making recommendations regarding strategic direction, compliance, legal services and administrative support services; and approving a corporate merger or corporate dissolution. An integrated health care system, however, is more likely to have an “active” parent with the ability to exercise centralized powers and to implement programs and policies to accomplish systemwide goals. The distinction between an “active” and “passive” parent is determined by state regulations enumerating activities that constitute the active operation of a hospital under PHL Article 28.

PHL Article 28 governs the licensure and regulation of hospitals, hospices, nursing homes, diagnostic and treatment centers, ambulatory surgery centers and certain other health care facilities (collectively referred to in the PHL as hospital) and sets forth the requirements for their establishment and incorporation. Hospitals and operators of hospitals must first file “certificate of need” (CON) applications with the Department of Health (DOH). These applications are reviewed by DOH staff according to criteria that include financial feasibility, the “character and competence” of the proposed operator and its governing board members, the need for such a facility in the community, and so on. The DOH staff then forwards the application along with the staff’s recommendation to the New York State Public Health and Health Planning Council (PHHPC), which has the final say on any establishment application. (PHL §2801-a(1)) CON approval must be obtained for the establishment of any hospital and to file the certificate of incorporation of any business or not-for-profit corporation whose purpose is to establish or operate a hospital, or to solicit contributions for such purpose. In addition, CON approval is required for a change in the operator of a hospital. (PHL §2801-a(4)(a))

The question as to what constitutes the “operation” of a hospital arises when a corporation seeks to become either the “passive” or “active” parent of an Article 28 licensed facility. A hospital’s corporate parent must be licensed under Article 28 when it is an “active” rather than a “passive” parent, since an “active” parent will be considered an operator of the hospital. (Under these regulations, an active parent equals a hospital operator.)

Under the DOH’s regulations, an Article 28 licensed hospital must maintain management control over its operations. (10 NYCRR §§405.2, 405.3) This mandate is also reflected in 10 NYCRR (New York Codes, Rules and Regulations) §600.9(d) which states:

- Except as provided in §405.3 of this title, the governing authority or operator may not contract for management services with a party which has not received establishment approval.
- The criteria set forth in this paragraph shall be used in determining whether there has been an improper delegation to the management consultant by the governing authority or operator of its responsibilities:
 - authority to hire or fire the administrator or other key management employees;
 - maintenance and control of the books and records;
 - authority over the disposition of assets and the incurring of liabilities on behalf of the facility;
 - the adoption and enforcement of policies regarding the operation of the facility.

In essence, a hospital may not turn over control of its management to a party that has not received PHHPC establishment approval. Therefore, if a parent corporation seeks to exercise control over the management of a hospital, the parent itself must be licensed under Article 28.

More Regulations

Other regulations enumerate specific actions that constitute hospital operation. For example, 10 NYCRR §405.1(c) provides that an entity is an operator of a hospital if it has decision-making authority over any of the following:

- appointment or dismissal of hospital management-level employees and medical staff, except the election or removal of corporate officers by the members of a not-for-profit corporation;
- approval of hospital operating and capital budgets;
- adoption or approval of hospital operating policies and procedures;
- approval of certificate of need applications filed by or on behalf of the hospital;
- approval of hospital debt necessary to finance the cost of compliance with operational or physical plant standards required by law;
- approval of hospital contracts for management or for clinical services; and
- approval of settlements of administrative proceedings or litigation to which the hospital is party, except approval by the members of a not-for-profit corporation of settlements of litigation that exceed insurance coverage or any applicable self-insurance fund.

If a parent corporation satisfies these criteria or is otherwise found to have “active” control in these areas, it will be considered an operator, and therefore must seek Article 28 establishment approval to operate its hospital, nursing home or other Article 28 licensed affiliates. Moreover, any management contract with an Article 28 licensed facility must be submitted to DOH for approval by the Commissioner of Health. (10 NYCRR §505.3(f)(2))

The regulations also prohibit the sharing of revenues for providing health related services between an Article 28 licensed entity and a non-licensed entity. (10 NYCRR §600.9(c) states: “An individual, partnership or corporation which has not received establishment approval may not participate in the total gross income or net revenue of a medical facility.”) Therefore, if an Article 28 licensed hospital shares any of the revenue that it receives for health-related services with its corporate parent, the parent must also be licensed under Article 28. That is to say, a parent corporation—whether active or passive—must be licensed under Article 28 to be a hospital operator if it intends to share in the revenues of any of its affiliated Article 28 licensed entities.

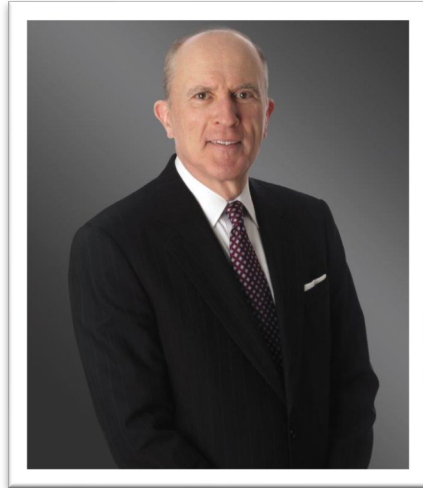
Conclusion

New York’s regulatory scheme for Article 28 licensed hospitals was carefully designed to assure that those facilities and their governing bodies would be directly accountable to the DOH for the quality of care provided to the patients served by those facilities. As multi-hospital systems have evolved under the control of active parent corporations, most of these systems have sought and obtained appropriate establishment approval for their corporate parent. However, every system with a passive corporate parent should periodically review the scope of the parent’s involvement with its licensed affiliates to determine if it has crossed the line into being an active parent, and thereby need establishment approval under PHL Article 28.

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