

# In an Era of Healthcare Delivery Reforms, The Corporate Practice of Medicine is a Matter That Requires Vigilance.

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# IN AN ERA OF HEALTHCARE DELIVERY REFORMS, THE CORPORATE PRACTICE OF MEDICINE IS A MATTER THAT REQUIRES VIGILANCE

*Stuart I. Silverman, Esq.\**

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|       |   |    |
|-------|---|----|
| I.    | INTRODUCTION .....  | 2  |
| II.   | MEDICAL PRACTICE ACTS .....   | 4  |
| III.  | APPLICATION OF THE CORPORATE PRACTICE OF MEDICINE DOCTRINE TO HOSPITALS .....       | 4  |
| IV.   | APPLICATION OF THE CORPORATE PRACTICE OF MEDICINE DOCTRINE BEYOND PHYSICIANS .....  | 7  |
| V.    | STATUTORY EXCEPTIONS.....   | 8  |
| VI.   | APPLICATION TO MANAGEMENT SERVICES.....   | 9  |
| VII.  | ENFORCEABILITY OF CONTRACTUAL OBLIGATIONS BETWEEN MEDICAL PROVIDERS AND PAYORS..... | 11 |
|       | A. PAYMENT FOR SERVICES .....   | 11 |
|       | B. NON-COMPETE CLAUSES IN PHYSICIAN EMPLOYMENT CONTRACTS .....                      | 16 |
| VIII. | FEE-SPLITTING ARRANGEMENTS .....  | 20 |
| IX.   | OBSERVATIONS.....   | 23 |

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## I. INTRODUCTION

Since the early 20<sup>th</sup> century, the corporate practice of medicine doctrine (CPMD), the contours and content of which are determined by state law, generally prohibits business corporations from practicing medicine or employing physicians to perform professional medical services. The doctrine's origin is rooted in public policy, championed by the American Medical Association in 1934, when it proclaimed ethical principles for the practice of medicine.<sup>1</sup>

The corporate practice prohibition is rooted in the perceived evils that corporations and laypeople motivated by profit will exert control over physicians, tainting the fiduciary role of the physician vis-a-vis patient, and compromising the medical judgments of physicians. There is a corollary to the corporate practice ban whereby states have imposed restrictions on fee-splitting involving physicians and their services as a way to mitigate financial influences on medical decision-making. States provide for sanctions for unauthorized fee-splitting arrangements.<sup>2</sup>

To this day, the CPMD implicates various interrelationships in the medical sector. Not all states embrace a strong sense of vitality for the doctrine, and in a few jurisdictions, the prohibition does not exist. For a majority of states, however, the prohibition's reach, and consequences arising from its breach, have import for the transactional lawyer, medical facilities, physicians, and payors.

The sources of state law on the corporate practice of medicine prohibition are varied. The corporate practice ban can arise as a matter of common law, state legislative enactments and regulations. Courts have ruled extensively on the prohibition, and State Attorneys General, as well as professional licensing boards, have opined on the doctrine.

State legislatures have considered bills to amend the prohibition, re-calibrating the public policy bases relied upon in the past to adapt to more integration and collaboration as the new norm in healthcare delivery. This is so, for example, in Texas, where in 2011 the legislature enacted new provisions enabling employment of physicians by certain county hospital districts.<sup>3</sup> In 2011 and 2012, legislation was also enacted in Colorado,<sup>4</sup>

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<sup>1</sup> *Medical Ethics and New Methods of Practice*, 103 JAMA 263, 263–64 (1934); see also Am. Med. Ass'n Principles of Med. Ethics, ch. 3, art. VI, Section 2 (1937). The AMA's 1934 Principles, as interpreted by the ABA's Judicial Council in 1971, were challenged by the Federal Trade Commission (FTC) as an unreasonable restraint of trade. The FTC issued an order requiring the AMA to end its corporate practice restraints. On appeal, the Second Circuit affirmed the FTC's decision. See *Am. Med. Ass'n v. Fed. Trade Comm'n*, 638 F.2d 443 (2d Cir. 1980). The Supreme Court affirmed the Second Circuit's decision in a per curiam opinion. 455 U.S. 676 (1982). The individual states, though, have pursued their own paths to impose the corporate practice ban under their Medical Practice Acts.

<sup>2</sup> For example, in New York State, the Education Law § 6531 provides for the revocation or suspension of a physician's license on grounds of professional misconduct if a physician participates in splitting of a fee in connection with professional care or services. See also California's Business and Professional Code, § 652 (imposing criminal sanctions).

<sup>3</sup> See *infra*.

<sup>4</sup> SB 11-084 (Colorado).

Tennessee<sup>5</sup> and Washington<sup>6</sup> lifting the corporate practice ban for the employment of physicians by nursing homes, and mandating protections to ensure a physician's independent decision-making.

The moorings for the corporate practice prohibition is in a state's inherent police powers to guard the fiduciary relationship between physician and patient from corrupted motives of the commercialization of medicine and allied professional disciplines. Barring a corporate entity, or layperson, from owning a medical practice, employing a physician, or influencing medical decisions safeguards the medical judgment on a patient's health and safety.<sup>7</sup> The corporate practice prohibition has withstood constitutional challenge.<sup>8</sup>

The corporate practice prohibition has attracted heightened interest. This is so because of trends in hospital-physician alignment and payment regimes for a more integrated health delivery system. For these reasons, healthcare attorneys are best advised to become knowledgeable on the corporate practice of medicine prohibition as it may apply, as a matter of state law, in various state jurisdictions.

Noncompliance with a state's corporate practice ban has ramifications. State laws provide for criminal sanctions, including for aiding and abetting.<sup>9</sup> Additionally, physicians and other medical professionals risk disciplinary action by a licensing board.<sup>10</sup> Separate from these punitive measures, a state attorney general may seek to dissolve, or enjoin, an illicitly formed entity.<sup>11</sup> There are other implications as well for contracting parties, between insurers and providers of care, and those employed by healthcare entities.

The CPMD, then, is one that should give pause to attorneys representing healthcare clients, including insurers, on any number of issues. The corporate practice ban can influence the structuring of a legal entity, define collaborations, or impact reimbursement decisions. This is particularly germane in contemporary discourse on healthcare reform.

The purpose of this article is to highlight some state laws, and how courts in various jurisdictions have addressed the corporate practice prohibition in the context of reimbursement and non-compete clauses in employment agreements. The article will also mention fee-splitting to raise a level of awareness of rules set by states that prohibit

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<sup>5</sup> SB 3263 (Tennessee).

<sup>6</sup> SHB 1315 (Washington).

<sup>7</sup> As observed in *Cal. Med. Ass'n. Inc. v. Regents of Univ. of Cal.*, 94 Cal. Rptr. 2d 194, 199 (Cal. App. 2000), the corporate practice of medicine doctrine was "adopted to protect the professional independence of physicians and to avoid the divided loyalty inherent in the relationship of a physician employee to a lay employer."

<sup>8</sup> *Miller v. State Bd. of Dental Exam'rs of Colo.*, 287 U.S. 563 (1932) (denying appeal for want of a federal question); *Semler v. Or. State Bd. of Dental Exam'rs*, 294 U.S. 608, 611 (1935).

<sup>9</sup> *E.g.*, N.J. Stat. Ann. § 45:1-21(n).

<sup>10</sup> *E.g.*, I.C.A. § 147.55 and I.C.A. § 148.6(1) (Iowa) (provides for revocation or suspension of license, civil penalties not in excess of \$10,000); *see also William Steinsmith v. Medical Board of California*, 102 Cal. Rptr. 2d 115 (Cal. App. 4<sup>th</sup> Nov. 13, 2000).

<sup>11</sup> *See, e.g., Bill Schuette, Attorney General of the State of Michigan v. Health Care Clinic, Inc., Womens Choice Clinic, Inc., et al.*, Case No. 11-1507-AW (Mich. 56<sup>th</sup> Judicial Cir. Ct. Nov. 7, 2011) (Verified Complaint In *Quo Warranto* To Dissolve Health Care Clinic, Inc. and Womens Choice Clinic, Inc. And For Injunctive Relief and Consent Judgment, entered Nov. 21, 2011).

or limit this practice. The lesson to be learned is that state laws are not uniform, and each state has pursued its own path of public policy.

## II. MEDICAL PRACTICE ACTS

Generally, the ban on the corporate practice of medicine is rooted in the notion that a corporate or business entity is not able to satisfy the licensure requirements mandated by state statutes to practice the learned professions.

The starting point for determining whether a state prohibits the corporate practice of medicine is the jurisdiction's Medical Practice Act and its definition of the "practice of medicine." A state's Medical Practice Act imposes licensure requirements. For example, the Maryland Medical Practice Act mandates that "an individual shall be licensed" to practice medicine.<sup>12</sup> The "practice of medicine" is defined, "to engage, with or without compensation, in medical . . . diagnosis, healing, treatment [ ] or surgery," and the "preventing, prescribing for, or removing any physical, mental, or emotional ailment . . . of an individual."<sup>13</sup> Exemptions from licensure are noted by statute,<sup>14</sup> none of which apply to entities. Thus, by implication, the Maryland Practice Act prohibits corporations from practicing medicine.<sup>15</sup> Under Maryland law, certain entities whose formation is governed by specialized statutes do not fall within the ambit of the corporate practice ban. As discussed further below, these statutes are exceptions, allowing the corporate practice of medicine, provided enumerated conditions are met. Thus, an entity is not affected by the corporate practice ban in Maryland if formed as a professional service corporation<sup>16</sup> or a limited liability company.<sup>17</sup> Some states impose by statute an explicit ban on the corporate practice of medicine. In Colorado, the legislature enacted a provision that reads "corporations shall not practice medicine."<sup>18</sup>

## III. APPLICATION OF THE CORPORATE PRACTICE OF MEDICINE DOCTRINE TO HOSPITALS

States are divided on the applicability of the corporate practice ban to hospitals. California prohibits outright hospital employment of physicians. The corporate practice ban is embodied in California's Business and Professions Code within the Medical Practice Act.<sup>19</sup> Section 2052 mandates the licensure of any person "who diagnoses, treats, operates for or prescribes for any ailment . . . [or] . . . disease." Performing these acts without a license is a criminal offense.<sup>20</sup> Those who assist or participate

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<sup>12</sup> Md. Code Ann. Health Occ. § 14-301.

<sup>13</sup> Md. Code Ann. Health Occ. § 14-101(l).

<sup>14</sup> See Md. Code Ann. Health Occ. § 14-302.

<sup>15</sup> Maryland is not alone in providing for a corporate practice ban by implication. New York, along with other jurisdictions, imposes a corporate practice ban by implication, rather than by explicit statutory language. See N.Y. Educ. L. §§ 6521, 6522 and 6524 (mandating a person to be licensed to practice medicine, and setting forth licensure requirements).

<sup>16</sup> Md Code Ann. Corps. & Ass'ns § 5-101, *et seq.*

<sup>17</sup> Md. Code Ann. Corp. & Ass'ns § 4A-203(10).

<sup>18</sup> C.R.S. § 12-36-134(7)(a).

<sup>19</sup> Medical Practice Act, Business & Professions Code § 2400, *et seq.*

<sup>20</sup> See Cal. Bus. & Prof. Code, § 2052(a).

in committing the offense can be implicated and charged for aiding and abetting.<sup>21</sup> California's corporate practice ban, as applied to hospitals, is in section 2400, which explicitly states that corporations have "no professional rights, privileges, or powers."<sup>22</sup> Exceptions to the corporate practice ban provided by the California legislature are in the State's Business and Professions Code. There, certain entities are permitted to employ physicians, provided the conditions specified by statute are met. Thus, within section 2400, the Division of Licensing is empowered, in the exercise of its discretion, to "grant approval of the employment of licensees on a salary basis" by certain specified licensed entities. These licensed entities are: charitable institutions, medical foundations, teaching hospitals,<sup>23</sup> and clinics.<sup>24</sup> For example, under section 2401(a), a clinic operated for medical education purposes by a non-profit university medical school may charge for professional services by licensees who are on the faculty of the university. Additionally, under section 2401(b), a non-profit clinic operating pursuant to specified criteria<sup>25</sup> for charitable purposes may employ licensees and may charge for those services. However, it is explicitly provided that the clinic is prohibited from interfering with or controlling the professional decision-making of the physician or surgeon. Under section 2401(d), a hospital owned and operated by a health care district may employ a licensee and may impose charges for services if the physician or surgeon approves of the charges. It is explicitly provided, though, that the hospital shall not interfere with or control the judgments of the licensees.

California's general ban on hospital employment of physicians is in stark contrast to the law in Illinois. In Illinois, duly licensed hospitals may, as a matter of law, employ physicians. This exception in Illinois was established by the seminal case of *Berlin v. Sarah Bush Lincoln Health Center*.<sup>26</sup> The exception carved out for hospitals in Illinois, arising from *Berlin* is a narrow one. In that case, the Supreme Court of Illinois explained that the CPMD is rooted in a state's Medical Practice Act, in which education and training are mandated to obtain a professional license to practice medicine. Since corporations do not have the ability to undergo the rigorous licensing requirements imposed under the Medical Practice Act, such entities cannot lawfully practice medicine. The Court further wrote that, generally, in theory, hospitals cannot employ physicians since the actions of physicians while under the employ of a hospital would be imputed to the hospital which is not eligible to obtain a license for the practice of medicine. The Supreme Court of Illinois in *Berlin* also emphasized that the corporate practice ban is based on public policy, which seeks to guard against the profit motive influences of lay entities over a physician's medical judgment and their fiduciary role vis-à-vis patients.<sup>27</sup> The Court in

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<sup>21</sup> See *id.*, at § 2052(b).

<sup>22</sup> Cal. Bus. & Prof. Code § 2400.

<sup>23</sup> See *Cal. Med. Ass'n v. Regents of the Univ. of Cal.*, 79 Cal. App. 4th 542 (2000).

<sup>24</sup> California, like many states, imposes fee splitting restrictions. See California Business and Professions Code § 650. California has also regulated beyond hospital-physician employment, to include alignments between physicians and management services organizations. See 83 Op. Atty. Gen. Cal. 170 (July 27, 2000).

<sup>25</sup> See Cal. Health and Safety Code § 1206(p).

<sup>26</sup> 688 N.E.2d 106 (Ill. 1997).

<sup>27</sup> *Id.* at 110.

*Berlin* examined whether the corporate practice ban would logically apply to hospitals in Illinois in view of the rationale for the doctrine. The Court concluded that it would not, and thus carved-out an exception for hospital employment of physicians. The Court's reasoning is based on the regulatory regime to which hospitals must adhere in Illinois. In that State, under the Hospital Licensing Act,<sup>28</sup> hospitals are authorized to practice medicine under a license to do so. The Court observed that In Illinois, the legislature enacted legislation allowing hospitals, duly licensed, to provide medical services. It thus concluded that to enable hospitals to perform this function, it was inferred that hospitals would need to employ licensed physicians. The Court in *Berlin* put to rest the public policy concerns that originally motivated the corporate practice ban. Specifically, the concern regarding corrupt influence of lay corporations over physicians would be mitigated since a separate medical staff in a hospital is responsible for the quality of medical services. The Court also noted that hospitals, as licensed facilities, had statutory duties to ensure the health of their patients.<sup>29</sup> In view of the statutory licensing authority for hospitals in Illinois, and the regulatory regime applicable to duly licensed hospitals more generally, the State Supreme Court in *Berlin* concluded there were grounds to exempt hospitals in Illinois from the corporate practice ban.

Illinois is not alone in its permissive stance on hospital employment of physicians. Other states allow this employment relationship, notwithstanding a corporate practice ban generally. Tennessee, for example, has provided by statute for hospital employment of physicians, with conditions. This provision authorizes a duly licensed hospital to employ physicians, except where noted, provided that the employing entity “shall not restrict or interfere with medically appropriate diagnostic or treatment decisions.”<sup>30</sup> Tennessee, though, prohibits hospitals from employing radiologists, anesthesiologists, pathologist, or emergency physicians.<sup>31</sup> This jurisdiction, however, allows research hospitals to employ radiologists, anesthesiologists and pathologists.<sup>32</sup> In Florida, the Medical Practice Act imposes licensure for individuals to practice medicine,<sup>33</sup> but is silent on the authority of corporate entities to engage in the practice of medicine. The Florida Board of Medicine has opined on this point, concluding that the Medical Practice Act does not prohibit licensed physicians as employees of corporations.<sup>34</sup> Case law in Kansas similarly has established that there is no restriction to hospital employment of physicians. This was made clear in *St. Francis Reg'l Med. Ctr. v. Weiss*.<sup>35</sup>

It is noteworthy that those jurisdictions that do accommodate hospital-physician employment have done so in a way that ameliorates perceived evils underpinning the CPMD. Conditions on such affiliations, explicit in the statute, preclude influence by the

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<sup>28</sup> 210 ILCS 85/1, *et seq.*

<sup>29</sup> 688 N.E.2d 106, 110-114.

<sup>30</sup> Tenn. Code § 68-11-205(b)(1)(A).

<sup>31</sup> Tenn. Code § 68-11-205(b)(9).

<sup>32</sup> *Id.*

<sup>33</sup> Fla. Stat. § 458, *et seq.*

<sup>34</sup> *In re: Petition for Declaratory Statement of Conrad Goulet, M.D.*, Case No. 89-COM-01 (1989).

<sup>35</sup> 869 P.2d 606 (Kan. 1994).

employing hospital over the medical judgments of the physician, thereby ensuring a degree of professional independence.

Texas has historically been a state with a stringent corporate practice ban, precluding hospitals from employing physicians. In 2011, the Texas legislature inaugurated reforms in this area with the enactment of several laws. For example, SB 1661 was enacted to protect physicians employed by hospital-run, non-profit health care corporations known in Texas as 501(a) corporations. These types of entities are viewed as a viable avenue for hospital-physician alignment. The provisions protect the independence of physicians from lay influences in their treatment decisions.<sup>36</sup> SB 894 allowed critical access hospitals, sole community hospitals and hospitals in counties of 50,000 or less to employ physicians. Most of these hospitals are run by county governments. This new law contains provisions to protect physician independence. There were also a series of separate bills enacted that allow specific hospital districts in Texas to employ physicians, with explicit provisions to protect the autonomy of physicians.<sup>37</sup>

#### **IV. APPLICATION OF THE CORPORATE PRACTICE OF MEDICINE DOCTRINE BEYOND PHYSICIANS**

States have extended the corporate practice ban beyond physicians to other health professions, such as dentistry, podiatry, and chiropractic, and other learned professions. For example, in Maryland, the Dentistry Act prohibits the practice of dentistry by a corporate entity, except where otherwise noted.<sup>38</sup> Florida has similar restrictions for the practice of dentistry.<sup>39</sup> The New Jersey legislature has enacted an explicit ban for optometry, whereby it is unlawful “for any unlicensed person, or any association or corporation directly or indirectly to engage . . . in the practice of optometry by utilizing the services . . . of any person licensed to practice optometry.”<sup>40</sup> Where states extend the practice ban to other health disciplines, there is a notable lack of uniformity,<sup>41</sup> and even

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<sup>36</sup> Tex. Occupations Code §§ 162.0021, 162.0023 and 162.0022.

<sup>37</sup> The bills enacted were: HB 1568 (Harris County Hospital District), HB 2351 (Bexar County Hospital District), HB 840 (El Paso County Hospital District), SB 303 (Tarrant County Hospital District). In 2005 and 2009, the Texas legislature also enacted bills that would allow Maverick County Hospital District and Dallas County Hospital District to employ physicians, dentists and other health care providers. SB 1027 (2005) and SB 1705 (2009), respectively.

<sup>38</sup> Md. Code Ann. Health Occ. § 4-603(a),(b), (c). Maryland law allows a licensed dentist to practice, under the name of the licensee, as an employee of a health maintenance organization that is properly certified. State law also permits a licensed dentist to practice, under the name of the licensee, as a member of a limited liability company. Additionally, Maryland provides for the practice of dentistry through a professional corporation. *See* Md. Code Ann. Corps. & Ass’ns § 5-101 *et seq.*

<sup>39</sup> Fla. Stat. § 466.0285. Section 466.0285 states that, except for a dentist duly licensed, a professional corporation or limited liability company composed of dentists, no person may employ a dentist or dental hygienist in the operation of a dental office, control use of dental equipment or interfere with a dentist’s clinical judgment.

<sup>40</sup> N.J. Stat. Ann. § 45:12-19.1.

<sup>41</sup> *E.g., Isles Wellness, Inc. v. Progressive N. Ins. Co.*, 703 N.W.2d 513 (Minn. 2005) (Minnesota) (holding that the corporate practice ban does not apply to physical therapy); Iowa Op. Att’y Gen. No 74-9-4 (Sept. 4, 1974) (Iowa) (opining that the corporate practice ban applies to physical therapy).



by courts within the same state. This can be readily seen in Minnesota. In that state, the corporate practice ban applies to chiropractors, but not to optometrists.<sup>42</sup>

## V. STATUTORY EXCEPTIONS

It is important to emphasize, as previously noted, that legal avenues exist under state statutory exceptions for the practice of medicine, and other professional disciplines, by entities that are formed under explicit statutory mandate for this purpose. By way of example, North Carolina allows the formation of a professional corporation under that state's Professional Corporation Act (applicable to, e.g., medicine, dentistry and chiropractic).<sup>43</sup> There is statutory authority, as well, in North Carolina for the formation of professional limited liability companies.<sup>44</sup> New Hampshire allows for the formation of this genre of entities, professional corporations,<sup>45</sup> and professional limited liability companies.<sup>46</sup> Arizona has legislated for not-for-profit medical service corporations whereby the provision of services is accomplished through contracts with physicians, podiatrists, dentists and optometrists.<sup>47</sup> California law authorizes the formation of dental corporations,<sup>48</sup> and optometric corporations,<sup>49</sup> for the practice of those disciplines, provided conditions specified by statute are met. Under California's Knox-Keene Act, a health service plan may contract with "any professional licensed . . . to deliver professional [medical] services."<sup>50</sup> Connecticut allows nonprofit medical foundations to be established for the provision of health care services by employees and agents.<sup>51</sup> New York allows for the formation of not-for-profit medical and dental expense indemnity corporations and hospital service corporations granting authority to employ licensed physicians and to enter into other contracts.<sup>52</sup> Thus, generally, states provide statutory exceptions, granting authority to organize entities for the practice of medicine and other medical professions where services rendered are by duly licensed professionals. State law usually mandates that all shareholders be duly licensed to render the same professional services as those for which the corporation was organized. Additionally, licensees must be designated as directors and officers. States also have legislated exceptions to the corporate ban for health maintenance organizations.<sup>53</sup>

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<sup>42</sup> See *Isles Wellness, Inc. v. Progressive N. Ins. Co.*, 703 N.W.2d 513 (Minn. 2005) (Minnesota) (holding that the corporate practice of medicine doctrine applies to chiropractic clinics); *Williams v. Mack*, 278 N.W. 585 (Minn. 1938) (Minnesota) (holding that there is a statutory exceptions to the corporate practice ban for optometry).

<sup>43</sup> N.C. Gen Stat. § 55B-2(5).

<sup>44</sup> N.C. Gen. Stat. §§ 57D-2-01, 02.

<sup>45</sup> N.H. Rev. Stat. § 294-A:2.

<sup>46</sup> N.H. Rev. Stat. § 304-D:2.

<sup>47</sup> ARS § 20-822(3).

<sup>48</sup> Cal. Corp. Code §§ 13401 and 13401.5

<sup>49</sup> Cal. Corp. Code §§ 13401 and 13401.5

<sup>50</sup> Cal. Health & Safety Code § 1395(b).

<sup>51</sup> Conn. Gen. Stat. § 33-182aa *et seq.*

<sup>52</sup> N.Y. Educ. L. § 6527(1).

<sup>53</sup> See, e.g., S.C. Code Ann. § 38-33-50(A)(3) (South Carolina); N.Y. Pub. Health L. § 4410(1) (New York).

South Dakota is a jurisdiction that has an explicit statutory corporate practice ban. That State's Medical Practice Act states that "it is the public policy of this state that a corporation may not practice medicine or osteopathy."<sup>54</sup> The legislature provided an exception, however, by allowing a corporation to enter into an employment agreement with a duly licensed physician provided such agreement does not impinge on the physician's independent judgment. Additional restrictions are imposed on the corporation's ability to make charges associated with services rendered. The statute also limits the agreement to three years, and is renewable thereafter annually.<sup>55</sup>

It is noteworthy that in Ohio, the State Medical Board in 2012 opined on the state of the law on the corporate practice ban.<sup>56</sup> Traditionally, Ohio has been known to have had a robust CPMD. Essentially, in its 2012 opinion, the Medical Board declared an end to the CPMD in Ohio. In the Board's view, the State legislature had enacted various laws for the formation of entities, including a professional corporation under O.R.C. section 1701.03 for the practice of medicine and other learned professions, thus obviating the rationale for the CPMD. It is interesting to observe that under Ohio law, a corporation can be formed under section 1701.03 to provide a combination of professional services. It is provided that the entity formed shall not control the professional judgment of the medical professional in rendering treatment. The State Medical Board observed that although the Ohio Attorney General had previously opined that the CPMD was viable in the State, his views predated subsequent statutes enacted by the State legislature. In the Board's view, those statutes vitiate the vestiges of the corporate practice ban in Ohio.

## **VI. APPLICATION TO MANAGEMENT SERVICES**

In an era that exemplifies collaboration between physician practices and entities engaged for the provision of management services, the corporate practice ban can impact the legality of such arrangements. North Carolina has recognized this, and, for the practice of dentistry, provides by regulation a structure that permits management services by non-licensed individuals and entities for dental practices. Specifically, the North Carolina State Board of Dental Examiners recognizes such management services agreements provided the arrangements do not entail the practice of dentistry by non-licensed persons or entities. The state's regulation of these management agreements imposes strict criteria, crafted to restrict the control of dental practices, including clinical and professional services.<sup>57</sup>

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<sup>54</sup> SDCL § 36-4-8.1.

<sup>55</sup> *Id.*

<sup>56</sup> Statement of the State Medical Board of Ohio on the Corporate Practice of Medicine (March 15, 2012).

<sup>57</sup> 21 NCAC 16X.0101 (Management Arrangements). The regulation mandates that the management agreement be in writing, signed by all parties, and describe the services to be performed by the management company as well as the aggregate compensation to be paid, or the method of deriving compensation. 21 NCAC 16X.0101(b). The regulation also prohibits ownership or control of the dental practice, its operations, clinical decisions or distribution of revenues. No ownership or control may be exerted by a management company over patient records, or control over the transfer of ownership interests of the professional practice. Compensation to the management company may not be determined by the profitability of the dental practice, its gross revenues or net revenues. 21 NCAC 16X.0101(c). The regulation does not preclude setting payments

Other states have opined on the role of a management services organization (MSO), vis-à-vis payors and providers. The Attorney General for the State of California issued an opinion on July 27, 2000,<sup>58</sup> expressing concern about the difficulty of separating business and medical decision-making by the MSO. Where those two functions merge, there is the prospect that the MCO could be viewed as engaging in the unlawful practice of medicine. The State Attorney General was asked to opine on an arrangement whereby an MSO, unlicensed to practice medicine, was paid a fee by a labor union for the MSO to arrange for radiology diagnostic services that were prescribed by a physician for members of the union. The State Attorney General wrote that such an arrangement would result in the MSO practicing medicine without a license. He took issue with the involvement of the MSO in the details of arranging for the diagnostic services. Specifically, he explained that the MSO was tasked with duties that were an integral part of the practice of medicine. The MSO selected the venue and scheduled for the radiology procedure, ensuring that there would be the necessary equipment and personnel in view of the patient's physical ailment. The MSO also selected a radiologist to view and interpret the films. The State Attorney General viewed these tasks as requiring professional judgment, and thus the practice of medicine by the MSO. Additionally, the opinion noted that the MSO paid for the radiology services and added a separate management fee for profit. The Attorney General objected to this aspect as well, making clear that this would be a "further intrusion" into the physician-patient relationship.

The decision in *Flynn Brothers, Inc. et al. v. First Medical Associates, et al.*<sup>59</sup> provides further instruction. There, the court considered an arrangement between a professional corporation organized under Texas law and a management services company. The professional corporation, First Medical Associates (FMA), was organized by a physician, and it was under contract with a hospital to staff its emergency department. FMA entered into a contract with a management services company, Flynn Brothers, Inc. (FBI) to assist FMA in administering the contract with the hospital. It was agreed that FBI was the exclusive agent of FMA, with restrictions on the ability of the physician owner of FMA to sell his stock in the professional corporation. The contract precluded FMA from engaging another entity for management services. Additionally, the contract between FMA and FBI provided for a share of net profits of FMA for the services of FBI. The court in *Flynn Brothers* also noted that FBI was the recipient of revenues which were, in turn, deposited into the FMA checking account maintained by FBI. It was not unusual for there to be a commingling of funds between the accounts of FMA and FBI. It was further noted that, to secure a pre-existing FBI debt, FBI pledged assets of FMA. A dispute arose regarding the contract between FMA and FBI, resulting in a lawsuit. The court determined that the contract was not enforceable since it contravened the Texas Medical Practice Act. Explaining that the heightened concern for the physician-patient relationship, untainted by abuses from lay control of professional corporations employing physicians, the court concluded that the terms of the contract between FMA

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to the management company that takes into account cost increases and decreases of the professional practice. 21 NCAC 16X.0101(d). All management agreements are subject to advance review by the North Carolina State Board of Dental Examiners.

<sup>58</sup> Op. Atty. Gen. Cal. 00-206 (July 27, 2000).

<sup>59</sup> 715 S.W.2d 782 (Tex. Ct. App. 1986).

and FBI, in practical effect, allowed FBI to practice medicine without a license, contrary to law. The court emphasized several key points. The FBI management contract specified that FBI was to receive 66.6 percent of the profits derived from the FMA practice. FBI had the right to use the medical license of FMA's owner to conduct business. FBI also retained the right to select medical staff to work in hospitals under contract with FMA. All of these things led the court to conclude that the management company was indirectly practicing medicine.

## **VII. ENFORCEABILITY OF CONTRACTUAL OBLIGATIONS BETWEEN MEDICAL PROVIDERS AND PAYORS**

The corporate practice ban can have implications in the contractual relations between medical providers and insurers for the payment for medical services. The ban can also arise in the context of non-compete agreements for physicians.

### **A. Payment for Services**

Case law has developed in disputes between medical providers and insurers, where the insurer either sues for the return of payments made to the provider, or refuses to make payment for medical services, arguing that the contract between the parties is not enforceable on grounds that the provider has run afoul of the state's corporate practice ban. In either one of these scenarios, the insurer contends that the contractual obligation to make payment is void. The courts have not always ruled in favor of the insurer.

Some courts, as a threshold matter, have determined that the insurer lacks standing to bring suit. Here, the courts decline to recognize a private right of action for the insurer, concluding that the authority to enforce a state's corporate practice ban resides solely with the state's attorney general under state law. Thus, in *State Farm Mutual Automobile Insurance Company and State Farm Fire and Casualty Company v. Andrew Jacobs, et al.*,<sup>60</sup> State Farm brought an action to recover payments made to Tacoma Therapy and Tacoma Rehabilitation for medical services rendered to policyholders. The two entities provided massage and physical therapy services. State Farm contended it was entitled to refunds because the two entities were never properly formed under Washington state law professional service corporations, and thus they were in violation of the state's ban on the corporate practice of medicine. The district court for the Western District of Washington granted a motion to dismiss under Fed. R. Civ. P. 12(b)(6). The court concluded that there was no express or implied private right of action to bring the suit. The district court observed that state law prohibits corporations from employing medical professionals to practice their profession. There is, though, an exception to this rule, allowing for the formation of an entity under Washington State's Professional Service Corporation Act (PSCA). That statute allows medical professionals to form, and to be employed by, a professional service corporation, provided that the shareholders are licensed to provide the medical services that are offered.<sup>61</sup> It was conceded by the plaintiff insurer that there was no express private right of action under the PSCA. The issue was whether the insurer had an implied private right to sue for recovery of monies paid. The district court

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<sup>60</sup> 2014 U.S. Dist. LEXIS 152564, No. C14-5512 (W.D. Wash. Oct. 28, 2014).

<sup>61</sup> Wash. RCW § 18.100.010.

declined to find such an implied right. To reach that conclusion, the court explained that the purpose of the legislature in enacting the PSCA was to preclude layperson influences on the doctor-patient relationship. Thus, insurers were not within the class for whose benefit the PSCA was enacted. The court wrote that the PSCA expressly provides that enforcement of the PSCA resides with the state.

In *State Farm Mutual Automobile Insurance Company v. Mobile Diagnostic Imaging, Inc.*,<sup>62</sup> the District Court for the District of Minnesota ruled against State Farm in an action brought by the insurer to relieve it of payment obligations to Mobile Diagnostic Imaging (MDI) for magnetic resonance imaging (MRI) scans performed for State Farm's insureds. In that case, MDI was in the business of doing MRI scans, and hired technicians for this purpose. Once the scans were done, MDI forwarded the results of the scans to physicians and radiologists with whom MDI independently contracted to interpret the results and write a report on the findings from the scan. These physicians and radiologists were employed separately by ProScan Reading Service (ProScan). In *Mobile Diagnostic Imaging*, State Farm contended that it was relieved of making further payments, on behalf of its insureds, to MDI for MRI scans since, in State Farm's view, MDI was in violation of Minnesota's ban on the corporate practice of medicine. The district court disagreed, and rejected the insurer's attempts to be relieved of payments to MDI on behalf of its insureds. First, State Farm argued that the technical component of the MRI scan was indivisible with the professional component of interpreting the scan, which was done by licensed medical professionals. According to State Farm, the MRI scanning procedure, as a whole, required the involvement of a licensed medical professional. Thus, the corporate practice ban was implicated, and MDI was in violation of it. The district court declined to reach this result. The court took note that under Minnesota law, a diagnostic imaging facility can be organized by laypeople,<sup>63</sup> suggesting that the MRI service itself can be performed by an unlicensed professional. The court's reading of the state statute thus provided for divisibility between the performance of the MRI scan and the interpretation of the test results. The court rejected State Farm's assertion that MDI technologists exercise independent professional judgment as unsupported by the evidence. State Farm pressed other points. It asserted that the actual performance of the scans by MDI, a lay organized entity, was itself a violation of the corporate practice ban. The court rejected this argument, explaining that the

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<sup>62</sup> 7 F.Supp.3d 934 (D. Minn. 2014). There are divergent views among states on the issue presented in *Mobile Diagnostic Imaging*. For example, New Jersey addresses ownership interests in diagnostic imaging facilities. Under N.J. Admin. Code § 13:35-2.6, "[a]ny diagnostic or screening office offering diagnostic or screening tests for a fee shall [b]e solely owned and under the responsibility of one or more physicians." In a Florida case, the court rejected the global billing used in *Mobile Diagnostic Imaging*. In *Regional MRI of Orlando, Inc. v. Nationwide Mut. Fire Ins. Co.*, 884 So.2d 1102 (Fl. Dist. Ct. App. 2004), the court reached its decision based on Florida Statute § 627.736(5) (a) that mandated a provider to "lawfully render" a medical service to be entitled to payment for the service. The court read "render" as not allowing the hiring of another company, or independent contractor, to perform the professional component on the MRI provider's behalf. In *Regional MRI of Orlando*, the MRI provider did not "render" the professional component of the MRI service, but rather used physicians under independent contract. The Florida court concluded that, in view of the global billing used by the MRI provider, it was not entitled to payment for the professional component.

<sup>63</sup> Quoting from Minn. Stat. § 144.565, subdiv. 1(2).

technicians employed by MDI were not state-licensed professionals. Finally, State Farm also argued that MDI relationship with the physicians and radiologists, as independent contractors, ran afoul of the corporate practice ban. This was so since, in State Farm's view, MDI used these professionals to interpret the scans and write a report on the findings. Thus, MDI was indirectly practicing medicine. The district court disagreed. It observed that MDI communicates directly with the patient's physician by transmitting the scans and the reports done by ProScan that interpret the scans. Thus, MDI has no direct communication with the patient's physician that would suggest the unlicensed practice of medicine.

Courts have declined to adopt a *per se* rule that would vitiate contractual duties for the payment of services rendered to an insured's enrollees where the medical provider is organized in violation of a state's corporate practice ban. The Supreme Court of Minnesota took this position in *Isles Wellness, Inc. v. Progressive Northern Insurance Co.*<sup>64</sup> There, the Court ruled that an insured's duty to pay must be honored where there is no determination that the owners exhibited a "knowing and intentional failure"<sup>65</sup> to adhere to a state's corporate practice ban. In *Isles Wellness*, three clinics, with a sole shareholder, were organized under Minnesota's Business Corporation Act,<sup>66</sup> and they provided chiropractic, massage, and physician therapy services. The owner was not licensed as a chiropractor; rather, the clinics hired chiropractors to provide services to the clinic's patients. Services were covered by the state's No-Fault Insurance Act, with patients assigning their insurance claims to the clinics. Two insurers had been paying under this insurance program for services rendered by the clinics; however, the insurers ceased payments, contending that there was no contractual duty to pay for the clinic's services. The insurers insisted that, since the clinics employed chiropractors, the clinics were in violation of the CPMD, and thus, as a matter of public policy, the contracts were void.<sup>67</sup> The Minnesota Supreme Court disagreed. The court wrote that the inquiry is whether the illegality has "tainted the transaction."<sup>68</sup> It ruled that, as a matter of law, a contract is not void as against public policy "unless it is injurious to the interests of the public."<sup>69</sup> The court emphasized that the corporate practice ban is aimed to protect the fiduciary role of physicians in making medical judgments, and to guard against conflicts that arise from profit motives. In *Isles Wellness*, the clinics, in seeking payment from the insureds, argued that the hired licensed chiropractors rendered services, thus allowing contracts with the insurers to be upheld on fairness grounds. The Minnesota Supreme Court rejected a bright-line rule that would have necessitated vitiating the contracts. It emphasized that the clinics hired licensed professionals. While state law allows for the voiding of contracts in violation of public policy, that need not always be the result. Voiding the contracts would do little to vindicate the policy for the corporate practice ban, to protect the public from lay control over the judgments of physician. On the other

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<sup>64</sup> 725 N.W.2d 90 (Minn. 2006).

<sup>65</sup> *Id.* at 95.

<sup>66</sup> Minn. Stat. ch. 302A.

<sup>67</sup> In *Isles Wellness, Inc. v. Progressive N. Ins. Co.*, 703 N.W.2d 513 (Minn. 2005), the Minnesota Supreme Court ruled that the corporate practice of medicine doctrine applies to chiropractic clinics.

<sup>68</sup> 725 N.W.2d 90, 93.

<sup>69</sup> *Id.*

hand, the court emphasized that voiding the contracts would unjustly enrich the insurers since their insureds reaped the benefits of medical treatment. The court concluded that since there was no evidence that the clinics intended to organize in violation of state law, fairness dictated that the contracts be enforced.

Similarly, in *California Physicians' Service v. Aoki Diabetes Research Institute*<sup>70</sup> Blue Shield, a health care service plan organized under California's Knox-Keene Act,<sup>71</sup> entered into a contract with Aoki Diabetes Research Institute (ADRI) whereby Blue Shield would reimburse ADRI for services rendered to Blue Shield subscribers. A dispute arose over Blue Shield's duty to continue payments to ADRI for services being rendered to Blue Shield's subscribers. Blue Shield brought suit for declaratory judgment seeking to establish that it was not obligated to reimburse ADRI. One of the arguments pressed by Blue Shield was that ADRI was in violation of California's corporate practice ban since, as a non-profit corporation, it contracted with licensed physicians to render services. That relationship was not permitted under state law. The Court of Appeal of California agreed that ADRI was doing business contrary to the state's corporate ban. It nonetheless declined to declare the contract between Blue Cross and ADRI unenforceable. The court emphasized that the contract between Blue Shield and ADRI was not *malum in se*, but rather was *malum prohibitum*. Moreover, citing *Isles Wellness v. Progressive*,<sup>72</sup> the court explained that to declare the contract void would raise the specter of unjustly enriching Blue Shield for services rendered to its subscribers without reimbursing ADRI. The court wrote that allowing Blue Shield to avoid payment would not vindicate the policy behind the corporate practice ban, that of protecting patients from the lay influence over medical judgments. Thus, although ADRI had not adhered to the CPMD, the court ruled that ADRI was entitled to receive payments from Blue Shield for services that had been rendered under its contract.

*Spine Imaging MRI, L.L.C. v. Country Casualty Insurance Company, et al.*<sup>73</sup> is an interesting case where the court allowed discovery on the issue of the independent contractor status of licensed radiologists. In that case, filed in the District Court for the District of Minnesota, the plaintiff, Spine Imaging MRI, was a provider of magnetic resonance imaging services to patients who assigned their claim for benefits under their insurance policies to Spine Imaging. The insurers had informed Spine Imaging that in their view, Spine Imaging was in violation of the corporate practice ban, and thus, the insurers were seeking recoupment of monies paid to Spine Imaging as assignee under the insureds' policies. Spine Imaging then brought suit seeking a declaratory judgment against the insurers to establish that it was not in violation of the state's CPMD. Spine Imaging admitted that its owner was an unlicensed layperson. The business did not employ licensed physicians or chiropractors. The MRI services provided by Spine Imaging was comprised of two separate steps, a technical component and a professional component. Spine Imaging contracted with independent licensed contractors to analyze

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<sup>70</sup> 2008 Cal. App. LEXIS 922 (Cal. Ct. App. June 17, 2008), *review denied* 2008 Cal. LEXIS 11250 (Cal. Sept. 17, 2008).

<sup>71</sup> Cal. Health & Saf. Code § 1340, *et seq.*

<sup>72</sup> 725 N.W.2d 90 (2006).

<sup>73</sup> 2011 U.S. Dist. LEXIS 9681 (D. Minn. Feb. 1, 2011).

the scans. The district court declined to grant the insurers' motion to dismiss. Of import to the court was the involvement Spine Imaging maintained after the scans had been done, when radiologists, as independent licensed contractors, analyzed the scans. Spine Imaging insisted that its independent contractors exercised their own judgment when analyzing the scans. Thus, according to Spine Imaging, there could be no unlawful practice of medicine by laypeople. It was on this basis that the district court denied the insurers' motion to dismiss, allowing discovery on the independence of the radiologists, and implications for the corporate practice ban.

Some courts have ruled against the provider of medical services, in favor of the insurer, in disputes over entitlement to reimbursement. The decisions in those cases are fact-specific, and governed by the state regulatory regime. For example, in *Prudential Property & Cas. Ins. Co. v. Midlantic Motion X-Ray*,<sup>74</sup> the insurer sought a declaratory judgment to establish that it need not reimburse the defendant, a facility for medical diagnostic testing. Diagnostic testing was provided to Prudential's subscribers, and the insurer offered personal injury automobile coverage for such services under New Jersey's Personal Injury Protection law. The court determined that the facility was a "medical diagnostic testing service," and as such, was subject to state statutory rules for the formation and operation of such facilities. The court ruled in favor of Prudential, explaining that the defendant was organized and operated contrary to New Jersey law.<sup>75</sup> Under state statute, the facility was required to be owned and controlled by a licensed physician. Additionally, the test results were to be interpreted by a licensed physician. However, the court determined that the facility was organized and operated by a chiropractor, not a licensed medical doctor. Moreover, tests were interpreted by the lesser licensed individual. Since the defendant was not organized and operated as required by New Jersey law, the court concluded that it was not eligible for reimbursement. A similar result followed in *Andrew Carothers, M.D., P.C. v. Progressive Insurance Company*,<sup>76</sup> a case arising under New York State's no-fault insurance regime. There, the court concluded that an MRI provider was not eligible for reimbursement as an assignee of benefits under New York's no-fault insurance statute since it failed to comply with the State's regulation, 11 NYCRR 65-3.16(a)(12). That regulation, promulgated to implement the State's no-fault insurance regime, deemed a provider of health care services ineligible for reimbursement under the no-fault law where the provider "fails to meet any applicable New York State or local licensing requirement." In that case, the provider of MRI services had organized as a professional service corporation, but the entity ran afoul of New York State's licensing laws that required the entity to be owned and controlled only by licensed professionals. Thus, the court ruled in favor of the defendant insurers.

Where there is an element of fraud in the formation of a corporation that renders medical services, resulting in a violation of the corporate practice ban, courts are more inclined to hold the incorporators accountable, and rule in favor of an insurer that seeks to recoup or to withhold payments for medical services rendered. For example, in a seminal New

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<sup>74</sup> 737 A.2d 711 (N.J. Super. Ct. 1999).

<sup>75</sup> Citing N.J.C. 13:35-2.5(b).

<sup>76</sup> 979 N.Y.S.2d 439 (2013).



York case, *State Farm Insurance v. Mallela*,<sup>77</sup> State Farm participated in New York State's no-fault insurance regime<sup>78</sup> as assignee of claims for medical services rendered to patients covered by that program. State Farm had brought suit in federal district court seeking relief, alleging that the corporation billing for medical services was fraudulently incorporated to evade the state's corporate practice ban. State Farm sought a declaratory judgment that it need not pay for medical claims, and, separately, that it was entitled to equitable relief for payments made for past claims. The district court dismissed the insurer's complaint. The Court of Appeals of the State of New York accepted certification to address whether, as a matter of law, a fraudulently incorporated company that rendered medical services was entitled to reimbursement under the state's insurance law. In this case, it was alleged that medical service corporations were established with bogus applications filed with the state. The unlicensed defendants had paid licensed physicians to use their names on papers to establish the physicians as nominal owners of the entities. The physicians played no role in the medical service corporations. Rather, the non-physician defendants controlled the business. To further the scheme, the defendants had the corporations enter into separate contracts with management companies (owned by the defendants) which billed the medical corporations for services at inflated rates. This allowed profits to be siphoned from the medical service corporations to the non-physician owners of the management companies. In rendering its opinion, the Court of Appeals assumed that the allegations made by State Farm were correct, that the medical provider was fraudulently incorporated. The Court of Appeals applied implementing regulation 11 NYCRR 65-3.16(a)(12), a rule that precluded payment for medical services where "the provider fails to meet any applicable New York State or local licensing requirement."<sup>79</sup> The Court of Appeals found that the rule was valid, precluding payment where a provider was fraudulently licensed. It thus ruled, as a matter of law, in favor of State Farm on its request for declaratory judgment.<sup>80</sup>

## **B. Non-Compete Clauses in Physician Employment Contracts**

There is a lack of uniformity nationally with regard to the enforceability of non-compete provisions governing physician employment contracts. Some states have legislated that such restrictions are against public policy, and thus restrictive covenants in such contracts are not enforceable. State courts, moreover, differ in their views regarding non-compete provisions. Case law indicates that some courts have taken a dim view of these clauses, applying a *per se* rule of illegality and refusing to enforce them. Other state courts prefer to consider the terms of a non-compete clause in a physician's contract, especially the durational and geographic limitations, and render a judgment based on a rule of reasonableness. In litigation over these restrictive covenants, physicians have either sought a declaration of invalidity of the non-compete clause, or have asserted a

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<sup>77</sup> 827 N.E.2d 758 (NY 2005).

<sup>78</sup> N.Y. Insurance Law § 5101, *et seq.*

<sup>79</sup> Rule effective April 4, 2002.

<sup>80</sup> The Court of Appeals ruled that no cause of action was allowed for any payments made by the insurer before April 4, 2002, the effective date of the regulation. *See also Liberty Mutual Insurance Company, et al. v. Excel Imaging, P.C. et al.*, 879 F. Supp. 2d. 243 (E.D. N.Y. 2012).

defense in an action for breach of contract, arguing that the non-compete provisions in the employment agreement are not enforceable.

In litigation where the enforceability of a non-compete agreement is at issue, physicians have separately raised the ban on the corporate practice of medicine, arguing that the employment contract between the hospital, or other medical facility, and the physician is itself void. There has been mixed success with this argument. In *Dr. Allison, Dentist, Inc. v. Allison*,<sup>81</sup> the Supreme Court of Illinois declined to enforce the non-compete provision on grounds that the employment agreement between the physician and a dental corporation ran afoul of the corporate practice ban, and thus, under state law, was illegal. A similar result was reached in a case considered by the Supreme Court of Kansas, in *Early Detection Center, Inc. v. Wilson*,<sup>82</sup> where the Court addressed a restrictive covenant in an employment contract between a physician and a general corporation. In that case, two physicians licensed to practice medicine and surgery in Kansas formed a partnership, and later established their practice as a professional corporation. The articles of incorporation restricted the directors and ownership of the corporation to persons licensed to practice medicine. The physician owners later took steps to re-organize into a general corporation, and the articles of incorporation permitted non-licensed individuals to be owners of the general corporation. Following the re-organization, the two physician owners sold a percentage of their ownership interests in the general corporation to individuals who were not licensed to practice medicine. The general corporation was in the business of offering medical services, and thus ran afoul of the State's CPMD. A dispute over management issues arose involving one of the licensed physicians, who resigned and then began to steer the corporation's patients to another medical provider. The corporation filed suit against the physician, claiming a breach of the non-compete provision in his contract. The district court declined to enforce the restrictive covenant, ruling that there could be no contract between a general corporation and a physician to perform medical services. The court of appeals affirmed, citing the Kansas Healing Arts Act,<sup>83</sup> which imposed licensure requirements and precluded entities from practicing medicine or offering such services through licensed practitioners. The court thus reasoned that the contract between the general corporation and its physicians was not enforceable.

Other courts have similarly ruled in favor of physicians, declining to enforce non-compete clauses in contracts that run afoul of the CPMD. For example, in *Nipun Parikh, M.D. v. Family Care Center, Inc.*,<sup>84</sup> a corporation sought judgment against a physician for alleged violation of a non-compete clause in an employment contract. The Supreme Court of Virginia denied relief sought by the plaintiff after concluding that the corporation did not have a protected interest in enforcing the covenant not to compete. The plaintiff was originally organized as a professional corporation, the Family Care Center, with a physician as its owner and director. At that time, the corporation entered into an employment agreement with a physician. When the entity's physician owner died,

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<sup>81</sup> 196 N.E. 799 (Ill. 1935).

<sup>82</sup> 811 P.2d 860 (Kan. 1991).

<sup>83</sup> K.S.A. § 65-2803.

<sup>84</sup> 641 S.E.2d 98 (Va. 2007).

by operation of law it became a non-professional corporation. At the time the employment agreement was signed by the parties, it stated that the entity “is presently engaged in the practice of medicine . . .”<sup>85</sup> Upon becoming a non-professional corporation, the entity was no longer permitted to practice medicine. The physician terminated his employment with Family Care Center, leaving to work for another medical center nearby. The corporation brought suit to enforce the restrictive covenant. The Supreme Court of Virginia focused on whether the non-professional corporation had a legitimate business interest in enforcing the non-compete clause. The court concluded there was no such interest, noting that the employment agreement containing the restrictive covenant stated that, at the time it was executed, the corporation was “presently engaged” in the practice of medicine. At that time, the corporation had a protected business interest in the non-compete clause. The Court wrote that when the entity reverted to a non-professional corporation, it lost its legal authority to practice medicine. Thus, the Court reasoned that the corporation no longer had a legitimate business interest in enforcement of the covenant not to compete.

An often cited case, *Carter-Shields v. Alton Health Institute*,<sup>86</sup> provides instruction on the mode of reasoning used in Illinois by courts when faced with disputes involving non-compete agreements involving physicians where the CPMD is implicated. In that case, a board-certified family practice physician entered into an employment agreement with Alton Health Institute (AHI), a non-licensed general not-for-profit corporation. AHI was owned by two separate entities, each holding a 50 percent interest.<sup>87</sup> The contract between the physician and AHI contained a restrictive covenant. Disputes arose between the physician and AHI. The physician filed suit for declaratory judgment, contending that her employment agreement violated the corporate practice ban, and asked the court to find her employment agreement containing a restrictive covenant unenforceable. Defendant AHI filed a counterclaim, and moved for injunctive relief, seeking to enforce the non-competition clause in the employment agreement. The trial court ruled in favor of the defendant, in part citing the decision rendered by the Supreme Court of Illinois in *Berlin v. Sarah Bush Lincoln Health Center*. The trial court read that decision as carving out an exception to the Illinois corporate practice ban for entities, like AHI, that are non-profit charitable organizations. The court also held that the non-compete clause was reasonable on its face, and thus enforceable. The trial court further concluded that plaintiff had breached the employment agreement. On appeal, the court of appeals reversed the lower court’s decision. It determined that the trial court’s reliance on *Berlin* was misplaced. Specifically, the court of appeals explained that in *Berlin*, the Supreme Court of Illinois carved out an exception from the corporate practice ban for hospitals only. Thus, the trial court had wrongly applied the exception announced in *Berlin* to the defendant, a non-licensed charitable not-for-profit corporation. The court of appeals

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<sup>85</sup> *Id.* at 99.

<sup>86</sup> 777 N.E.2d 948 (Ill. 2002).

<sup>87</sup> The first entity that owned a 50 percent interest in AHI was a health system, a tax exempt not-for-profit corporation, and was not licensed as a hospital or medical services corporation. The second entity owning a 50 percent share of AHI was a partnership, composed primarily of physician groups, and had one non-physician member.

wrote that “from its inception, the agreement between AHI and plaintiff was void . . .”<sup>88</sup> The Supreme Court of Illinois affirmed, in part, the appellate court’s decision, finding that its earlier ruling in *Berlin* did not provide an exception to what was otherwise the unlawful practice of medicine by AHI in view of its nature as an entity that was not licensed to provide medical services to the public. Thus, the employment agreement between the physician and AHI, and thus the non-compete clause, were unenforceable.

Where an Illinois professional corporation fails to obtain a certificate of registration, as required by the Illinois Professional Service Corporation Act,<sup>89</sup> that fact, standing alone, will not provide grounds for declaring a contract between a medical group and a physician void. That was the holding in *Mary T. Riggs v. Woman To Woman, Obstetrics and Gynecology, P.C. (Riggs)*,<sup>90</sup> where the court declined to void a contract in a challenge to a covenant not to compete. In that case, the plaintiff, a physician employed by a medical practice brought suit, alleged fraudulent accounting practices by the medical practice. The physician also averred that prior to employment with the medical practice, she was misinformed by the medical group in that assurances were given to her that the medical practice, a corporation, was registered to practice medicine in Illinois. It was alleged that at the time the employment contract was signed, the medical practice failed to register for a certificate with the Illinois Department of Professional Regulation (IDPR), as required under the Professional Service Corporation Act. In the lawsuit, the plaintiff sought a declaratory judgment that the contract with the medical group was void *ab initio*, and thus the restrictive covenant was not enforceable. The district court granted the relief sought and certified the matter for interlocutory appeal. On appeal, the court declined to rule in the plaintiff’s favor. The court of appeals noted that the defendant was originally formed as a medical corporation, and it filed an application with the IDPR for a certificate of registration. The IDPR misdirected its written request that “minor, technical changes”<sup>91</sup> be made to the application. The application filed by the medical corporation expired. The IDPR was ultimately successful in communicating with the medical corporation, and it requested that a new application be filed, with the needed changes to the application. This was done, and a certificate was issued to the medical corporation, after the plaintiff brought her lawsuit. The court of appeals emphasized that no fine was imposed against the medical corporation, and no investigation was undertaken as a result of the “inadvertent expiration”<sup>92</sup> of the initial application for a certificate. The court then reviewed the purposes of the Professional Service Corporation Act. It interpreted the text of the Act, and observed that the Act was not enacted for the protection of the public health. Rather, the statute was “primarily permissive,” affording medical professionals an avenue, and benefits, under state law to incorporate. In reaching this conclusion, the court of appeals contrasted the Act with the State’s Medical Practice Act of 1987.<sup>93</sup> The Medical Practice Act, in the court’s view, was a public health statute, enacted to impose licensure requirements to ensure adequate

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<sup>88</sup> *Id.* at 954.

<sup>89</sup> 805 ILCS 10/12.

<sup>90</sup> 812 N.E.2d 1027 (Ill. Ct. App. 2004).

<sup>91</sup> *Id.* at 1029.

<sup>92</sup> *Id.* at 1030.

<sup>93</sup> 225 ILCS 60/1 *et seq.*

training, and thereby protect the public. The Professional Service Corporation Act, on the other hand, had a different purpose. That statute was to ensure that the owners, directors and officers, licensed to practice in their profession, are organized solely to render a type of service. The court wrote that “[c]learly, the intent of the legislation . . . was not to advance the public welfare but to allow professionals to incorporate . . . to enjoy certain . . . benefits” arising therefrom. Thus, the court rejected attempts by the plaintiff to analogize the lack of a certificate of registration by the defendant to practice as a medical corporation with the lack of a license to practice medicine. Since the Act lacked a public health purpose, the court ruled that the lack of a certificate of registration by the defendant would not result in voiding the contract between the plaintiff and the defendant, where there was no showing of prejudice against the plaintiff. The court of appeals in *Riggs* distinguished its ruling to the holding in *Carter-Shields v. Alton Health Institute*, reasoning that in *Carter-Shields*, a general corporation incorporated under Illinois law by non-licensed owners employed licensed physicians to practice medicine, directly contrary to licensure laws and the corporate practice ban. In *Riggs*, the professional corporation was owned by licensed physicians, and thus there was no implication of a lay entity employing the physicians.

It is reasonable to construe the decision in *Riggs* as predicated not only on the interpretation of the State’s registration law, but on the facts as well. The court of appeals noted technical issues with the certificate of registration for the professional corporation, and through inadvertent mishaps, a delay occurred in the issuance of a certificate. There was no suggestion of fraud or attempts to evade state law, and the medical corporation, as required, was owned by licensed physicians. The analysis and reasoning of the *Riggs* court was embraced by the Supreme Court of Illinois in *Chatham Foot Specialists, P.C. v. Health Care Service Corporation*,<sup>94</sup> on a different set of facts. The issue in *Chatham* concerned the registration requirements under Illinois’ Professional Service Corporation Act (the Act),<sup>95</sup> and a podiatric practice organized under that statute. The practice had as a sole shareholder, officer, and director who was a duly licensed podiatrist under the Podiatric Medical Practice Act of 1987.<sup>96</sup> The Court in *Chatham* wrote that the requirement under the Act to obtain a certificate of registration was not a regulatory measure to protect the public health. Thus, failure to have had a certificate would not lead to the conclusion that the professional service corporation was practicing podiatry without a license.

## VIII. FEE-SPLITTING ARRANGEMENTS

As a corollary to the corporate practice prohibition, many states have fee-splitting rules that impact relationships between medical professionals and other parties. These rules differ among jurisdictions, and are an important consideration in crafting collaborations. The fee-splitting rules are codified in statutes, and some courts have rendered decisions on their applicability and scope. Additionally, state attorneys general have opined on the subject. Several opinions from various jurisdictions illustrate the issues that can arise in this area.

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<sup>94</sup> 837 N.E.2d 48 (Ill. 2005).

<sup>95</sup> 805 ILCS 10/12.

<sup>96</sup> 225 ILCS 100/1, *et seq.*

A decision rendered by the Supreme Court of Illinois on fee splitting is instructive. In *Vine Street Clinic et al. v. Healthlink, Inc.*,<sup>97</sup> the Court addressed the payment arrangement between Healthlink and its network of physicians. Healthlink engaged physicians to join its network of providers, and marketed the services of its network to members of health plans. The network physicians agreed to provide medical services to health plan members, and charge the plans a discounted rate. Healthlink would process the claims of the network physicians, and send them to the health plans for benefit determination and payment. Plaintiff Vine Street (a partnership of physicians) and an individual physician plaintiff were part of Healthlink's network, and they paid Vine Street an administrative fee for its services. Healthlink initially used a percentage-based fee, and later switched to a fixed flat-fee arrangement. The percentage-based fee was 5 percent of the amount in HealthLink's rate schedule for physician services provided to plan members. The fixed flat fee was derived by considering the physician specialty, and volume of claims submitted by the physician. In *Vine Street Clinic*, plaintiffs challenged these fee arrangements, alleging that both types of fees violated the Illinois Medical Practice Act.<sup>98</sup> In construing section 22(A) (14) of the Act, the court in *Vine Street Clinic* determined that the percentage fee was void, and deemed the fixed flat fee lawful. The court explained that a goal of section 22(A)(14) was to guard against referrals by a non-physician for medical services out of personal gain, and to safeguard the physician's independence. The court reasoned that the flat fee "fairly compensates" Healthlink and avoids "a prohibited diversion of the physician's remuneration."<sup>99</sup>

The Illinois legislature in 2009 amended the Illinois Medical Practice Act of 1987 regarding fee-splitting rules.<sup>100</sup> There, the State legislature relaxed restrictions on fee-splitting by physicians and optometrists. The newly enacted amendments permit a percentage fee for billing and collection services, and allow only a fixed fee for management and administrative services. Specifically, a fair market value, percentage fee or flat fee is permitted for billing, administrative preparation and collection services, provided the licensee maintains control over the amount of fees charged and collected, and the charges collected are deposited in an account of, and controlled by, the licensee. Additionally, the amendment precludes payment of a percentage fee by a licensee, but allows a flat fee paid to a third party for marketing or management of the licensee's practice, allowing the licensee to be included in a network of providers and negotiating fees on behalf of the licensee.

In *Alpha Real Estate Company of Rochester v. Delta Dental Plan of Minnesota, et al.*<sup>101</sup> the court reviewed a five percent charge formula that was at the heart of a dispute in negotiations to purchase property being leased as a dental practice. The dispute was between a lessee of a dental clinic, Alpha Real Estate Company, and a company that owned the property, Delta Dental Plan. Delta owned a subsidiary, Sui Generis Development Company. Sui Generis constructed and equipped the dental clinic, and it

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<sup>97</sup> 856 N.E.2d 422 (Ill. 2006).

<sup>98</sup> 225 ILCS 60/22/(A)(14).

<sup>99</sup> 856 N.E.2d 422, 435.

<sup>100</sup> Ill. Public Act 096-0608.

<sup>101</sup> 671 N.W. 2d 213 (Minn. Ct. App. 2003), *reviewed denied* 2004 Minn. LEXIS 27 (Minn. 2004).

leased the property to Alpha. Delta Dental was also a health service plan that sold and administered dental benefits to group plans. The clinic was, in turn, leased by Alpha to a separate dental center, Apollo Dental Center, PLC, which entered into a provider agreement with Delta Dental to provide services to plan members. A licensed dentist owned both Alpha and Apollo. The lease agreement between Sui Generis and Alpha contained a provision stating that if during a period of years, the adjusted cash receipts exceeded \$1 million, Alpha would pay to Sui Generis an additional five percent of adjusted cash receipts. Alpha did not honor this provision under the lease. The owner of Alpha, the dentist, attempted to exercise the option to purchase the property Alpha had been leasing from Sui Generis. The owner of the leased property, Delta Dental, conditioned the sale on Alpha's agreement to pay, after the sale, a five-percent charge, similar to the five percent clause in the lease agreement, on a continuing basis after the sale. A dispute arose, and Alpha sued to enforce its option to purchase the property. The court in *Delta Dental Plan* considered the five percent charge that Delta Dental had sought as a condition of the sale. The court determined that the five percent charge violated Minnesota's anti-fee splitting law.<sup>102</sup> Under the state's statute, it was unlawful for a dentist to divide fees, or to pay a commission to a person who sends patients to the dentist for treatment. The court in *Delta Dental Plan* explained that public policy precludes the payment of referral fee, and fee-splitting agreements require a division of labor to be lawful. The court viewed the five percent charge as directly tied to the amount of receipts from patients. It viewed Delta Dental, the health service plan, and the owner of the property to be sold, as engaging in marketing efforts to refer patients to the dental clinic. In finding the five percent charge to be in violation of Minnesota's anti-fee-splitting statute, the court concluded that the law prohibited dentists from dividing fees with those who refer patients for treatment.

Other courts have addressed the splitting of fees in the context of management services arrangements. *Virgiliu Necula, M.D. v. Martin J. Conroy et al.*,<sup>103</sup> involved a physician and radiologist, as a provider under the New York Medicaid program. In that case, the federal court construed and applied New York's fee-splitting statute,<sup>104</sup> and ruled against the physician. The physician established a radiology practice. Under review were contracts at different times that the physician had with two MSOs for management services. Those agreements specified that the MSO would provide facilities, x-ray and other medical equipment as well as non-physician staff and management of the finances for the radiology practice. The physician agreed to pay the MSOs a fixed percentage of his receipts for billing services and a fixed dollar amount for each procedure performed. During the period of these management services agreements, the physician received payments from the New York's Medicaid program. The State audited Medicaid payments made to the physician, and a determination was made that the physician engaged in unlawful fee-splitting under the MSO arrangements. New York's fee-splitting statute prohibited sharing in fees by the physician with the MSO as payment based upon "a percentage of, or is otherwise dependent upon, . . . income or receipts of the licensee . .

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<sup>102</sup> Minn. Stat. § 150A.11.

<sup>103</sup> 2000 U.S. Dist. LEXIS 8928 (S.D. N.Y. June 30, 2000); *aff'd* 2001 U.S. App. LEXIS 13729 (2<sup>nd</sup> Cir. 2001).

<sup>104</sup> N.Y. Education law § 6530(19).

. .”<sup>105</sup> The State determined that the physician violated the fee-splitting provision. It thus requested the physician to return Medicaid payments received and also excluded the physician from the State Medicaid program. The physician sought review of the State’s actions at several administrative and judicial levels. The district court granted New York’s motion for summary judgment. The court affirmed the State’s determination that the physician violated the state’s prohibition on fee-splitting, and upheld the remedies and sanction imposed by the state.

## **IX. OBSERVATIONS**

The CPMD is a state law driven concept, and is thus one that varies widely from state to state. This variance, of necessity, requires a heightened inquiry in any given case to determine how state law applies to a particular set of facts. Practitioners need to also have an awareness of the fee-splitting rules adopted by many states.

The healthcare industry has looked for ways to adapt to the CPMD because of economic forces and the mounting pressures to collaborate and integrate among medical providers. This is no less so in the present day, with healthcare reform’s emphasis on adopting models to promote and reward collaboration among medical providers of varied disciplines.

Through time, the restrictive impacts of the corporate practice ban, in its absolute form, have been reined in either by state enactment of statutory exceptions and amendments to state laws. Legal structures have also been crafted to accommodate, or work around, the reach of the prohibition. To be sure, the corporate practice ban is still a doctrine that retains relevance in many states, necessitating an awareness of the prohibition by those who are participants in healthcare delivery, and the collaborations that arise therefrom.

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<sup>105</sup> *Id.*