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CLIENT ALERT

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Corporate Practice of Medicine on Steroids

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At a time when many are questioning the continued utility and viability of the corporate practice of medicine ban, California may be doubling down. On May 3, 2021, the California Senate Health Committee approved SB-642, the stated purpose of which is to protect medical decision-making from lay control. The bill is currently pending in the California Senate. Assembly Bill AB-705 is a substantially identical bill in the California Assembly.

The SB-642 adds Section 2408.5 to the Business and Professions Code, as follows:

> **2408.5.** (a) The shareholders, directors, and officers of a medical corporation as set forth in Section 2408 shall manage and have ultimate control over the assets and business operations of the medical corporation and shall not be replaced, removed, or otherwise controlled by any lay entity or individual, including, without limitation, through stock transfer restriction agreements or other contractual agreements and arrangements.
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> (b) For purposes of this section, "ultimate control" shall mean and be consistent with the definition provided by generally accepted accounting principles.

New Section 2408.5 takes direct aim at the management services organization ("MSO")/friendly professional corporation ("PC") model. Under this model, an MSO, owned wholly or in part by non-licensed individuals, provides administrative support services to a medical practice pursuant to a written services agreement. Often, the MSO provides everything that that does not require a medical license to provide, including space, supplies, equipment, non-professional staff, accounting, billing and collection, and payables management. A well-crafted management services agreement clearly recognizes the PC's control over all clinical decisions and the medical practice itself, including the authority to hire physicians, set clinical protocols and enter into agreements to provide medical services.

As it is currently used, the MSO/friendly PC model permits physicians to concentrate on the practice of medicine while delegating to experienced managers the myriad non-clinical functions necessary to keep the practice afloat. It also provides a vehicle for investment capital, by providing a mechanism for unlicensed investors to provide financing to medical businesses. For this reason, most telemedicine businesses in California (and other states that ban the corporate practice of medicine) are organized using the MSO/friendly PC model, as are other specialty practices requiring expensive equipment, such as radiation oncology. The model further permits medical practices to realize economies of scale by pooling support resources while maintaining control over their individual practices.

Section 2408.5 mandates that the shareholders, directors and officers of a medical corporation "manage and have ultimate control over the assets and business operations of the medical corporation." Unfortunately, it is not clear what that means in the MSO context. Does it mean that the physician shareholder of a professional corporation must personally bill and collect for his own professional services or must personally pay the bill of the linen service that the practice uses? Is the professional corporation required to directly employ staff to perform these functions or may it purchase the services from a third party as long as it retains the rights of a principal in dealing with an agent? How can this language be applied in practice? None of these questions are answered by the language of SB-642.

Further, the Section's use of the financial accounting term "ultimate control" implicates the ability of MSOs to consolidate financial results, a practice important to investors. Historically, health care lawyers have recognized that the definition of "control" used for a financial consolidation analysis is not dispositive of the issue for corporate practice of medicine purposes, especially where the PC explicitly retains all clinical control. Conflation of the two control definitions could have the unintended effect of cutting off California health care businesses, including California's burgeoning telemedicine industry, from investment capital under the guise of preserving physician autonomy.

Section 2408.5 also provides that the shareholders, officers and directors of a medical corporation "shall not be replaced, removed, or otherwise controlled by any lay entity or individual, including, without limitation, through stock transfer restriction agreements or other contractual agreements and arrangements." This portion of the Section is clearly aimed at agreements commonly called succession agreements or stock transfer restriction agreements, which permit the MSO to require the PC's shareholder to transfer ownership to a designated licensee upon the occurrence of certain events, including death, disability or loss of license of the shareholder, breach of the services agreement or a simple notice by the MSO. The intention of this restriction, as set forth in Section 1 of SB-642, is to prevent undue interference in the practice of medicine due to improper motives, including discrimination, profit or cost control, business or competition, or any other nonmedical motives.

Section 2408.5 also implicates the delivery of managed health care in California. California generally utilizes a "delegated model," under which health care service plans delegate to medical groups or independent practice associations ("IPAs") the delivery of health care services to a defined group of enrollees. These medical groups and IPAs are medical corporations governed by Section 2408.5. Most, if not all, have agreements with lay MSOs to handle their contract management, credentialing, and claims submission, as well as to assist with utilization management and quality assurance. The MSO services are provided by companies with deep experience in the nonclinical aspects of delivering health care services under a delegated model. The same statutory language that vaguely mandates physician control and management in the medical practice context similarly fails to provide guidance in the managed care context, potentially affecting the delivery of health care to millions of Californians.

The issues for the hundreds (if not thousands) of California PCs currently contracted with MSOs are obvious: first, do their existing services agreements comply with the imprecise requirements of Section 2408.5 in terms of the degree of control over the practice the PC must retain; and second, how can they attract investment capital if the investors are not permitted to have any say in the shareholders, officers and directors of the medical business they are supporting and are not permitted to consolidate financial results?

The ability of licensed physicians to practice medicine free of undue influence from unlicensed persons or entities has been the purpose of California's corporate practice of medicine ban since its inception. There is no question that specific guidance from the legislature and the California Medical Board can assist in making sure that this goal is achieved. Unfortunately, SB-642 in its present form cannot achieve that goal, because its mandates are not concrete or specific enough to be practically applied. California medical practices, IPAs and MSOs, in the exercise of utmost good faith, will struggle to determine whether their existing arrangements satisfy the terms of new Section 2408.5, and investors in medical businesses may well steer clear of California until the permissible terms of their arrangements can be determined.

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