New York is one of many states that prohibit the “corporate practice of medicine” (CPOM). The CPOM doctrine generally bars a business corporation from practicing medicine or employing a physician to provide professional medical services. The doctrine has existed since the early 20th century, but its continuing vitality is evidenced not only by periodic litigation, but as well by recent scrutiny from and investigations by state regulatory agencies.

The CPOM prohibition finds its sources in the New York Education Law, which in Section 6522 states that “only a person licensed or otherwise authorized under this article shall practice medicine.” The scope of New York’s CPOM doctrine has been expanded to include “arranging for” medical services by an unlicensed corporation. For example, in State v. Abortion Information Agency, a 1972 case, the Court of Appeals found that an abortion referral agency violated the CPOM ban when it engaged physicians to perform abortions, as well as paid the hospitals, and then submitted global bills to the patients.

The rationale behind the CPOM prohibition is rooted largely in considerations of public policy—corporate ownership of physician practices may undermine the physician’s exercise of independent medical judgment in the best interest of the patient, since a corporation’s interests are presumed to be maximizing its own profits. The prohibition is intended to ensure that medical decisions are based exclusively upon the sound and independent judgment of licensed medical professionals without interference from unlicensed persons or entities, and that a physician’s loyalty remains with his or her patients and is unaffected by improper financial influence.

The unlicensed practice of medicine, or aiding in or abetting the unlicensed practice of medicine, is a felony in New York. The attorney general is authorized to seek injunctive relief against repeated fraudulent or illegal acts, and is further authorized to bring an action to dissolve a corporation for exceeding its legal authority or conducting or transacting its business in a persistently fraudulent or illegal manner.

Inherently intertwined with New York’s CPOM ban is its fee-splitting prohibition. It is professional misconduct for a licensed professional to share fees for professional services with another person other than the licensee’s partner, employee, associate in a professional corporation, or a professional subcontractor or consultant authorized to practice medicine. This prohibition includes percentage-based payment arrangements in agreements involving the furnishing of space, facilities, equipment or personnel to professionals.

Exceptions to Prohibition

There are several exceptions to New York’s CPOM prohibition. Physicians are permitted to practice medicine and share fees through partnerships, professional corporations (PC), professional limited liability companies (PLLC), and university faculty practice plans. PCs and PLLCs may employ physicians without violating the CPOM or fee-splitting prohibitions, provided that each of the shareholders or members is a licensed physician and that the physicians are actively involved in the practice.

New York courts have recognized the ability of hospitals, including general hospitals, public health centers, diagnostic and treatment centers, nursing homes, as well as medical schools, to engage in the practice of medicine, to charge fees and share such fees with licensed professionals.

School health programs are an exception to the CPOM bar. Also, a business corporation may have a physician or nurse staff its employee health service or handle medical emergencies because it is not holding itself out as supplying health care services to the general public or charging fees to those being treated.
In addition, business corporations may provide management services for licensed professionals (e.g., scheduling, billing, clerical staffing, etc.), as long as there is a clear distinction between the party providing the professional services and the party providing the management services. The management services arrangement must allow the physician/professional entity to retain independent judgment in all matters related to the practice of medicine.

Litigation and Scrutiny

The CPOM prohibition has often been litigated in the context of breach of contract lawsuits. In several reported cases, parties to agreements that were found to violate the CPOM ban were denied the ability to recover insurance company payments, and were unable to assert contract breaches. In *Accident Claims Determination Corp. v. Dust*, the Appellate Division, First Department, held that a corporation that arranged for medical examinations for clients of insurance companies was engaged in the illegal practice of medicine. In *State Farm v. Mallela*, the Court of Appeals held that an insurance carrier could withhold no-fault payments for professional services provided by a company owned and controlled by non-physicians, and which therefore was considered to have been fraudulently incorporated.

The New York State Education Department regularly monitors claimed CPOM violations involving medical care in which business corporations are involved. One area that has received much scrutiny is the provision of health care services to inmates in jails and prisons located throughout the state. Over the course of the past two decades, there has been a marked increase in the privatization of health care provided to prisoners, with state and local municipalities outsourcing prison health care to business corporations serving as private contractors.

In those states that do not have a CPOM prohibition, correctional health care companies provide medical, nursing and other health services directly through employed personnel. In corporate practice of medicine jurisdictions such as New York, however, the CPOM ban does not allow the direct rendering of such services.

For many years, New York’s Commission of Correction (COC), which investigates deaths in correctional facilities within New York and makes recommendations for improving the delivery of health care to detainees and sentenced offenders, has raised concerns about the increasing privatization of health care provided in correctional facilities. When investigating adverse incidents at an institution in which care is provided through a private business corporation, the COC regularly cites to the corporation’s practice structure as a contributing factor to what it may believe is inadequate care.

The CPOM prohibition is intended to ensure that a physician’s loyalty remains with his patients and is unaffected by improper financial influence.

In the mid-2000s, the Education Department investigated the manner in which a business corporation provided correctional health care services to the incarcerated population in certain New York prisons and jails. The company was knowledgeable about New York’s CPOM requirements, and structured its contracts, both with the municipalities operating the penal institutions and with the health care professionals, to comply with those requirements. Nonetheless, the department’s investigation ultimately led the corporation to restructure its contracts in order to remain in compliance with CPOM requirements.

New York’s regulatory oversight has not been limited to the Education Department. Over the past few years, the Attorney General’s Office, which has law enforcement authority, has investigated correctional health care provided to inmates in various New York prisons and jails through a particular business corporation. The Attorney General’s investigation was critical of the quality of care in several instances, and drew a connection (contested by the company) between the failure to follow CPOM requirements and deficiencies in care, including several inmate deaths.

The need to comply with New York’s CPOM requirements is by no means confined to the correctional health care context. CPOM considerations often stand in the way of private equity investors and others who may seek to monetize, or otherwise capitalize upon, the revenue generation capabilities of large and sophisticated medical practices. Since direct ownership of such medical practices by non-medical business entities is not permitted, transactions of this type (assuming the requisite return on investment and other economic considerations of the parties are able to be met) have resorted to the use of management agreements and other devices to achieve the desired ends.

These issues demonstrate that it is extremely important for any corporate entity involved in the delivery of health care services—not just limited to the correctional facility context—to create an appropriate organizational and contract structure in order to avoid running afoul of the CPOM prohibition.

Contract Guidance

Since corporate entities that are neither licensed nor owned by licensed professionals are unable to directly own a physician practice, they often enter into contractual arrangements commonly known as “friendly PC” relationships.

In the friendly PC model, the PC issues its stock to one or more “friendly” physician shareholders, who are cooperative with the business corporation with which it proposes to structure a deal. The PC and its employed physicians, nurses and other professionals provide the professional services to the PC’s patients, but the structural, operational and, to varying degrees, financial control over the PC is exercised by the business corporation pursuant to any number of documents and agreements.

These can include (i) an asset purchase agreement, pursuant to which...
the tangible assets (e.g., equipment, supplies, etc.) of the physician practice are acquired by the business corporation; and (ii) a management services agreement between the business corporation and the PC, whereby the business corporation is delegated all of the non-professional functions of the practice, such as billing, collection, practice management services (medical malpractice coverage, office services, etc.), accounting, legal services, human resource services and more.

Percentage-based management fees are problematic from a fee-splitting perspective. As a result, the “safe” course of action to follow in setting management fees would be on a fixed fee, fair-market basis. While that is the prudent approach, it is not always possible for an investor’s financial goals to be able to be met within fixed fee, fair-market value constraints.

A stock transfer restriction agreement (pursuant to which the physician shareholder is prohibited from transferring his shares to another physician without the prior approval of the business corporation, or conversely, is required to transfer his shares to another physician at the direction of the business corporation) is a common security mechanism for a business corporation in a friendly PC transaction. However, use of stock transfer restriction agreements has been met with resistance by the Education Department.

In theory, the combination of the business corporation’s authority over the non-professional business affairs of the practice, while at the same time allowing the physician to treat patients without infringing on his professional judgment, should strike the right balance of control from a regulatory perspective. However, there is always the risk that a regulator will find that such an arrangement violates the CPOM prohibition.

In the commercial business context, i.e., in situations in which a non-health care entity (such as a private equity firm) attempts to control a licensed provider, the friendly PC model (particularly if it is coupled with the use of a stock transfer restriction agreement) is more likely to encounter difficulties from state regulatory agencies and courts, than a friendly PC arrangement with an entity that itself is in the business of health care, or perhaps is a health care provider—such as a hospital, a dialysis center, or other licensed entity. These latter situations may be less likely to raise regulatory concerns since they would not thwart the public policy issues that underlie the CPOM prohibition.

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In the municipal contracting scenario (such as that involving correctional health care), even after implementing the friendly PC model, business corporations must be mindful of their contract structure in order to avoid violating the CPOM ban. Once a friendly PC is in place, the business corporation can structure its contracts in a number of ways:

- The friendly PC would be a party to the contract between the business corporation and the applicable county or governmental agency. The contract would state that the professional services are provided only by the PC, and that management/administrative services are provided by the business corporation.
- Alternatively, the friendly PC would not be made an actual party to the business corporation’s agreement with county or governmental agencies. Instead, the business corporation would enter into a subcontract relationship with the PC, pursuant to which the PC would provide the clinical services required under the main contracts. This variation has a potential flaw, however. A regulator could argue that since the business corporation does not have the legal ability to provide professional medical services in the first place, the business corporation therefore does not have the ability to subcontract such services, even to a PC or physician.

• In either of the above circumstances, the business corporation would enter into a management agreement with the PC. The management agreement should state that the business corporation will not share in any professional fees of the PC, and that the business corporation shall have no control over the clinical decision-making of the PC’s employed or contracted physicians.

Conclusion
The CPOM doctrine is alive and well in New York. As a result, practitioners advising corporations and other unlicensed entities in structuring transactions with physicians, or which otherwise involve the provision of health care, need to be aware of its ramifications in order to ensure compliance with its rules.

Since corporate entities that are neither licensed nor owned by licensed professionals are unable to directly own a physician practice, they often enter into contractual arrangements commonly known as ‘friendly PC’ relationships.