KUTAKROCK

Recent Enforcement of Corporate Practice Laws Magnifies Risk

January 4, 2018

The New Jersey Supreme Court, in a noteworthy 2017 case, blew the dust off a decades-old and nearly forgotten statute and dramatically reminded physicians, dentists and management organizations that ignoring state corporate practice statutes can have catastrophic consequences. In *Allstate Insurance Company v. Northfield Medical Center*[1], the high court unanimously reinstated an insurance company's fraud claims **and $4 million verdict** against a management company, its owner, and their attorney for knowingly, or with "willful blindness," violating so-called "corporate practice statutes"[2]—laws intended to ensure that medical practices are in fact owned and controlled by licensed physicians.

In *Allstate*, the management company had entered into space rental leases, equipment leases and management contracts with a physician practice. The leases and management contracts contained cross-termination provisions and significant penalties for termination, and the management company charged 100% of the practice's profits for its services and rental of space and equipment. The court found that the arrangement was a sham, structured to circumvent the relevant corporate practice statute, and that the arrangement, in substance, granted control of the medical practice to a non-physician.

A majority of states restrict the practice of medicine and dentistry by entities that are not owned and controlled by the relevant licensed professionals. These "corporate practice" restrictions are imposed by statute in some states, and in others by regulation or case law. While state law and interpretations vary, nominal ownership may not be sufficient to avoid the reach of these restrictions. Contracts such as real estate and equipment leases, franchise agreements, and management contracts that provide non-licensed persons significant control over the practice and/or a share of the practice's fees or profits, may also be prohibited under a state's corporate practice doctrine. Where the state's corporate practice restrictions are violated, there can be adverse effects on **BOTH** the non-professional (person or entity) who controls the practice **AND** the professional who ceded control to the non-professional. Depending on the state, these adverse consequences could include civil or criminal penalties, loss of license, invalidation of contracts or false claims allegations. For instance, in *Allstate* the physician in question was also a defendant, but settled with Allstate separately.

In *Allstate*, the court relied in part on a letter opinion from the New Jersey Board of Medical Examiners interpreting the New Jersey corporate practice statute, but the Board was not a party to the *Allstate* litigation. In fact, the failure of some state medical and dental boards to enforce corporate practice

[1] 159 A.3d 412 (N.J. 2017).

[2] Although the specific restriction in question involved the corporate practice of medicine, the same principles apply in dentistry. In fact, the New Jersey Dental Association filed an amicus brief in support of *Allstate*.

restrictions has led some practitioners to treat corporate practice statutes as dead letters or to become "willfully blind" to them—to use the *Allstate* court's formulation.

One notable exception has been the State of Washington, which in February 2017 took enforcement action against a dental franchisor, Comfort Dental, its subfranchisor, its accountant, and its general counsel[3]. Even in Washington, however, state enforcement came not from a medical or dental board, but rather from the Department of Health. The seeming disinterest of many professional boards stems partly from limited funding and heavy workloads. Another factor almost certainly at work, however, is that many Boards fear antitrust litigation. State boards, consisting either solely or principally of licensed, practicing dentists or physicians with limited governmental oversight, have been accused of enforcing professional practice restrictions in order to restrain competition and to exclude newer and potentially more cost-effective ways of delivering medical or dental care.[4] The other potential challengers to corporate practice law violations, the doctors or dentists themselves, have, with few exceptions, posed little threat, the disparity in economic power clearly favoring the typically well-financed practice management organizations.

As a result of the *Allstate* decision, however, insurance companies, which have the will, financial incentive and economic muscle to take action, now have more precedential support for a direct cause of action for fraud against doctors, dentists, practice management organizations and their legal counsel for being "willfully blind to," or for inventing schemes to circumvent, corporate practice laws. The *Allstate* court held the practice's failure to comply with the corporate practice statute meant that the practice had failed to satisfy a "necessary precondition to a valid insurance claim," rendering the medical insurance claims submitted to Allstate for services rendered to patients of the practice invalid **and subject to recovery by Allstate**.

New Jersey is not alone. A New York appellate court, in 2017, slammed a medical practice, also at the insistence of an insurance carrier, for failing to comply with the state's corporate practice laws, treating submissions of claims under such circumstances as fraudulent claims. In *Andrew Carothers, M.D.P.C. v. Progressive Insurance Company*[5], Progressive defended its refusal to pay insurance claims on the grounds of fraud[6]—the fraud consisting of the practice's delegation of control to non-professionals in violation of the state's corporate practice statute. The court in *Carothers* found that the profits of the professional corporation were funneled to two non-physicians through grossly inflated equipment lease payments; that there were no warranties as to the condition of the equipment;

[3] In Case No. M2016-153, Comfort Dental Group, Inc., Kent McMahan, Graig Bears, and CDWA, LLC (the "Respondents") and the Washington Department of Health, also in 2017, entered into an Agreed Order to Cease and Desist the unlicensed practice of dentistry, by ceasing, among other things: the imposition of restrictions outside the scope of reasonably objective standards on which vendors can be used for clinical supplies, lab work (dentures, bridges), and janitorial and office supplies; the enforcement of non-competition agreements affecting a broad geographic area during the term of the subfranchise agreement and a broad noncompetition covenant after its term; contractually prescribed restrictions on the transferability of the ownership interest in the practice beyond those needed for the transferee to comply with state licensing requirements; and compensation to the subfranchisor based on a monthly payment of 5% of gross collections from the practices.

[4] See, *North Carolina State Board of Dental Examiners v. Federal Trade Commission*, 135 S. Ct. 1101 (2015).

[5] 150 A.D.3d 192 (N.Y. App. Div. 2017).

[6] Technically, it was the defense of "fraudulent incorporation" embraced by the court in *State Farm Mut. Auto. Ins. Co. v. Mallela*, 827 N.E.2d 758, which "held that under no-fault insurance law, an insurance carrier may withhold payment for medical services provided by a professional corporation which has been fraudulently incorporated to allow non-physicians to share in its ownership and control."

that the lease contained a one-sided termination provision; and that if the equipment lease was terminated, the facilities lease would terminate automatically (all of which would severely disrupt patient care). Further, non-physicians hired all of the personnel and signed all of the checks of the practice's operating account, and the practice's accounts were emptied each month and funneled to the non-physicians' accounts.

In structuring arrangements with physicians and dentists, parties must be careful to sculpt arrangements that violate neither the letter nor the spirit of applicable corporate practice and other restrictions designed to promote quality patient care. Increasing efficiency in the delivery of health care (medical and dental) and lowering its cost are laudable goals and are not unlawful. At the same time, mechanisms, processes and structures that incentivize shortcuts that increase revenue or cut costs at the expense of quality patient care and that allow non-professionals to control medical and dental judgment collide head-on with the purpose underlying corporate practice restrictions. Moreover, as courts have repeatedly held, it is not enough to recite in the relevant contracts that "under no circumstances will the professional/medical judgment of the professional be influenced or interfered with" if the arrangement allows fundamental business decisions about the practice (e.g., hours of operations; choices of equipment, supplies and service providers; and practice personnel decisions) to be made by persons other than the relevant licensed professionals. For example, in *OrthAlliance, Inc. v. McConnell*[7], a case involving corporate dentistry, the court invalidated an agreement making a corporation responsible for "employing and training office staff, providing and maintaining office space, marketing and advertising, and handling payroll" for an orthodontic office. In *Packard v. OCA, Inc.*[8], another federal court held that an agreement for a corporation to provide "office space and equipment, and provide marketing and advertising services" was illegal and void.

That control of dental and medical practices by non-licensed persons can violate corporate practice restrictions is not news. The potentially explosive impact of *Allstate* and *Carothers* is their treatment of payment requests as "false" or "fraudulent" claims. Moreover, tremors from *Allstate* and *Carothers* may be felt beyond insurance claims and state law disputes in the federal realm, particularly as to reimbursement arrangements with Medicare, Medicaid and other federal health care programs. For example, the federal False Claims Act (FCA) may be implicated when claims for program reimbursement are made by practices that falsely "certify" they are in compliance with state law, including state corporate practice laws. A full review of the FCA laws is beyond the scope of this Alert. Nevertheless, it should be noted that potential penalties for violating these laws range from civil monetary liability to criminal liability, as well as certain administrative or regulatory penalties (including exclusion from eligibility for reimbursement from federal health care programs and private whistleblower suits). Violations could also be used to challenge or invalidate existing contractual arrangements between providers and management companies.

Additional Information

Thomas J. Kenny is a partner in Kutak Rock's Omaha Litigation Department, with a practice focused on healthcare litigation and government disputes. Ed Marquette is a partner in Kutak Rock's Kansas City office with a practice focused on transactional, technology, and trade regulation matters in healthcare and other industries. Neil L. Arney is a partner in Kutak Rock's Denver Litigation

[7] No. CIV. A. 8:08-2591-RBH 2010 WL 1344988, at *5 (D.S.C. Mar. 30, 2010).
[8] No. 4:05 CV273 2009 WL 334645, at *6 (E.D. Tex. Feb. 5, 2009).

Department, with a practice focused on complex litigation, including technology and healthcare litigation. Kelsey E. Fohner is an associate in Kutak Rock's National Health Care practice group, with a practice focused on healthcare regulatory compliance. If you would like assistance evaluating and handling these and other related matters, please contact one of the authors or any member of our National Health Care Practice Group or our Government Disputes Practice Group. For more information regarding our practices, please visit us at www.KutakRock.com.

Contacts

Thomas J. Kenny	Omaha	(402) 231-8769	Thomas.Kenny@KutakRock.com
Ed Marquette	Kansas City	(816) 502-4646	Ed.Marquette@KutakRock.com
Neil L. Arney	Denver	(303) 292-7882	Neil.Arney@KutakRock.com
Kelsey E. Fohner	Rogers	(479) 250-9708	Kelsey.Fohner@KutakRock.com