



Physicians Caring for Texans

The Corporate Practice of Medicine

TMA Office of General Counsel

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Introduction

The unique patient-physician relationship and the ability to use uninhibited medical judgment is foundational to effective health care and the ability to meet patients' needs. For that reason, Texas and many other states have enacted laws to keep nonphysicians or corporate entities out of the practice of medicine. This prohibition — known as the corporate practice of medicine doctrine — ensures that physicians are able to exercise professional medical judgment relating to a patient's health care needs without financial or other outside pressures. Government regulators are increasing pressure on physicians to pool their practices into group or hospital-controlled corporate employment in the purported interest of saving costs and increasing efficiency. The corporate practice of medicine doctrine pushes back against that pressure to ensure that physicians have space to exercise independent judgment in the best interests of the patient instead of the corporate bottom line. This document provides a basic explanation of the corporate practice of medicine doctrine by: (1) describing the background of the corporate practice of medicine doctrine, (2) explaining the current application of the lay control of medical practice prohibition in Texas, (3) listing possible exceptions to the doctrine, and (4) setting out possible penalties a physician may face for violation of the prohibition.

Development of Corporate Practice of Medicine Prohibition

In its earliest forms, the corporate practice of medicine doctrine represented an effort to protect the public from gimmicky quick fixes sold to naïve and unsuspecting individuals:

[Corporate practice of medicine statutes] have been adopted as a result of hindsight and in the wake of a stream of public abuse at the hands of the entrepreneur medicine man purveying his snake oil elixir. Odious chicanery of this type was rivaled only by the 'Shell game' artist and rainmaker. Eventually, public outrage over insipid and often harmful patent medicines and the ministrations of untrained healers became so widespread and the effects of their handiwork so egregious that the Federal and State governments were forced to act. With the assistance of each profession (medicine and law) rigid licensing procedures and requirements were adopted by all States to insure the quality and competency of the practitioner in the interest of public welfare. . . . Such has been the long, arduous development of the legislative safeguards we cherish today. *Garcia v. Tex. St. Board of Med. Exam.*, 384 F. Supp. 434 (W.D. Tex. 1974).

The Texas response to this issue was the passage of the Texas Medical Practice Act — a statutory prohibition on the use of a physician's license to aid an unlicensed person in practicing medicine or the allowance of another to use a physician's license to practice medicine.

The Medical Practice Act — now codified in the Texas Occupations Code — became the foundation for future corporate-practice-based Texas Medical Board (TMB) disciplinary actions and court cases that resulted from alleged violations of the act. The first corporate practice of medicine cases in Texas date back to 1956 and 1957. These cases resulted from appeals of disciplinary orders imposed by the Texas State Board of Medical Examiners (TSBME), the predecessor of TMB, on physicians who had violated the corporate practice of medicine doctrine. In two early landmark cases, physicians faced TSBME discipline as a result of the physicians' employment with medical clinics controlled by nonphysicians. Though the physicians received a salary unrelated to fees their services generated, courts held that allowing a corporation to employ a physician has the potential to commercialize the practice of medicine and destroys



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the physician-patient relationship. See *Rockett, M.D. v. St. Board of Med. Exam.*, 287 S.W.2d 190 (Tex.Civ.App. 1956); *Watt v. St. Board of Med. Exam.*, 303 S.W.2d 884 (Tex. Civ.App., 1957).

These early cases made it clear that physicians could not be employees of corporate entities. On the other side of the spectrum of corporate entity-physician relationships is a contractual relationship, which was treated in another early case, *Woodson v. Scott & White Hospital*, 186 S.W.2d 720 (Tex.Civ.App.—Austin 1945, writ ref'd w.o.m.). The court determined whether a contract between Woodson, a physician, and Scott & White Hospital could be invalidated because it inappropriately authorized the hospital to practice medicine. The contract gave the hospital a one-third interest in the doctor's practice; the hospital reimbursed the doctor for the cost of the property and the facility construction costs; the hospital referred patients needing specialized treatment to the doctor; and in return, the hospital was entitled to 25 percent of the doctor's net income. Ultimately the court concluded that this was purely an independent contractor relationship because the doctor was able to exercise independent judgment in the practice of medicine, and he fixed and collected his own fees.

Thus the main factor in the corporate practice of medicine came down to the distinction between an employee relationship and an independent contractor relationship. This unclear line of distinction began to be drawn in the 1986 case of *Flynn Brothers v. First Medical Associates*, 715 S.W.2d 782 (Tex.App. 1986). While earlier cases looked strictly at the face of a business relationship between a physician and a corporation, *Flynn Brothers* looked deeper to scrutinize the indirect effects of business arrangements. In that case, a physician was not directly an "employee" of a corporation — the physician claimed to be an independent contractor — but the court did not buy it. Because the corporation received two-thirds of the physician's fees and the corporation controlled administrative staff for the physician, the court held that this physician effectively allowed the corporation to use the physician's license to practice medicine in violation of the corporate practice of medicine doctrine.

Current Application and Prohibitions

Current enforcement of the corporate practice of medicine doctrine relies on the current statutory form of the Medical Practice Act, TMB's administrative rules relating to the corporate practice of medicine, and continued application of the precedent established in the early *Rockett*, *Watt*, and *Flynn Brothers* cases.

Statutory Framework

Relevant provisions relating to the corporate practice of medicine are found in the Texas Occupations Code and include the following:

- Section 155.001: A person may not practice medicine in Texas unless that person holds a license issued by TMB.
- Section 155.003: A person must satisfy certain eligibility standards — including standards relating to age, professional character, and education — to obtain a medical license. Notably, the requirements for a license to practice medicine are requirements that only an individual can meet; business entities would never be able to comply.
- Section 157.001: Physicians may delegate to qualified people certain medical acts, but the person to whom the act is delegated is prohibited from representing to others that the person is authorized to practice medicine.
- Section 164.052: Physicians may not purchase or sell a medical degree, license, or certification for application to TMB for a license to practice medicine. Physicians also may not permit another to use the physician's license to practice medicine, nor can the physician assist another unlicensed person, or a partnership, association, or corporation in practicing medicine.
- Section 165.156: Any unlicensed person, or a partnership or other entity may not indicate that it is authorized to practice medicine.

In addition to statutory prohibitions listed above, Texas law includes helpful permissive guidelines that can provide methods of avoiding violations of the corporate practice of medicine doctrine. A notable example is the authorization

of health care collaboratives (HCCs) — Texas's version of an accountable care organization (ACO). These organizations have been growing in significance and prominence nationally, but some have expressed concern that some elements of ACOs might violate the corporate practice of medicine doctrine. Texas law regarding HCCs — found in Chapter 848, Insurance Code — provides important guidelines for staying in line with the doctrine. For instance, the Texas HCC law provides direction on the composition of governing boards for HCCs and includes an important prohibition on physician noncompete agreements that might potentially inappropriately restrict a physician's practice of medicine.

Judicial Application

Judicial interpretation of the seemingly straightforward statutory framework of the corporate practice of medicine doctrine has yielded a much more nuanced body of law. Essentially, as business entities have tried to concoct unique ways of contravening the corporate practice of medicine, courts have been tasked with trying to draw the line between what does and what does not violate the doctrine.

From a broad perspective, perhaps the greatest consideration when courts try to draw this line is whether the physician or the corporation is controlling medical decisions — in other words, “courts consider the amount of control the [nonphysician] entity exercises over the doctor's practice and whether that control is such that it renders the relationship more of an employer/employee relationship.” *Xenon Health LLC v. Baig*, CIV.A. H-13-1828, 2015 WL 3823623, at *4 (S.D. Tex. June 19, 2015), citing *Gupta v. E. Idaho Tumor Inst., Inc.*, 140 S.W.3d 747, 753 (Tex.App.—Houston [14th Dist.] 2004, pet. denied).

Beginning with the *Flynn Brothers* case, then, courts have scrutinized physician-entity relationships to determine at what point the physician foregoes too much control over to a contractual partner. Still, though, where that turning point is can be illusive. As one court said, no case can “[provide] a finite or mandatory list of factors to determine whether a certain agreement or arrangement contravenes the [Medical Practice Act].”

In *Flynn Brothers*, a nonphysician corporate entity acted as the exclusive agent for a physician corporate entity. The court found several factors to indicate that the physician had relinquished too much control over the practice of medicine. The corporate entity was entitled to:

- Collect two-thirds of the profits from the medical practice,
- Trade and commercialize on the physician's license to procure emergency care contracts, and
- Select the medical staff to work with the physician.

Further, one recent decision saw right through a scheme to allow a California physician and his business entity to have control over a Texas medical practice by carefully analyzing the contracts involved. As in *Flynn Brothers*, the court determined that the Texas physician did not maintain adequate control over his medical practice because the operating contracts provided merely a ruse to allow a corporation to maintain control. As a result, the contracts were void and unenforceable:

The transparent purpose of this amalgam of contemporaneous contracts and Delegation of Signature Authority devised by Dr. Chaudhry and agreed by Dr. Khan was to allow Dr. Chaudhry, ‘a person ... not licensed to practice medicine by the [Texas State Board of Medical Examiners],’ and his California business entity Xenon, to engage in providing anesthesia services in Texas through the subterfuge of a shell operation with a ‘paper owner.’ Such a scheme is illegal under Texas law, rendering the inextricably intertwined Exclusive Management Services Agreement, Purchase and Sale Agreement, and Equity Interest Agreement all void and of no force or effect. *Xenon Health LLC v. Baig*, CIV.A. H-13-1828, 2015 WL 3823623, at *6 (S.D. Tex. June 19, 2015) (internal citations omitted).



On the other side of the spectrum, other recent cases have followed *Woodson v. Scott & White Hospital* (discussed above) in treating business arrangements that leave sufficient control with the physician. For instance, *McCoy v. FemPartners, Inc.*, 484 S.W.3d 201 (Tex. App.—Houston [14th Dist.] 2015, no pet.) held that service agreements between a nonphysician corporation and a physician association adequately complied with the corporate practice of medicine act because they did not “[evidence] any right of or level of sufficient control with regard to the dispensing of medical services.” According to the service agreements, the nonphysician corporation provided offices, facilities, equipment, supplies, support personnel, and management and financial advisory services, while the physician provided medical services and maintained responsibility for recruitment and hiring of physicians and all issues related to patient care. Even though the nonphysician corporation was contractually entitled to approximately 20 percent of clinic distribution funds, the court rendered this as simply payment for the corporation’s business management and administrative services it provided to the physician association. Ultimately, the court found that it was the physician association that “accepted full responsibility to its patients for the nature and character of all professional medical services it rendered.”

There is thus no bright line between an allowable physician-nonphysician business arrangement and one in which a physician more closely resembles an employee of a nonphysician corporation. Instead, much depends on the specific circumstances and facts surrounding the business arrangement. The table on the next page summarizes key considerations in relevant cases.

Administrative Application

In addition to judicial application of the corporate practice of medicine doctrine, TMB enforces the doctrine by investigating allegations of violations, disciplining physicians found to be in violation of the doctrine, and by filing formal complaints with the State Office of Administrative Hearings to seek more significant penalties. Possible penalties imposed by the board are discussed in a different section below.

Potential Exceptions

The health care industry is significantly different from what it was when the corporate practice of medicine doctrine was first developed. Changing health care needs and adaptive health care delivery models have encouraged the Texas Legislature to recognize exceptional circumstances in which certain entities may employ physicians as long as adequate safeguards are in place to ensure the physician maintains independent judgment. Based on some of these exceptional circumstances, TMB enacts regulations — contained in Chapter 177, Title 22, Texas Administrative Code — that provide a fairly comprehensive list of entities that may employ physicians.

The following is a list of some examples of exceptions to the corporate practice of medicine doctrine.

Nonprofit Health Organizations

Nonprofit health organizations are approved and certified by TMB if the organization meets certain requirements, including the requirement that it is:

- Organized as a nonprofit corporation;
- Organized for a purpose in the public interest such as research, education, or public health; and
- Incorporated and directed by physicians licensed by TMB and who are actively engaged in the practice of medicine.

This exception is not without limitations, however. The Texas Legislature has passed very specific legislative requirements to ensure physicians employed by nonprofit health organizations are able to exercise uninhibited medical judgment. Those requirements include prohibitions on interference with a physician’s judgment and on disciplining physicians for reasonably advocating for patient care. Subchapter B, Chapter 177, Title 22, Texas Administrative Code contains important

Key Considerations in Relevant Court Cases

	<i>Flynn Brothers</i>	<i>McCoy</i>	<i>Gupta v. E. Id. Tumor Inst.</i>
Fees	Nonphysician corporation entitled to collect two-thirds of physician profits	Nonphysician corporation collected approximately 20 percent of fees for payment of management services; physician was able to set all fees for medical services	Physician and nonphysician divided gross revenue equally to one-half for each; physician fixed own fees
Hiring of Physicians	Nonphysician corporation selected medical staff to work under the contract	Physician completely controlled hiring, compensation, and termination of physicians	Physician was solely responsible for all professional staffing
Administrative Functions	Nonphysician corporation handled all revenues	Nonphysician corporation performed business functions, including hiring staff, signing leases, arranging for equipment rentals, and billing	Nonphysician corporation contributed all necessary equipment, office space, and machinery for the medical practice; physician was responsible for any administrative staffing; nonphysician corporation handled billing, collections, and accounts payable
Use of License	Nonphysician corporation solicited contracts on physician's behalf and pledged contract rights and other physician assets to secure debt	Nonphysician corporation provided physicians with paychecks, pledged physician accounts receivable to secure debt to acquire new equipment, and traded on the name of the physician to secure payment and business arrangements with third parties	Nonphysician corporation was not allowed to trade or commercialize physician's license
Other Considerations	Nonphysician corporation was to be the exclusive management entity for physician; agreement between parties restricted physician's transfer rights	Nonphysician corporation had no ownership interest in physician association; agreements explicitly stated the agreement was not intended to violate Medical Practice Act and that corporation was not to exercise control over or interfere with patient-physician relationship	Joint venture between nonphysician corporation and physician provided the right of each party to engage in other business opportunities — no rights of first refusal
Outcome	Violation of the corporate practice of medicine	No violation of the corporate practice of medicine	No violation of the corporate practice of medicine



provisions relating to these limitations (*see e.g.*, 22 TAC §177.5, which provides special requirements for nonprofit health organizations in which a member is an entity that is not wholly owned by physicians).

Nonprofit Charitable Health Centers

These organizations are similar to nonprofit health organizations in that they must be organized as a nonprofit corporation under state law and must be certified by TMB. But while nonprofit health organizations are not necessarily tax exempt, state law requires that nonprofit charitable health centers be nonprofit corporations under the federal tax code as well. Additionally, these organizations must either be:

- A migrant, community, or homeless health center; or
- A federally qualified health center.

Independent Contract Agreements

The corporate practice of medicine doctrine does not prohibit a hospital from entering into an independent contractor agreement with a physician to provide services for the hospital. Under this type of allowable agreement, the hospital could:

- Pay the physician a minimum guaranteed amount to ensure the physician's availability,
- Bill and collect from patients the physician's fees; and
- Retain collected fees up to the guaranteed amount plus a reasonable collection fee.

As noted above, however, calling a certain arrangement an "independent contract agreement" is not a free pass to physician employment. Whether the arrangement is indeed an independent contractor arrangement and not an employer-employee relationship is a question of law and depends on attendant facts.

Hospital Districts

Texas law authorizes the establishment of hospital districts, which are special purpose taxing districts that fund hospital care provided to eligible people residing within the district. Certain hospital districts may be able to employ physicians if either the district's enabling statute expressly allows it or if the district falls into certain exceptional categories described elsewhere in statute. Depending on how the district is eligible for the exception, some hospital districts must first be certified by TMB before the district may employ physicians. As mentioned above, the Texas Administrative Code has a list of hospital districts that are statutorily authorized to employ physicians. *See* 22 TAC §177.17.

Professional Associations

Physicians who establish certain legal entities such as partnerships or limited liability companies may employ other physicians. These legal entities do have to satisfy certain legal requirements that relate to the ownership interests and control of the entity. These entities can be formed, for example, with other physicians, with optometrists, therapeutic optometrists, physician assistants, or podiatrists. *See e.g.*, Tex. Occ. Code §§162.051 and 162.053.

Optometrists

Physicians may establish a partnership, limited partnership, or limited liability company with optometrists or therapeutic optometrists. If a physician establishes this type of relationship, only the physician, optometrist, or therapeutic optometrist may own an interest in the entity. *See* Tex. Occ. Code §162.051.

Physician Assistants

There are also important specifications about a physician-physician assistant jointly owned corporation, partnership, professional association, or professional limited liability company. For example, a physician assistant may not be an officer or general partner, as applicable, of a jointly owned entity. Nor may a physician assistant contract with or employ a physician to be a supervising physician of the physician assistant or any other physician in a jointly owned entity. A physician assistant must have only a minority ownership interest in a jointly owned entity, and the ownership interest in a corporation or partnership of any physician assistant may not exceed the interest of any individual physician in the same entity. *See* Bus. Org. Code §§22.0561 and 152.0551.

Podiatrists

Physicians may establish a professional association or professional limited liability company with a podiatrist. Few special regulations exist relating to jointly owned entities between physicians and podiatrists except that, like any other jointly owned entity between a physician and another health professional, the authority of each practitioner is still limited by the practitioner's scope of practice, and one professional cannot exercise control over the other's clinical authority granted by their respective license. *See* Bus. Org. Code §301.012.

Pain Management Clinics

A pain management clinic is a facility — public or private — for which a majority of patients are issued on a monthly basis a prescription of certain pain management medications including opioids and benzodiazepines. There is no specific exception permitting a pain management clinic to employ physicians, so a clinic would have to fall under another exception. But physicians employed in a pain management clinic should be careful to ensure that the clinic complies with relevant statutory requirements related to corporate practice, among many other important compliance standards. Specifically with respect to corporate practice, a pain management clinic must be owned and operated by a medical director who is a physician who practices in Texas under an unrestricted license. *See* Tex. Occ. Code §168.102. Also, more than one Texas-licensed physician may own an interest in a clinic, but a nonphysician may not hold any ownership interest. *See* 22 TAC §195.4.

Other Possible Exceptions

Texas law allows for other exemptions to the corporate practice prohibition in certain settings. Certain types of hospitals, private nonprofit medical schools, and certain state institutions may be able to employ and contract with physicians as long as required protections for independent judgment are in place.

Penalties

Consequences of violations of the corporate practice of medicine doctrine include civil liability, administrative penalty, and criminal punishment.

As was seen in several cases discussed above, violating the corporate practice of medicine doctrine could subject a physician to civil penalties and damages. In the case of *Flynn Brothers*, when one party attempted to enforce the contract that violated the corporate practice doctrine, the court did not enforce the illegal contract and simply left the parties where the court found them, meaning that each party still bore its own costs of bringing or defending the lawsuit.

The Texas Medical Board also has authority to impose administrative penalties. These could range from fines to suspension or revocation of a physician's license.

The Texas Medical Act also makes criminal penalties a possibility. Violating the act or TMB rules administering the act is a criminal offense that imposes a wide range of criminal penalties.



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