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HEADNOTE: The proposed total provision of all services and supplies necessary to a medical practice by a business corporation may involve violations of both Article 28 of the Public Health Law and Education Law §6530. The proposed management by a management corporation of services provided by a hospital raises management contract issues under the Hospital Code, establishment issues and the physician self-referral prohibitions. (5/2/95)

May 2, 1995

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Dear Mr. Naclerio:

This is in response to your letter to Harriet Katz of March 1, 1995, in which you question the legality of several proposed arrangements between your client, a business corporation, and a professional corporation. We believe that the first fact pattern presented by you raises issues pursuant to §6530 of the Education Law and Article 28 of the Public Health Law ("PHL") and that the second fact pattern also raises issues pursuant to Article 28 and §238-a of the PHL for the reasons set forth below.

In hypothetical #1, your client would provide the professional corporation with the following services: the rental of office space, all equipment necessary for the professional corporation to conduct an MRI practice, supplies, fixtures/furniture, and management services. You define management services as including accounting, bookkeeping and medical records functions, processing insurance claims, billing and collection activities, advertising, marketing, and promotional activities, equipment maintenance, fiscal management, and "business planning services." As payment for all of the above services, the professional corporation would pay your client a fee equal to $700 for each MRI scan performed.

Among the potential statutory violations posed by this arrangement are the following:

1. Education Law §6530(19) prohibits "[p]ermitting any person to share in the fees for professional services other than a partner, employee, associate in a professional firm or corporation, professional subcontractor, or consultant authorized to practice medicine or a legally authorized trainee practicing under the supervision of a licensee." The prohibition includes "any arrangement or agreement whereby the amount received in

payment for furnishing space, facilities, equipment or personnel services used by a licensee constitutes a percentage of, or is otherwise dependent upon, the income or receipts of the licensee from such practice, except as otherwise provided by law with respect to a facility licensed pursuant to article 28 of the public health law or article 13 of the mental hygiene law." In other words, the non-licensed party can be paid only for the fair market value of the services provided in an arms length transaction. As stated in an opinion issued by this office to you on June 13, 1994, a transaction cannot be characterized as an arms length transaction when the non-licensed party is responsible for generating the number of patients seen and provides the professional corporation with everything necessary for the practice from office space and medical equipment to technical and administrative support personnel. A copy of that opinion is enclosed.

2. Public Health Law §2801-a. For the same reasons discussed in the above opinion of June 13, 1994, the proposed arrangement can be viewed as the proposed establishment of a de facto diagnostic and treatment center. Control of the facility apparently rests primarily with the business corporation rather than with the professional corporation. Operation of a diagnostic and treatment center without establishment approval from the Department's Public Health Council constitutes a violation of §2801-a of the Public Health Law.

3. Education Law §6530(18). Again, for reasons discussed in the above opinion, we believe that the marketing component of the proposed arrangement may violate this provision since a portion of the business corporation's fee apparently constitutes payment by the physicians for the referral of patients.

4. Education Law §6530(17) and (35). Although your letter of March 1, 1995, does not discuss any specifics regarding the provision of rented office space to the professional corporation, our June 1994 opinion involved an arrangement in which the business corporation secured rental space for professional corporations in other physicians' offices with a quid pro quo being furnished in the form of referrals from the physicians renting out the space to the professional corporations renting the space. If a similar arrangement is contemplated in this situation, violations of Education Law §§6530(17) and 6530(35) are likely for the reasons mentioned in our prior opinion.

You question whether any potential violations could be eliminated by excluding marketing from the services to be provided to the professional corporation. While that modification would eliminate certain issues, it would not

eliminate all of them. The potential violation of PHL §2801-a, for example, would still remain in view of the amount of control over the practice being exercised by the business corporation. The issue of whether the "per use" fee reflects the fair market value of the equipment and technical services being provided also is not resolved by the elimination of the marketing services.

In addition, if the professional corporation were to charge excessively high fees in order to recoup excessively high equipment rental fees, the physicians could be charged with violating Education Law §6530(17) for promoting the sale of services so as to exploit the patient for the financial gain of the licensee or of a third party. If, on the other hand, the professional corporation will be charging "usual and customary" fees for all tests but will be reducing its income by the amount that the "per use" fees exceed the customary value of such services, the professional corporation could be viewed as engaging in prohibited fee splitting pursuant to Education Law §6530(19).

The nature and scope of the proposed agreement in hypothetical #2 is unclear and could raise a number of legal issues. The primary issue is whether the hospital is operating under or will be applying for a certificate of need to provide MRI services. Pursuant to 10 NYCRR §710.1(c), any proposal by a hospital to add, modify, or change the method of delivery of certain services and/or the purchase of certain equipment, including MRIs, requires approval by this Department. Consequently, even if the hospital already has certificate of need approval to provide MRI services, it must obtain approval for any change in how these services are to be provided.

We are assuming that the hospital proposes to have its radiologists and technicians perform the MRIs and to contract with the business corporation to manage the MRI program and provide it with the necessary MRI equipment. Pursuant to 10 NYCRR §405.3(f), any contract that a hospital enters into with an outside entity for the outside entity to assume management responsibility for a defined patient care unit must comply with the provisions of that subdivision and be approved by the Commissioner before taking effect. The above regulation requires evidence of financial feasibility and the maintenance and/or improvement of the quality of care provided pursuant to the contract. In addition, the governing body of the facility cannot delegate certain elements of control to the management authority, including the authority to appoint and discharge key management employees, independent control of the books and records, and independent adoption of policies affecting the delivery of health care services. 10 NYCRR §405.3(f)(3).

Finally, the proposed arrangement raises an issue pursuant to PHL §238-a, which prohibits a practitioner, inter alia, from making referrals to a health care provider with which the practioner or an immediate family member has a financial relationship. If any practitioner who would be making referrals for these services has an interest in the business corporation, PHL 238-a restrictions and prohibitions are applicable.

Sincerely,

Jerry Jasinski
Acting General Counsel

JJ/FEA