

New York Law Journal



Web address: <http://www.nylj.com>

VOLUME 234—NO. 10

FRIDAY, JULY 15, 2005

ALM

OUTSIDE COUNSEL

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Is Your Management Agreement a Swan or a Duck?

Effective April 4, 2002, a New York Medical Professional Corporation (the "P.C.") that is "fraudulently incorporated" is not entitled to be reimbursed by no-fault insurance carriers.

So stated the Court of Appeals in response to a certified question presented to it by the U.S. Court of Appeals for the Second Circuit in the case of *State Farm v. Mallela*.¹

The 'Mallela' Case

Interestingly, *Mallela* does not turn on whether the services billed were, in fact, provided, as State Farm "never alleged the actual care received by patients was unnecessary or improper."² Rather, the case centered upon "unlicensed" defendants paying physicians "to use their names on paperwork filed with the State to establish medical service corporations."³ Specifically, State Farm filed a civil action against five individual physicians (the "Paper Owners"); 28 medical professional corporations (the "P.C. Defendants"); 18 individuals (the "True Owners"); and 18 business corporations (the "Management Company Defendants") in the U.S. District Court for the

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Eastern District of New York.⁴

The State Farm claim: involves a Doc-In-The-Box fraud

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scheme through which chiropractors and unlicensed individuals (True Owners) unlawfully own and control medical professional service corporations and/or de facto diagnostic and treatment centers operating without the requisite licensure, unlawfully employ and control physician practices; and submit charges to State Farm for services that are not compensable generally under New York law...⁵

As soon as the *Mallela* decision was published, healthcare lawyers began to receive calls from their clients inquiring as to the "legality" of their management companies' agreements.

In an attempt to address this question, a brief historical perspective is appropriate. In the late 1980s, New York chiropractors (chiros) were caught up in a trend that started in California and Florida. The concept was simple and financially rewarding. Instead of a chiro treating a patient for a modest "adjustment fee," why not employ a physician to see the chiro's patients at the significantly higher physician fee schedule rate? The chiro would then pay the physician a salary and recoup the "profit" from the medical practice. While a tempting prospect for the chiros, many of whom believe they are treated as second-class citizens in the health care world, this scenario was not possible under the laws of New York, as a chiro is not permitted to own a medical practice.⁶

To overcome this legal impediment, enter the "management agreement." The use of a management agreement was designed to provide a "turnkey" office to a physician who just "wished to practice medicine." The concept is sound and cost-effective. Many physicians are either mediocre business people or don't want the headache of running the business side of their practice. Hence, they can out source the administrative duties and do what they prefer—treat patients. The purpose and advantage of hiring a

management company was that it offers the expertise, economies of scale and purchasing power to reduce the physician's overhead while providing the requisite administrative services. The physician was required to pay the management company a flat fee so as not to run afoul of the prohibition of fee splitting.⁷

Twisted Into a 'Duck'

This traditional method of providing management services to physicians would not duplicate what was occurring in California and Florida, so what was once a "swan" management agreement was twisted into a "duck."

Certain healthcare counsel retained by chiro not only prepared management agreements, but would locate an "owner doctor" who, on paper, would be the owner of the P.C. Once the owner doctor incorporated "his" P.C., the chiro would close her chiropractic office and the office would re-emerge the next day as a "medical office." The former chiropractic patients would then become patients of the M.D.'s office. The P.C. would then enter into a management agreement with a business corporation owned by the chiro.

The "owner doctor" would receive a monthly fee from the P.C. for "holding the stock" and the "manager" (a/k/a chiro) would find a "working doctor" to actually see the patients. The working doctor would be present at the office approximately one to two days a week but the office would be open six days a week to conduct all the physical therapy sessions ordered by the working doctor.

The so called "duck" management agreement was also tailored to have such excessive fees charged for the provision of space, equipment, clerical personnel and billing/collection that the majority, if not all, of the profit generated by the P.C. would go to the chiro manager. Hence, the chiro manager would be able to reap the profit of the practice of medicine.

Soon, lay people, who saw the

"success" of the management company concept, joined in and a flood of "duck" management agreements were prepared. The frenzy continued and more and more P.C.s were created with some of the same doctors owning in excess of 20 P.C.s, all of which had management agreements.

The script was the same: the doctor sold his license to lay people so they could profit from the practice of medicine. One such "owner doctor," who subsequently cooperated with an Insurance Carrier, reported that he, inter alia, did not (i) share in the profits of the P.C.; (ii) hire or supervise the professional staff; (iii) control the P.C.'s bank account; and (iv) did not recall ever being at the P.C.'s office. Soon "duck" management agreements hatched across the state.

The fact that the management agreement concept was bastardized to meet the desires of people who wished to evade the New York corporate practice of medicine laws does not make all management agreements inherently corrupt or illegal. Management agreements between business corporations (which provide space equipment, clerical assistance, etc.) and physicians, and which nonphysician shareholders own, can be perfectly legal.

One way to ensure "legality" is to test your management agreement against the Safe Harbors published by the Office of Inspector General (OIG) for Health and Human Services on July 29, 1991.⁸ In response to the broad proscriptions of the federal anti-kickback statute,⁹ the OIG set forth certain parameters, which if contained in an agreement, would provide a "safe harbor" with respect to anti-kickback prosecution. The elements of the OIG Safe Harbor include generally:

- (1) a written agreement signed by the parties,
- (2) a description of the premises covered,
- (3) a term for not less than one year, and

- (4) an aggregate rental charge which is
 - i. set in advance,
 - ii. consistent with fair market value,
 - iii. not set to take into account the volume or value of any referrals generated between the parties.

While the Safe Harbors only apply to Medicare and Medicaid billings, it is prudent to assume that if a Management Agreement contains all of the fail-safe ingredients of the OIG Safe Harbors it will withstand the attack of "illegality."

Key Element

The key element to have locked down is the issue of fair market value. The days of working "backwards" (where the Doctor gets "x," the management company gets "10 times x"), are long gone; management companies are strongly encouraged to retain the services of an independent accountant with health care experience to provide a fair market analysis.

A fair market value letter along with the reliance on the Safe Harbors will make sure your management agreement is a "swan" and not a "duck."

In short, carriers are going "duck" hunting with their newly minted *Mallela* hunting permits. If your management agreement has the telltale signs of a "duck," you stand a good chance of coming in their sights. The goal is to be a "swan," ensure you are within the boundaries of the law—and avoid being shot.

1. *State Farm Mut. Auto. Ins. Co. v. Mallela*, 2005 WL 705972 (N.Y. March 29, 2005).

2. *Id.*

3. *Id.*

4. See Second Amended Complaint, 175 F. Supp. 2d 401 (EDNY 2001) CV-00-4923.

5. *Id.*

6. N.Y. Bus. Corp. Law §1507.

7. N.Y. Educ. Law §6530 (19).

8. 42 CFR 1001 (2005).

9. 42 USC 1320a-7b (2003).