Management Services Organization (MSO) Checklist

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This checklist addresses the formation and operation of ***management services organizations***, often called MSOs. It provides guidance to investors and healthcare practices on how to legally structure ***MSO*** arrangements to benefit both parties. This checklist focuses on strategies for regulatory compliance and ***management*** issues and risks.

For a list of resources addressing key issues related to healthcare organizations, see Healthcare Transactions, Licensing, and Regulation Resource Kit.

For more on healthcare generally, see Healthcare Fundamentals Resource Kit. For a general discussion of the statutes, case law, and regulations that impact healthcare provider transactions, see Critical Legal and Regulatory Issues Impacting Healthcare Provider Transactions. For information on the legal issues and strategic considerations regarding healthcare organization combinations, see Physician Practice Acquisitions, Hospital and Other Health-Care Provider Mergers and Acquisitions, and Medical Practice Acquisition Due Diligence Checklist. For information about corporate practice of medicine issues, see Corporate Practice of Medicine State Law Survey.

Forming the *MSO* – Avoiding the Corporate Practice of Medicine Doctrine

Professional investors have long been interested in investing in healthcare businesses. With an aging population and economic instability, many investors view healthcare businesses, and particularly professional healthcare practices, as attractive investments. But long-held prohibitions have prevented many outside investors from entering the healthcare arena.

- **CPOM prohibition.** The corporate practice of medicine prohibition, or CPOM, is a doctrine that has been adopted by many states, which has caused many investors to be reluctant to jump into investing in professional healthcare practices. The CPOM rule sets forth the restriction that non-licensed professionals cannot own, operate, or control professional healthcare practices. It is a doctrine often ascribed to medical practices, but there are similar prohibitions for other professional healthcare practices, such as dental practices, mental health practices, and others.
- **Social policy considerations.** The idea underlying the CPOM prohibition is one based in social policy concerns. The public has generally decided that it does not want corporations and non-licensed professionals dictating private healthcare decisions. These decisions and judgments should rest solely in the hands of licensed healthcare professionals.
- **The *MSO* model.** Because of the CPOM prohibition, outside investors, such as private equity and venture capital investors, have often employed MSOs as the organizational model allowing them to invest in professional healthcare practices.

Identify Target Healthcare Practice to Acquire

Once their CPOM concerns have been addressed, investors then turn to the question of the type of practice in which to invest.

- **Identify acquisition target.** Often, these outside investors begin the process of ***MSO*** investment by identifying a successful medical or other type of existing healthcare practice that they can acquire.
- **Conduct due diligence.** After conducting appropriate due diligence on this practice, its operations and ownership, as well as researching surrounding market indicators, a third-party investor may make an offer to acquire the nonclinical assets of this practice.
- **Purchase nonclinical assets.** The investors often create an ***MSO*** entity to purchase the nonclinical assets of the practice, but the clinical parts of the practice must remain owned and operated by the licensed professionals. The professional practice entity can be owned by the existing healthcare professionals of the

target practice, or a new entity owned by the requisite licensed professionals can acquire the clinical assets of the practice.

Agree on Entity Organization

After a target practice has been identified, investors and practitioners must next determine the types of business organization structures to use for their ***MSO*** and professional practice, respectively.

- ***MSO*** **entity formation.** The ***MSO*** entity will often be formed as a limited liability company or corporation in a state with favorable corporate laws for the ***management*** of the business and administrative side of the practice, but the rules surrounding the organizational type for the professional practice are generally more complicated.
- **Professional practice formation.** Because of the CPOM laws discussed above, not only do states often limit the ownership and ***management*** of the professional practice to licensed professionals, but the entity organizational type also is often dictated by state laws. Some states, like California, require a medical practice be formed as a professional corporation and will not allow it to be organized as a limited liability company or regular corporation.
- **State law considerations.** Researching appropriate state laws on CPOM and professional practice licensing requirements is necessary to understand the type of entity formation required in each state.

Prepare MSA and Accompanying Documents

To complete the transaction, the investors and their targeted practice will then begin drafting the deal documents.

- **Asset purchase agreement.** As part of the acquisition documents to acquire the nonclinical assets of a professional healthcare practice, the parties will typically begin by drafting the underlying acquisition agreement, which is often an asset purchase agreement. The parties will then draft several additional documents more specific to an ***MSO*** arrangement that accompany the asset purchase agreement.
- ***Management*** **services agreement.** The main document for an ***MSO*** is usually a lengthy and highly specific ***management*** services agreement, or MSA, which details the nature of the relationship between the ***MSO*** and the professional practice. This MSA will specifically delineate the clinical and nonclinical functions of the practice. It will carefully set forth the areas upon which the nonprofessionals in the ***MSO*** cannot encroach, to prevent them from influencing the professionals and their clinical decision-making.
- **Additional documents.** In addition to the MSA, many other documents often accompany the acquisition of the target healthcare practice. There are often succession agreements or stock transfer restriction agreements tying up the ownership of the professional practices and limiting the rights of the professional owners to sell and transfer assets and equity interests of the practice. Sometimes, transition services agreements are also necessary, as credentialing the professionals and transferring payor contracts can take considerable time. Often, lease assignments or new lease agreements need to be prepared as well.
- **Employment agreements and restrictive covenants.** Employment agreements are also usually drafted to ensure the professionals have clear duties and compensation arrangements. In these employment agreements, advisors should pay close attention to restrictive covenants. Confidentiality, non-solicitation, and non-competition restrictions are generally deemed advisable to prohibit certain activities of the healthcare professionals. However, advisors must examine appropriate state laws on restrictive covenants to ensure the legality of these rules as they apply to healthcare professionals. Certain states, like California and Massachusetts, specifically prohibit non-competes for physicians; other states severely restrict them. At the very least, these non-compete prohibitions are usually closely scrutinized to determine their reasonability. If deemed unreasonable, they risk being unenforceable. Previously, the FTC proposed a ban on non-competes, with certain limited exceptions. However, this ban was later blocked by a federal court and does not seem likely in the near future. While such a ban could void non-compete covenants for employees, even the prior proposals have included an exception to such ban on non-competition clauses for certain shareholders in the context of a sale of business. Drafters must continue to pay close attention to these rules and proposals and how they would affect healthcare transactions.

- **Long-term relationship intended.** Ultimately, the ***MSO*** arrangement and the MSA are designed to keep the relationship between the outside investors and professionals "friendly," so their interests are tied together for the long-term prospects of the business. However, these documents should be carefully drafted to provide for rules and contingencies in the event this relationship severs, or becomes "unfriendly," in the future.

Assess Regulatory Risks and Concerns

MSOs are heavily regulated. Investors and their targeted practice must pay close attention to federal and state laws to ensure their new ***MSO*** conforms to all applicable legal requirements.

- **Review applicable state and federal laws.** The operation of an ***MSO*** is complicated. The arrangement must be carefully formed and operated to comply with the necessary healthcare rules and regulations. In addition to CPOM laws, these arrangements are closely scrutinized for compliance with many other laws affecting healthcare entities, such as the federal Physician Self-Referral (Stark) Law, the federal Anti-Kickback Statute, the False Claims Act, and numerous parallel state self-referral and fee-splitting laws. States, such as California, have attempted to challenge these types of arrangements as violating state CPOM rules.
- ***Management*** **fee.** The fee associated with the ***management*** of the professional practice is also carefully analyzed. Advisors must take a close look at the federal and state laws that affect the type of ***management*** fee that can be imposed on the professional practice for using the services of the ***management services organization***. This fee should reflect the fair market value of the services rendered and should not be based on the value or volume of referrals to the healthcare practice. Many state laws have rules about these fees and whether a percentage approach can be used to calculate the ***management*** fee. Some states, like Illinois, allow percentage formulas for billing, but strictly prohibit a fee based on a percentage of the net revenues or profits for the ***management*** of a healthcare practice. A flat fee approach to the ***management*** fees is generally considered the safest approach to setting these fees. It should be set in advance and not be based on the value or volume of referrals.
- **State notification requirements and emerging laws.** A number of states have enacted healthcare notification laws that require the notification and review of certain healthcare transactions, including certain mergers, acquisitions, and other business combinations. In submitting these notifications, the parties generally have to wait for the expiration of the notice period before undertaking the proposed transaction. States have different laws governing these transactions, which must be reviewed to ensure state law compliance when structuring specific types of ***MSO*** transactions. Massachusetts recently enacted a law to expand scrutiny of certain healthcare transactions involving private equity firms, MSOs, and healthcare real estate investment trusts (REITs). In the Fall of 2024, California Governor Newsom vetoed a bill attempting to regulate and restrict these kinds of transactions, which would have prohibited these “friendly PC” structures. Despite this veto, states continue to examine these types of healthcare transactions.
- **FTC scrutiny.** In 2024, the FTC looked closely at private equity investment in the healthcare industry. The FTC focused on the effects of certain private equity transactions in healthcare that could arguably undermine competition. It is unclear whether 2025 will bring the same degree of scrutiny on these types of healthcare transactions involving ***MSO*** structures and private equity investment.

Differentiate Clinical and Nonclinical Functions

As noted at the outset of this checklist, MSOs may acquire only the nonclinical assets of the practice. Accordingly, the transaction documents must delineate which services the ***MSO*** will provide.

- **Separate clinical and nonclinical aspects.** The MSA must carefully separate the clinical and nonclinical aspects of the healthcare practice, ensuring that the ***MSO*** is only responsible for managing the administrative and business functions of the practice and not the clinical, healthcare functions.

- **Nonclinical functions.** For instance, billing and collection, human resource functions, payor and contracting issues, IT services, administrative services, accounting, leasing the space, and the employment of nonprofessionals are all considered nonclinical functions that can remain the domain of the ***MSO***.
- **Clinical functions.** The clinical aspects, however, like the employment and compensation of the healthcare professionals, hiring and termination of licensed professionals, ownership of certain clinical assets, and healthcare decisions must rest squarely within the realm of the professional healthcare providers. The ***MSO*** should not dictate the time spent with patients, patient volume, or courses of treatment, as these are all generally considered the province of the professionals.
- ***MSO*** **cannot interfere with the professional practice.** The ***MSO*** must not interfere with professional decisions of the doctors and other healthcare professionals, and these unlicensed personnel should not impose their influence on the medical and healthcare decisions of the providers. The idea underlying this guiding principle is that the patient-doctor relationship should be protected and preserved and not interfered with for the sake of profit or generating additional business. Any attempt by the nonprofessionals in the ***MSO*** to steer medical decisions could cause the ***MSO*** to run afoul of the CPOM laws and could be viewed as the unlicensed practice of medicine.
- **Compliance.** It is recommended to have a compliance officer at the ***MSO*** to ensure that the ***MSO*** is run correctly and does not overly interfere with the professional practice. The compliance officer and a robust compliance program should work to maintain the separation of the clinical and non-clinical aspects of the organization.

Operating the *MSO*

Following completion of the transaction, the parties must continue to honor the terms of the deal and comply with applicable laws.

- **Risks.** Regardless of how advisors set up the ***MSO*** arrangement, if the operation of the professional practice and the ***MSO*** violates the CPOM or other healthcare laws and regulations, the arrangement and professionals are at risk.
- **Substance over form.** In other words, even if the form of the MSA and other documents drafted strictly separate the clinical and nonclinical functions of the healthcare practice in an appropriate way, if the substance of the arrangement or the actual operation of the practice violates these rules, the arrangement could be found to be in violation of the applicable state and federal healthcare laws, subjecting reimbursements to significant clawbacks and additional claims, fines, and penalties asserted against the professionals as well as the nonprofessionals.
- **Close analysis required.** Because of the complexity of these structures and the ever-changing nature of the laws affecting them, careful research and consideration must be done into applicable state and federal laws before forming an ***MSO***.