

LLCs and the Corporate Practice of Medicine: A Modern Problem Raised by an Aged Doctrine

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The LLC is a relatively young form of business entity, but it has quickly become a favorite of business-owners and professionals. Hundreds of Washington medical service providers, including physicians, medical centers, dentists, and more are currently organized as LLCs. But in Washington, this formation could be illegal. Organizing as an LLC, rather than a Professional Limited Liability Corporation

(PLLC) could subject professionals to regulatory, civil or even criminal liability. It is past time to consider the impact the corporate practice of medicine doctrine has on LLCs.

Washington's Corporate Practice of Medicine Doctrine

The corporate practice of medicine doctrine arose to protect the public from possible abuses arising from

the commercial exploitation of the practice of medicine. It also came about due to the state's licensing requirements: a corporation, though considered a "person" by the law, cannot obtain the education and qualifications that are required to obtain a medical license.

Washington first recognized the doctrine in 1943, when the Washington Supreme Court determined that optometry was a profession that could only be practiced by a person, not a corporation.¹ Further, a corporation could not employ a licensed optometrist without itself engaging in the unlicensed practice of optometry. The court likened it to the practice of other learned professions, and noted it was similarly impermissible for a corporation to practice law or medicine.

The doctrine has been extended—preventing an unlicensed person or corporation from having any part in owning, maintaining, or operating an office that practices medicine. In *Tito v. Morelli*, a doctor, Dr.

Ehsan, and a non-doctor, Morelli, entered into a limited partnership to establish an emergency and family care clinic.² Dr. Ehsan treated patients, while Morelli was in charge of operations. The two men shared equally in the partnership profits and losses. The partnership operated at a loss for several years, until Morelli sued for dissolution and accounting.

Dr. Ehsan moved to dismiss the complaint, arguing that the partnership agreement violated the corporate practice of medicine doctrine, and it was therefore illegal and void. The Washington State Supreme Court agreed. The Court determined that the doctrine applied to partnerships as well as corporations: “It would be anomalous if, by simply structuring an organization as a limited partnership, rather than a corporation, lay businessmen could participate in a business that provided the same professional services.”³ Most interestingly, the court stated that it would not entertain an action for an accounting and distribution of the assets of an illegal company; therefore, the remedy was to leave the parties as they were.

In Washington, the Secretary of Health is responsible for investigating complaints concerning the unlicensed practice of medicine. That office has the authority to issue a civil fine, or a temporary or permanent cease and desist order.⁴ The Attorney General, county prosecuting attorney, or any other person may maintain an action in the name of the state to enjoin an unlicensed practice.⁵ Criminal liability is also a possibility—a single instance of unlicensed

practice of medicine is a gross misdemeanor, and each subsequent violation is a class C felony.⁶

Legislative exceptions to the Doctrine

Over the years, the state legislature has established exceptions to the doctrine. In 1969, the legislature enacted the Professional Service Corporations Act, which authorizes licensed physicians to organize a professional corporation. Only licensed individuals can form a professional service corporation or be shareholders.⁷ The corporate name must indicate that it is a professional service corporation (PSC). Health Maintenance Organizations (HMOs) are also exempted from the doctrine; they may employ physicians to practice medicine.⁸ The legislature has also amended the Limited Liability Partnership Act, allowing LLPs to perform professional services.⁹

The corporate practice of medicine has been somewhat dormant over the past few decades. However, a 2010 Washington State Supreme Court decision revealed that the doctrine is alive and well.¹⁰ *Columbia Physical Therapy, Inc. v. Benton Franklin Orthopedic Associates, PLLC* presented the question of whether doctors may employ physical therapists through a PLLC without running afoul of the corporate practice of medicine doctrine. The court examined whether the PLLC “engages in any business other than the practice of medicine,” and found that it did not.¹¹ Physical therapists are licensed, and the practice of physical therapy falls within the “practice of medicine.” The arrangement did not violate the doctrine. This case indicates that

other licensed professions which are generally associated with provision of medical services may also fall within the confines of the corporate practice of medicine doctrine.

The unclear status of an LLC

In 1995, the legislature enacted Washington’s Limited Liability Company Act. This included a provision which specifically authorizes professional service providers to form and become members of Professional Limited Liability Companies (PLLCs) for the purposes of rendering professional services.¹² PLLCs are subject to all the provisions of the Professional Service Corporation’s Act. A PLLC differs from an LLC only slightly: 1) it must include indication of PLLC status in its name, and 2) it must maintain professional liability insurance amounting to one million dollars, or the members may be personally liable.

Washington appellate courts have not considered whether the corporate practice of medicine doctrine applies to LLCs. Based on the reasoning of *Morelli*, extending the doctrine to partnerships, it likely does. This conclusion is supported by the legislature’s creation of the PLLC entity, which appears to be a specific exemption (like the PSC) to the doctrine.

We were presented with this precise issue in a case last year. The case involved two medical providers who jointly owned an LLC for the purpose of providing medical services. Relations between the two soured, and one decided to leave the clinic. The departing physician sued, claiming that the LLC was illegal in violation of the corporate

practice of medicine doctrine, and that any contracts, including their non-compete agreement, were void. He argued that only PLLCs may practice medicine, not LLCs. On summary judgment, the King County Superior Court judge essentially agreed. She did not find the business to be illegal, or any contracts to be void. But she did find that the business had been improperly formed. She ordered the company to convert to a PLLC.

The findings and remedy ordered by the judge reflect a certain practicality—the order brought the company into compliance with the doctrine without putting the Clinic out of business, potentially harming employees and patients. However, the outcome in such cases is unpredictable, and the stakes are high. This is an issue waiting to be tested.

Many health care providers are currently using the LLC business form. This potentially leaves them open to attacks by competitors or hostile co-owners. The strong language of the *Morelli* case indicates that a court could declare

such an LLC to be illegal, its contracts to be void, and leave the parties where it finds them, refusing to administer any accounting or distribution of assets. Carrying on business as an LLC could subject care providers to civil or criminal penalties, as well. Violators could be subject to civil fines, a cease and desist order from the Secretary of Health, or worse. A single instance of unlicensed practice of medicine is a gross misdemeanor, and each subsequent violation is a class C felony. Likely, carrying on a medical practice under the LLC form would qualify as multiple violations.

While the corporate practice of medicine doctrine was originally intended to protect patients, it can be used as a sword to sever relationships or destroy a business. Professional service providers, particularly those in the medical field, should take note of this uncertainty in the law and the risks that it poses. Luckily, the solution is simple. An LLC may convert to a PLLC by simply filing a Certificate of Amendment with the Washington Secretary of State. Taking this simple step could prevent calamity down the road.

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¹*State ex rel. Standard Optical Co. v. Superior Court*, 17 Wn. 2d 323 (1943).

²*Tito v. Morelli*, 110 Wn. 2d 555, 556-57, 756 P.2d 129 (1988).

³*Tito*, 110 Wn. 2d at 561.

⁴RCW 18.130.190(2), (4).

⁵RCW 18.130.190(6).

⁶RCW 18.130.190(7).

⁷RCW 18.100.050.

⁸RCW 18.100.050 (amended in 1983 to add the so-called HMO exception).

⁹RCW 25.05.510.

¹⁰*Columbia Physical Therapy, Inc. v. Benton Franklin Orthopedic Associates, PLLC*, 168 Wn. 2d 421, 228 P.3d 1260 (2010).

¹¹*Columbia Physical Therapy, Inc.*, 168 Wn. 2d at 434.

¹²RCW 25.15.045.

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