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The Growth of Med Spas and Their Legal Considerations

Over the past several years, there has been substantial growth in the number of medical spas in the country, with many projecting it to be among the fastest growing industries throughout the decade. However, with regulators vowing to keep up with the pace, it is particularly important to keep all compliance requirements in mind. Therefore, this Client Alert will (i) outline what is considered a medical spa; (ii) discuss some legal considerations every medical spa owner and operator should know; and (iii) recommend best practices and structures to optimize compliance. Though this Client Alert will focus on Illinois law, the legalities are generally applicable to other states with a similar regulatory scheme.

What is a Med Spa?

A "medical spa" or "med spa" provides any number of unique, non-surgical treatments and procedures. Most med spas focus on anti-aging treatments, including Botox, injectable fillers, mild chemical peels, non-surgical face lifts, and photorejuvenation.[i] Others offer solutions for weight-loss – such as CoolSculpting, fat, and cellulite reduction treatments – while still others offer procedures for hair loss treatment and restoration. Other similar services are available as well. Any given med spa may offer some or all of these treatments.

It is a burgeoning field. In 2019, the med spa industry already held a value of nearly $14 billion, with a projected growth upwards of $47 billion by 2030.[ii]

Med Spas Practice Medicine

A common misconception from the name (the "spa" part) is that med spas are treated the same as cosmetologists, estheticians, and other aesthetic businesses. This is incorrect. Once at least injectables are being administered, the business is immediately considered to be providing medical services, triggering the need to comply with the same regulatory schemes as traditional clinical practices. This includes regulations governing ownership structure, payment terms for

employees and contractors, and even advertising practices. Below are some of the most essential legal considerations to keep in mind when opening and operating a med spa.

Starting Out – Forming the Proper Legal Entity

An important – though often overlooked – consideration is the type of business entity to use. In many jurisdictions, a standard business entity (like a corporation or a limited liability company) technically may provide clinical services so long as all other regulatory and licensing requirements are met (more on that below). However, a standard business entity does not enjoy any of the valuable legal protections that otherwise would be available under the statutory schemes for professional entities (such as medical corporations, professional service corporations, and professional limited liability companies).[iii]

Further, in some jurisdictions, providing clinical services through a professional entity (rather than a standard entity) is not just a good idea, it's *mandatory*. Indeed, since 2018, Illinois has fully *required* that, for limited liability companies at least, clinical services *must be* provided by a PLLC (formed under 805 ILCS 185 *et seq.*) instead of a standard LLC (formed under 805 ILCS 180 *et seq.*).[iv] As such, it is imperative that the legal entity for any Illinois med spa be formed specifically pursuant to the appropriate statutory provision when filing its articles with the Secretary of State. This is an often-overlooked nuance when entrepreneurial clinicians are selecting the legal entity for their med spa business, and it can be a costly headache to correct or undo later.

Med Spa Ownership – Corporate Practice of Medicine

Next – and perhaps the most important consideration – is the Corporate Practice of Medicine doctrine (CPOM). This doctrine is applicable in most states to varying degrees, with Illinois being among the strictest. The CPOM doctrine generally provides that only licensed professionals – traditionally (but certainly not always) physicians – may own the business entities through which the licensed services are provided.[v] This prohibition historically has been intended to ensure that the licensed services are being provided without any undue, non-clinical influence from perhaps more profit-minded lay owners.[vi] As a consequence, by law in states with a CPOM prohibition, no lay person generally may own, in whole or in part, any portion of a business entity that provides clinical services.[vii]

The Fee-Splitting Prohibition

A close corollary to the CPOM prohibition is the state prohibition against fee splitting. This historically has been focused on prohibiting any form of revenue sharing between the clinician who actually provides the clinical services and a lay person or lesser-licensed clinical professional (regardless of such person's ownership/lack of ownership in the professional entity).[viii] It is typically formally codified by statute.[ix] While similar in dynamic to the CPOM prohibition, it is implicated mostly in non-ownership payment arrangements, such as between an employer and its employee, or between a business and its contractor.

Indeed, many well-intentioned med spas often inadvertently trip over this prohibition through their compensation arrangements with their employees (i.e., nurses) and vendors (like marketing agencies). For example, oftentimes, employee compensation is proposed to be a percentage of the revenue generated by the services the employee exclusively provides. Marketing agencies similarly may propose being paid via a percentage of the additional practice revenue directly generated by their marketing efforts. However, each such scenario would risk violating the fee-splitting prohibition, and legal counsel should flag this. The easiest way (although certainly not the only way) to avoid this is simply for the clinical entity to use a flat-fee arrangement with its employees and contractors, set at fair market value.[x] Compensation that is tied to the volume of certain services may also be permitted under select circumstances.[xi]

The Management Services Organization (MSO)

Given the growth that the med spa industry has experienced in recent years, lay entrepreneurs have been seeking opportunities to participate in the industry without violating CPOM or fee-splitting prohibitions. They may do this through a Management Services Organization (MSO).

The import of the MSO is significant. As with any other enterprise, med spas need to utilize the help of others for their daily operations, administration, and all other aspects of the business that do not involve the direct provision of clinical services. An MSO facilitates providing these non-clinical services by functioning as the essential management/support arm of the clinical entity. In so doing, the MSO saves the clinical entity money it otherwise would spend on overhead for such support services, while often providing economies of scale that the clinical entity otherwise would not enjoy.

To establish an MSO, a lay individual or individuals typically form a standard business entity (usually an LLC). This entity then officially provides all the back-office, management, and other administrative services the clinical entity needs to operate, including branding, advertising, payroll, accounting, billing, scheduling, and similar forms of support. MSOs also oftentimes lease equipment, space, personnel, and other items to the clinical entity to assist in the management and operations of the practice. The key is that the MSO must in no way be directly involved with the actual provision of clinical services.

In exchange for these services, the MSO receives fair market compensation from the clinical entity. This compensation usually takes one of three forms: (1) the clinical entity pays a set percentage of its profits/revenues to the MSO; (2) the clinical entity covers all the costs of the MSO, plus a reasonable set percentage above that (known as the "cost-plus" model); and (3) the clinical entity pays the MSO a flat fee per month or flat fees per basket of services. Each state has specific laws and guidance on what types of compensation structures are permissible, which varies widely depending on the state.[xii] As such, it is essential to structure these compensation arrangements properly, especially in a multi-state med spa enterprise.

The Management Services Agreement (MSA)

The official relationship between the clinical entity and the MSO is governed by a contract known as the Management Services Agreement (MSA). The MSA sets forth the precise responsibilities of the MSO and the clinical entity, and the fair market compensation terms. When drafted correctly, the MSA memorializes the parties' respective obligations and optimizes compliance with CPOM and fee-splitting prohibitions, as well as other regulatory considerations. As such, it is best negotiated and drafted with the assistance of counsel.

This arrangement is typically a win-win: the MSO frees up the clinical personnel to focus on the most important thing – the direct provision of clinical services. The MSO in turn is able to have a steady stream of business from a (hopefully) profitable med spa.

The Unlicensed Practice of Medicine/Exceeding Scope of License

Another regulatory consideration is the unlicensed practice of medicine / staff otherwise exceeding the scope of practice authorized under their respective licenses. For example, a physician may delegate the provision of many clinical services, including the initial good faith

exam, to appropriately trained, educated, and licensed mid- and lower-level clinicians.[xiii] However, it is critical that a written collaboration/supervision agreement exists that outlines the precise practice relationships between the physician and these other clinicians.[xiv] The parties should stick to it carefully. Disciplinary action may ensue if clinicians exceed their scope of practice or perform services that are reserved only for a physician.[xv]

Additionally, healthcare treatments must be administered only by appropriately licensed healthcare professionals, not others. While seemingly intuitive, unwary med spas potentially can run afoul of this prohibition when administering relatively low-complexity treatments, especially when similar, non-clinical aesthetic services are also being offered under the same roof. For example, a med spa with smaller staff should be especially vigilant in training their personnel on who may administer Botox and fillers (clinical services) and who may administer facials (aesthetic services). This will help to ensure that, for example, those with an esthetician license (not clinical) do not risk engaging in the unlicensed practice of medicine/nursing/etc.[xvi]

Advertising Legally

As with other businesses, med spas have the right to advertise their services to the general public to encourage clients to come in and receive treatments. The difference between med spas and other businesses, however, is that med spas are part of an industry that is heavily regulated, including how to advertise lawfully. For example, Illinois places restrictions on what medical providers may advertise. Therefore, some of the advertising techniques that med spas may not utilize include:

1. Comparing fees and rates to other medical spas;
2. Advertising services that the medical spa does not have a license to perform;
3. Guarantying results from treatments offered;
4. Making claims that cannot be proven as true; and
5. Using patient/client testimonies that may violate HIPAA[xvii][xviii]

Noncompliant advertising likely violates Illinois' Consumer Fraud and Deceptive Business Practices Act as well, which is enforced by the Illinois Attorney General's office.[xix] The ubiquitous use of social media as a key advertising tool alone requires immense care and oversight to ensure optimal compliance in this area.

Enforcement and Penalty Structures

In the event that regulators initiate an investigation or find reason to believe that a med spa/its clinicians are engaging in unlawful conduct, consequences vary in severity. For example, the Illinois Department of Financial and Professional Regulations (IDFPR) regulates licensing and enforcement standards for professional practices in Illinois, including licensees involved with med spas.[xx] Disciplinary action against a med spa's physician can include penalties up to and including revoking the physician's license and imposing a $10,000 fine for each violation.[xxi] For fee-splitting specifically, any violation constitutes an unlawful practice under the Consumer Fraud and Deceptive Business Practices Act, and all the remedies and penalties thereunder are available for enforcement by the Illinois Attorney General's office.[xxii]

The most extreme consequences arise when it is determined that a med spa/its principals engaged in the unlicensed practice of medicine. In Illinois, in the most serious cases, first-time violators may be found guilty of a Class 4 felony, which is punishable by up to 3 years in prison, as well as a $25,000 fine.[xxiii] This is on top of any civil penalties and licensing discipline. Furthermore, anyone who aides and abets the unlicensed practice of medicine will be subject to penalties as well.[xxiv]

Conclusion

While owning and operating a med spa may seem simple enough, as illustrated just by the above considerations, manifold regulatory concerns are implicated from the very outset and throughout all stages of a med spa's lifecycle. As with many other industries, the more popular med spas become, the more they become the focus of law enforcement and regulators. The associated penalties can be significant. As such, it is essential to seek legal counsel to ensure any med spa enterprise is formed, structured, and operated in the most compliant manner.

The Firm

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Endnotes

[i] American Society of Plastic Surgeons, WHAT TO LOOK FOR IN A QUALITY MED SPA (March 8, 2019). Available at: https://www.plasticsurgery.org/news/blog/what-to-look-for-in-a-quality-med-spa#:~:text=A%20med%20spa%20is%20a,supervision%20of%20a%20licensed%20physician.

[ii] United Consumer Financial Services, TRENDS SHAPING THE MED SPA INDUSTRY OUTLOOK IN 2022 (October 2022). Available at: https://www.ucfs.net/med-spa-trends-outlook/

[iii] *Compare*, *e.g.*, Illinois' Business Corporation Act (805 ILCS 5 *et seq.*) with Illinois' Professional Services Corporation Act (805 ILCS 10 *et seq.*) and with Illinois' Medical Corporation Act (805 ILCS 15 *et seq.*).

[iv] Public Act 100-0894; 805 ILCS 180/1-25(d).

[v] 805 ILCS 15/13 (CPOM prohibition as applied to physicians).

[vi] Nicole Huberfeld, *Be Not Afraid of Change: Time to Eliminate the Corporate Practice of Medicine Doctrine*, *in* 14 HEALTH MATRIX: JOURNAL OF LAW-MEDICINE 243, 243-245 (2004). Available at: https://scholarship.law.bu.edu/faculty_scholarship/894

[vii] *Id*.

[viii] *Id*.

[ix] *See, e.g.*, 225 ILCS 60/22.2(a).

[x] *See id*., although 225 ILCS 60/22.2(b) permits dividing fees among healthcare providers who concurrently render services for a particular patient under set conditions. This carveout may be utilized for properly structured employment and contractor arrangements involving percentage compensations.

[xi] *See, e.g.*, *Vine St. Clinic v. HealthLink, Inc.*, 222 Ill. 2d 276, 294 (finding that a flat fee arrangement did not violate the fee-splitting prohibition because it was "not based or linked to revenue, gross receipts or billings collected. Instead, it is based on the volume of claims that [the vendor] processed for a physician during the prior year and the physician's specialty.")

[xii] For example, Illinois permits a percentage-based arrangement in some instances, provided specific conditions are met. *See* 225 ILCS 60/22.2(d). California permits similar such arrangements as well. *See* CA Bus & Prof Code § 650(b). In contrast, a percentage arrangement likely would be absolutely prohibited under New York law. *See* 8 NYCRR § 29.1(b)(4).

[xiii] 225 ILCS 60/54.2, 60/54.5.

[xiv] Although some states, Illinois included, have granted full practice authority to Advance Practice Registered Nurses, such as nurse practitioners, if they meet specific education and clinical experience requirements. *See* 225 ILCS 65/65-43(b). In such cases, these nurses may serve independently of a physician within the scope of their practice authority, and own and operate med spas accordingly. Though traditional arrangements with a physician are likely still the best arrangement from a compliance and liability perspective, it is no longer strictly necessary in these jurisdictions.

[xv] *See* 225 ILCS 60/3, 60/3.5; 225 ILCS 60/54.2.

[xvi] *See id*. (unlicensed practice of medicine); 225 ILCS 65/50-15 (unlicensed practice of nursing).

[xvii] 225 ILCS 60/26. *See also* 225 ILCS 65/65-55 (advertising rules for APRNs).

[xviii] Indeed, those spas without a physician medical director (such as one lawfully owned/run by an APRN with full practice authority) should avoid using the word "med spa" or "medical services" when advertising, and avoid holding the APRN out as a "medical director." After all, the APRN's license permits the practice of nursing, not the practice of medicine. Advertising anything to the contrary is proscribed. 225 ILCS 65/65-50(b); 225 ILCS 60/26(3). Illinois' Nurse Practice Act even requires any advertising of an APRN to clearly include their credentials. 225 ILCS 65/65-50(a). In short, spas should consult with legal counsel when planning their advertising campaigns to avoid unwittingly violating the law, especially those spas directed, owned, or operated by an APRN.

[xix] 815 ILCS 505 *et seq.*

[xx] Division of Professional Regulation https://idfpr.illinois.gov/dpr.asp#:~:text=The%20mission%20of%20the%20Illinois,are%20properly%20evaluated%2C%20applied%2C%20and

[xxi] 225 ILCS 60/22(A).

[xxii] 225 ILCS 60/22.2(g).

[xxiii] 225 ILCS 60/50, 60/59; 730 ILCS 5/5-4.5-45.

[xxiv] 225 ILCS 60/22(A)(32).