

Publications

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California AG Settlement Signals Heightened Scrutiny of Corporate Practice of Medicine and Dentistry

Key Takeaways:

- California's Attorney General opened a new front in the state's war against private equity-backed PC/MSO¹ arrangements through its recent settlement with a dental services organization. The settlement reaches far beyond recent legislative action and demands careful attention from operators in this space.
- While the settlement does not create any binding legal precedent, investors and operators in PC/MSO structures involving licensed professionals should evaluate their existing operations in light of the settlement framework — with a particular emphasis on licensed professional control of clinical decisions.
- Careful attention to public communications, advertising, marketing and branding is more important than ever, as the settlement reinforces that consumer-facing statements may draw scrutiny where they suggest control over clinical services, provider relationships or practice operations.

California regulators are taking a harder look at PC/MSO structures, and the message for providers, investors and operators is increasingly clear: arrangements that appear to involve undue MSO influence over practice ownership, operations, compensation, advertising or clinical-facing controls may face heightened scrutiny. This alert focuses on the California Attorney General's recent \$2.3 million settlement with Aspen Dental Management, Inc. and why it offers a timely warning for PC/MSO operators to reassess existing California arrangements now.

The Background: California's Expanding Scrutiny of PC/MSO Models

California has long been a state with meaningful enforcement around corporate practice of medicine (CPOM) and other licensed professions. Over the past several months, however, the state has taken additional steps that highlight the need for providers using an affiliated practice or "PC/MSO" model in California to pay close attention to the state's regulatory landscape. Three recent developments are particularly notable:

- January 1: California's recently enacted SB 351 took effect, which further codified a

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number of existing restrictions on PC/MSO relationships and gave the California Attorney General (AG) enforcement authority over corporate practice violations.²

- March 30: The AG filed an *amicus* brief with the California Court of Appeals attacking a common contractual structure in PC/MSO models that permits the MSO to direct transfer of PC ownership to an alternative licensed physician.³
- May 7: The AG released its settlement agreement with Aspen Dental — a private equity-backed dental services organization (the DSO) operating across the country, with a number of offices in California — following allegations that the DSO unlawfully controlled affiliated dental practices and engaged in deceptive marketing and advertising practices.

The Allegations: California AG Targets the DSO Practice Management Model

The California AG filed a complaint against the DSO alleging that certain components of the DSO's relationship with its affiliated dental practices violated California corporate practice restrictions. While details are sparse, the complaint describes a fairly comprehensive suite of back-office and administrative services typical to PC/MSO structures, including bookkeeping, patient scheduling, billing, payroll, licensing, taxes, laboratory services and recruiting non-clinical office staff. The complaint focused on a few key aspects of the relationship between the DSO and the practices, including control of the practice space and equipment, restrictive covenants for clinical professionals, direction and control regarding the identity of the practice owner, the DSO and clinical employee compensation methodologies and incentives, and implementation and introduction of clinical policies for practice operations.

Additional aspects of the relationship that appear to have drawn the focus of the AG include allegations that the initial dentist owner of the DSO's California clinics — although licensed in the state — did not actively practice in any California clinics, lived outside of California and was married to an executive of the DSO. The complaint also discusses the DSO's complete design, furnishing and staffing control of brand-new dental clinics — contrasting this arrangement with a business model that contracts with pre-existing dental practices owned by California-licensed dentists.

The second prong of the complaint focused on the DSO's marketing and advertising practices, alleging that the DSO did not comply with California restrictions on deceptive or unlawful advertising. Here, the AG focused on advertisements related to discounts and specials, insurance coverage and other consumer-facing communications, as well as the use of specific words and phrases that California disfavors for public advertisements.

The Settlement: Terms Focus on Ownership, Control, Compensation and Advertising

The parties settled these allegations through an agreement that included \$2 million in penalties, \$300,000 in restitution, three years of compliance monitoring and broad injunctive provisions governing the DSO's role in managing or influencing its affiliated dental practices, including:

- Not replacing any practice owner with another dentist of the DSO's choosing;
- Not requiring practice owners to effectively give up ownership of any dental practices if they decide to terminate their contractual relationship with the DSO;
- Not owning the property for any practice;
- Not practicing dentistry, including but not limited to owning or managing any dental office;
- Not basing service fees on revenue, sales, or profits;

- Not suggesting, directing, or encouraging any licensed clinician, other than a practice owner, to sell or increase revenue for any service or product;
- Not compensating any of its employees based on the sales or revenue of practices;
- Not paying any practice employees incentives based on practice sales, revenue, or profit, including the sale of a particular service or product;
- Discontinuing the use of and not enforcing any existing contractual provision that restricts where any licensed clinician may practice or be employed;
- Providing a written fee schedule for products and laboratory services;
- Registering with the Dental Board of California as a Dental Group Advertising and Referral Service; and
- Clearly and conspicuously identifying the practice owners' name when creating, publishing, or disseminating advertisements.

The list above comes from the AG's press release announcing the settlement, but the substance of the agreement is more nuanced. For example, the injunctive provision against "owning" the property of the practice contains a detailed discussion of how space lease arrangements between the DSO and the practices should be structured.

Lessons Learned: What PC/MSO Operators Should Take from the Settlement

The settlement, combined with SB 351 and the AG's unsolicited brief in the *Art Center* case, clearly demonstrates that California is taking a serious look at private equity and its use of the PC/MSO model. The implications of these actions extend beyond dentistry and invite PC/MSO investors and operators — particularly private equity-backed enterprises — to carefully review existing arrangements in light of these developments.

To guide that review, PC/MSO investors and operators should keep the following key points in mind:

- **The settlement may signal enforcement priorities beyond SB 351.** The provisions of the settlement agreement are not binding law, and many go beyond the conduct contemplated by the California legislature in SB 351. In fact, some of the injunctive provisions relate to conduct that is expressly permitted by other California statutes. But the content of the settlement agreement in particular highlights areas of enforcement priority for the AG's office, and consequently, areas of potential increased risk for PC/MSO operators.
- **Marketing claims remain a key risk area.** A significant portion of the complaint and subsequent settlement is dedicated to allegations regarding consumer-facing advertising and marketing. California already has strict laws regarding false, deceptive or misleading advertising, and this action reinforces that those laws apply in the PC/MSO context as well.
- **Clinical control and ownership relationships warrant close review.** As with any corporate practice analysis, pay particular attention to the interactions and relationships with the licensed clinical personnel. The involvement, authority and agency of practice owners is clearly in the spotlight, as is their ancillary relationships with the MSO.
- **The AG appears focused on the full PC/MSO relationship.** It appears the AG evaluated the DSO arrangement based on a totality of the circumstances surrounding the PC/MSO relationships. While SB 351 offers some bright lines, it is clear the AG is intent on examining all aspects of the PC/MSO relationship, including some areas that might have previously been considered a lower priority.

Now is an excellent time for PC/MSO operators to evaluate their existing relationships. If you have questions regarding these recent developments and the potential implications

for your business model, reach out to Paul Gomez, Ryan Thurber, Matthew Lin or your regular Polsinelli attorney.

[1] References to MSO apply to DSOs as well.

[2] Polsinelli's prior analysis of SB 351 can be found here:

<https://www.polsinelli.com/publications/newsom-signs-ab1415-sb351-california-health-care-investment-requirements>

[3] Polsinelli's prior analysis of the AG's amicus brief can be found here:

<https://www.polsinelli.com/publications/california-corporate-practice-of-medicine-pc-mso-interpretations>