California Appellate Decision Limits Hospital's Options For Exclusive Contracts

Insights 02.11.19

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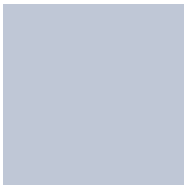

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On February 4, 2019, the California Court of Appeal affirmed a judgment awarding plaintiff, Dr. Kenneth Economy, substantial damages for his suspension and subsequent termination of his staff privileges at defendant Sutter East Bay Hospitals. The Court of Appeal held that, because Dr. Economy's termination, even though done under the provisions of an exclusive contract, was based on "medical disciplinary cause or reason," he was entitled to prior notice and a hearing in accordance with Business and Professions Code section 809 *et seq*. This decision flies in the face of the underlying premise for exclusive contracts: the ability for a hospital to enter into a contractual arrangement that allows it to set superior metrics in exchange for exclusive rights to provide services. Clinical issues have long been mandated to be within the purview of the medical staff but exclusive contracting gives hospitals the ability to contract for higher standards of quality of care. The severity of the *Economy* decision calls into question the accepted approach to exclusive contracts.

Background

Dr. Economy was an anesthesiologist who had practiced at Sutter East Bay Hospital for 20 years. The hospital operated a "closed" anesthesiology department pursuant to a contract with the East Bay Anesthesiology Medical Group ("East Bay Group"). Under the contract, East Bay Group exclusively provided administrative and coverage services to the hospital's anesthesiology departments. Importantly, the parties' contract authorized the hospital to require that East Bay Group immediately remove from the schedule any physician whose actions jeopardized the quality of care provided to the hospital's patients. In July 2011, Dr. Economy was found responsible for numerous violations that jeopardized patient safety. Consequently, the hospital's peer review committee recommended to East Bay Group that Dr. Economy complete a continuing education course through the Physician Assessment and Clinical Education ("PACE") program.

Dr. Economy completed the PACE program. Despite this additional training, he was once again found to have performance issues related to clinical care. The hospital then asked East Bay Group to remove Dr. Economy from its schedule pursuant to the parties' contract. East Bay Group complied and later terminated his employment. Dr. Economy filed suit against the hospital alleging, among other things, a violation of his right to notice and a hearing under Business and

Professions Code section 809[1] as well as his common law right to fair procedure.

Trial Court Finds in Favor of Dr. Economy

The trial court found that the hospital's action of removing Dr. Economy from the anesthesia schedule was indisputably based on a medical disciplinary cause or reason, which ultimately constituted a summary suspension of his right to exercise his privileges and use the hospital's facilities. The trial court found that the hospital's failure to provide Dr. Economy with notice of the charges against him and an opportunity for hearing amounted to a violation of Section 809.5, as well as his common law right to fair procedure. Although the trial court awarded Dr. Economy approximately $4 million in damages, it denied his request for attorney's fees and costs as a prevailing party under Section 809.9.

Court of Appeal Upholds Trial Court Decision

On appeal, the hospital argued that East Bay Group was not a "peer review body" within the meaning of Section 805 and therefore Dr. Economy's suspension and termination did not trigger a duty to file a report with the state licensing board or to provide a hearing mandated by such reportable actions, which hearings are triggered by medical staff actions. The hospital also argued, to no avail, that Dr. Economy was not entitled to notice and hearing because he was terminated by his employer, East Bay Group, rather than the hospital.

The Court of Appeal was not persuaded by the hospital's arguments and held that the hospital's request that Dr. Economy be removed from its anesthesiology schedules was tantamount to a decision to suspend and ultimately revoke his privileges. Because the hospital's contractual terms with East Bay Group prohibited anesthesiologists from performing services at the hospital if not employed or scheduled by the group, the hospital's decision effectively terminated his right to exercise clinical privileges at the hospital. Under the hospital's medical staff bylaws, such a decision could be made only by its medical executive committee ("MEC") after the provision of notice and an opportunity for hearing before the peer review committee.

In *Economy*, it was undisputed that the hospital did not provide notice or a hearing, nor did the MEC review Dr. Economy's disciplinary action. The Court also concluded the hospital did not delegate its peer review duties to East Bay Group under the terms of their contract. Indeed, the Court specifically noted that the hospital's medical staff bylaws did not require or authorize a closed department to conduct peer review in lieu of the procedures set forth in its bylaws. The Court further noted that there was no evidence that East Bay Group had any policies or procedures for the conduct of peer reviews. The Court of Appeal reasoned that the hospital was therefore the entity solely responsible for reviewing physician performance pursuant to the contractual relationship. Accordingly, its failure to provide Dr. Economy with notice and an opportunity for hearing was a violation of his statutory and common law rights to due process. The Court of Appeal held that the hospital's request to remove Dr. Economy from East Bay Group's anesthesia schedule ultimately constituted a summary suspension of his right to exercise his privileges—a deprivation which could only lawfully be undertaken by way of formal peer review in accordance with Sections 805 and 809.

The Court of Appeal further reasoned that if the hospital were permitted to contract with third-party employers such as East Bay Group, who could suspend and terminate a physician without complying with statutory due process requirements, then a hospital could essentially avoid compliance with such statutes altogether, which would be contrary to public policy. Although it found that Dr. Economy was entitled to notice and a hearing, the Court of Appeal denied his request for attorney's fees and costs, finding that the hospital's defense was not frivolous, unreasonable, without foundation, or asserted in bad faith.

Exclusive Contracting in the Wake of Economy

As the Court of Appeal acknowledged in footnote 3, "[h]ospitals often enter into closed or 'exclusive contracts . . . with healthcare entity-based physicians such as pathologists, radiologists, and anesthesiologists, . . . for a variety of reasons including (1) improving the efficiency of the healthcare entity; (2) standardization of procedures; (3) securing greater patient satisfaction; (4) assuring the availability of specific services; (5) cost containment; and (6) improving the quality of care.' (citing

to Health Law Practice Guide (2018) Exclusive Contracts, § 2:24.)" However, the Court of Appeal in *Economy* clearly took issue with the means by which the hospital enforced the provisions of its contract with East Bay Group.

It is unknown at this point whether this case will be appealed to the California Supreme Court. Certainly, there are numerous factual distinctions to be made when considering the ramifications of *Economy* and every situation would require a careful case by case analysis. However, if *Economy* stands, it will require careful analysis and should encourage hospitals to consider the parameters of their exclusive contract relationships, the terms of those contracts, and even reweigh the benefits of closed departments in connection with their specific circumstances. At the very least, it is apparent that in the wake of *Economy* a more conservative approach will be to defer clinical issues to the medical staff for any necessary determinations and action.

Hooper, Lundy & Bookman, P.C. has experience representing Medical Staffs and advising Health Care Entities regarding exclusive contracts with third-party employers. For questions relating to these issues, please contact Harry Shulman, Ross Campbell, or Ruby Wood in San Francisco at (415) 875-8500; Jennifer Hansen or Catherine Wicker in San Diego at (619) 744-7300; Katherine Dru in Los Angeles at (310) 551-8111, or your regular Hooper, Lundy & Bookman contact .

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[1] All statutory references are to California Business and Professions Code unless otherwise specified.

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