



March 2019

## California Appellate Decision Limits Hospital's Options For Exclusive Contracts

*By Ruby W. Wood and Catherine S. Wicker*

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

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Professions Code section 809<sup>1</sup> 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

<sup>1</sup> All statutory references are to California Business and Professions Code unless otherwise specified.

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.*

## Proposed Challenge to Site-Neutral Medicare OPPS Payments for Clinic Visits in Grandfathered, Off-Campus Provider Based Departments

*By Katrina Pagonis and Bob Roth*

Hooper, Lundy and Bookman, P.C. (HLB), would like to make its hospital clients and friends aware of an issue concerning a “site-neutral” reduction in Medicare reimbursement that we believe is susceptible to legal challenge. Specifically, in the Calendar Year (CY) 2019 Medicare Outpatient Prospective Payment System (OPPS) Proposed Rule, the Centers for Medicare and Medicaid Services (CMS) proposed to adopt a 60% cut to OPSS payments for outpatient clinic visits furnished in grandfathered, off-campus provider based departments billed with HCPCS code G0463 and the PO modifier. CMS finalized part of this payment cut (30%) as part of its CY 2019 OPSS final rule, indicating that it plans to phase-in the remainder of the payment cut next year (in the CY 2020 OPSS final rule) for a total payment cut of 60%. Moreover, CMS implemented this cut in a non-budget neutral manner, which will result in an estimated reduction of \$380 million in OPSS payments and patient co-payments in CY 2019 and double that amount in CY

2020, if CMS finalizes its anticipated 60% payment cut.

It is our view that hospital clients that receive OPSS payments for clinic visits furnished in grandfathered, off-campus provider based departments should do the following to protect their interests:

1. Appeal OPSS payments for CY 2019 claims for off-campus clinic visits (HCPCS code G04563) billed with the “PO” modifier through the administrative claims appeals process.<sup>1</sup>
2. Include protest language concerning the non-budget neutral OPSS payment cut for off-campus clinic visits in Medicare as-filed cost reports covering any portion of CY 2019.

We will provide clients that engage us in this matter an appeals packet containing (1) language to include in reconsideration and redetermination requests when appealing these CY 2019 OPSS payments and (2) protest language for Medicare cost reports for portions of CY 2019. In addition, should this matter be unresolved by the time notices of program reimbursement (NPRs) are issued for CY 2019, we may coordinate and litigate group appeal(s) before the Provider Reimbursement Review Board (PRRB) and in federal district court. We are also exploring clients’ interest in filing suit directly in federal district court to challenge the cut to CY 2019 OPSS payments.

### **Background and Arguments Challenging the Payment Cut**

CMS has taken the position that these payment cuts constitute “a method for controlling unnecessary increases in the volume of covered [outpatient department] services” authorized under 42 U.S.C. § 1395l(t)(2)(F), notwithstanding Congress’ explicit direction in section 603 of the Bipartisan Budget Act of 2015 (Section 603) that these grandfathered provider-based department are not subject to site-neutral payment. Although CMS is generally statutorily required to implement adjustments to the OPSS in a budget neutral manner under 42 U.S.C. § 1395l(t)(9)(B), CMS has taken the position that the site-neutral payment cut cannot be considered an OPSS adjustment subject to budget neutrality requirements because it is a “method” for controlling unnecessary increases in volume.

HLB has evaluated this payment cut, and we believe that there are three key arguments against it:

<sup>1</sup> Note, if your hospital receives OPSS payments generally but does not receive OPSS payment for clinic visits (HCPCS code G0463) furnished in a grandfathered, off-campus provider based department (“PO” modifier), you may still be affected by this issue. Please contact us to discuss your options.

- **First, the payment cut is not a method to control unnecessary increases in the volume of covered outpatient department services.** It is our view CMS has no legal authority to implement this payment cut because CMS' argument that the payment cut is a "method to control unnecessary increases in the volume of covered" outpatient department services is without legal merit. The payment cut applies with equal force to necessary and unnecessary outpatient department services, and CMS has not set any target for necessary increases in the volume of covered outpatient department services. In addition, the evidence cited by CMS in the proposed rule focuses largely on pre-Section 603 data concerning clinic visits at off-campus, provider based departments, and therefore does not establish an ongoing problem of unnecessary outpatient clinic visits at grandfathered provider-based departments. Without any benchmark for necessary increases in outpatient volume, it is our view that this site-neutral policy operates as a simple negative payment adjustment rather than a method to control volume authorized under subsection (t)(2)(F).
- **Second, the payment cut conflicts with Section 603.** We believe that the payment cut is at odds with Congress' express determination in Section 603 that excepted, off-campus provider based departments are exempted from Section 603's site-neutral payment policy and are therefore entitled to full OPPS reimbursement. When the site-neutral payment cut is fully implemented next year, there will be no distinction between how CMS reimburses clinic visits at off-campus provider based departments that are subject to Section 603 and those that are grandfathered under Section 603.
- **Lastly, the payment cut should be budget neutral.** Regardless of whether the payment cut is permissible under the first two arguments, it is our view that CMS is required to implement this payment cut in a budget neutral manner under subsection (t)(9)(B) and cannot use its authority under subsection (t)(2)(F) to pull money out of the OPPS through payment cuts.

The American Hospital Association (AHA) and a number of hospitals have filed suit contending that the payment cut violates the site-neutral exception under Section 603 and the budget-neutrality requirements

under subsection (t)(9)(B). The AHA suit, however, does not currently advance the argument that the payment cut is not a method available to CMS to control unnecessary increases in the volume of covered outpatient department services. Briefing on dispositive motions in the AHA suit is scheduled to be completed on April 19, 2019.

HLB is advising its clients on how to protect their right to challenge the 30% (and planned 60%) reduction in OPPS payments for outpatient clinic visits furnished in off-campus provider based departments grandfathered under Section 603 and is in the process of putting together a group of plaintiff hospitals to challenge the payment cuts. We propose:

1. Providing clients that engage us in this matter with an appeals packet containing targeted language that can be used in OPPS payment redetermination requests to the Medicare Administrative Contractors (MACs), in reconsideration requests to Qualified Independent Contractors (QICs), and as a protested item in the cost report.
2. Coordinating and litigating a group appeal or appeals before the PRRB once NPRs are issued, if necessary and appropriate.
3. In the interim, we believe that the issue of whether this payment cut constitutes a method to control unnecessary increases in the volume of covered outpatient department services should be presented. Therefore, we will explore filing suit directly in federal district court based on the futility of advancing this challenge through the administrative appeals process.

*If you would like more information about this issue, are interested in engaging HLB to provide an appeals packet for use in redetermination and reconsideration requests, or are interested in engaging HLB to file suit challenging the non-budget neutral, site-neutral payment reduction for clinic visits at grandfathered, off-campus provider based departments, please contact [Katrina Pagonis](#) in HLB's San Francisco Office, [Bob Roth](#) in HLB's D.C. Office, or your regular HLB contact.*

Given the pending deadline for requesting redeterminations before the MAC, we are asking that facilities interested engaging us in this matter contact us by **April 19, 2019**.

# CALENDAR

- April 5-7** **2019 CSHA Annual Meeting & Spring Seminar, La Jolla, CA**  
Mark Reagan and Ben Durie presented *Emerging Trends in Post-Acute Care*  
Charles Oppenheim and Stephanie Gross presented *New Knox-Knee Licensure Regulations: A Sea Change?*
- April 7-10** **HCCA 23rd Annual Compliance Institute, Boston, MA**  
David Schumacher presented *A Compliance Case Study from the Trenches with Current and Former DOJ Prosecutors*. Amy Joseph presented *Relationships in the Academic Medical Center Context: Anti-Kickback and Stark Law Issues*. Jeremy Sherer presented *Telehealth Contracting for Compliance Officers*. Mark Reagan presented *Will CMS Turn Down the Volume? Patient-Driven Payment Model (PDPM) and the Effort to Replace RUGs*. Charles Oppenheim presented *Hidden Treasure, or Hidden Kickback? If it Looks too Good to Be True, It Might Be an Anti-Kickback / Stark Violation*.
- April 9** **HLB-Wolters-Kluwer Webinar Series (Part 2)**  
Bob Roth, Katrina Pagonis, Joe LaMagna, and Jeremy Sherer presented *The First Quarter is In the Books — What's In Store for the Rest of 2019*
- April 9** **Los Angeles County Bar Association, Los Angeles, CA**  
Bridget Gordon and Robert Miller presented *Hello from the Other Side: What Litigators and Transactional Attorneys Wish the Other Knew*
- April 10** **Massachusetts Senior Care Association Spring Conference, Boxboro, MA**  
Mark Reagan presented *Compliance Under PDPM: The New Frontier*
- April 11** **Suffolk University Journal on Health and Biomedical Law Symposium 2019**  
Jeremy Sherer presented *Talking Telehealth: Exploring the Role of Technology in Healthcare*
- April 12** **CAMSS Desert Chapter Annual Legal Conference 2019, Upland, CA**  
Jennifer Hansen presented *Handling the Disruptive or Dishonest Physician - From Credentialing to Peer Review*
- April 18** **Hooper, Lundy & Bookman Webinar**  
Stephanie Gross and Charles Oppenheim present *A Regulatory Shift In Knox-Keene Licensing Requirement Takes Effect This Summer*
- May 4** **Colorado Association of Medical Staff Services Spring Conference, Colorado Springs, CO**  
Katherine Dru presents *National Practitioner Data Bank Reporting Guidelines*
- May 9** **California Association of Health Facilities, Garden Grove, CA**  
Mark Johnson presents *Discharge or Dumping: Nursing Home Law, Policy and Practice*
- May 22** **LeadingAge California Annual Conference, Monterey, CA**  
Mark Johnson presents *Are you prepared for Medicare Patient Driven Payment Model?*
- May 23-24** **CAMSS Conference, Universal City, CA**  
Ruby Wood and Alicia Macklin present *Sharing Peer Review Information – Practical Approaches to Protect Confidentiality and Immunity Protections*  
Jennifer Hansen and Katherine Dru present *Medical Staff Legal Update*
- June 9** **HCCA 2019 Research Compliance Conference, Orlando, FL**  
Amy Joseph presents *Identifying and Managing Physician Conflicts of Interest in the Research Context*
- June 14** **HCCA 2019 Orange County Regional Conference**  
Charles Oppenheim and Alicia Macklin present *Regulatory Update*
- June 17-18** **Northeast Regional Telehealth Conference**  
Jeremy Sherer and Amy Joseph panelists
- July 9** **HLB-Wolters-Kluwer Webinar Series (Part 3)**  
Bob Roth, Joe LaMagna, Amy Joseph, Andrea Frey and Jeremy Sherer present *The First Half is In the Books — What's In Store for the Rest of 2019*
- July 14-17** **CAHF Summer Conference, San Diego, CA**  
Mark Reagan and Jeremy Sherer co-present  
Mark Johnson and Scott Kiepen co-present
- Nov 10-13** **CAHF Annual Conference, Palm Springs, CA**  
Mark Johnson presents

# HILB

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