THE CONTRACTION OF THE ECONOMY CREATES SYSTOLIC RISKS FOR HEALTHCARE ORGANIZATIONS

Welcome to the first in a special five-part series on the effects of the down economy and how healthcare organizations can manage the risks and exposures that come with increased pressure to stay profitable while managing staff and patient needs. Each issue will feature a major theme and related topics to give as clear a picture as possible. This first issue discusses directors and officers (D&O) liability and exposure. Subsequent issues will focus on employment practices liability, fiduciary liability, crime, and kidnap/extortion for ransom.

HOSPITALS and other healthcare organizations are facing increasing risk due in large part to the tremendous decline in the economy. As the economy contracts, increased pressure is placed on all management components of the healthcare system. Many exposures are created as capital becomes scarce and decisions are made purely on an economic basis, particularly with job cuts. The resources to defend against claims and resolve disputes are diminished unless appropriate insurance coverage and risk management techniques are in place.

Other risks to healthcare organizations and their directors and officers are exacerbated by economic conditions that bring to public attention deficiencies that might otherwise be overlooked in a stronger economy. Such deficiencies include:

- Security measures to protect the privacy of patient records related to the Health Insurance Portability and Accountability Act (HIPAA).
- Patient care during an emergency under the Emergency Medical Treatment and Labor Act (EMTALA).
- Antitrust issues increased by exclusive contracts with service providers or vendors.
- Third party discrimination of patients and other business invitees.
- Lack of proper billing oversight leading to government investigation alleging over-billing of Medicare services.

Inadequate capital raises concerns about an organization’s ability to perform responsibilities in a manner that meets expected standards. This makes directors and officers more susceptible to greater scrutiny and legal action from many sources, including employees, bondholders, providers, customers, vendors, creditors, and regulatory agencies. Consider the following:

A recent federal district court case featured neurologists alleging that a hospital’s decision to use only members of the radiology department for official interpretation of MRI results was a violation of state and federal antitrust law (unfair competition). The neurologists also alleged that the hospital’s refusal to allow them to interpret MRI results was a restriction of their medical staff privileges and did not give them due process (which refers to how and why laws are enforced) under the medical staff bylaws. The hospital’s request for motion for summary judgment to dismiss the complaint was successful, but the neurologists have appealed. The results of the appeal are pending. The hospital’s defense expenses have already exceeded $1.4 million.

The economic downturn combined with an increased demand for reform creates exposure for which few organizations are prepared or insured. Claims are on the rise, and when they hit they are significant. Consider the statistics on the following page to give you a better idea of the risks faced by healthcare organizations.
Strains on the Healthcare System Are from Varied Sources
Hospitals and healthcare organizations are experiencing problems from several directions simultaneously. Their assets—endowments and investments—have fallen with the stock market. Income seems to be in decline as patients lose healthcare coverage or are deferring elective procedures. The demand for healthcare reform, accompanied by a politically mandated demand for operational efficiency, will continue to force changes in the business models of many healthcare organizations. Staffing and employment costs are difficult to reduce because of the threat of employment practices litigation. And the cost of carrying debt is growing far more expensive and encumbered with constraints and financial risks.

Deteriorating Finances Leads to Vulnerability
Many healthcare organizations are heavily leveraged; in this recession they have become highly vulnerable. Organizations have found that there is no longer easy access to inexpensive financing. Cautious underwriting of loans and bonds is critical in the new financial climate. While in the past healthcare organizations were often seen as being as safe as educational institutions or municipal governments, they may no longer be recognized as such. Many may have difficulties maintaining a positive cash flow due to the higher cost of borrowing and the demand for lower operating costs. Interest rates will be higher while competing for credit.

One concern generated by the current economic crisis is the status of bonds. Debt will be at significantly higher rates, and a related problem is that many organizations will find themselves in violation of bond covenants. The structure of the bonds, including the rates and accompanying covenants, can lead to financial disarray as organizations face the danger of being out of compliance with bond covenants.

Market conditions have not only severely impaired the investment portfolios of healthcare organizations, but also contributing foundations and individuals, who in the past provided a consistent donor base.

Litigation Trends Survey
The 2008 Litigation Trends Survey by Fulbright & Jaworski, LLP, of New York reports:

- 40% of healthcare companies expect litigation to increase in the next year.
- 55% of healthcare companies faced 6 or more new lawsuits last year.
- Lawsuits related to labor and employment matters were the biggest concern of 53% of healthcare companies.

D&O Liability Risk
According to Tillinghast-Towers Perrin’s Directors and Officers Liability Survey:

- Healthcare organization directors and officers are, on average, at least 10 times more likely to be sued than most other business classes.
- More than 50% of all claims made against directors and officers are made by employees.
- Defense costs per D&O claim average nearly $500,000.

Changing Business Models
As economic conditions dictate changes in the operations of healthcare organizations, they face increased exposure to allegations ranging from negligence to violation of statutory law. One growing area of risk is the application of the common law cause of action for negligent credentialing and privileging.

Pitfalls in Credentialing Physicians
There is a justified concern that hospitals will be held liable for negligence in granting credentials or privileges to a physician who later fails to meet the standard of care when providing services to a hospital patient. The public expectation is that physicians cannot treat patients at a particular hospital unless they demonstrate their competency.

Credentialing decisions concerning a doctor’s ability to practice at a hospital, and privileging decisions related to what specific procedures can be performed, are usually based on an analysis of the physician’s training, experience, and skill. Patients rely on the hospital’s decisions since they do not have access to the same information as the hospital. Patients have the right to assume that hospitals will protect them from incompetent physicians and substandard care. Increasingly, malpractice committed by a credentialed physician will result in a challenge of the hospital’s analysis of the physician’s competence and qualifications. The harm caused by a negligent physician will be attributed to the negligence of the hospital.

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The exposure of hospitals may also increase because the credentialing process is changing. The process is becoming less an evaluation of competence and more an investigation of the economic value a physician or group practice can bring to the hospital. This trend of “economic credentialing” driving decisions, rather than credentialing based on qualitative criteria, lessens the focus on competence and increases the exposure of the hospital. Economic credentialing uses criteria such as volume of services and number of patients, which is unrelated to the quality of care or professional competence formerly used to determine hospital privileges.

Preparing for Claims Against Directors & Officers
Virtually everything executives do creates potential for claims by persons adversely affected by their actions and decisions. An effective D&O liability loss prevention program will help to reduce liability exposure for the directors and officers and the organization.

First, directors and officers need to recognize that their fundamental duty is to prudently represent the interests of corporate shareholders, non-profit organization members, and other constituencies in directing business affairs. Just as medical professionals must meet a standard of care for their services, directors and officers have a duty of care that requires them to act in good faith.

Second, the composition of the board should be selected based on the organization’s unique requirements considering director attributes, independent directors, size of the board, and self-evaluation.

Third, directors and officers need to establish operating procedures and financial controls, including preparation of financial statements (balance sheet and income statement), and risk management and loss control programs.

Fourth, new directors and officers should be properly oriented to the operations of the organization, including the competitive and regulatory environment, the nature of the industry, and the legal arena in which directors and officers serve as fiduciaries.

While healthcare organizations and their directors and officers can reduce their liability exposure by employing good loss prevention procedures, they cannot eliminate the risk entirely. For this reason it is important that directors and officers make sure that appropriate insurance coverage and risk management techniques are in place.