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FINPRO Focus

New California Law re: Medical Staff Standing to Sue Hospital

By Geoff Fallon

Background on the role of hospitals and their medical staffs

The board of directors of a hospital is ultimately responsible for the quality of medical care provided by the hospital, but it is the medical staff (MS) that actually provides the medical care. The MS is composed of physicians, nurses and other medical professionals. Physicians are not employees of the hospital but have privileges (i.e., "credentials") to practice at the hospital. On the other hand, nurses, residents and other medical professionals are hospital employees. Although a typical MS may have administrative offices and staff provided by the hospital, it is not a legal entity per se and is not organized as a corporation or other form of business organization.

The hospital is responsible for providing the staff, buildings, equipment, billing, regulatory compliance, etc. But, since the hospital is ultimately responsible for the quality of medical care provided, it has the final authority over decisions first made by the MS. For example, in the first instance the MS credentials physicians to practice in the hospital, but the final authority on credentialing physicians rests with the board of the hospital.

In light of the overlapping roles of the hospital and MS, the relationship between the parties becomes contentious at times. The state of California has decided to formalize and codify the relationship between the hospital and the MS to some extent and specifically gives the MS standing to sue the hospital.

New California Law

Effective January 1, 2005, a new California law (SB 1325) becomes effective. A key provision of this law is that, unlike any other state, in California a hospital's MS will have standing to sue the hospital (or any other person or entity) when the hospital is, or is about to, engage in any acts or practices that hinder the ability of the MS to do its job. The new law requires the MS to adopt bylaws and rules for self governance including such things as:

- Credentialing
- Utilization review
- Quality assurance

- Selecting and removing medical staff
- The ability to retain and be represented by independent legal counsel at the expense of the MS
- Assessing dues from the members of the MS

Despite the law's mandate to formalize the structure of the MS and to clearly give it the right to sue the hospital, the new law specifically provides, however ironically, that the hospital's board retains the ultimate authority and responsibility for the quality of care.

Directors and Officers (D&O) Liability Coverage Issue

The new law clearly provides that the MS may sue the hospital, but the individuals who comprise the MS are insureds under the D&O policy. Therefore, would a claim by the MS against the hospital be barred by the Insured versus Insured ("IvI") exclusion?

Policy Language

In order to better focus the discussion of coverage only the policies of AIG and Chubb are referenced, and both AIG and Chubb are leading underwriters of hospital D&O coverage. The rationale, generally speaking, behind the IvI exclusion is to prevent a collusive lawsuit between parties who are not truly adverse.

The AIG August 1997 Not-for-Profit Hospital D&O policy (the "AIG policy") defines "Individual Insured" to mean, in pertinent part a: "director, officer, trustee, trustee emeritus, executive director, department head, committee head…staff or faculty member…Employee or volunteer of the Organization."

The Chubb April 1996 Executive Risk Healthcare Policy (the "Chubb policy") defines "Insured Person" to mean, in pertinent part a: "director, officer, trustee, employee, volunteer, or any member of the staff, faculty or any duly constituted committee of the Insured Entity."

The IvI exclusion in the AIG policy states, in pertinent part, that the insurer will make no payment for loss in connection with a claim "which is brought by or on behalf of the Organization against any Individual Insured."

The IvI exclusion in the Chubb policy states, in pertinent part, that the insurer shall not pay loss for claims "by or at the behest of the Insured Entity."

Coverage Commentary

The definition of insured person is very broad under both policies and clearly includes many, if not all, members of the medical staff. Physicians would likely be considered members of the MS when they are acting in the capacity of department heads or committee members, and by definition, all employees such as nurses, medical technicians and residents, are also insureds. But the IvI exclusions in both the Chubb and

AIG policies do not broadly exclude all claims by one insured against another. Rather, they only exclude claims brought by the hospital.

It appears, therefore, that a claim by the MS against the hospital would not be barred by the IvI exclusion under either the AIG or Chubb policies. But the new California law is not yet effective, and it is not clear how either hospitals or MSs will adjust their business practices, if at all, as a result of the new law. It is also too soon to determine how insurers will respond, and some additional coverage issues may arise.

For example, if the MS must adopt bylaws and rules of self-governance, will insurers consider the MS to be an insured entity under the D&O policy akin to a subsidiary? If so, the IvI may bar coverage for a claim by the MS against the hospital. While the new law permits the MS to sue the hospital, it says nothing about the hospital's right to sue the MS. If a hospital is sued by the MS it would not be equitable to deny the hospital the right to file a counter-claim, but a suit by the hospital against the MS may be barred by the IvI exclusion. For understandable reasons, a single insurer would not want to be on both sides of a lawsuit.

Generally speaking, based upon the language of the new law and the standard IvI exclusions in the AIG and Chubb policies, hospitals should take some comfort that a claim against them by the MS of their hospital is likely not barred by the IvI exclusion. But, as the new law evolves and businesses practices change, California hospitals should stay in close contact with their legal and risk advisers to assure that coverage is maximized for this new risk.

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