

SPECIAL REPORT

MANAGED CARE LIABILITY LOSS EXPOSURES

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The third party administrator (TPA) for my company's group health insurance program inadvertently pre-approved a medical procedure for one of our employees and then, after the surgery, rescinded their approval, leaving the employee with over \$130,000 in medical bills. The employee sued. The TPA expects my company to pay for the lawsuit even though we did not do anything wrong. Do we have insurance for this?

Our health plan administrator denied coverage for a bone marrow transplant submitted by a cancer victim on the grounds that it was an "investigational" procedure. The employee died and my company is now being sued by her estate for \$77 million dollars. Are we responsible even though this was the Administrator's decision?

INTRODUCTION

In an effort to reduce the cost of group health insurance, employers have implemented various types of managed care programs in order to provide a controllable level of care at a reduced cost. Managed Care Organizations ("MCO") require employers to dictate specific guidelines to restrict an employees' right to choose individual health care providers and facilities as well as the extent of coverage that will be provided. As a result, employers face a host of liability exposures. The following is a common MCO arrangement:

ABC Corporation self-insures the first \$250,000 of the employee group health insurance plan. ABC has purchased insurance for claims that exceed \$250,000. ABC has hired a third party administrator (TPA) to process employee claims and administer the coverage guidelines. Employees are usually limited to a network of doctors and facilities that have been pre-approved by the employer. ABC's agreement with the TPA states that ABC will protect the TPA from all claims arising out of the TPA's acts or omissions.

The purpose of this Special Report is to analyze the nature of managed health care organizations and describe the typical liability exposures associated with these plans.

FEATURES OF MOST MANAGED CARE ORGANIZATIONS

Under a managed care system, subscribers (employees) pay an annual premium in exchange for certain health care services which are governed by a health insurance contract. Subscribers must choose their provider from within a limited network of physicians who have been designated by the organization.

From the employer's perspective, the major benefit of an MCO is cost control. In order to be admitted to the MCO's network, all providers must agree to certain volume discounts and strict practice guidelines aimed at avoiding waste and over-treatment. The net result is lower health care cost.

The problem is that MCOs are often accused of irresponsible and potentially dangerous penny pinching at the expense of beneficiaries. This exposes the MCO and the TPA to a variety of lawsuits and liability losses.

WHO WILL THE BENEFICIARY SUE?

If a beneficiary is wrongfully denied coverage or is injured as a result of malpractice, they will likely sue the physician, the TPA and the MCO. It is likely that the physician (or its insurance carrier) will seek to settle their portion of the lawsuit early on in exchange for testifying that he or she sought to do a certain test or procedure but that the MCO decided to save the money and refused to approve the procedure.

Regardless of who is sued, the sponsoring employer was likely required to sign a defense and indemnification agreement with the MCO or TPA. The agreement usually requires the employer to indemnify and defend the MCO or TPA for any claims arising out of the administration of the benefit program, including the MCO's own negligence. Thus, if the beneficiary pursues the MCO, they are ultimately suing their own employer.

ERISA PREEMPTION – WHAT EMPLOYEE'S CANNOT RECOVER

The Employee Retirement Income Security Act ("ERISA") is the federal law which governs all disputes pertaining to employee benefit programs. The purpose of the Act is to allow a federal uniform interpretation of disputes involving employee benefit plans.

Under the ERISA law, a plan beneficiary is barred from recovering medical expenses, lost wages, death or disability, pain and suffering, emotional distress, or other harm that a patient may suffer as a result of the improper denial of care. This means that if the plan wrongly refused to cover cancer treatment, for example, and the beneficiary died due to the denial, their estate is not allowed to sue for wrongful death arising out of the denial of coverage.

Section 502(a) of the ERISA law provides that, "[A] civil action may be brought...by a participant or beneficiary...to recover benefits due to him under the terms of his plan...or to clarify his rights to future benefits under the terms of the plan." Essentially, a plaintiff's remedies are limited to those provided by § 502 of ERISA. § 502(a)(1)(B) states that claims may be brought to recover benefits due under the terms of the plan or to enforce or clarify the plaintiff's rights under the plan. This means that a patient is only entitled to recover the monetary amount of the benefit denied (i.e., the actual cost of the treatment) or the actual benefit itself. No recovery for losses resulting from personal injury such as medical expenses, lost wages, death or disability, pain and suffering, emotional distress, or other harm that a patient may suffer as a result of the improper denial of care is permitted. In addition, ERISA precludes punitive damages and plaintiffs are not entitled to a jury trial.

Although the ERISA law provides a great deal of protection for MCOs with respect to wrongful denial of coverage, there are a host of other exposures that should be considered.

WHAT EMPLOYEES CAN RECOVER

If the employer is involved in directing the employee's choice of medical providers or facilities, the employer could become liable.

Defense Costs

Regardless of whether the beneficiary's claim for damages is actually compensable, the MCO will be forced to defend the suit. This could potentially cost thousands of dollars.

Limited Choice of Providers

Employees can allege restrictions in their freedom to choose health care providers. There are a number of situations where restrictions could be alleged to have caused injury. By way of example, an employee who was prohibited from seeing the physician of his or her choice might claim the following:

- Negligence on the part of an MCO's medical personnel which would not have been committed by his own doctor.
- Failure on the part of the MCO to screen out incompetent providers.
- Withholding of necessary treatment based solely on financial considerations.

Negligent Selection of MCO or Provider

Employers are also subject to claims that they were negligent in the selection of their MCO or TPA. Beneficiaries may allege that the employer failed to adequately investigate the particular organization from which health care services were obtained. In effect, a claimant could attribute a medical injury to his employer's negligence in managing the due diligence process during the course of selecting an MCO for the corporation.

Benefit Denial or Delay

The federal ERISA law allows a beneficiary to bring a suit against the MCO to recover wrongfully denied or delayed benefits. In such a case, the claimant is limited to the recovery of the monetary amount of the benefit denied (i.e., the actual cost of the treatment) or the actual benefit itself. In addition to the exposure associated with the indemnification, the MCO will incur defense costs.

Inadequate Review Process

MCO's can be sued for their failure to administer a full and fair review of all disputed claims. In *Crocco v Xerox Corp*, a beneficiary requested health care treatment for her work-related depression. The MCO refused to cover her in-patient care because she was permitted to leave the hospital during the day. The beneficiary filed suit against the MCO because it failed to include an objective third party review. As a result, the MCO was forced to incur substantial legal defense costs.

Breach of Confidentiality

An MCO is liable for the breach of confidential medical information by the provider or by any of its agents. In one case, an MCO inadvertently disclosed a patient's psychiatric medical records to a disgruntled former friend. The records were then sent by this individual to the patient's friends, family, business associates, and clients.

MCO Indemnification Agreements

Most MCO or TPA agreements require the Plan Sponsor (usually the employer) to protect the MCO/TPA from any lawsuits arising out of the administration of the plan.

Most agreements provide some version of the following:

Sponsor agrees to indemnify and defend the MCO, its officers, directors, attorneys and agents, and to hold them harmless from, any and all claims, demands, causes of action, liabilities, costs, losses, penalties, assessments, damages, judgments, arbitration awards, settlements or expenses (including reasonable attorney and accountant fees) which may be paid or incurred by the MCO with respect to any Participant or any other person or persons (including any governmental authority) resulting from or in connection with the operation of the Plan (or Trust), any action or inaction by Sponsor with respect to the Plan, or any act or omission by the MCO with respect to its duties under this Agreement, unless such claim, liability, cost, loss, expense, damage, penalty, assessment, judgment, arbitration award or settlement results from MCO's gross negligence, willful misconduct or fraud.

Medical Malpractice & Negligence

In *Dukes v U.S. Healthcare*, the court held that the HMO should be vicariously liable for the medical negligence of the providers that it arranged for under the HMO plan. The U.S. Supreme Court held that in fact, malpractice claims are not preempted by ERISA and allowed the case to proceed in state court. The beneficiary was free to bring claims against the MCO for claims related to the "quality of treatment" such as medical negligence or malpractice.

ERISA does not preempt state laws related to professional medical liability for the quality of care.

In one case, a newborn child died a day after the child and mother were discharged from a hospital because their HMO required that all mothers and their newborns be discharged within 24 hours of birth. The daughter died of a strep infection that went undiagnosed and untreated as a result. They sued the MCO for the negligence of the hospital in failing to diagnose the condition.

In 1998, a federal court ruled that an HMO could be sued for negligence in state court over a doctor's decision to deny mental hospital care for a teenage schizophrenic who later killed himself.

The Illinois Supreme Court has ruled that a beneficiary could sue their MCO for failing to quickly diagnose mouth cancer.

Where an MCO effectively controls a physician's exercise of medical judgment and that judgment is exercised negligently, the HMO cannot be allowed to claim that the physician is solely responsible.

We have insurance for this, right?

Some employers mistakenly believe their insurance policies will cover liability claims related to an MCO or other employee health plans. A review of your policy language will reveal that there is no coverage for the exposures associated with Managed Care Liability under any of the following policies.

- General Liability
- Excess Liability
- Fiduciary Liability
- Employee Benefit Liability
- Employers Liability
- Directors and Officers Liability
- Employment Practices Liability

No Coverage Under Employee Benefit Legal Liability Policies

Employee benefit legal liability only covers an act, error or omission that is negligently committed in the "administration" of your "employee benefit program." This boils down to unintentional mistakes in the administration of the employee benefit plan, like forgetting to add a beneficiary. There is no coverage for bad decisions or acts of indiscretion.

It is also interesting to note that EBL policies exclude coverage for bodily injury claims. If the MCO is sued for the malpractice of its provider, there is no coverage. Also, there is no coverage for discrimination. If the insured extends experimental coverage to male employees but refuses to extend the same coverage to females, EBL will not cover the discrimination lawsuit.

TRENDS

Plaintiff attorneys are increasingly combining regular medical malpractice claims with one or more of the following “managed care” issues:

- Negligent selection or supervision of providers
- Inconsistent denial of experimental or investigational services
- Inappropriate delegation to nonphysicians
- Nonphysician control of approving emergency services
- Misrepresentation/false advertising
- Financial incentives which discourage needed services.

WHAT INSURANCE IS AVAILABLE FOR THIS EXPOSURE?

There are a few carriers willing to provide coverage for the managed care liability exposure under an optional endorsement to the fiduciary liability policy. These coverages are weak, at best.

Travelers Insurance Company

Travelers offers an endorsement to its fiduciary liability policy for scheduled managed care plans. This endorsement removes the bodily injury exclusion for claims related to MCOs. In addition, the Travelers form also covers contractually assumed liability arising out of employee benefit plans which would arguably include the indemnification provision under a TPA agreement.

Chubb Insurance Company

Chubb offers a Plan Purchasers endorsement to its fiduciary liability policy. The major disadvantage of the Chubb form is that it does not cover self-administered plans, such as those handled by a third party administrator. Even if self-administered plans were covered, there is no coverage for liability assumed under contract, thus a TPA's claim for indemnification and defense coverage would not be covered.

Stand alone policies for the MCO exposure are also available from certain specialty markets.

HOW TO MINIMIZE MANAGED CARE LIABILITY

The following are a few ways that organizations can minimize their exposure to liability loss arising out of their MCO:

- Select providers carefully.
- Provide and document ongoing supervision and evaluation of providers.
- Establish written criteria for approving or denying experimental or investigational services, and document all exceptions with full explanations.
- Ensure that all non-physicians are properly trained and are limited in their duties.
- Have legal counsel review all TPA and MCO agreements.

CONCLUSION

Managed Care Health Plans will continue to undergo more and more scrutiny in the years to come. Regardless of the measures set in place, employers will always be exposed to lawsuits from plan beneficiaries as they seek to find a balance between quality of care and the cost of services.

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