Peer Review Advice For Healthcare Systems: California Court Of Appeal Ruling In *Smith v. Selma*

*By Nathaniel M. Lacktman and Shirley P. Morrigan, Foley & Lardner LLP**

In *Smith v. Selma Community Hospital*, No. F050816 (Cal. Ct. App. July 21, 2008), the California Court of Appeal held that, unless circumstances indicate otherwise, a hospital may not solely rely on the peer review findings of another hospital when considering whether to terminate a physician's medical staff membership and clinical privileges. The Court of Appeal emphasized that it was not holding that a hospital may *never* rely solely on the results of the peer review proceedings of another hospital when it decides whether to terminate a physician's medical staff membership and privileges. Rather, a hospital cannot make a decision solely on external information *if* there is evidence that questions the reliability of the prior proceedings.

This California case provides important national guidance for peer review bodies, which frequently learn of and become concerned by information from other sources. The primary implication of *Smith* is that a peer review body should independently evaluate outside information and review the practitioner's practice at its healthcare organization(s) to determine whether similar behavior, or practice, might occur, and then consider corrective action.

Factual Background

Dr. Branton R. Smith was a member of the medical staff of Hanford Community Medical Center (HCMC) and Central Valley General Hospital (CVGH), two related hospitals in Hanford, California (collectively, the Hanford Hospitals). Dr. Smith also was a member of the medical staff at Selma Community Hospital (SCH). All three hospitals are owned by Adventist Health System. Dr. Smith owned 11 clinics that competed with Adventist. He agreed to sell the clinics to CVGH, but the transaction was not completed and CVGH filed suit against Dr. Smith for his failure to complete the sale.

In 2002, the Hanford Hospitals both suspended Dr. Smith's privileges and charged him with substandard care, abusive behavior, and falsification of records. Dr. Smith challenged the Hanford Hospitals' decision through the peer review process, but the governing board affirmed his suspension. Dr. Smith then sought a writ of administrative mandamus in California court to challenge the ruling.

In September 2002, Dr. Smith informed SCH of his suspension from the Hanford Hospitals. SCH's Medical Executive Committee (MEC) began an investigation of Dr. Smith and, in April 2004, the MEC summarily suspended his medical staff membership and privileges. The MEC's action was based solely on the summary suspension of Dr. Smith's medical staff membership and privileges at the Hanford Hospitals. Dr. Smith requested a hearing before SCH's Judicial Review Committee (JRC) and filed suit against SCH. He also obtained a temporary restraining order that enjoined SCH from taking any action to suspend, restrict, or otherwise impede his SCH medical staff membership and privileges. In settlement discussions during May 2004, SCH offered to reinstate Dr. Smith in exchange for dismissal of his lawsuit. Dr. Smith did not accept the offer. The MEC rescinded the summary suspension (thereby lifting the temporary restraining order) and recommended termination of Dr. Smith's medical staff

membership and privileges.

In March 2005, SCH's JRC rejected the MEC's recommendation to terminate Dr. Smith's medical staff membership and privileges. The JRC found there was no evidence of substandard care by Dr. Smith at SCH, that the MEC's actions appeared potentially financially motivated, and that the MEC did not persuade the JRC, by a preponderance of the evidence, that the MEC's recommendation was reasonable and warranted. The JRC believed the peer review findings from the Hanford Hospitals should not be solely relied on for corrective action unless independently verified by SCH and stated, "[w]e believe that SCH must do their own investigation of Dr. Smith."

The SCH Governing Board (Board) reversed the JRC and affirmed that the MEC's recommendation to terminate Dr. Smith's medical staff membership and privileges was reasonable and warranted. The Board afforded the Hanford Hospitals' decision the "full force and effect of a final administrative decision" and held that, under the doctrine of collateral estoppel, the JRC was obligated to accept the Hanford Hospitals' peer review findings as conclusive. Dr. Smith then filed a petition for writ of administrative mandamus and claimed that the Board lacked jurisdiction and abused its discretion by substituting its own judgment for that of the JRC. The Superior Court granted Dr. Smith's writ and directed SCH to reinstate the JRC's decision. SCH appealed.

Reliance on Other Hospitals' Peer Review

According to the Court of Appeal, the "most significant controversy" between the parties concerned the legal effect of the Hanford Hospitals' peer review findings on Dr. Smith's medical staff membership and privileges at SCH. Neither SCH's bylaws nor California's peer review statute (Cal. Bus. & Prof. Code §§ 805 *et seq.*) addresses the role that corrective action findings at one hospital play in the peer review process of another hospital. The Court of Appeal held that collateral estoppel did not apply to the Hanford Hospitals' peer review findings because the decision was not final, as Dr. Smith's writ of administrative mandamus was still being contested in Superior Court.

The Court of Appeal explained that collateral estoppel only applies if: (1) the issue sought to be precluded is identical to that decided in a former proceeding; (2) the issue was actually litigated in the first action; (3) the issue was necessarily decided in the first action; (4) the first decision was final and on the merits; and (5) the party against whom preclusion is sought is the same as, or in privity with, the party to the former proceeding. Thus, the Court of Appeal held that SCH's Board erroneously ruled that the JRC could not substantively challenge, and was obligated to accept as true, the Hanford Hospitals' peer review findings.

Settlement Negotiations Admissible and Relevant

SCH claimed that the JRC did not provide a fair hearing process because the JRC considered irrelevant and inappropriate evidence, including settlement negotiations between SCH and Dr. Smith. The Court of Appeal disagreed, finding that SCH's argument was based on the erroneous assumption that collateral estoppel applied. According to the Court of Appeal, evidence of settlement negotiations between SCH and Dr. Smith was relevant because reasonable inferences could be drawn regarding the MEC's motive for treating the Hanford Hospitals' findings as conclusive (e.g., to gain leverage against Dr. Smith's competing clinics). Furthermore, SCH's Bylaws are less strict than the California rules of evidence and expressly allow evidence that would otherwise be excluded under California law.

The Court of Appeal also deemed relevant evidence of Adventist's economic interests relative to Dr. Smith (who owned 11 competing clinics), the fact that all three hospitals were owned by Adventist, and

that Adventist had unsuccessfully attempted to buy Dr. Smith's competing clinics. This evidence was relevant because it provided the JRC a rational reason to be skeptical of the Hanford Hospitals' peer review findings. Thus, the Court of Appeal ruled that the Board erroneously decided that the JRC had considered irrelevant evidence.

Common Ownership, Financial Interests Undermined Reliability of Findings

The Court of Appeal rejected SCH's contention that the JRC impermissibly ignored SCH's Bylaws and instead followed a legal standard proposed by an expert witness when the JRC suggested that "SCH must do their own investigation of Dr. Smith." The Court of Appeal interpreted the JRC's statement as a recommendation, rather than an invariable standard or rule. According to the Court of Appeal, that recommendation was part of a fact-based explanation of the JRC's ultimate finding that the MEC's action was not reasonable and warranted. The Court of Appeal found that the JRC properly applied the standards of SCH's Bylaws by deciding that the MEC's action was not reasonable and warranted because the MEC failed to conduct its own investigation.

The Court of Appeal held that the Board erroneously concluded that the JRC's decision was not supported by substantial evidence. The court held that the MEC's decision to treat the Hanford Hospitals' findings as conclusive and, on that basis, to recommend termination of Dr. Smith's medical staff membership and privileges, was not reasonable because SCH's Bylaws did not require such a course of action and collateral estoppel did not apply. In so doing, the court found that the MEC improperly ignored other relevant evidence. According to the Court of Appeal, that evidence showed "significant conflicts between the interests of [Dr.] Smith and the interests of the Hanford Hospitals and their owner [Adventist]." In particular, the court stated that the evidence "provides some support for [Dr.] Smith's theory that the Hanford Hospitals were pursuing peer review proceedings against him in an attempt to gain a stronger position in [Adventist's attempt to buy Dr. Smith's clinics]."

The Court of Appeal's concern about the reliability of the Hanford Hospitals' findings was further buttressed by the fact that SCH did not identify any cases of substandard care by Dr. Smith while at SCH. Coupled with expert testimony that refuted the Hanford Hospitals' factual findings, SCH's own experience with Dr. Smith "undermines the reliability of the findings of the Hanford Hospitals" and "provides additional support for the inference that the [findings] were motivated by concerns other than patient safety."

The Court of Appeal determined that the proper remedy for the MEC's errors was to reinstate the JRC decision not to terminate Dr. Smith's medical staff membership and privileges at SCH.

California Supreme Court Petition for Review

On September 2, 2008, SCH filed a petition for review with the California Supreme Court. SCH's petition focused on two main issues: whether the Court of Appeal applied the proper standard of judicial review and whether the appellate ruling conflicts with prior decisions on the use of another hospital's peer review findings as a basis for a peer review action at a hospital.

SCH's petition claims the Court of Appeal failed to apply the standard of review set forth by *Hongsathavij v. Queen of Angels/Hollywood Presbyterian Hospital*, 62 Cal.App.4th 1123 (1998). SCH argues that, if the Court of Appeal believed the SCH Board applied the wrong legal standard, the Court of Appeal should have remanded the case back to SCH. SCH's petition contends that the Court of Appeal, after finding that the SCH Board applied the wrong legal standard, should not have looked to the JRC recommendation and ordered the SCH Board to implement and adopt it. SCH's petition alleges

that the Court of Appeal should have simply remanded the matter to the SCH Board. According to SCH, the Court of Appeal's actions conflicted with existing law.

In the second issue raised by the petition, SCH argues that hospitals should have the right to rely solely on the peer review findings of other hospitals when they make their own peer review and credentialing decisions. SCH contends that a hospital should not have to wait until a physician harms a patient before taking appropriate corrective action. In this sense, the petition claims the Court of Appeal's decision created a conflict with existing California law. It is important, however, to recognize that the Court of Appeal emphasized it did not hold that a hospital may never rely solely on the results of the peer review proceedings of another hospital when deciding whether to terminate a physician's medical staff membership and privileges. Instead, the Court of Appeal held that a hospital cannot make a decision solely on such information if there is evidence questioning the reliability of the prior proceedings. The financial conflicts and co-ownership of the hospitals was a material element in the Court of Appeal's questioning of the prior proceedings.

As of the date this article went to print, the California Supreme Court has not decided whether to grant or deny SCH's petition. Generally, the Supreme Court has at least 60 days in which to rule on a petition for review.

Practical Advice for Peer Review Bodies

1. Peer review bodies and medical staffs should exercise caution when using the peer review findings of another healthcare organization as a basis for their own corrective actions. *Smith* illustrates how another healthcare organization's peer review findings cannot be the sole basis for corrective action if there are questions about the reliability of the findings. A peer review body should definitely pay attention to the other organization's findings and use them as a starting point to conduct its own internal evaluation.

2. Peer review bodies should comply with their governing documents, including, but not limited to, medical staff bylaws, internal rules, policies, or practices, and, in particular, their peer review policies. A peer review body should always seek legal advice if a proposed action is not expressly contemplated in its governing documents.

3. Peer review bodies should engage in progressive discipline, with summary suspension used only when clearly and legally justified (generally, to prevent imminent danger to the health of any individual).

4. Peer review bodies should be aware of any conflicts of interest. These conflicts can create the appearance that ulterior motives, and not patient safety and quality of care, are guiding the peer review process. Information regarding common ownership and economic interests might be relevant. If there are any participants in the process who cannot be objective, they should recuse themselves from both the discussion and the decision.

5. While settlement of a peer review action should be explored, peer review bodies and healthcare organizations must be cautious in the manner they communicate settlement offers because those communications might be introduced by the medical staff member during a peer review hearing. SCH's JRC characterized SCH's settlement offer to rescind its summary suspension if Dr. Smith dismissed his lawsuit as follows: "This is hypocrisy if the hospital wants the panel to share their concerns about patient safety. This, in and of itself, makes it appear as if Selma and the Selma MEC has more economic concerns than patient safety worries."

6. The Health Insurance Portability and Accountability Act (HIPAA) creates challenges to the sharing of information between peer review bodies. In addition, state confidentiality laws may create their own hurdles to sharing patient identifiable and peer review information. Healthcare organizations should consult legal counsel regarding those laws when a request is made to share such information.

** Nathaniel M. Lacktman is an associate in the Tampa office of Foley & Lardner LLP and a Certified Compliance & Ethics Professional (CCEP). He is a member of the firm's Health Care Industry Team and its White Collar Crime and Corporate Compliance Practice Group. Mr. Lacktman practices healthcare litigation and has focused experience in matters involving medical staff peer review, internal investigations, and defense against enforcement actions by state and federal regulators. He has represented healthcare clients in state, federal and appellate courts, administrative hearings, mediations and arbitrations. He is admitted to practice in Florida and California and may be reached at 813.225.4127 and NLacktman@Foley.com.*

Shirley P. Morrigan is a partner in the Los Angeles office of Foley & Lardner LLP and co-chair of the Regulatory and Strategic Counseling Work Group of the Health Care Industry Team. Ms. Morrigan represents hospitals, medical staffs, medical groups and integrated healthcare systems in matters related to medical staff governance. She has extensive experience in bylaws, credentialing, corrective action, hearings and appellate reviews, and writ of mandate proceedings at the Superior Court, Court of Appeal and California Supreme Court levels. She is a frequent national speaker on issues including peer review, the Health Care Quality Improvement Act, and allied health professionals. She may be reached at 213.972.4668 or SMorrigan@foley.com.