Monograph

Pre-dispute arbitration agreements in provider contracts: What healthcare risk managers should know

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INTRODUCTION

Healthcare providers have sought to reduce litigation costs and avoid exposure to runaway jury verdicts in medical malpractice trials in recent years by implementing arbitration agreements in healthcare admission contracts.

Arbitration is a private dispute resolution forum that is binding, legally enforceable and often confidential. The rules and procedures of arbitration vary widely. Arbitrators often are legal professionals but can also be laypeople who make a determination out of a sense of fairness. Similarly, an arbitrator may or may not follow the rules of evidence. Attempts to enforce arbitration agreements by healthcare providers have met strong opposition from plaintiff's lawyers seeking to preserve the right to a jury trial in malpractice lawsuits against healthcare providers.

This monograph examines the historical increase in large compensatory awards and punitive damages in jury verdicts in medical malpractice/long-term care cases and the concomitant increase in the costs of defending these claims.

This monograph will also examine the myriad factors a healthcare provider must consider in implementing a successful arbitration program that will withstand judicial scrutiny and reduce exposure to punitive awards and litigation costs.

Historical rise of malpractice jury verdicts and defense costs

Empirical evidence available shows that jury awards to successful plaintiffs in medical malpractice cases and long-term care cases have increased dramatically in recent years.

For instance, CNA HealthPro's "Long Term Care Claims Study," published in 2004, demonstrates the rising costs of litigating long-term care cases, and further demonstrates the significant increase in average indemnity payments in such cases. The CNA claims database included 16,241 professional liability and general liability claims for occurrences between 1996 and 2003. The average indemnity payment rose 415 percent during that time period (from $25,919 in 1996 to $107,609 in 2003), while the average costs incurred in defending those claims ballooned from $3,956 to $34,714 in 2003. Assisted living facilities experienced the sharpest rise in terms of the severity of claims. The average indemnity payment in 1996 was $9,646, while the average payment rose to $215,594 in 2003. The study noted that the long-term industry has been working to mitigate the costs of litigation by removing personal injury litigation from the courts through the use of arbitration programs.

Aon's 2006 Actuarial Analysis(1) of claims against long-term care providers, commissioned by the American Health Care Association, concluded:

1. The average amount to defend a claim has quadrupled in the past seven years from $13,600 to $52,800.
2. Frequency of claims continues to climb, and the number of claims per 1000 occupied beds doubled from 5.6 per thousand in 1995 to 11.1 in 2006. States that have not adopted tort reform remain especially problematic in this area.
3. The average severity of claims has stabilized at approximately $160,000 since 2004 after an exponential growth from $39,000 in 1995 to a high of $181,000 in 1998, though the average indemnity payments are 60 percent higher in states that have not adopted tort reform than those that have adopted tort reform.
4. The average amount to indemnify patients has recently started to decrease, likely due in some part to the increased amounts spent on defense.

The increase in the costs of defending the long-term care industry is consistent with the increase in the costs of defending physicians in medical malpractice cases. The American Medical Association reports that while physicians prevail at trial in 83 percent of the cases against them, the average cost of obtaining a defense verdict is nearly $94,000.(2) Moreover, the median medical liability jury award in medical liability claims increased from $157,000 in 1997 to $439,400 in 2004.(3) The U.S. Department of Justice, Bureau of Justice Statistics confirm that the median trial award in medical malpractice cases increased by 70 percent to approximately $425,000.(4)

Exposure to punitive damages awards

The plaintiff's bar has been developing themes in patient care liability cases against nursing homes to turn cases with seemingly limited exposure under traditional tort principles into punitive damages cases where jurors punish corporate defendants. The explosion of nursing home litigation over the past decade can be linked to the availability of punitive damages under Residents' Rights laws and Wrongful Death statutes, combined with the willingness of juries to award staggering punitive awards when presented with the opportunity to punish corporate defendants that are perceived to have violated their obligations to care for their elderly residents.

According to one study of 186 plaintiff's verdicts in nursing home litigation in California, Florida and Texas, juries awarded punitive damages in 30 percent of long-term care cases in those jurisdictions with an average award in those cases of $22,625,432.(5) The average punitive

damages verdict was skewed by several astronomical verdicts, including the highest verdict to date against a nursing home of $312 million.(6) Notwithstanding the impact of this single verdict, massive punitive awards were hardly an aberration. Of the 34 punitive damage awards in Texas, 24 were $1 million or greater, while nine of those awards exceeded $10 million.(7) A more recent verdict in Texas of $160 million rendered after the Justad study confirms the ongoing threat of runaway jury verdicts.(8) In Florida, 10 of the 15 punitive damage awards were $1 million or greater, while three of the six awards in California exceeded $1 million.(9) Punitive awards of greater than $10 million have not been confined to these hot-bed states, as juries in several other jurisdictions have reached similar results.(10)

The effect of arbitration agreements on malpractice litigation

While a comprehensive comparison of arbitration vs. litigation has not yet been conducted, it appears that arbitration has several advantages over traditional litigation. Advocates of arbitration argue that arbitration yields similar results in less time and at less expense.(11) Several studies seem to support those claims. A study in the Dispute Resolution Journal comparing employment discrimination claims found that employees prevailed 46 percent of the time in arbitration while only 34 percent in federal court. Additionally, the median monetary award was slighter larger in arbitration and took nearly one-third less time to resolve.(12) Another study published in the Columbia Human Rights Law Review found that employees prevailed at a far higher percentage in arbitration as compared to federal litigation and took roughly one-third of the time.(13)

Despite these studies, reliable statistical data as to the overall effect on malpractice litigation is unavailable. However, anecdotal evidence suggests that arbitration agreements reduce the costs of litigation and reduce the ultimate indemnity payments by eliminating the risk of extreme jury verdicts such as those cited above.

The implementation of arbitration programs has been cited as one explanation for the decrease in the number of overall plaintiff's verdicts in long-term care cases in recent years by systematically removing large numbers of neglect and abuse cases from the legal system.(14) As concluded by the Aon study, "[t]he increased use of arbitration has been cited by participants in [the Aon] report as a key factor in reducing average severity."(15)

A recent Massachusetts case demonstrates the potential value of a binding arbitration agreement, and the attitude of some plaintiff's lawyers concerning the importance of having the threat of a runaway jury verdict as a negotiating weapon. In *Constantino v. John Adams*,(16) the plaintiff asserted a wrongful death action against the nursing home and three nurses employed by the home. The nursing home moved to dismiss the wrongful death complaint and compel arbitration on the basis of the arbitration agreement entered into at the time of the resident's admission. The trial court allowed the nursing home's motion to dismiss, but denied the motion to dismiss the claims brought against the individually named nurses on the grounds that they were not "parties" to the arbitration contract. The trial court ordered the plaintiff to submit the case against the nursing home to binding arbitration, and ordered that the remaining claims against the nurses be stayed in accordance with the Massachusetts Arbitration Act pending a resolution of the arbitration.

The trial court correctly noted that in the event that the nursing home prevailed at the arbitration by obtaining a finding of "no negligence," the plaintiff's claims against the nurses would be barred based on the principles of collateral estoppel. More problematic for the plaintiff was that in the event that she prevailed at the arbitration, the damages for wrongful death *and punitive damages* would have been set by the arbitrator, rather than a jury. Given this dilemma, the plaintiff chose to dismiss the case against the nursing home with prejudice, leaving the plaintiff with individual nursing malpractice cases the individual nurses, each of whom has appealed the trial court's

decision denying their right to arbitrate pursuant to the arbitration agreement. Whether the case is ultimately arbitrated or tried, the arbitration agreement was successful in obtaining a dismissal of the corporate entity, thereby eliminating the potential relevance of the typical "corporate greed" evidence that motivates juries to award large punitive awards.

Applicable law

Whether a contract to arbitrate a dispute is enforceable is primarily a question of state contract law. States are free to regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of any contract."(17) The Supreme Court, however, has held that state laws seeking to limit the use of the arbitration process are superseded by the Federal Arbitration Act (FAA) when those contracts substantially affect interstate commerce.(18) The Supreme Court has vigorously enforced the pro-arbitration perspective of the FAA against non-conforming state statutes under the Supremacy Clause. In the absence of grounds for revocation of a contract, such as fraud, duress or "unconscionability," arbitration agreements are enforceable, and have been enforced in nursing home admission agreements.(19)

Underlying the Federal policy is Congress' view that arbitration constitutes a more efficient dispute resolution process than litigation.(20) Congress' power to regulate commerce under the Commerce Clause may be exercised in individual cases without showing any specific effect upon interstate commerce if the aggregate economic activity would represent a general practice subject to federal control.

Accordingly, at least two state supreme courts have recognized that the provision of healthcare in nursing homes affects interstate commerce in the aggregate, and thus the FAA is applicable to individual nursing home admission contracts.(21) For cases that fall within its reach, the FAA governs all aspects of arbitration procedure and pre-empts any inconsistent state law.(22) However, if a case does not involve interstate commerce, then state arbitration law will apply.(23) The FAA does not raise a substantial question of federal law sufficient to establish jurisdiction in the federal court where a resident has signed an arbitration agreement subject to the FAA.(24)

Plaintiffs most often seek to invalidate arbitration agreements based upon the contractual defense of substantive and/or procedural unconscionability. Substantive unconscionability occurs when contract terms are unreasonably favorable to one party.(25) This is distinguished from procedural unconscionability which "requires an examination of the contract formation process and the alleged lack of meaningful choice."(26) The language used by the Massachusetts Supreme Judicial Court in a recent case is instructive as to the significant burden a party must bear to establish unconscionability:

> *Unconscionability has historically been found if the contract was such that no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other. Later, a contract was determined to be unconscionable when the sum total of its provisions drives too hard a bargain for a court of conscience to assist.(27)*

The plaintiff's bar is committed to invalidating arbitration contracts in order to preserve clients' rights to a jury trial. Arguments are being asserted in furtherance of this objective with varying degrees of success throughout the country. Accordingly, the law is evolving, and the success of a healthcare provider's arbitration program requires healthcare risk managers to be cognizant of the ongoing changes and vigilant in the modification of the arbitration agreement. Following are the major considerations in implementing an arbitration program.

Is the arbitration agreement optional?

Perhaps the most common and most persuasive reason cited by plaintiffs seeking to invalidate arbitration agreements on the grounds of procedural unconscionability is the contention that the arbitration provision was a non-negotiable term that was presented as a "take it or leave it" proposition.(28) The applicable federal regulations require Medicare-certified and Medicaid-certified facilities to accept Medicare/Medicaid reimbursement rates as payment in full.(29) Furthermore, nursing homes may not solicit or accept any other consideration as a precondition of admission to the nursing home.(30) This prohibition has often served as a basis for invalidating arbitration agreements where the nursing home presented the arbitration agreement as a "take it or leave it" proposition, or where the prospective resident was not provided with a reasonable opportunity to decline to agree to the provision.

Notwithstanding the prohibition against mandatory arbitration clauses, the Centers for Medicare and Medicaid Services issued a memorandum in 2003 stating that "[u]nder Medicare, whether to have a binding arbitration agreement is an issue between the resident and nursing home."(31)

On the other hand, drafting arbitration contracts that clearly give the resident the option to decline the agreement make enforcing the agreement much more probable. For instance, the Massachusetts Supreme Judicial Court recently emphasized the nursing home's attempt to make it clear that the arbitration agreement was not a condition of admission in enforcing the arbitration agreement.(32) Specifically, the court noted that the arbitration agreement was printed on a separate document as opposed to being contained in the same form as the admission agreement, and required a separate endorsement from the rest of the admission agreement. Additionally, the agreement gave the plaintiff a unilateral right of rescission for 30 days after execution of the agreement.(33)

Risk managers should also be aware of state law that may *require* a separate form and/or dictate the format of the agreement.(34) Several courts have emphasized that the importance of making the arbitration provision conspicuous by using bold-faced type of equal or greater font size to the rest of the printing in the agreement,(35) and some state statutes dictate the substance of the information that must be provided to render the agreement enforceable.(36)

Does the arbitration agreement deprive substantive rights?

Attempts to deprive a resident of substantive rights guaranteed by state or federal laws will most often establish grounds for invalidating the arbitration agreement. For instance, an agreement purporting to deprive the resident of substantive remedies, such as the right to seek punitive damages and or attorneys fees, may be determined to be substantively unconscionable.(37) While it is a prudent idea to include a severability provision that would permit a court to strike an offending clause from an arbitration contract and still enforce the remainder of the arbitration agreement, such a provision should not be counted on in all jurisdictions. Some courts have accepted this approach. For instance, the Mississippi Supreme Court held that an arbitration clause in a nursing home admission contract was enforceable after striking a waiver of punitive damages provision that would have rendered the contract unconscionable because of the waiver of substantive rights. Other courts have thrown the baby out with the bath water, finding that this approach provides a disincentive for a nursing home to write a fair agreement.(38)

The arbitration agreement should acknowledge the resident's right to seek administrative review of a transfer or discharge. Both state and federal regulations limit the permissible reasons for a transfer or discharge of a nursing home resident.(39) The regulations provide a discrete administrative mechanism for a resident to appeal the decision to transfer or discharge, and this

right should be carved out as an exception within the arbitration agreement to ensure that this right of administrative appeal is preserved.

Is the arbitration agreement a bilateral contract?

In evaluating whether an arbitration contact is substantively unconscionable, courts often consider whether the healthcare provider is also bound to arbitrate any claims it may have against the patient. In *Small v. Perrysburg*,(40) the court determined that the agreement was substantively unconscionable in light of the absence of a mutual agreement to arbitrate. While the arbitration agreement compelled the consumer to arbitrate all claims, the nursing home reserved the right to proceed in any form it chose for the resolution of fee disputes.

Should the agreement designate a forum and rules for arbitration?

Several issues must be considered when deciding whether to name a specific arbitration forum and whether to reference a specific set of arbitration rules. A recent decision by the Ohio Court of Appeals concluded that a consumer arbitration agreement was unconscionable because it failed to adequately describe the process to permit a "voluntary meeting of the minds."(41) The court reasoned that the plaintiff was "substantially less informed" about the process, and thus refused to enforce the arbitration agreement.

Selecting an arbitration forum raises other potential pitfalls. For instance, the best known arbitration forum, the American Arbitration Association, has amended its rules such that it will no longer agree to arbitrate healthcare cases that were the subject of an arbitration agreement that was executed before the dispute arose. Another popular arbitration forum, the American Health Lawyers Association (AHLA), will only administer consumer healthcare liability claims if the agreement to arbitrate was entered in writing after the dispute arose, or upon order of a court. In either case, plaintiffs argue that the where these forums were chosen in the arbitration contract, the performance of the contract has become impossible in light of the position taken by the arbitrator. While the defense of impossibility of performance has been rejected by some courts,(42) it has not been decided in every jurisdiction.

Consideration must be given to the specific rules of the arbitration forum selected, and a determination must be made as to whether the forum's rules violate any of the protections or substantive remedies guaranteed by the state law. In *Fletcher v. Huntington Place Limited Partnership*,(43) the court voided an arbitration agreement requiring that the arbitration be administered by the AHLA as against public policy. The court noted that section 6.06 of the AHLA Rules of Procedure for Arbitration requiring "clear and convincing evidence of intentional or reckless misconduct" to recover consequential, exemplary, incidental, punitive or special damages impermissibly conflicted with the protections afforded by section 400.023[2] of the Nursing Home Resident's Act, which allowed recovery for negligence based on a preponderance of the evidence. It rejected the argument that the severability clause allowed enforcement of the remaining arbitration agreement, reasoning that permitting courts to excise offending provisions would provide a disincentive to draft fair form agreements.

What information should be provided about the arbitration process?

In the absence of fraud in the formation of a contract, a party's failure to read or understand a contract provision does not free him from its obligations.(44) Notwithstanding this basic tenet of contract law, a lack of information provided at the time of the execution of the arbitration

contract has been held sufficient to defeat an otherwise valid arbitration agreement based upon a finding of procedural unconscionability.

In *Small v. HCF*,(45) the plaintiff was a 69-year-old woman who arrived at the nursing home on the day of admission of her husband, who was unconscious upon his arrival to the nursing home. Mrs. Small was approached by an employee of the nursing home who asked her to sign the admission agreement. The agreement was not explained to her and the entire time spent at the nursing home until her husband was transported to the hospital was approximately 30 minutes. In light of these facts, the court determined that there were issues demonstrating procedural unconscionability.

This problem can be avoided by providing basic information about the arbitration process and by including citations in the arbitration agreement to additional references that are readily available on the internet or by contacting the arbitration forum noted in the contract. Providing written materials about the arbitration process is advisable, as this approach creates a record of the information that was actually provided and anticipates the argument that the healthcare provider provided inaccurate information that convinced the patient to sign the agreement. When combined with a right of rescission, attempts to educate can sharply undercut a patient's claim of procedural unconscionability. If possible, the arbitration agreement should be presented by staff with a working understanding of the arbitration process. Plaintiff's lawyers seeking to invalidate arbitration agreement often seek to depose the person that presented the agreement was "explained" to the patient by a person who did not understand the process himself.

Does the representative have authority to bind the resident?

The failure of the healthcare provider to have the arbitration agreement signed by a person with legal authority to bind the resident or patient is fatal. This problem often arises from the exigencies of how they are admitted to healthcare facilities, or the practical reality of legally incompetent residents being admitted by a "responsible party" such as a spouse who may not have actual legal authority to enter contracts on behalf of the patient.(46) Admissions coordinators should ensure that the person executing the agreement has a valid power of attorney that has been activated. In the absence of such documentation at the time of admission, the arbitration issue should be revisited after steps are taken to obtain confirmation of a true legal representative.

A recent decision of the Missouri Appeals Court raises the related issue of whether a resident may bind his or her heirs to an arbitration provision. In *Finney v. Nat'l Healthcare Corp.* (47), the court held that a validly executed arbitration agreement signed by the resident of a nursing home was insufficient to bind her daughter in a subsequent wrongful death action because the cause of action for death under Missouri law belongs to the decedent's survivors, and thus the right to a jury trial could not be waived by the resident prior to death.

Waiver

Risk managers must be vigilant in ensuring that defense counsel representing the provider is made aware of the arbitration program to avoid waiving the right to arbitrate after suit is filed.

Waiver may occur if the defendant actively participates in litigating the merits of the plaintiff's claim before seeking dismissal.(48) Cases are often assigned to defense counsel by insurers and their third-party administrators who may be ignorant of the provider's arbitration program. This problem is confounded when, due to turnover at the healthcare facility or inconsistent record-keeping practices, the provider is unable to determine whether an agreement was actually signed by the resident/plaintiff. Copies of the arbitration agreement should be maintained in the patient's

permanent patient-care record as opposed to being maintained in billing or administrative records that may be stored off-site or not maintained with the vigilance of the original medical record.

CONCLUSION

Arbitration programs can be an effective part of a healthcare provider's risk management strategy. While tort reform has helped to neutralize jury exposure in several states, healthcare providers in the overwhelming majority of states remain exposed to verdicts that are restrained only by the imagination of the jurors that decide their cases.

Quantifiable data supporting a decision to implement an arbitration program may not be readily available, though the absence of arbitration verdicts that rival the gaudy verdicts handed out by juries across the country confirm the utility of arbitration contracts as a risk management tool. Further, the general consensus that the spiraling costs of litigation can be mitigated by instituting an alternative dispute resolution program is probably sufficient to justify the business expense of the program.

Risk managers should be aware of the evolving law in this area and recognize that a successful arbitration program does not consist of drafting a static arbitration provision in a contract. Rather, a commitment should be made to ensuring that the program is administered in accordance with the developing law, and that admissions coordinators and administrative personnel are equipped to serve an important role at the facility level.

REFERENCES

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3. Id.
4. U.S. Dept. of Justice, "Medical malpractice insurance claims in seven states," 2000-2004 (March 2007).
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(2003) (concluded that success rates in employment discrimination cases fared as well or better in arbitration as compared to federal court).

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27. *Miller,* supra, (citing *Hume v. United States,* 132 U.S. 406, 411 (1889)); *Waters v. Min Ltd.,* 412 Mass. 64, 66 (1992).
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30. See 42 U.S.C. §1396r(c)(5)(A)(iii).
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32. See *Miller,* supra.
33. Id.
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35. Vicksburg Partners, supra; *Miller v. Cotter,* supra.

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48. *Companion Life Ins. Co. v. Whitesell Mfg. Inc.,* 670 So.2d 897 (Ala. 1995).

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