PIICA

21st April 2004

Ms Fiona Spry
Insurance Contracts Act Review Secretariat
c/- Department of Treasury
Langton Crescent
PARKES ACT 2600

Dear Ms Spry

Please find attached a submission from Professional Indemnity Insurance Company Australia regarding the *Insurance Contracts Act 1984.*

Our submission is specifically addressed to section 45 of the *Act* and relates to matters other than those already included in the Issues Paper.

In its present form, section 45 of the *Act* constitutes a major impediment to the medical indemnity insurers (MIIs) in Australia being able to provide effective, comprehensive and affordable medical indemnity insurance to medical practitioners and their practice entities.

BACKGROUND
Unlike most forms of professional indemnity insurance in Australia, medical indemnity has historically been provided to medical practitioners as individuals by a medical defence organisation (MDO). MDOs are mutual organisations, which provided discretionary indemnity to subscribing medical practitioners, via payment by the practitioner of an annual membership subscription to his/her chosen MDO. There was no contract of insurance, or policy wording involved, and hence the *Insurance Contracts Act* and the principles of insurance law did not apply to the indemnity arrangements between MDO members and their MDO. In the event of a claim being made against a medical practitioner, he/she would request assistance and indemnity from his/her MDO, and this was provided at the discretion of the organisation concerned.

Most unusually, even in employment situations, medical practitioners have historically still paid for and taken out their own individual discretionary indemnity cover. In the event of contribution issues arising between two or more practitioners, medical practice entities (such as service companies) being named in litigation, or claims based in vicarious liability being made against a practitioner on the basis of the negligence of another, in the main, the MDOs were able to work cooperatively to sort out contribution issues, and to resolve these largely on the basis of an assessment of the degree of contribution (if any) of the practitioners involved. As such, separate cover for exposures such as vicarious liability, or for claims against service companies and other practice-related entities was not traditionally required.

Pelham House
165 Bouverie Street Carlton Vic 3053
PO Box 1059 Carlton Vic 3053

Telephone 1300 88 66 00
Reception +61 3 9347 3900
Facsimile +61 3 9347 3439

Professional Indemnity Insurance
Company Australia Pty Ltd
ABN 53 007 383 137

A wholly-owned subsidiary of
The Medical Defence Association
of Victoria Limited

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The arrangements outlined above are almost unique to the medical profession. Most professional indemnity insurance is purchased by the employer or employing company, for the benefit of all professional employees, associated staff, and any legal entity/ies operating the business. This type of insurance extends cover to the employer and operating entity/ies for any negligence on the part of professionals employed in, or working in the insured business enterprise.

The *Medical Indemnity Act 2003* required all MDOs to cease offering discretionary medical indemnity via a membership subscription from 01 July 2003, and instead to issue cover in the form of a contract of insurance, underwritten by a licenced and approved insurer. These insurers, (referred to as medical indemnity insurers, or MIIs), are generally companies wholly owned by their parent MDO, which function as captive insurers.

REGULATION OF THE INDUSTRY

The effect of regulation of the MDO industry by the *Medical Indemnity Act* has been to bring the MIIs under the jurisdiction of both the *Insurance Contracts Act* and the common law principles of insurance law. The *Medical Indemnity Act* and recent federal government reforms have also effectively enshrined the individual practitioner cover model (but in the form of an insurance contract between the individual practitioner and the MII), by linking premium subsidies and levies to the individual medical practitioner and his/her premium, and linking claims support such as the High Cost Claims Scheme to the policies of individual practitioners. This makes offering more standard types of professional/medical indemnity insurance product (which provide cover on an enterprise basis) as primary medical indemnity insurance difficult and unattractive to MIIs and medical practitioners alike.

Even without the effects of regulation of the MDO industry and the recent reforms, the rate of take-up of commercial medical malpractice policies (which provide enterprise based cover, including cover for any corporate entity/ies operating the practice, and all personnel employed by or working in the insured practice, in respect of claims arising out of their work within the practice) within the private medical practice arena has been, and remains very low. Medical practitioners clearly perceive that individual cover is the best solution. Contributing factors to this view include:

- The long tail nature of medical negligence risk. Practitioners are concerned about being left exposed to uninsured liability if they rely on an employer's policy, and the employer ceases to trade or does not purchase adequate run-off cover;
- Common work arrangements associated with the practice of medicine, particularly in relation to general practitioners. Many doctors undertake sessions at a number of different practices, and may also periodically undertake locum assignments. They are anxious to ensure that they have insurance cover which will protect them in all these circumstances.

The overwhelming majority of Australian doctors have individual medical indemnity cover, and are likely to continue to choose this form of cover. Given this, the requirement under the legislation for cover to be provided via a contract of insurance, with a policy wording which is subject to the *Insurance Contracts Act*, has resulted in the emergence of 'gaps' in cover. These may vary slightly from one MII to the next, depending upon their policy wordings, but generally relate to a number of vicarious liability exposures, including vicarious liabilities of individual practitioners, and more particularly of practice entities (such as an incorporated sole practice, a service company, or similar practice-related entity). They also relate to situations where claims arise out of process or system failures within a medical practice, where it cannot be clearly identified that an individual practitioner or practitioners were responsible for the process or system involved.

Historically, these liabilities did not require separate cover, because of the MDOs' ability to cooperate and manage them within the context of the discretionary indemnity framework. However, there is now a need to provide policies to insure such liabilities, while ensuring that these policies do not result in a situation of dual insurance. If these policies cannot be provided without creating dual insurance, or on an excess only basis (ie, the individual cover is the primary cover, and the corporate cover is excess only), the MIIs will have great difficulty in obtaining reinsurance support for the covers, and their cost to medical practitioners is likely to be prohibitive.

EFFECT OF SECTION 45

As it is currently worded, section 45 renders void any provision in a contract of insurance which purports to limit or exclude liability where the insured has also entered into another contract of insurance which would respond to the same risk. In other words, insurers are unable to impose exclusions to avoid situations of dual insurance. Case law has interpreted the definition of 'insured' for the purposes of section 45 broadly. It does not restrict that definition to the actual policyholder, but extends it to any person or entity deemed to be an insured or entitled to be indemnified under the contract of insurance.

The purpose of section 45 is clearly to prevent insurers which have accepted premium and entered into a contract of insurance from denying or limiting their liability under the policy simply because the insured also holds another policy which would respond to the same claim. However, as it has been construed by the courts, section 45 also has the unfortunate effect of preventing insurers from limiting their exposure to dual insurance in situations where the intention is not to insure the same peril on behalf of the same insured, in particular circumstances. These circumstances include:

- situations where an MII intends to provide cover for individual practitioners and/or practice entities to address vicarious liability risks, but with the intention that the practitioner/s whose negligent acts or omissions gave rise to a claim will seek indemnity for that claim under their own individual medical indemnity policy/ies;

- situations where the circumstances giving rise to a claim may encompass a combination of individual practitioner negligence, and negligence within the practice as a whole (such as process or system failures), and the intention is for the individual practitioner's negligence to be covered by his/her policy, and the 'practice' negligence to be covered by a policy taken out by the practice.

Sub-section (2) of section 45 provides some relief from section 45 (1) in that it states that sub-section (1) does not apply in very narrow circumstances where there is an excess of loss policy, which provides cover only for that part of a loss as is not covered by a contract of insurance specifically listed in the excess of loss policy. While this principle could potentially be used to overcome the current difficulties associated with offering corporate or practice based policies of medical indemnity insurance, sub-section (2) would not assist in its present form, as it is a practical impossibility for such a policy to list details of all the individual covers of every practitioner who provides medical services in the insured practice during the policy period. This is particularly so given that medical indemnity insurance in Australia is written on an exclusively 'claims made' basis. It is quite possible that the indemnity provider and/or policy details which would respond to a subsequent claim involving an individual practitioner may change from the time when a corporate policy is taken out, and the future time at which a claim is first notified.

PIICA'S SUBMISSION REGARDING AMENDMENTS TO SECTION 45

It is contended by PIICA that to ensure the ongoing availability of affordable and adequate medical indemnity insurance which extends to cover vicarious liability and 'practice' liability, amendments to section 45 are required. It is obviously undesirable for medical practitioners and their practice entities to have potentially uninsured liabilities (which is currently the case), because policies cannot be offered without exposing the MIIs to dual insurance situations. Given the high cost of insurance to individual practitioners, a solution where policies intended to respond only to vicarious and practice-based liability are priced to take account of dual insurance exposures is unlikely to be acceptable. Such a solution would render this form of cover unaffordable to the average medical practitioner or practice.

It is recognised by the industry that situations will sometimes arise where an individual medical practitioner will have taken out two policies of medical indemnity insurance with two different insurers to cover his/her individual medical indemnity risk. This may occur due to inadvertence, or even (in the early years of practice when premiums are relatively low) by design. Where this occurs, a situation of 'true' dual insurance exists, and PIICA would agree that section 45 should operate to void any policy exclusion related to dual insurance. PIICA does not seek that the *Insurance Contracts Act* be amended in respect of these situations.

However, where an individual medical practitioner has taken out a policy of medical indemnity insurance for the express purpose of obtaining cover for claims against him or herself, and a 'group' or 'practice' policy also exists with the intention of responding only to vicarious liability claims and claims relating to practice-based liability, it is contended that the MII issuing the 'group' or 'practice' based policy should be able to either exclude claims or liabilities against the individual practitioner which are covered under his/her individual policy, or provide that the corporate policy will only respond in excess of the cover provided under the individual practitioner's policy. The rationale behind this is that:

- the 'group' policy is intended to respond to vicarious and/or practice-based liabilities only, and has not been priced to include liability for claims against individual practitioners;

- the MII which issued the policy for the individual medical practitioner has collected premium to cover that practitioner's risk, and ought not be able to claim a windfall by seeking to apply dual insurance.

If section 45 is not amended to enable the above to occur, then it is likely that the cost of vicarious and practice-based liability cover will render this cover unattractive and unaffordable to medical practitioners. This will increase the risk that medicine will be practiced through uninsured entities, or that practitioners will set up corporate structures with minimal assets to reduce their exposure to uninsured liabilities. This is obviously not in the interests of the medical or general community.

WORDING/AMENDMENT

Specialist legal advice will need to be obtained to ensure that the wording of any amendment would operate to achieve the desired objective, without enabling insurers to exclude liability in genuine situations of dual insurance where both insurers intend to cover the same persons or entities and the same liability/ies, and have collected premium to cover an identical risk. It is not within the scope of this submission to propose the form of wording to be adopted, as this will require careful consideration and input from a number of parties.

It is, however, considered that one solution to the current problem would be to either:

- amend sub-section (2) to extend it to medical indemnity policies issued for the benefit of a medical practice or enterprise, where the policy provides that the cover is in excess of the cover provided under a policy of medical indemnity insurance issued for the benefit of an individual medical practitioner, which would respond to the same claim. The amendment would need to dispense with the necessity of listing specific policy details in such contracts of medical indemnity insurance; or

Further or in the alternative, it is considered that a wording which retained the status quo where dual insurance existed and the policyholder and peril insured were the same in both policies, but permitted dual insurance exclusions where the policyholders or named insureds were not the same person or entity would achieve the desired objective.

Review of section 45 is urgently required to enable MIIs to be able to offer insurance coverage that meets the full needs of the medical profession. Given the importance of ensuring that medical practitioners and their associated practice entities are able to adequately insure themselves at premiums which are affordable, it is requested that an amendment to section 45, along the lines suggested above, be added to the issues to be considered in the current round of amendments to the *Act*.

Yours sincerely

Mark Valena
Chief Executive Officer