MEDICAL DEFENCE ORGANISATIONS and DISCRETIONARY INDEMNITY

By David Hirsch

According to a recent news report, a medical defence organisation (MDO) has been exploiting a 'legal loophole' to avoid compensating two children allegedly injured by an obstetrician's negligence.[1] Unfortunately, this legal manoeuvre is not new and many claims have been abandoned or compromised because of it.

The issue involves the supposed right of a MDO to exercise its 'absolute discretion' to refuse to indemnify a member found liable to compensate an injured patient.

One positive consequence of tort reform is that doctors have been required to have insurance in order to practise. Mandatory medical indemnity insurance was considered necessary, at least in part, because the lack of government regulation of MDOs had encouraged poor management practices and insufficient reserves being kept for future claims.[2] MDOs had escaped regulation (and consequently mismanaged their businesses into a crisis situation) as they were not 'insurance companies' within the meaning of the *Insurance Act* 1973 (Cth).

A cornerstone of the MDOs' argument that they were not insurance companies was that they offered their members 'discretionary indemnity' rather than 'a contract of insurance'. This argument has been accepted as legally correct.[3]

But ask any doctor who was a member of a MDO offering only 'discretionary indemnity'[4] whether they had insurance, and they would say, 'Of course I have insurance – I am a paid-up member of my MDO!'

Although legally incorrect, the doctor could point to many representations by MDOs that their 'discretionary indemnity' was better than insurance because it was more flexible than an insurance contract. And they could also point to representations that 'discretionary indemnity' had never been and would never be used to refuse indemnity in a 'proper claim'. Doctors believed that their membership fees bought peace of mind for themselves and their patients: if a mistake was made, the doctor would be protected financially and the injured patient would be properly compensated. That belief was not misplaced; it was precisely what the MDOs had told them, and the government.[5]

In the recently reported cases, an obstetrician requested and obtained assistance from his MDO to defend against the claims of the two children. This means that the MDO had already accepted that these were 'proper claims'. The cases proceeded in the normal way until the doctor suddenly died in 2002. Soon afterwards, his estate went into bankruptcy. The MDO decided to exercise its 'absolute discretion' and refused to pay any compensation should the doctor be found liable.

In these circumstances, had the doctor been insured by an insurance company, the children would have had certain rights because the proceeds of an insurance policy are an asset of the estate. But 'discretionary indemnity', it was argued, created no rights – other than a doctor's right (or his or her estate or the trustee in bankruptcy) to request assistance which might or might not be given.

This bizarre situation has been recognised by the courts for what it is:

> 'It seems improbable in the extreme that many people would be content for their premiums to purchase no right to any money or money's worth in any event but merely a right to have their claims considered by a body of directors or others with full discretionary power to pay nothing or as much as they think fit.'[6]

Nevertheless, the only guarantee for doctors and patients that an MDO would 'do the right thing' and not abuse its discretion lay in the fact that MDOs were run by 'honourable members of an honourable profession'.[7]

Playing the 'discretionary indemnity card' in order to avoid paying compensation for proper claims is not what one expects of an honourable profession. It is, however, what we have come to expect these days from insurers whose only interest is self-interest.

I am not convinced that patients who are told that an MDO has decided not to indemnify a member or a member's estate have no legal recourse. And there is no doubt that the court of public opinion is against the MDOs. Even the Australian Medical Association has criticised the MDO in the reported cases and supported the injured patients.[8]

This is a golden opportunity for the medical profession to prove that it is the 'honourable profession' it claims to be. It is also an opportunity for lawyers to join forces with doctors to force MDOs to stop playing legal games and start doing what their members pay them to do: defend cases on their merits and pay proper compensation when it is due.

If readers know of other cases where MDOs have used 'discretionary indemnity' to avoid paying claims, or as a threat to extract a settlement, please notify the Alliance immediately. ■

Notes: **1** *The 7:30 Report*, 28 May 2007, see transcript at http://www.abc.net.au/7.30/content/2007/s1935736.htm. **2** The lack of adequate reserves led UMP to put a 'call' on its members for more money. This provoked a revolt by doctors, who called for tort reform, blaming litigation, rather than mismanagement, for their predicament. **3** *Medical Defence Union Ltd v Department of Trade* [1979] 2 All ER 421. **4** This includes most MDOs operating in Australia before the mandatory indemnity insurance legislation. **5** See *The Tito Inquiry into Medical Indemnity in Australia (Interim Report)* (1994) paras 8.21-8.23. **6** Above note 2 at 431, per Robert Megarry VC. **7** *Ibid.* **8** AMA representative, Dr Andrew Pesce, said in the news report, above note 1: 'I believe that the public and the medical profession would both be very horrified to learn that discretion was being used in that way.'

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