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# Benchers' Notes

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*These Benchers' Notes are written to provide members with information concerning the Transaction Levy arising out of the Winter Term Convocation of Benchers held on February 22, 2005, the Special Meeting of Benchers held March 16, 2005, and the Spring Term Convocation of April 4, 2005. This and previous editions of Benchers' Notes, beginning December, 1999, are available at [www.lawsociety.nf.ca](http://www.lawsociety.nf.ca)*

## The Insurance Program and the Transaction Levy

During the week of March 28 all members were distributed an information package containing Rules to implement a Transaction Levy. Prior to that delivery in March, the Levy was discussed on two occasions in earlier *Benchers' Notes*, in January, 2004, and a few months ago in December, 2004. This edition of *Benchers' Notes* provides further information.

Context is all and, for the purposes of the Levy, history and present circumstances, both, are driving considerations. Accordingly, these *Notes* provide historical background about the insurance program and the challenges currently faced, about current known and projected future costs of the program, and why Benchers believe these costs are equitably paid through a Transaction Levy. How the Levy will operate is discussed, but not exhaustively. Information seminars organized by the Law Society for later in April will address details. Also discussed in these *Notes* are the additional safeguards and remedies enacted by Benchers for the protection of the public interest and of members.

### Context and Background

The Law Society's sole legislated mandate requires Benchers to govern the profession in the public interest. Mindful, in the mid-1970's Benchers introduced an insurance program. The program became compulsory in 1978. Allowing for inflation, and scaling-up to present coverage, the Law Society's accountants inform that by the early 1980's members were paying approximately \$9,000 2005 dollars in annual premium. Even at this premium, there was a \$10,000 deductible, the equivalent of a \$19,000 deductible in 2005 dollars. The insurance program was purchased in the international market.

Considerable effort was made by Benchers to improve coverage and reduce the high cost. For example, in the 1980's Benchers decided to self-insure a portion of members' insurance risk. To retain this risk required the Society accumulate a capital pool from which to pay locally all claims to a certain dollar value, \$30,000. In 1983, the total value



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of claims paid was \$75,000. By retaining a significant portion of risk, Benchers were able to reduce the member per claim deductible to \$5,000, approximately \$9,500 in 2005 dollars.

In 1989/1990, the Law Society joined with the Law Society of Upper Canada on a program with a retained risk of \$250,000. In 1990, a \$250,000 retention captured more than 95% of the claims paid. To cover this risk, the Society accumulated a capital pool from premiums charged to members. For risk beyond \$250,000, insurance was purchased in the international market. During this period members' premium had two components, one to capitalize the retained risk, the balance to purchase additional cover in the market. The joint program with Upper Canada continued during a period of very low claims costs and without significantly drawing down the capital pool.

During the early 1990's, and with increasing claims and litigation costs, it was evident to the Insurance Committee and to Benchers that a policy with significant retained risk now carried significant exposure as well. For example, by 1992 the total value of claims paid increased from \$75,000 in 1983 to \$1,015,000. Aware of the mandate for public protection, and aware also the need for economic protection of members, the Insurance Committee recommended change from a retained risk policy to pure insurance. This decision coincided with creation at the Law Society of Upper Canada of the Lawyers' Professional Indemnity Company, LPIC, an insurance company owned and managed for the Law Society. In 1994, the Law Society of Newfoundland and Labrador purchased 100% cover on the international markets through LPIC. In doing so, our Law Society was able to piggyback the purchasing power of the Upper Canada program. Typically,

Upper Canada purchased \$60 to \$70 millions of premium in the international markets, Newfoundland and Labrador purchased \$2,000,000. The Upper Canada policy then represented approximately 16,000 lawyers, Newfoundland and Labrador, 441. As a small Law Society, we were, and remain, extremely vulnerable to insurance calamities and to international markets. The affiliation with Upper Canada and LPIC (now LawPRO) was generous and beneficial.

Between 1993 and 2000, insurance exposure increased dramatically and averaged between \$1,500,000 and \$1,750,000 a year. In 2002, exposure was \$3,013,000. There was some improvement in 2003, with \$1,703,000.

Even as members' claims experience was deteriorating, international and national events were impacting the ability of the Law Society to obtain cover. The events of 9/11, and some natural disasters in the period following, frightened the industry and led to consolidation. Since professional liability cover is said to have "a long tail", the Law Society, through LawPRO, contracted typically with two or three only among the largest and most secure insurers. One of these, a primary carrier for the Society, was bought out during consolidation by another large American insurer with no interest in a Canadian portfolio. In consequence of this changing market, negotiations for the 2004 policy were difficult and protracted and continued late into December; Benchers approved the 2004 Budget without knowing the premium to be paid. Members that year received insurance invoices very late and payment deadlines had to be extended. Policy features imposed by insurers for 2004 include a 10% risk component to be held by the Law Society plus a loss-ratio surcharge and a deductible surcharge.

The loss-ratio surcharge is a surcharge based on the actual loss experience for 2004. The Law Society is responsible for payment of this surcharge on an annual basis until all 2004 claims are paid. In 2005, the Law Society paid a surcharge of \$312,000 on the 2004 policy; a further payment of \$160,000 is anticipated during 2005 for the 2004 policy. Future liability on this surcharge may amount to as much as \$250,000 per year for the next several years and could total \$1,500,000 to \$2,000,000. The policy further contained a risk layer. With the risk layer, coverage is interrupted at \$1,300,000 and the Law Society required to step in and pay accumulated claims from that point to \$1,700,000, after which the insurers are again on risk. The 2004 premium charged to members included a costing for the 10% risk and for the risk layer for 2004 based on projected losses of approximately \$2,300,000.

Coincident with these circumstances in Newfoundland and Labrador, LawPRO was building on its success with a Transaction Levy introduced to the Upper Canada program in 1995. LawPRO was able to use accumulated surpluses increasingly to self-insure its program for the Law Society of Upper Canada. No longer could the Law Society of Newfoundland and Labrador piggyback the significant purchasing power of the Upper Canada program. The 2004 policy wording mentioned above reflected change within the international markets, and change in purchasing and negotiating power absent LawPRO participation.

Looking ahead from the backdrop of the 2004 negotiations, the Insurance Committee sounded a warning note to members in the 2003-2004 *Annual Report* of the Law Society, stating:

Our existing insurance fund is currently insufficient to stabilize our risk, espe-

cially if we are required to self-insure for a period of time until our claims record normalizes. Adding funds to these resources over a short period of time is, in the Insurance Committee's view, an important step that must now be taken. The Transaction Levy is one proven tool that can achieve this objective. Otherwise, a significant per member annual assessment would have to be made. There are only limited choices available to a small society such as ours.

The *Annual Report* was published shortly after the Parsons' Custodianship and before subsequent unrelated, and unprecedented, 2004 claims losses.

After the Parsons' Custodianship mid-year it was quickly evident to LawPRO that Parsons and other claims during 2004 would be extraordinary. The Insurance Committee was notified there would be considerable difficulty selling the Newfoundland and Labrador program in constrained international markets. Premiums requirements as high as \$15,000 per member were openly mentioned as a possibility. Given the situation, and as a courtesy, LawPRO encouraged the Insurance Committee, chaired by John Roil, QC, to begin early consideration of alternatives. In September, 2004, LawPRO, now entirely self-insuring the Ontario program and not itself requiring cover in the international markets, provided the Society notice of its intention to close the relationship with Newfoundland and Labrador. The Insurance Committee was faced with the need, and within a few months, to construct a policy acceptable to its public-interest mandate, acceptable nationally under Mobility protocols to which the Law Society is a signatory, and affordable for members. Fortunately, and anticipating the likelihood of change for 2005 and the desirability of keeping informed about the market-

place, the Committee earlier began discussions with the Canadian Lawyers Indemnity Association, CLIA. CLIA, a reciprocal insurer for lawyers, covers lawyers in Nova Scotia, Prince Edward Island, New Brunswick, Manitoba, Saskatchewan, Alberta.

#### **Insurance 2004:**

##### **Parsons Costs and Unrelated Claims Losses**

As the dimensions of the Parsons' claims began to form, policy-related costs rose in two categories: First, as members' deductibles resulting from Parsons-related claims, and Second, as shared-cost responsibilities included in the 2004 policy wording discussed above.

Deductibles occasioned animated discussion amongst Benchers during several Convocations. Approximately 70 members were innocently involved in 149 Parsons' transactions, and a number of these with multiple claims. Under the escalating deductible rule in the policy, multiple claims are subject to increasing deductibles. Two members with multiple claims could be subject to a million dollar deductible. Several would have deductibles in the \$50,000 to \$100,000 range. At a Special Convocation on August 19, 2004, Benchers agreed to pay members' deductibles. There was a meeting later that day with impacted members to inform them of Benchers' decision. While the total cost of deductibles was not then known, Benchers and members were informed the cost likely would be \$1,300,000. The final cost of deductibles is not yet available but the 2004 estimate has not changed significantly.

The year closed with added difficulty. At December 31, 2004, insurance claims reserves for 2004, reasonably and prudently estimated to insurers during 2003 as likely to reach \$2,300,000, now exceeded \$11,000,000,

a sum almost four times the worst previous insurance year. Of that amount, Parsons'-related claims comprise slightly more than \$5,000,000. The remainder come from high-risk areas of practice: 40% missed limitation claims, mostly from personal injury actions, 40% real estate claims, and the balance a miscellaneous grouping.

This surge in claims during 2004 resulted in part from the deadline to declare potential claims before the LawPRO policy expired on December 31. With the 10% risk in the 2004 policy, this \$11,000,000 in reserves, paid out over several years and thereby invoking each year the risk layer penalty, presents a potential \$2,000,000 cost to the Law Society. Add to this amount the loss-ratio surcharge earlier discussed and the total potential cost to the Society on the 2004 policy is \$4,000,000, exclusive of the deductibles.

Returning briefly to Parsons' claims, not all are insured. There are a number of real estate transactions where Mr Parsons acted for both sides. Claims arising out of these transactions will be paid out of the Law Society's Assurance Funds and are estimated will cost \$700,000, all of it to be paid during 2005. The Assurance Funds are an essential component of public protection and must be replenished promptly if the Law Society is to meet its statutory mandate and its obligations to other law societies under National Mobility protocols.

##### **Future Financial Responsibilities, CLIA**

There is the further and going-forward responsibility of the Law Society to the new CLIA policy. During fiscal 2005, CLIA is providing a transition year for the Law Society to adapt its internal administration to accommodate the new policy. Unlike past experience with LawPRO where claims manage-



ment was handled entirely by LawPRO, CLIA anticipates claims management directly by the Law Society and with the assistance of a specialized Claims Management Committee. The policy anticipates the Law Society will, as do other provinces with CLIA, soon retain a significant portion of its own risk, possibly in the range of \$350,000, this representing perhaps 95% of all claims paid. The capital funding necessary to self-insure that level of risk, and given the experience of recent years, is significant. The Insurance Committee believes it is a sum not less than \$5,000,000. The Law Society will likely soon be required to self-insure some level of its risk, and must begin accumulating the necessary capital pool, during the 2005 and 2006 policy years.

### **A Cost Summary of Insurance Liabilities**

Based upon information provided above, a summary of projected liabilities on the insurance program follows next, the dollar values approximate: Shared-cost responsibilities under the 2004 policy wording for shared risk at 10% plus the risk layer, \$2,000,000; loss-ratio surcharge on the 2004 policy paid over several years, \$2,000,000; members' deductible costs arising out of William J Parsons' Law Office transactions, \$1,300,000; Assurance Fund claims, \$700,000. Total: \$6,000,000. Add now the \$5,000,000 minimal capitalization costs necessary for retained risk on the CLIA program as it moves forward, Total: \$11,000,000.

### **The Transaction Levy**

Faced with the projected liabilities outlined above, and after much deliberation at Convocation and preceding at meetings of the Insurance Committee since 2002, Benchers concluded that a Transaction Levy is an equitable way to protect the Society's insurance program, the public interest, and

members. Modelled after the experience with a Levy in the Upper Canada insurance program, Benchers believe the Levy will generate per transaction revenues that reflect in part the risk of the transaction. High volume, and therefore potentially higher risk, practices, will generate more Levy revenues. Senior members with established practices will contribute more Levy revenues than young members working to establish a new practice. Government members, a class that never had and cannot now have an insurance claim, are exempted. Levy revenues will be used exclusively for the insurance program.

The Levy Rules provide that a Transaction Levy (in the amount of \$50.00 + HST) applies to real estate transactions that transfer, charge, or insure an interest in real property, personal property transactions that transfer or charge title to personal property, and civil litigation transactions (the commencement of a proceeding and a first response in any level of court in the province excepting Small Claims Court). The Rules provide certain exceptions and also state that members not participating in the Law Society insurance program (and thus who pose no risk of loss) are not subject to the Levy. Further details on the operation of the Levy will be discussed at the upcoming information sessions in St John's, in Grand Falls-Windsor, and Corner Brook.

By its Rules, the Law Society makes the Levy a responsibility of the member to remit. Members may in turn, and where they consider appropriate, disburse the Levy to their clients. Some members may choose to do so, some may choose not to do. The Levy does qualify as a disburseable expense because it is incurred in the course of the file.

### **How Newfoundland and Labrador Insurance Costs Compare**

How do insurance costs in this province compare to other parts of Canada? Traditionally, our costs have been markedly higher. There are two reasons. First, in a small Society significant losses have a disproportionate impact on premium. As earlier stated, in 2004 the premium paid was \$2,450,000; claims reserves for 2004 exceed \$11,000,000. Second, The Law Society of Newfoundland and Labrador may be the only provincial law society that does not significantly subsidize the insurance premium charged to members. Some examples illustrate. In New Brunswick, the insurance program (CLIA) from July 2003 to July 2004 produced a surplus of \$703,968 (2003), and \$440,313 (2004). A portion of this money was paid to their capital pool and the balance, as well as the interest earnings on the entire capital pool, was used to subsidize their premium down to \$1,700 per member. In Ontario, revenues from the Transaction Fee Levy introduced in 1995, initially used to capitalize the new insurance company and pay costly insurance liabilities, are now used entirely to subsidize the insurance premium. For 2005, the Levy subsidizes the premium down to approximately \$1,325. In Ontario, use of the Transaction Levy to subsidize the premium is so popular that the Levy cannot be removed and at members' request has been incorporated directly into insurance policy wording.

The Barreau du Quebec provides a third, and enviable example. With a surfeit of insurance monies from excellent claims experience from its 14,000 members over many years, the Barreau subsidizes its policy down to \$1 per member for coverage that is five times greater than any other jurisdiction in Canada.

While insurance costs will remain high in Newfoundland and Labrador for some years, the next two or three will realize a complete transition to the new program in this province.

Members' 2005 policy premium reflects some of these transition costs. The base premium for each member is \$4,100. To this amount is added a 20% Equity Fund charge (\$800) that the Law Society must contribute to an Equity Fund at CLIA, the Fund collecting monies from all member law societies and as a safeguard in emergency. The Fund is separate from a capital pool required for self-insurance purposes. As the final component of the premium members' pay, there is an added \$1,100 for adjusting and defence costs, for a total of \$6,000.

Will insurance costs in Newfoundland and Labrador decline in the near future? Costs are unlikely to decline until the Transaction Levy pays down the liabilities associated with 2004 claims and there is a capital pool sufficient to manage retained claims in this province. Once claims costs are paid, and a capital pool available, the Levy becomes available, as in Ontario, to subsidize the insurance premium. Current projections have Levy revenues at approximately \$2,000,000 annually. At this rate, premium subsidy will not be available for four or five years.

### **Given these Insurance Claims Costs, are Members Practising Correctly?**

As earlier indicated, Parsons' claims represent approximately 45% of the 2004 claims reserves, a significant sum but not half the reserved costs. Why the remaining 55%? Two years ago LawPRO compared and analyzed the insurance claims history of this Law Society with the claims history of the Law Society of Upper Canada. The results indicate, if groups of 450 practising insured members are selected at random in Ontario, their claims history experience over time mimics the Newfoundland and Labrador program. In Ontario, however, the problems associated even with several groups of 450 members are quickly lost among 18,000 practitioners.

### **Should the Law Society Manage its Members More Closely?**

Faced with difficulties in the insurance program and the costs of a Custodianship, the Insurance Committee and Benchers examined whether the Law Society is doing enough to prevent poor management practices among its members. For example, should members be allowed to act on both sides of a real estate transaction; should there be closer controls over members who declare bankruptcy; should trust accounts be more closely monitored; are members lacking in substantive knowledge, resulting in errors? Briefly, some answers.

#### **Real Estate Transactions**

Members frequently act on both sides of a real estate transaction, whether because they are working in a small community or because they are acting on the one hand for a developer and on the other for a purchaser. After close examination, an *ad hoc* Committee appointed to examine the concerns of Benchers about these transactions concluded that some risks are unavoidable, that the overall integrity of the profession should be allowed to prevail, and various proposed remedies were unpalatable. The *ad hoc* Committee is currently examining whether such transactions can be protected through mandatory title insurance. It is this *ad hoc* Committee that developed the Two-Cheque Practice Standard recently adopted by Benchers and circulated to members as one means to reduce difficulties in real estate transactions.

#### **Bankruptcies**

Members are aware that new Rules concerning bankruptcy were approved recently by Benchers and distributed. The Law Society of

Newfoundland and Labrador has been abreast on these types of Rules for some years. The old bankruptcy Rules of this Law Society were used as a model by some other societies when developing their own. The new Rules, however, are tough and advance public protection by suspending the bankrupt from practice until the Executive Committee have the member address the Committee's concerns. A member who fails to report can be subject to discipline.

#### **Trust Accounts**

In recent years this Law Society was responsible for bringing together and Chairing meetings of the Atlantic law societies with the purpose to create common trust account rules throughout the region. The consolidated Rules bring together the best components of all in Atlantic Canada. Later in April, meetings will begin next to consolidate the reporting Forms used by members in the region. The work is expected to take a year. This Law Society, and Atlantic law societies collectively, are leading the rest of Canada in developing strong, uniform Rules for public protection.

Most members have now met Jerry Oser, CA, the Law Society's random auditor. The Society's random audit program, considered and in development over the last few years, is proving a significant success. The Society is obtaining better information about members' trust accounts, and sooner, than ever before, and has been able to address member concerns and propose remedies in a timely manner. While interventionist, the program continues to meet with member acceptance and approval. Under the program, trust account activities are very closely monitored. The program is one of the most comprehensive and careful in Canada, second only in frequency to the program in Prince Edward Island where audits are conducted of all firms every

year. No other law society in Canada provides the level of trust account monitoring that occurs in Prince Edward Island and Newfoundland and Labrador.

### **Does a Lack of Substantive Knowledge Lead to Errors?**

The question arises on occasion whether better training, or more CLE, will address the areas of concern and thereby reduce insurance costs? The short answer is, No. There is no indication from insurance program experience that members are making errors due to lack of substantive knowledge or information. The significant majority of claims arise out of law office administrative errors and inadvertence in practice, and not from lack of substantive knowledge. The Newfoundland and Labrador CLE program is now among the most successful in Canada, with one of the highest percentage per member participation rates year-over-year. While the CLE program is important to address new developments in the law and to assist members in keeping current and competent, it cannot substitute for good office management.

### **Looking to the Future**

As earlier indicated, 2005 is a transition year to the new CLIA policy and requires many adjustments for the Law Society. A Claims Management Committee will soon be struck and trained in part from discussion and observation at a similar Committee meeting in New Brunswick. The Society's insurance adjuster, Ray Walsh, FIIC, will take training in New Brunswick also and to assure he is current with CLIA policy management. The Claims Management Committee will operate independently of, and confidentially from, the Insurance Committee. Within a few years it is possible this aspect of the insurance program will operate independently from the Law Society, perhaps as a separate corporation.

The current Insurance Committee will continue to have overall responsibility for the CLIA policy wording, premiums and revenues, and will report to Benchers. Some policy considerations to be discussed by the Committee during 2005 include whether the \$5,000 claim deductible, unchanged in amount since 1983, should now be increased. And, should the deductible be higher for claims arising out of a missed limitation period? The Committee will be responsible as well to monitor capitalization of the program, and for setting the retained risk level.

### **A Closing Word**

It is fitting to close with discussion, however brief, about integrity. In her recent work, *Dark Age Ahead*, Jane Jacobs chides the great professions, law and medicine, for occasionally losing sight of the core values that maintain their importance and place in society. For the legal profession, among these core values are integrity, honour, word, trust. And to this abbreviated list each member will add one or two of direct personal importance.

When difficulties arise, the Law Society staff, the Benchers, and members must resist the immediate and easy temptation to paper all possible errors with a rule and a punishment. If we eliminate undertakings, if we undermine the word and bond of colleagues, if we insure against every detail, then we may put at peril our extraordinary qualities.

Jacob's also stated that the great professions must meet their obligations to public interest and public protection if they are to maintain their role in society. The information outlined in these *Benchers' Notes* sets out how the Benchers and members will meet that necessity.