File: N10

THE LAW SOCIETY
OF SOUTH AUSTRALIA

MEMORANDUM

TO: Mr Tony Abbott
Ms Margery Nicoll
Mr Harold Cottee

FROM: Richard Mellows, President

DATE: 15 December 2009

SUBJECT: COAG National Legal Profession Reform Project
Discussion Paper: Fidelity Cover

Please find below the Law Society of South Australia's comments in relation to COAG's Discussion Paper on Fidelity Cover.

Comments are limited to those matters where the Society feels further comment is warranted at this time and to draw to the attention of the Taskforce matters the Society considers worthy of further consideration.

Attachment A

It should be noted that the information in Attachment A as it relates to South Australia is incorrect in respect of the following

Sources of funding

- add "78.5% of Practising Certificate fees and 37.5% of interest from statutory deposits (s56(5) of the *Legal Practitioners Act 1981)*"

- delete reference to "supplemented by excess trust account interest (interest accrued on Statutory Interest Account)"

Current contribution per practitioner

- add "78.5% of practising certificate fee"

Who administers fund

- delete "through Deed of Trust"

Monetary limit on pay-out

- delete "none"; and

- add "Sections 61 and 64 of the Act and in particular s 64(2) provide "where the Society has published a notice under this part in the respect of a specified fiduciary or professional default, or a specified series of fiduciary or professional defaults, the maximum amount that may be acquired towards satisfaction of all claims to which the notice relates is the prescribed percentage (5% under Regulation 38(6) of the balance of the Guarantee Fund calculated to the nearest $1,000) as disclosed in the accounts of the Guarantee Fund last audited before the proposed application of money towards satisfaction of the claims."

Other information to note

Payments are "authorised by" the Attorney-General, not "made by" the Attorney-General.

Introduction

The proposal appears to put forward a two tiered approach to the restructure process. This is because the establishment of one National Fund would *"involve a major restructure of existing statutory accounts and could disrupt existing funding flows"* (see last paragraph on page 2). The first proposal is that the State based system would remain at the outset. However, what is then proposed is that the National Legal Services Board would ultimately seek to implement one National Fund (see first paragraph on page 3). The effect of this is that the actual final format of the National Fund will be left solely at the discretion of those people comprising the National Legal Services Board. This has the potential to significantly impact on South Australia, as one of the States that relies on the Guarantee Fund to fund the Legal Services Commission. While it is good that no radical change is proposed for the time being, it would be useful to have at least some indication as to when a single national Fidelity Fund is contemplated to be introduced.

The expanded ambit of claims that would be met by the Fund, (see paragraph 2 under "Background" on page 1) does not take into account the compulsory Professional Indemnity (PI) cover that solicitors hold and its possible response to claims of this nature. Further, if the Fund is a "fund of first resort" then it is the Fund under its rights of subrogation that will be suing the negligent solicitor/practice. Where PI Schemes are mutual schemes run by the Society this has the potential for conflict.

Rules vs regulations

Once again we need to make the point that matters as important as the requirement for fidelity cover and the terms and conditions of that cover should be in the Act or at least Regulations and not merely in the Rules under the new Scheme. The terms of, and the process for making, a claim should be part of the legislation and not be set by the Board.

Capping of claims

Why should claims be capped? It is hard to see any "moral" justification for this, but there may be a necessity to do so for resourcing purposes, especially in the early days of the fund. It would probably come down to actuarial evidence as to whether some form of cap would be needed, but we would suggest the structure of a cap (as high as possible), with a discretion in the fund administrator to go beyond it in exceptional circumstances, would be a good model to consider.

Who should administer the fund?

At present South Australia's Fund, and we believe most other States' Funds, are looked after by their respective Attorneys -General. Will this fund be run/ invested/ managed by the Federal Attorney General or will each State's collected revenue continue to be invested and administered within the State? It would be preferable for this decentralisation to continue so that the States can hopefully keep some control over the distribution to the public purposes for which it is currently used. The public purpose uses should of course be enshrined in the legislation for protection.

It is noted that the National Legal Services Ombudsman (NLSO) is one suggestion as the "independent person" to administer the Fund. If the NLSO is also the adjudicator of complaints, is that not a conflict of interest? The only truly independent model is that the Fund be administered by a totally independent Board.

Contributions to the Fund

Experience has unfortunately shown that it is not necessarily the big jurisdictions that will give rise to the big defalcations. What does it mean then, to suggest that contributions to the fund be risk-based? It is hard to imagine a system that could be fairly and simply devised based on claims history, claims potential, type of work done by each firm, proportion of partners to other staff etc. Furthermore these factors as "claim-generators" could well change in the next few years, particularly as claims begin to arise out of MDPs.

We would submit that the contribution should be as simple as possible, and be a flat fee for every practitioner entitled to practise in Australia, and imposed as part of the Practising Certificate fee for ease of collection. (Barristers, having little or no access to trust monies, could be exempted or pay a nominal levy). It may also be appropriate to impose on a firm a levy for each "non-legal practitioner associate" employed who has access to trust funds, which arose in Magarey Farlam Lawyers as a result of the actions of the accountant, Mr Willoughby.

Claims administration

We suppose we have to concede that there might be a perception of conflict of interest in local solicitors administering claims against local practitioners (at least in the media), even though we know that there is none. Actual or perceived conflict of interest in the administration of funds has never been a problem in South Australia until some of the victims of the Magarey Farlam Lawyers defalcation floated the suggestion. The suggestion is ill-founded.

The paper makes the point that the profession has valuable expertise in the area. We suggest that those bodies which currently administer claims in each State or Territory continue to do so.

Jurisdiction shopping

We are concerned about the section headed *"Fidelity Cover – where a claim would be made"*, on page 3 of the paper. If some form of risk- or population-based contribution is arrived at, it will inevitably make some States and Territories cheaper than others for contribution purposes, and if a multi-jurisdiction practice is able to nominate a "home jurisdiction" there would inevitably be a rush to nominate the cheapest place as home jurisdiction. You might therefore find a "Top 10" NSW based practice setting up a small office in Canberra or Darwin from which to run their administration and trust account, therefore avoiding many thousands of dollars in Fidelity Fund contributions for its staff Australia-wide. There would need to be a Regulation preventing this opportunism.

The multi-jurisdictional law practices have obviously successfully argued for each such practice to be permitted to operate only one trust account held in one of the jurisdictions in which the practice operates. Victims would be required to make claims in the home jurisdiction of the associate, under this proposal.

Under the original model law proposal the jurisdiction for claims was, in the first instance, to the place where the trust account operated. As multi-jurisdictional practices were also required to keep a trust account in each jurisdiction a victim of a trust account default would therefore be able to make a claim in the victim's home jurisdiction. It may well prejudice a victim by being required to make a claim in another State. There could also be difficulties in proving "default" if the trust account is maintained in another State.

If firms need only operate a trust account in one jurisdiction but provide legal services in a number of jurisdictions interest on the trust account would be payable in one jurisdiction only. Coupled with a loss of revenue from practising certificate fees it could result in some jurisdictions having substantially diminished revenue.

The South Australian Fund

The paper does not seem to take into account of the various activities other than acting as a fidelity fund which apply to the Guarantee Fund in this state. In addition to funding the activities of the Legal Practitioners Conduct Board, LPEAC, the activities of the Professional Standards section of the Society and the like, there are other matters such as the payment for educational or other publishing programs conducted for the benefit of legal practitioners or members of the public.

There is also the matter of interest earned on trust accounts and how it is presently applied – 50% to the Legal Services Commission, 40% to the Guarantee Fund and 10% to a person nominated by the Attorney-General.

The paper recognises that establishing a single national fund would involve a major restructure of existing statutory accounts and existing funding flows and on that basis proposes to retain the existing fidelity fund in each jurisdiction in the short term. The fund in South Australia is not simply a fidelity fund. Those monies are used to fund a range of other services which must be protected. Otherwise, the services will either need to be decreased or discontinued or funded from general state revenue which is unlikely. In our view the profession, the Society, the public and state government funding are all likely to suffer significantly as a result. The establishment of one national fund must be resisted for these reasons.

Please note: The Consultative Group Paper has been considered separately by the Society's Professional Indemnity Insurance Section through its Director, Ms Libby Bishop. A copy of Ms Bishop's response is attached. ***The Society endorses Ms Bishop's comments.***

Yours sincerely

Richard Mellows
PRESIDENT

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Law Claims Memo

TO: Jan Martin

FROM: Libby Bishop

DATE: 15 December 2009

RE: National Legal Profession Reform – Consultative Group Paper

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FIDELITY COVER - Paper - 11 December 2009
Recoveries

- I note the Paper is silent on the manner in which recoveries of expenditure by the Fidelity Fund / Guarantee Fund are to be determined / regulated. This was a significant issue in a recent claim by the Guarantee Fund for recovery of expenses incurred in relation to a claim.

- Principle 1 – a person who suffers loss as a result of a default of a law practice is ALSO entitled to make a claim against an insured pursuant to the Professional Indemnity Scheme. The Guarantee Fund in South Australia is a fund of last resort and in the first instance, claims resulting from defalcation must first be the subject of a claim, that may be denied pursuant to the Certificate of Insurance before the loss is appropriately directed for the consideration of the Guarantee Fund payment. This does not seem to be addressed in the Paper, that such claims are currently covered by the PI Scheme as a result of the provision of "innocent partner" cover. Of course the wording of the actual claim will be the subject of consideration of "indemnity" which will depend upon the circumstances.

- Principle 2 – a default by a law practice operating a Trust Account in the course of legal practice, where the failure is due to a dishonest act or omission may be the subject of PI cover if directed to the innocent partners.

- Principle 4 – I am unclear as to the meaning of "administering the Fidelity Fund" and exactly what insurance may be referred to, however I assume this relates to section 67 of the Legal Practitioners Act.

- Principle 5 – the Principle is unclear as to the meaning of "determined independently" and "at arms length from the profession". How independent? Does this Principle envisage that a non lawyer determine claims? Does it envisage a person/role/committee not associated in any way with the actual Fidelity Fund? Does it mean independent of any regulatory body? As we all know, claims can be very complex and require legal advice and on occasions senior counsel advice to determine issues such as coverage, indemnity, liability and quantum. My overall comment is that this Principle is fraught with difficulty and needs significant particularization

- My overall comment is the broad Principles raise significant issues in administration by centralization of claims management. Without an understanding of the local legal profession and other local factors taken into account when determining and resolving claims, the life of the claim can be extended which results in increased cost and consumer frustration. It may be more difficult to project claims liabilities, or to resolve them early using common sense whilst protecting reputations, and applying good claim management principals at a local level. The principles do not address minimisation of claims by risk management, by counselling, or by practice management advice.

LIBBY BISHOP
Director of Law Claims