

# CONTRIBUTION SYSTEM FOR LAWYERS' COMPULSORY PROFESSIONAL LIABILITY INSURANCE

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*In many Commonwealth jurisdictions, lawyers are required to pay contributions to fund compulsory professional liability insurance (CPLI) schemes. As the number and severity of claims against lawyers increase the size of each lawyer's contribution increases. Many lawyers are concerned about whether the system used to calculate the amount of their contribution is, given the level of risk in their legal practices, a fair one. A survey of the legal profession in several Commonwealth jurisdictions reveals two systems for calculating CPLI contributions. The most common, the fixed-rate contribution system, is administratively simple but unfair to lawyers involved in low-risk practice. The variable-rate contribution system is arguably more fair, but administratively complex. The purpose of this article is to review these systems and to suggest ways for designing a contribution system that is both administratively simple and fair to all lawyers.*

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*Dans de nombreux pays du Commonwealth les avocats doivent cotiser à un plan obligatoire d'assurance de la responsabilité professionnelle. Plus le nombre et le montant des réclamations contre les avocats augmentent et plus la cotisation imposée à chaque avocat augmente. Nombre d'avocats se demandent si, vu le niveau de risques du domaine de droit dans lequel ils exercent, le système employé pour calculer le montant de leur cotisation est juste. Une analyse de la profession dans plusieurs pays du Commonwealth révèle qu'il existe deux systèmes de calcul des cotisations. Le plus commun, le système de cotisations à taux fixe, est simple du point de vue administratif mais injuste pour les avocats qui exercent dans un domaine à faible risque. Le système de cotisations à taux variable est sans doute plus juste mais il est difficile à administrer. Le but de cet article est d'étudier ces systèmes et de suggérer des moyens pour établir un système de cotisations à la fois simple à administrer et juste pour tous les avocats.*

## Introduction

Compulsory professional liability insurance for lawyers is good for everybody. It is good for the public because the public can buy legal services without risk that negligent services will go uncompensated. It is good for lawyers because it enhances the reliability and credibility of the profession, thus increasing the attractiveness of its services. Nevertheless, a high price must be paid for compulsory professional liability insurance: as more and greater claims are made against lawyers by clients for alleged or actual negligence, the group premium to be paid to the insurer goes up. Consequently, each lawyer's contribution to a compulsory professional liability insurance scheme must go up. As contributions get bigger, more

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lawyers become concerned about justice in the *contribution system*. Given the level of risk in their practices, they wonder, is their contribution to the compulsory professional liability insurance scheme a fair one? If contribution systems are unfair will the very existence of compulsory professional liability insurance come under threat from lawyers who feel their contributions are too high? An important question for lawyers and law societies, therefore, is to create fair and administratively simple contribution systems to keep lawyers happy and compulsory professional liability insurance running for the public good.

## I. *Contribution Systems*

### A. *Compulsory Professional Liability Insurance Schemes in Outline*

In the British Commonwealth, compulsory professional liability insurance is required by law in many jurisdictions. The profession in each jurisdiction, through its governing body, makes its own insurance arrangements.<sup>1</sup> In all jurisdictions surveyed for this article, except England, these arrangements involve partial self-insurance. Though partial self-insurance schemes differ from jurisdiction to jurisdiction, they usually involve the profession purchasing from an insurer a group policy which provides for coverage within a certain range. The profession provides coverage—the self-insured portion of the scheme—below that range. Individual members of the profession then have the option to buy excess or “top-up” insurance above that range.

In *fixed-rate* contribution systems each participant in the scheme pays an annual base-rate contribution toward payment of the group premium, which also funds the self-insured portion of the scheme and the administrative costs of running it. This is a fixed-rate contribution system because, though subject to various adjustments, the base-rate contribution is the same for everybody.<sup>2</sup> Adjustments may include surcharges (sometimes called loadings) added to the annual contribution as a result of paid-claims experience or the requirement imposed on lawyers to pay the deductible when a successful claim has been made against that lawyer. Adjustments may also include discounts for which lawyers may apply, for example, a discount

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<sup>1</sup> For this article, several different law societies were surveyed. Some provided more information than others. Since compulsory professional liability insurance schemes operate differently in different jurisdictions, much of the information and statistics came in different formats. As a result it is difficult, though not impossible, to generalize about compulsory professional liability insurance in different jurisdictions.

Information was received from the following law societies: Canada: British Columbia, Alberta, Manitoba, Ontario; Australia: New South Wales, South Australia, Western Australia; England; Hong Kong.

<sup>2</sup> Though certain classes of lawyer are usually exempted. For example, in Ontario, government employees, academics, in-house counsel who render no legal advice or service other than to the employers, are exempt. Source: Survey completed by The Law Society of Upper Canada.

for low-fee earners or newly-admitted lawyers.<sup>3</sup> This fixed-rate contribution system is the system in place for all Canadian and Australian jurisdictions surveyed.

England's scheme for solicitors is markedly different from this one. Firstly, it is entirely self-insured. The fund into which contributions are paid is administered by Solicitors Indemnity Fund Limited, a company set up by a resolution of the Law Society Council and established under The Solicitors Indemnity Rules pursuant to section 37(1) of the Solicitors Act 1974.<sup>4</sup> Secondly, its base-rates are not the same for everybody. It has a *variable-rate* contribution system in that each contributor's base-rate is tied to the level of gross fees generated.<sup>5</sup> After the base-rate contribution is calculated, further adjustments in the contribution may be made.<sup>6</sup>

In the English scheme, several adjustment increases such as loadings<sup>7</sup> and deductible payments<sup>8</sup> are required. In addition, however, discounts on the base-rate are available. Solicitors' firms with a low principal-to-staff ratio are entitled to a discount.<sup>9</sup> Firms located in small towns are entitled to another discount.<sup>10</sup> Firms whose gross fees are generated by work defined as "low-risk" are also entitled to certain discounts.<sup>11</sup>

The English scheme is undoubtedly the most complicated from the point of view of both scheme administrators and solicitors; but the complications result from a design which attempts, through variable rates and numerous adjustments, to relate contributions to risk and thus to make the scheme fairer to all solicitors. The fixed-rate schemes are much less complicated, but arguably less fair.

When compulsory professional liability insurance contributions are inexpensive in relation to lawyers' incomes, fairness is a non-issue. For a high-fee earner, inexpensive contributions are negligible; for a low-fee earner, they are still manageable. But if contributions are expensive in relation to lawyers' incomes, they may still be negligible to high-fee earners, but crippling to low-fee earners.<sup>12</sup>

<sup>3</sup> The survey revealed that surcharges are common in Canadian schemes, but not discounts. Both surcharges and discounts are common in Australian schemes.

<sup>4</sup> 1974, c. 47.

<sup>5</sup> The calculation of the base-rate contribution, called the "initial contribution", is set out in s. 4.1.1. of The Solicitors' Indemnity Rules (1988). The contribution is made by the firm, rather than individual solicitors.

<sup>6</sup> The only other variable-rate system surveyed was Hong Kong's. Hong Kong's system is partially self-insured.

<sup>7</sup> The Solicitors' Indemnity Rules (1988), s. 6.

<sup>8</sup> *Ibid.*, s. 7.

<sup>9</sup> *Ibid.*, s. 5.1.

<sup>10</sup> *Ibid.*, s. 5.2.

<sup>11</sup> *Ibid.*, s. 5.3.

<sup>12</sup> In England, the increase in the cost of claims is rising at a substantially higher rate than the increase in the number of solicitors in private practice. Source: First Annual

As compulsory professional liability insurance premiums increase, therefore, the issue of fairness becomes more significant in lawyers' minds and more significant in their decision whether to continue giving their support to the principle of compulsory professional liability insurance.<sup>13</sup>

### B. *The "Nearly" Perfect Contribution System*

In a world without administrative costs, a nearly perfect contribution system could be devised. In such a system, risk factors could be identified through claims statistics and each lawyer could be individually rated and then assessed a contribution according to the degree to which that lawyer's legal practice reflected those risks. This would be a "nearly" perfect contribution system because, though contributions would more nearly reflect risks, they could not reflect them with absolute precision. This is because in the business of professional liability insurance, the process of costing out premiums is highly inexact; there is no exact formula by which one can arrive at the true, correct and just premium.<sup>14</sup> This lack of precision in setting rates for professional liability insurance is exacerbated by the insurance community's view that professional liability risks are unpredictable.<sup>15</sup> In such a guesswork environment, setting premium contributions for members of the profession must be regarded as equally imprecise.

If, in a world without administrative costs, it is this difficult to devise a fair contribution system, it would be doubly difficult in the real world where there are administrative costs. For example, to ensure comprehensive fairness for all lawyers each lawyer should be individually rated and assessed a contribution according to the risks of his or her practice. But to rate the risks of every lawyer's legal practice, taking into account all relevant factors, would be a prohibitively expensive administrative task.<sup>16</sup> What some law societies seem to be trying to do, therefore, is to make some concessions to fairness without creating an administrative nightmare. They are trying to identify some risks and give some lawyers credit for avoiding them, while they charge others who assume them.

The English have made perhaps the most impressive advances in this direction, but the administrators of their system, though they try hard to relate contributions to risk, recognize the limits of fairness. Their goal is the achievement of rough justice, not perfect justice. "Differential rating",

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Report Solicitors Indemnity Fund Limited, p. 4.

<sup>13</sup> In British Columbia, in response to rapidly increasing insurance premiums, suggestions were made by some practitioners that they be permitted to opt out of compulsory professional liability insurance and arrange their own insurance. Source: Minutes of a Special General Meeting of the Law Society of British Columbia, December 16, 1985.

<sup>14</sup> P. Madge, *Professional Indemnity Insurance* (1968), pp. 94-95.

<sup>15</sup> L. Wright and R. Group (insurance brokers, British Columbia), *Monthly Letter* no. 198 (Dec. 1985).

<sup>16</sup> It would also defeat one of the objectives of group insurance which is to avoid the problems and the costs associated with rating individuals.

they explain, "can only be by class of solicitor or type of work such that all solicitors in a given class are provided with indemnity on identical terms. Any classification for rating purposes, whether by size of firm, type of work or any other criterion brings with it this rough justice."<sup>17</sup>

In England and several other jurisdictions, attempts have been made to introduce some "rough justice" into contribution systems by identifying certain risk factors and by requiring or allowing contribution adjustments to reflect these risks. What are these factors and how are they used to adjust contributions? A brief examination of some of these adjustments is a useful first step in developing some guidelines for a fair and simple contribution system.

## II. *A Brief Survey of Contribution Adjustments*

### A. *Gross Fees*

As we have already seen in the case of England's variable-rate contribution system the amount of gross fees generated can be used as a factor in calculating contributions. Solicitors' firms pay the base-rate contribution according to a scale of tapered percentages charged against notional gross fees per partner. The lower the gross fees generated, the lower the contribution, though for each £10,000 increment in gross fees, the percentage charged is lowered a notch. Thus a firm, each of whose partners earned an average of between £30,000 and £40,000 per year, would pay a base-rate contribution of 3.6% of the firm's total gross fees, but a firm whose partners earned an average of between £40,000 and £50,000 would pay 3.4% of the firm's total gross fees.<sup>18</sup>

This "gross fees" factor in the contribution system has the advantage of resulting in a higher charge to those better able to pay. It also may be based on the sensible assumption that individuals who are bigger earners may have riskier practices inasmuch as they are more likely to be dealing with a greater number of transactions or larger transactions, or both.<sup>19</sup> The main disadvantage of using gross fees to calculate contributions is that it is administratively more complex than using a fixed-rate contribution system. Each year gross fee statements must be filed by all firms, information supplied by firms must be analyzed, and an appropriate scale of percentage charges must be worked out.

In Australia, several law societies seem to have taken a different—and perhaps less complex—approach to using gross fees in setting contributions. The contribution systems in New South Wales, Western Australia,

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<sup>17</sup> Randall and Cooper, *Review of Professional Indemnity*, a report to the Law Society Council, June 8, 1989, at p. 9.

<sup>18</sup> Solicitors' Indemnity Rules (1988), Appendix 1.

<sup>19</sup> Though this assumption seems entirely sensible, no statistics have been drawn to my attention which support it.

and South Australia are fixed-rate systems, but sole practitioners who are low-fee earners may, on filing fee-disclosure statements, apply for discounts.<sup>20</sup> The virtue in this system is that low-fee earners are given some relief and extra administrative costs relate only to their applications. The disadvantage is that the system only addresses the needs of very low-fee earners. There is no attempt to vary systematically the contributions of all lawyers according to the fees they generate.

### B. *Sole Practice*

Statistics in England indicate that different sizes of practice pay contributions which are related fairly to their claims experience.<sup>21</sup> The principal apparent exception relates to sole practitioners who in 1988 paid 9.12% of the total contributions to the scheme, whereas since the inception of the scheme in 1976 they accounted for 16.29% of claims paid.<sup>22</sup> At the other end of the scale, firms with over twenty-five partners in 1988 paid 14.32% of the contributions to the scheme whereas the amount of their claims represented only 7.86% of the total.<sup>23</sup> There is, therefore, a statistical argument that single practitioners are under-contributing and firms with over twenty-five solicitors, over-contributing.<sup>24</sup>

The Law Society Council is considering how to redress this contribution imbalance.<sup>25</sup> It has calculated that the imbalance could be corrected by increasing contributions levied on sole practitioners by 80%.<sup>26</sup> But this approach is thought to be inappropriate given policy considerations other than the need to redress contribution imbalances. For example, the profession as a whole has supported the case for the retention of a network of solicitors' offices providing services to all sections of the community. Sole practitioners constitute an important part of that network. Increasing their contributions may run counter to that policy and be seen as an attempt to drive them out of practice as well as unfairly penalizing many sole practitioners. Consequently, other proposals have been put before the Law Society Council to redress the imbalance.<sup>27</sup>

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<sup>20</sup> From information supplied by these Australian law societies.

<sup>21</sup> First Annual Report of the Solicitors Indemnity Fund Limited, pp. 4-5. Statistics were compiled for the years 1976 through to May 1, 1988.

<sup>22</sup> *Ibid.*, p. 5.

<sup>23</sup> *Ibid.* The Annual Report, however, does lay down several *caveats* in relation to interpreting these statistics and warns that they should be treated with caution.

<sup>24</sup> Statistics in New South Wales for the period 1980-1983 seem to reveal a similar imbalance against sole practitioners. Source: I.S. Bowden, Report on Operation of Professional Indemnity Master Policy Scheme, 1st July, 1980 to 30th June, 1983, 2nd December, 1983, p. 8. (unpublished).

<sup>25</sup> Randall and Cooper, *op. cit.*, footnote 17.

<sup>26</sup> *Ibid.*, p. 9.

<sup>27</sup> *Ibid.*, p. 10. Detailed proposals have been put before the Law Society Council in a separate paper.

### C. *Claims Experience*

Those lawyers on behalf of whom claims are paid inevitably pay more than the base-rate contribution. This is generally accomplished in two ways: through the payment of deductibles and through the payment of surcharges (or loadings). For example, in British Columbia, lawyers have to pay up to \$5000 in damages and costs paid on their behalf for a first claim and up to \$10,000 for second and subsequent claims paid in any three year policy period.<sup>28</sup> In Hong Kong, loadings are imposed on the basis of the extent to which claims paid during the previous four years exceed contributions paid during those four years. The bigger the excess, the bigger the loading.<sup>29</sup>

### D. *Number of Years in Practice*

South Australia gives a discount to practitioners who have been admitted to practice for two years or less. If admission is one year or less the practitioner pays 60% of the base-rate contribution; if it is one to two years, the practitioner pays 80% of the base-rate contribution.<sup>30</sup> Though no claims statistics to support the validity of this type of discount for South Australia are available to me, I do have some statistics for British Columbia. According to these, younger lawyers and those with less than five years experience report the fewest number of claims among all age and experience groups.<sup>31</sup>

### E. *Area of Practice*

Area of practice is arguably the most relevant factor to take into account in adjusting contributions but certainly one of the most problematic.

It is arguably the most relevant factor because ample statistical evidence exists which suggests that certain areas of practice are consistently riskier than others. Though it is difficult to compare statistics from different jurisdictions in which compulsory professional liability insurance operates, certain trends are strongly evident: for example, in all jurisdictions for which figures were obtained, land transactions amounted to *at least* 32% of all claims in number or amount.<sup>32</sup> Civil litigation also accounted for

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<sup>28</sup> The 1986 Lawyers' Compulsory Professional Liability Insurance Program, June, 1986, Insurance Issues, p. 3.

<sup>29</sup> Solicitors (Professional Indemnity) Rules, Cap. 159 LHK (1985), s. 3(7) of Schedule thereto.

<sup>30</sup> From information supplied by J. Byrne, Director of Law Claims, Adelaide, South Australia.

<sup>31</sup> Composite Picture of Typical Claim, May 31, 1985 (unpublished).

<sup>32</sup> Non-comparable figures for several jurisdictions are available. Figures were supplied by various Law Societies in response to my requests:

England: for the years 1976 through 1988, conveyancing and landlord-tenant matters produced a total of 48.4% of the number of all paid claims. 36.96% of these were conveyancing-

a substantial percentage of claims in all jurisdictions—at least 20% in number or amount.<sup>33</sup> One can also say, looking at the statistics, that commercial work accounts for a significant percentage of claims, but there appear to be too many differences in the way claims are classified to compare commercial work in one jurisdiction with commercial work in another. On the other end of the scale, criminal litigation results in a negligible incidence of claims paid.<sup>34</sup>

Though area of practice is clearly a relevant factor to take into account in adjusting contributions, schemes for targeting area of practice for this purpose are rare. In all Canadian jurisdictions surveyed, “area of practice” is not targeted as a factor in contribution systems. In Australian jurisdictions, “area of practice” is not targeted except in a minor way in South Australia; there, lawyers who are barristers get some relief. If no claims have been made against them they are entitled to take an 80% discount in their contribution.<sup>35</sup> Only in England, as we have seen, are there significant discounts for low-risk areas of practice. Criminal law work and the collection of judgment debts or debts without dispute as to liability, amounting to £5,000 or less, are classified as low-risk work. Discounts range from 30% to 10% of the base-rate contribution and depend on the percentage of the practice’s gross fees attributed to low-risk work.<sup>36</sup>

In the absence of creating certified specialties, each with its own rating for insurance purposes, targeting areas of practice for the adjustment of

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related and 11.44% were landlord-tenant related. 40.9% of the total amount of claims paid was land-related. To give the reader an idea of the magnitude of claims paid, over the period 1976-1988 the total of all claims paid amounted to £127,589,830.

British Columbia: of the total amount of claims reported to the insurer, paid and unpaid, between 1977 and 1989, 32.49% are attributed to conveyancing.

Alberta: for the years 1972 to 1988, 34% of the number of claims reported are related to “real estate”.

Hong Kong: for the years 1980-1984, the dollar amount of land-related claims ranged from 37.9 % to 81.6% of the total each year.

Ontario: for an unspecified number of years, 45% of the number of claims is attributed to “real estate” and 44% of the amount of claims paid or reserved.

New South Wales: for the year 1983, 52.8% of the number of claims made was attributed to land transactions. For 1982, the figure is 54.2% and for 1981, 45.7%.

<sup>33</sup> For the same periods as set out in the above footnote:

England: 26% of the number of claims.

British Columbia: 20% of the number of claims.

Alberta: 32% of the number of claims.

Hong Kong: 35% of the total amount of claims.

Ontario: 27% of the number of claims.

New South Wales: 22.5% of the number of claims (for all three years).

<sup>34</sup> In the data studied, “criminal litigation” as an area of practice was specifically referred to only in the British Columbia material. It was not specifically referred to in any of the material supplied by other jurisdictions.

<sup>35</sup> Byrne, *loc. cit.*, footnote 30. South Australia has a fused profession, but some practitioners announce they will practice only as barristers.

<sup>36</sup> *Supra*, footnote 7. s. 5.



contributions becomes increasingly problematic and difficult to administer as more areas of practice qualify for discounts or surcharges. Under the present English system low-risk work, presently confined to criminal law and debt collection, is easily defined. It is unlikely that these two types of work would be readily mixed up, or combined with, other types of work. Therefore gross fees attributed to these types of work are easily identified. But how would one define "conveyancing" or "commercial" work or "litigation" and accurately attribute fees to these various areas of practice? Who would decide which files fell into which areas? Trying to define many areas of practice would be a mind-bending exercise. If a lawyer litigates a dispute and then settles it by conveying the assets of a business which also includes land, what area of practice would this be? And if it could not be easily classified, it would certainly be awkward to try breaking it up into areas of practice and then attributing fees to each. The record-keeping requirements for such a contribution system would be daunting.

Another obstacle stands in the way of full and accurate record-keeping in relation to area of practice, where that area is high-risk and liable to surcharges. In the English contribution system lawyers have an incentive to keep accurate records of fees attributed to low-risk work, because these will support their applications for discounts. But lawyers would have no incentive to keep accurate records of fees in relation to high-risk work because this would undoubtedly cost them money. Where classification into one or another area of practice is uncertain, lawyers will naturally classify matters, self-interestedly, into less risky, and thus less costly areas.

### III. *Towards a Fair and Simple Contribution System*

#### A. *An Alternative Approach to Adjusting Contributions—The Transaction Levy*

In a previous article, I suggested an alternative approach to adjusting contributions on the basis of area of practice.<sup>37</sup> The system I proposed is called the Transaction Levy Programme. In the Transaction Levy Programme, risky transactions, such as conveyancing and civil litigation matters, are identified through claims statistics. A levy is then imposed on registrable components of those transactions. In a conveyance, for example, documents registered in the land office would be levied through a stamp or decal system. In a civil litigation matter documents filed in court registries could be similarly levied. Stamps or decals would be purchased from the Law Society, and registry personnel would be asked to assist in enforcement, by reporting non-payers to the Law Society.

The Transaction Levy Programme would work in conjunction with a fixed-rate contribution system. Each lawyer would pay an equal con-

<sup>37</sup> S. Nathanson, *The Transaction Levy Programme: A Possible Solution to the Solicitors' Professional Indemnity Crisis* (1987), 17 H.K.L.J. 62.

tribution toward the compulsory professional liability insurance group premium, but this contribution would be supplemented by the levies collected. The price of the levy for any high-risk area of practice could be set to produce enough revenue to pay for the losses incurred in that area of practice (a loss-based calculation) or to produce revenue so that as a percentage of the group premium it is roughly equal to the percentage of total losses related to that area of practice (a premium-based calculation).<sup>38</sup>

There are several distinct advantages to the Transaction Levy Programme. Firstly, it reinforces the idea that certain transactions are *inherently* risky. Every time a document is registered, paying the levy will remind lawyers of that risk. Secondly, it is administratively simple, yet it still taxes busier lawyers more than those who are less busy. As such, it renders unnecessary a variable rate contribution system which also taxes busier lawyers—but in a more administratively complex way. The Transaction Levy Programme would also produce automatic relief for less busy lawyers, that is low fee-earners and new admittees. Thirdly, it is almost painless. The cost of the Transaction Levy Programme can be passed on to the client.<sup>39</sup>

The main disadvantage to the Transaction Levy Programme is that it targets certain high-risk transactions, but not others.<sup>40</sup> Why should only those transactions which have registrable components be targeted, critics ask. But the question is easily answered. At present, in fixed-rate contribution systems no areas of practice are targeted; what this means is that, in fixed-rate contribution systems, low-risk practitioners are being unfairly targeted. Even in England's variable-rate contribution system, low-risk practitioners who do not practice criminal law or debt-collection work are being "unfairly"

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<sup>38</sup> For example, suppose the total group premium is \$10,000,000, total losses \$6,000,000, and losses related to land transactions amount to 50% of this figure, or \$3,000,000. By the loss-based calculation, the levy price could be set to produce revenues of \$3,000,000. By the premium-based method, the levy price could be set to produce revenues to make up one-half of the group premium, or \$5,000,000. For a fuller account of the Transaction Levy Programme, see Nathanson, *loc. cit.*, footnote 37.

<sup>39</sup> This proposition has caused some controversy; some people have asked if it is proper that the cost be passed on to clients. Also, it is argued, the levy might be characterized as some sort of contract of insurance between the law society and the client, somehow insuring that transaction. These arguments have been made by a committee set up in British Columbia to study the Transaction Levy Programme. For a summary of the committee's report, see *Benchers' Bulletin*, The Law Society of British Columbia (1988), No. 8, August 4. But these arguments are easily put to rest. In the first place, in a fixed-rate contribution system, low-risk clients are already subsidizing high-risk clients, because their low-risk lawyers are paying the same contributions as high-risk lawyers. All lawyers pass on the cost of their fixed-rate contribution—albeit indirectly—to clients. The Transaction Levy Programme is simply a fairer way of passing on that cost. In the second place, the "contract of insurance" argument can be met by the law society not permitting the levy to be charged as a disbursement on the client's account. It can simply be built into the fee: in this way it would remain a charge to the lawyer, not to the client.

<sup>40</sup> *Ibid.*

targeted. The upshot is that both contribution systems *and* the Transaction Levy Programme can be justifiably accused of unfair targeting. But if we return to a first principle of professional liability insurance—that a fair contribution system should strive to do rough justice and not perfect justice—then we can see that the Transaction Levy Programme can go a long way, in combination with a fixed-rate contribution system, to achieving that rough justice.

Nevertheless, some commentators still assert that, to the extent the Transaction Levy Programme allocates insurance costs based on the mere filing of documents, it is arbitrary and therefore an unjust system of rating.<sup>41</sup> But this comment betrays a misperception of how the Transaction Levy Programme would fit, conceptually, into a broader contribution system.

The Transaction Levy Programme is not part of a rating system. If it were, it would be an insurance premium. It is clearly not an insurance premium, because it does not insure transactions, lawyers or anything else. It is simply one of two complementary schemes to fund the group premium. It is designed not to insure lawyers but to surcharge them for their involvement in riskier practice, and to redistribute responsibility for the group premium among members of the group. Imposing a levy on the filing of documents does not mean that the filing process itself is risky. In this sense, a levy on filed documents is indeed arbitrary; nevertheless, it is still completely valid as a useful index of that lawyer's activity in that area. The higher the index, the higher the contribution the lawyer must pay toward the group premium of all lawyers.<sup>42</sup>

#### B. *Further Refinements to the Contribution System*

Many areas of practice do have registrable components. Certainly most of the risky ones do. Of course, much depends on how these areas of practice are broken down for statistical purposes. By breaking them down into a small number of classifications, the targeting process can be facilitated. Consider below the Ontario classification of areas of practice for insurance purposes. With only five classifications each is obviously quite broad, but then one can see at a glance that, as classified, areas of practice which clearly have registrable components (real estate, civil litigation and matrimonial) produce most of the claims.

| <i>Area of Practice</i> | <i>% of total no. of claims</i> |
|-------------------------|---------------------------------|
| Real Estate             | 45                              |
| Commercial              | 18                              |
| Civil Litigation        | 27                              |
| Matrimonial             | 4                               |
| Other                   | 6                               |

<sup>41</sup> *Ibid.*

<sup>42</sup> Nathanson, *loc. cit.*, footnote 37, at p. 72.

If civil litigation and matrimonial are combined to form one classification called simply “civil litigation”, only four areas of practice remain for targeting purposes. Of these, two—real estate and civil litigation—are responsible for 76% of the number of claims in Ontario; and these areas of practice have registrable components. The “commercial” and “others” classifications may also have registrable components, but one cannot say for sure without closer scrutiny of the underlying information.

Nevertheless, even if it is assumed that these areas of practice have no registrable components, areas of practice which are responsible for at least 76% of claims in Ontario can still be targeted with levies. If the Transaction Levy Programme were grafted on to a fixed-rate contribution scheme in a jurisdiction such as Ontario it might work with something like the following guidelines:

1. The group premium would be funded in two ways, from the Transaction Levy Programme and from fixed contributions.
2. The Transaction Levy Programme would fund roughly 76% of the group premium, thereby reducing fixed contributions to 24%.
3. To uphold the principle that those responsible for actual losses should compensate the system for some of them, lawyers would continue to pay deductibles and loadings.<sup>43</sup>
4. The administrators of the system would be alert to new statistics as well as changes in the liability insurance market, so that levy and contribution rates as well as targeted areas of practice could be changed from time to time, if necessary.

What would be the consequences to contributors? Low-fee earners and those engaged in low-risk work would get considerable relief. Those engaged in high-risk, leviable work would contribute more to the system, though their increased contribution would be mitigated by their ability to pass on increases more directly to clients.

But what about lawyers engaged in risky, but non-leviable areas of practice and lawyers performing a great deal of low-risk work or exclusively low-risk work? The former may be contributing too little—their fixed-rate contributions would be too low; the latter may be contributing too much—their fixed-rate contributions would be too high.

Can the system be further refined to cure these residual inequities? How can high-risk, but non-leviable, work be targeted? Should lawyers

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<sup>43</sup> A question might be raised here: if practitioners engaged in high-risk work have to pay levies *and* loadings *and* deductibles, is this not a triple surcharge? The answer is no. *All* practitioners, doing high and low-risk work, are required to pay loadings and deductibles both in order to compensate the system for claims actually paid on their behalf and as an inducement to practise with care. Levies paid are paid only by those in high-risk, leviable work in order to compensate the system for higher premiums as a result of higher risk.

be required to file declarations stating to what degree their practices consist of "high-risk, non leviabie" work? As demonstrated earlier, this would be a difficult exercise, both for lawyers making declarations and for administrators auditing them. Among all the problems this scenario conjures up, the most fundamental is that lawyers would have no incentive to file accurate information, let alone devise and run systems to gather it.

The answer, I submit, lies in the English contribution system which allows for low-risk work discounts. To get these discounts, practitioners must file declarations to substantiate the degree to which their practices are comprised of low-risk work. Unlike their high-risk counterparts, low-risk practitioners have an incentive to gather and declare full and accurate information.

It makes sense, therefore, to combine the fixed-rate contribution system and the Transaction Levy Programme with low-risk discount provisions similar to those in the English system. This new, combined system would be even more flexible than a Transaction Levy Programme/fixed-rate system and could be creatively refined to produce desired results. The cost of these low-risk discounts, for example, could be reflected in higher fixed-rate contributions for all other practitioners *not* engaged in leviabie, high-risk work. In other words, those engaged in leviabie, high-risk work could pay a somewhat lower fixed-rate than those engaged in non-leviabie, high-risk work. Alternatively, those engaged in leviabie, high-risk work might be entitled to have their fixed-rate contribution discounted or eliminated after having paid a specified amount of levies into the system. If the number of areas of practice designated to be low-risk is expanded, the outcome would tend to leave only those primarily engaged in non-leviabie, high-risk work paying the full fixed-rate contribution. In this way residual inequities could be worked out of the system.

### *Conclusion*

Administrators in some jurisdictions may not yet see the need to move toward a more sophisticated contribution system, such as the one just described. A simple fixed-rate system can be justified where the cost of compulsory professional liability insurance can be absorbed with relative ease—and equanimity—by all practitioners.

Nevertheless, as the cost of compulsory professional liability insurance increases relative to lawyers' incomes, the pressure for change and for fairness will mount. This is especially true in times of economic recession, when incomes may decline and compulsory professional liability insurance rates rise.<sup>44</sup>

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<sup>44</sup> When transactions collapse or financial fortunes fail because of a generally poor economic environment, it is only natural that clients will tend to look to their lawyers and their insurers to bear the responsibility for their losses. Some evidence, though by no means conclusive, exists to support this assertion. For example, in Hong Kong, the

This article has surveyed features of various contribution systems in the British Commonwealth with the objective of trying to develop a system that is both fair and simple to operate. The system developed here combines the Transaction Levy Programme with a fixed-rate contribution system and elements of the English system. By implementing this combined system, administrators of compulsory professional liability insurance would almost certainly be able to introduce a high degree of fairness into their own compulsory professional liability insurance programmes. No doubt, these changes might seem rather less simple, and the administrative costs rather higher, than one might have hoped for. Nevertheless, to the extent that the costs are incurred to achieve fairness, I predict they will be readily tolerated, if not warmly welcomed.

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severity of claims shot up wildly in 1982 and 1983 when the recession, intensified by anxiety over sovereignty negotiations with China, sent markets into a tailspin. Source: Report on Professional Indemnity Insurance Scheme for the Law Society of Hong Kong, February 1986, Sedgwick Chartered Hong Kong Limited (unpublished).