



MEMORANDUM

Coverage Issues - March 27, 1996

This memorandum comments on the insurance coverage provided by CLLAS to its thirteen member firms and the underlying coverage provided in Ontario by Lawyers' Professional Indemnity Company ("LPIC"). The insurance programs of the other provinces differ from the LPIC program in some respects but it is not proposed to deal with the other programs or those differences in this memo. There is no difference in concept. Generally speaking, if there is a reduction or loss of the underlying insurance coverage for reasons described in the CLLAS "drop down" endorsement, CLLAS will provide "drop down" coverage to the \$250,000 level of each claim.

Introduction

This memorandum has been produced by the Policy Committee of CLLAS and approved by its Advisory Board following a review of the CLLAS policies in the context of the coverage changes introduced by LPIC in 1995. Our objective was to identify areas of practice of the thirteen member firms of CLLAS that may be uninsured or subject to reduced insurance, with a view to communicating our findings to the member firms and our reinsurers. It is fundamental that the language of the CLLAS policies should leave little, or preferably no, room for a material misunderstanding between the member firms, CLLAS and the reinsurers as to the coverage provided by the CLLAS policies.

The coverage review has resulted in the conclusions outlined in this memorandum. Of particular interest, are the issues surrounding the practice of foreign law which we have concluded is an insured activity under the CLLAS policies unless it takes place in a foreign office of the member firm - a specifically excluded activity. The intention of CLLAS has been to provide coverage for whatever the firms do and thus the very broad definition of "professional services" in the policies. The comfort that all member firms and reinsurers have is that each firm acts responsibly in the provisions of those services. In particular, in the area of foreign law

- (a) the firms will not practise foreign law unless qualified to do so and lawyers in the firms are trained to never offer advice which they are not licensed to give;
- (b) there will be occasions when advice relating to a Canadian matter, whether given in Canada or from an overseas location, could be construed as having a foreign law element;

- (c) advice regarding international law could also be construed in some circumstance as having a foreign law component;
- (d) on occasion, a member of a firm may express an informal opinion on foreign law or procedure which the recipient could allege was relied on to its detriment; and
- (e) a member of a firm may, notwithstanding the admonition not to do so, give specific advice on foreign law without being qualified to do so.

The foregoing are typical examples of involvement with foreign law which inevitably arise as an incidental and unavoidable adjunct to the practice of law by large firms with an international client base and domestic clients engaged in international transactions. It is the view of CLLAS that such exposure should be covered.

Coverage

LPIC provides coverage for each lawyer of \$1,000,000 per claim and \$2,000,000 in the annual aggregate with respect to its policy year which is the calendar year, subject to certain reductions in coverage which will be discussed below.

CLLAS provides coverage for each firm of \$34,000,000 per claim and in the annual aggregate in excess of law society coverage. There are two policies: the first for \$24 million excess of \$1 million and the second for \$10 million excess of \$25 million. Under a third policy, CLLAS provides umbrella coverage (shared by the thirteen firms) of \$25,000,000 per claim and \$50,000,000 in the annual aggregate in excess of not less than \$50,000,000 of underlying insurance. The CLLAS policy year runs from July 1, to June 30. CLLAS reinsures all but about \$7,000,000 of its coverage in the commercial reinsurance market and then reinsures a portion of the retention with Colchester Reinsurance Limited.

The CLLAS coverage also drops down, through a difference in conditions ("DIC") endorsement, \$750,000 each and every claim excess of a minimum \$250,000 in certain situations not covered or subject to reduced coverage under the applicable law society program. The effective coverage provided by CLLAS's first policy could therefore be as high as \$24,750,000 in any one claim.

Chronology

The following chronology may assist in the understanding of coverage issues:

1. LPIC's 1990 policy (its first) defined "Professional Services" as follows:

"Professional Services" means those services performed, or which ought to have been performed by or on behalf of an Insured in such Insured's capacity as a lawyer, subject to Special Provision II (a) and shall include, without restricting the generality of the foregoing, those services for which the Insured is responsible as a lawyer arising out of such Insured's activity as a trustee, administrator, executor, guardian, director, custodian, receiver or any similar fiduciary capacity, or as an arbitrator, mediator or patent or trademark agent."

The definition was restrictive in that all listed services must be provided "as a lawyer" and by virtue of special Provision II(a) there was a limit on the services that could be provided outside Canada and an exclusion with respect to foreign law services outside Canada. Special Provision II(a) read as follows:

II SPECIAL PROVISION

(a) Territory

The insurance afforded by this policy applies:

- (i) to the performance of professional services anywhere in Canada, and
- (ii) to the performance of professional services outside of Canada where such services are performed with respect to the practice of the Law of Canada, its provinces and territories, and where such services occupy less than ten percent (10%) of an Insured's time docketed for professional services in each calendar year."

The Exclusions to LPIC's 1990 policy also excluded from coverage "any dishonest, fraudulent, criminal or malicious act of an Insured" (but preserved innocent partner coverage) and provided reduced coverage for any claim in which the Insured had a direct or indirect equity interest of 10% in the claimant.

2. The expression "Professional Services" is defined in the CLLAS policy "to include services as an administrator, conservator, title searcher, arbitrator, mediator, liquidator, committee for incompetent, receiver, executor, guardian, trustee or other fiduciary, or patent or trademark agent". Under the CLLAS policy such services are in the context of the firm as well as the individual and the firm has coverage with respect to a claim against "any person for whose acts, errors or omissions the Insured [firm] is legally responsible". It is also not necessary that the services be performed in a legal capacity. The policy deems all services to be performed by the Insured in

his or her capacity as a lawyer "although such services could be performed wholly or in part by non-lawyers".

The definition of "Professional Services" is in the broadest terms and would include anything that the firm or a member or agent of the firm does in the course of the firm's practice whether or not the person is qualified to do so and whether or not licensed to do so. The only qualifications applicable to Professional Services are those found under item III Exclusions, which excludes the following claims:

- "1. any claim arising out of any Insured acting in a capacity as a director and/or officer of any company or organization---;
 2. any claim alleging the fraud or dishonesty of any Insured---[but innocent partner coverage remains in place];
 5. any claim arising out of professional services provided by the Insured from an office or branch of the Insured in a jurisdiction outside Canada arising from the practice of or advising on the laws of a jurisdiction other than Canada;
 6. any claim arising out of professional services provided by the Insured from an office or branch of the Insured located in the United States of America."
3. The CLLAS policy issued July 1, 1990 provided drop down coverage to \$100,000 with respect to professional services provided by the Insured "from an office or branch of the Insured situated outside Canada or any of the United States of America". Effective July 1, 1991, the drop down coverage provided by CLLAS was expanded to include equity interests and exhaustion of underlying insurance and the floor of \$100,000 was raised to \$250,000. Endorsement No. 2 provided drop down coverage for any claim:
- "(A) which is excluded from the coverage under the applicable underlying Law Society Professional Liability Insurance Program as a result of:
- 1) an exclusion in respect of professional services provided by the Insured from an office or branch of the Insured situated outside Canada; or
 - 2) an equity interest exclusion; or
 - 3) a more restrictive definition of Professional Services; or

- (B) for which coverage under the applicable underlying insurance program(s) is impaired by an amount greater than CAN\$250,000 as a result of the exhaustion of an annual aggregate per Insured lawyer limit of not less than CAN\$2,000,000."
4. Effective July 1, 1993 item (A) of Endorsement No. 2 to the CLLAS policy was reworded and in the process the words "type of professional service" were substituted for the previously used expression "more restrictive definition of Professional Services". Item (A) of Endorsement No. 2 was changed to provide that drop down coverage applies to any claim:
- "(A) which is excluded from coverage under any applicable underlying Law Society Professional Liability Insurance Program and other insurance providing coverage of not less than CAN\$1,000,000 as a result of:
1. the type of professional service which is or should have been rendered by the Insured or the location of the office or branch of the Insured from which the professional service is rendered; or
 2. any individual Insured hereunder having an equity interest in the claimant;"
5. Effective July 1, 1994, item (A) 1. of Endorsement No. 2 was revised to delete the notion that underlying coverage could be lost only if the professional service is provided from a foreign office of the Insured. As mentioned above, Special Provision II(a) of the LPIC policy provided for loss of coverage for claims arising from the performance of services "outside of Canada" from any location and not just from offices or branches of the Insured. Item (A) 1. was changed to read as follows:
- "1. the type of professional service which is or should have been rendered by the Insured or the professional service being performed from a location or locations outside Canada; or"
6. Effective January 1, 1995 the drop down coverage, now provided for in Endorsement No. 3 to the CLLAS policy, was extended to vicarious liability as per a new clause (C) but clauses (A) and (B) remained unchanged.
7. Effective January 1, 1995, LPIC revised its definition of "Professional Services" to mean
- "the practice of the law of Canada, its provinces and territories and further means those services performed or which ought to have been performed by or on behalf of an Insured in such

Insured's capacity as a lawyer subject to special Provision II(a) and shall include, without restricting the generality of the foregoing, those services for which the Insured is responsible as a lawyer arising out of such Insured's activity as a trustee, administrator, executor, or as an arbitrator, mediator or patent or trademark agent."

The definition now restricts legal services to the practice of the "law of Canada, its provinces and territories." It excludes foreign law altogether and not just the practice of foreign law outside Canada. It continues to exclude in certain circumstances domestic law practised outside Canada. The definition still contemplates non-legal services, performed by the Insured in his or her capacity as a lawyer, such as acting as an executor, arbitrator, etc.

8. Effective January 1, 1996 the drop down coverage now provided for in Endorsement No. 3 to the CLLAS policy, was extended to circumstances involving former members of a firm who leave private practice, as per a new clause (D).

Definition of "Professional Services"

Dealing first with the definition of "Professional Services" in the CLLAS policy, it has been drafted in the broadest of terms, without any qualifications, and there is nothing that a firm could do that would not be covered by insurance starting from the million dollar level other than the Professional Services specifically referred to in the Exclusions and they are

1. acting as a director or officer as per Exclusion 1;
2. acting fraudulently or dishonestly as per Exclusion 2;
3. practising foreign law from an office or branch of the firm outside Canada as per Exclusion 5; or
4. practising domestic law from an office or branch in the U.S. as per Exclusion 6.

These four Exclusions identify the only types of Professional Service not covered by insurance under the CLLAS policy. It follows that foreign law is a type of professional service. This is borne out by Exclusion 5 which goes to the trouble of excluding foreign law from coverage in a particular case.

The question has been asked whether "Professional Services" in the CLLAS policy would include activities for which a license is required and not obtained. For example, if a member of a firm licensed only in Ontario were to express an opinion on the laws of France, would

such opinion qualify as the provision of "Professional Services" and would it therefore be insured under the CLLAS policy? What if the same lawyer were to offer an opinion on the laws of New Brunswick? It is the view of CLLAS that there would be coverage in both cases. In the case of the French opinion there would be no LPIC coverage but CLLAS would drop down so long as the member of the firm was not attached to a foreign office. In the case of the New Brunswick opinion, it appears likely that there would be LPIC coverage because the matter involved Canadian law.

This concept of licensing is not part of the definition of "Professional Services" and all services provided by a lawyer, rightly or wrongly, in the category of foreign law will qualify as Professional Services. In view of the national and international nature of the practises of the thirteen firms, this concept would seem to be absolutely fundamental. Nevertheless, the firms have a duty to remind their members that they must not offer advice which they are not licensed to give.

Since the very beginning it has always been understood that CLLAS's definition of "Professional Services" would be general in nature and would not follow, in form, the LPIC definition. CLLAS should take care to preserve this approach.

Drop Down Coverage

It should be kept in mind that the purpose of items A and B (and now C and D) of Endorsement No. 3 is to describe in general terms the circumstance in which underlying coverage is lost or impaired. What is key is that the underlying coverage is gone or reduced and there is a gap to be filled by CLLAS through the DIC endorsement. If the language of Endorsement No. 3 is imperfect but it identifies the correct circumstance which has resulted in the loss of underlying coverage, that is what matters.

Up to June 30, 1993 drop down coverage was provided in any situation involving loss of underlying insurance as a result of LPIC's more restrictive definition of Professional Services. Post June 30, 1993 drop down coverage has been provided in any situation in which underlying coverage is not available because of "the type of Professional Service which is or should have been rendered by the Insured". This language was intended to have exactly the same effect as the previous version - difference in definition of Professional Services. There was never any discussion at the Advisory Board or with reinsurers to the effect that the new language would narrow the application of drop down coverage. The expression "type of Professional Service" is merely descriptive of a particular professional service that does not have LPIC coverage and would include foreign law as a type of Professional Service. It will be recalled that foreign law has been excluded from coverage under the LPIC policy in certain respects since 1990 and is now totally excluded.

CLLAS provides drop down coverage under item A(1) of Endorsement No. 3 to its policy in respect of a loss of underlying coverage resulting from the practice of Canadian law abroad. Up to July 1, 1994, the drop down coverage was provided in respect of any loss of underlying coverage arising from the provision of professional services from an office or branch of the Insured situated outside Canada. Under Special Provision II(a) of the LPIC policy such loss of underlying coverage could arise if the services were provided from any location and not just an office or branch of the Insured. The drop down provision may have been restricted to the office or branch on the assumption that the LPIC 10% rule would only be a problem for individuals based at or working out of a foreign office. Effective July 1, 1994 the concept of office or branch was dropped and the drop down with respect to this particular circumstance involving loss of underlying coverage now matches the circumstance outlined in Special Provision II(a) of the LPIC policy.

There are other circumstances in which drop down coverage applies but they do not appear to present any coverage issues.

Summary of Issues

The following is a summary of the coverage issues:

1. Foreign Law

- (a) Foreign law is a professional service under the CLLAS policy but is not so under the LPIC policy.
- (b) The practice of foreign law from a foreign branch or office of the firm is not insured by CLLAS by reason of Exclusion No. 5 or by LPIC. There is no insurance at all in this circumstance. The question has been asked "What is the practice of foreign law?". If a member of the Insured's firm based in a foreign office obtains an opinion (the "local opinion") from another firm ("local counsel") on the laws of that jurisdiction or any other jurisdiction and then opines to the client on the foreign laws in reliance upon and restricted to the local opinion, it is the view of CLLAS and LPIC that the Insured would not be considered to be practising or advising on the laws of a foreign jurisdiction. The member would have done nothing more than obtain a local opinion from qualified local counsel and pass it on to the client and no law society would consider such activity to constitute the practice of law by such member in such jurisdiction. CLLAS does not believe that such activity would be considered to

constitute advising on the laws of the foreign jurisdiction. Such activity does raise the following questions:

- (i) Would the Insured firm be responsible to the client if the local opinion is given negligently? This may be so if the Insured was aware or should have been aware of the negligence, if the Insured selected incompetent local counsel or if the Insured guaranteed the local opinion. There may be any number of reasons why the Insured would be liable to the client for a negligent local opinion but CLLAS does not believe that the claim would be excluded by Exclusion No. 5 because the Insured has not practised or advised on the local law.
- (ii) If it appears likely that the Insured firm could be liable for a local opinion, should it make enquiries as to the professional liability insurance carried by the local counsel? CLLAS encourages its member firms to avoid such liability but if this cannot be done then to seek reasonable assurance that local counsel carries adequate insurance.

If the person based in the foreign office advises on international legal issues, with or without Canadian content, but refrains from advising on the laws of a foreign jurisdiction, CLLAS is of the view that Exclusion No. 5 would not be applicable. There would be coverage under the CLLAS policy. There may not be any coverage under the LPIC policy because of LPIC's restrictive definition of "Professional Services" but if not, then CLLAS would drop down.

- (c) The practice of foreign law in Canada or outside Canada, otherwise than from a foreign branch or office, is insured by CLLAS but not by LPIC. There is drop down coverage.

2. Unlicensed Activities - CLLAS insures claims against an Insured who was required to be licensed by a law society or governmental body in order to perform the service in question and who was not so licensed. Presumably, LPIC would likewise provide coverage.

3. Non-Foreign Law Practised Outside Canada - CLLAS insures the practice of non-foreign law from a location outside Canada, other than from an office or branch in the U.S. (Exclusion No. 6). LPIC insures such activity, even from U.S. offices and branches, if the activity occupies less than 10% of the individuals docketed time or gross billings for professional services in each calendar year. If the activity exceeds the 10% test, LPIC will provide coverage if the claim is brought in Canada and the issues of liability and damages are determined and assessed on their merits in Canada pursuant to the laws of Canada or a Province thereof by a court in Canada. In the absence of LPIC coverage CLLAS drops down, subject to Exclusion No. 6.

Prior to July 1, 1994 the CLLAS drop down applied if the claim arose from non-foreign law services provided from a foreign office. It was a meaningless distinction not to include claims unrelated to a foreign office and was inadvertent.

4. Equity Interests - CLLAS insures claims in which a member of a firm may have a direct or indirect equity interest of 10% in the claimant. LPIC's coverage is reduced. CLLAS drops down.
5. Vicarious Liability - CLLAS provides vicarious liability coverage for innocent partners. LPIC limits its vicarious liability coverage to \$250,000. CLLAS drops down.
6. Exhaustion of Annual Aggregate Limit - If LPIC's annual aggregate limit of \$2,000,000 is exhausted, CLLAS drops down.
7. Former Members of Firm - CLLAS insures the firm in respect of the errors and omissions of former members. LPIC provides once in a lifetime coverage of \$250,000 for those who have left private practice. The firm or individual has the option to purchase additional protection from LPIC. CLLAS would drop down to \$250,000 or to a higher level if additional protection was purchased.
8. New Members of Firm - If a new member of the firm is a lateral hire, he or she will be insured under the CLLAS policy with respect to Professional Services performed on behalf of the firm. LPIC insures such individual on a continuous basis without reference to any firm.

If the individual joins the firm through a merger such that his or her previous firm becomes a "predecessor firm" within the terms of the definition of "Insured" in the CLLAS policy, the individual will be insured with respect to professional services provided on behalf of the predecessor firm as well as the firm.

9. Miscellaneous - Firms should be reminded that they are responsible for the first \$250,000 of any claim which does not carry LPIC insurance such as,

- (a) claims involving activities as a "Mortgage Broker" as defined in the LPIC policy;
- (b) trusteeships for which the Insured is not responsible as a lawyer;
- (c) activities as an administrator for which the Insured is not responsible as lawyer;
- (d) activities as an executor for which the Insured is not responsible as lawyer; and
- (e) activities as an arbitrator, mediator or patent or trademark agent for which the Insured is not responsible as a lawyer.

CLLAS provides drop down coverage in each of these circumstances.
