

Response to the Task Force Paper on Fidelity Cover

I am a member of the National Legal Profession Reform Consultative Group, and a non-practitioner member of the Legal Services Board in Victoria. I make this submission in my personal capacity, as an individual with an interest and expertise in consumer advocacy. The views expressed in my submission are not the views of the Legal Services Board.

This submission is made in response to the National Legal Profession Reform - Consultative Group paper: Fidelity cover, 11 December 2009.

Whether there is one National fund or individual State funds, I strongly support a Fidelity Fund with adequate resources to provide redress for consumers who have been wronged by the fraudulent actions of legal practitioners.

In particular I support the following aspects of the Taskforce proposals:

- the provision of adequate protection - removal of caps
- prescribed minimum terms and conditions
- that claims are determined at arms length from the profession

Introduction

In July 1994, the Law Council of Australia produced a paper entitled *Blueprint for the Structure of the Legal Profession: A National Market for Legal Services*. One of its key principles and objectives was the protection of consumers of legal services.¹ While the vast majority of consumers of legal services never need to call on a fidelity fund, the fund provides compensation for consumers who have lost funds that they have entrusted to their solicitor. While some clients of legal services are not financially vulnerable, for many consumers such a loss can be devastating. It is therefore important that this key part of the consumer protection regime offer adequate and fair protection for consumers who suffer financial loss.

A. Comments on proposed Legislative Principles

Overarching Objective

To ensure that consumers of legal services have a source of compensation for defaults by law practices arising from or constituted by acts or omissions of associates. ²

This objective should be widened. A range of persons who are not specifically consumers of legal services should have a right to be compensated by a fidelity fund. Examples include beneficiaries under a will or another party in a legal matter. For example, a purchaser of property, who may not

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http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews_CouncilofAustralianGovernments%28COAG%29NationalLegalProfessionReform. Blueprint item 7: "The protection of consumers of legal services through comprehensive education and training of the legal profession and the development of a uniform standard of client care"

² Taskforce proposed overarching regulatory objective

be a client of legal services, may pay a deposit into the vendor's solicitor's trust account. If the sale doesn't proceed, and the deposit is due to be returned, the potential purchaser should be protected if a defalcation occurs in the same way that a client of the solicitor is. While I suspect that Government's intention is to protect such individuals, this must be clear in the legislation.

It is unclear whether the legislative intent is to protect "service providers" who provide services on the basis that their fee is in the trust account, for example barristers or expert witnesses. I don't have a strong view on this question, but this should be clarified in the legislation.

Principle 2: A default³ by a law practice is a failure of the practice to deliver trust money or trust property received in the course of legal practice, where the failure is due to a dishonest act or omission.

I believe it would be preferable to use the term in the Model Rules and refer to where the failure is due to "an act or omission that involves dishonesty", as I believe this would give slightly wider coverage beyond the proposed wording of Principle 2.

Principle 5: Claims against the fidelity fund must be determined independently, at arm's length from the profession.⁴

I am supportive of this principle. While many decisions are legal decisions, and knowledge of the law and the profession is an advantage, there is the capacity for a conflict, or perceived conflict of interest. Decision making by the relevant body can require more than application of the law. For example, depending on the jurisdiction, decisions can involve exercising wide discretion in relation to whether a claimant is required to pursue other avenues to recover the money, whether to waive the time limit for lodging a claim, whether to waive a monetary cap, whether to impose a levy on practitioners and/or whether to make only partial payments.

B Comments on Taskforce proposals

1. Cost of providing consumer protection

While cost efficiency should be a key goal in regulatory reform, it is vital that consumer protection is not compromised by choosing a cheap option. This is particularly important in relation to a fidelity fund. While the costs of administering funds in each state differ, there is also some difference in the level of protection provided in various states.

As the contributions and administration costs of the Victorian Fidelity Fund have been outlined to the Taskforce by a number of members of the consultative group, it may assist the Taskforce to note that the administration costs include legal costs incurred – primarily as a result of claimant appeals. For example, of the \$357,590 of "administration costs" in 2006/2007, \$261,076 was incurred in legal costs. Of the \$302,270 "administration costs" in the following year, \$213,613 related to legal costs.

It has also been suggested that Victoria's fidelity fund fees (and reserves) should be lower due to some potential protection against fraud provided by LPLC professional indemnity insurance. This

³ The Taskforce proposes to adopt the Model Bill definition of 'default' (s 3.6.2).

⁴ Mr Bill Grant, Taskforce member, does not agree with this proposal.

would only be the case if the LPLC policy paid for some types of loss that resulted from a default which is covered by the Fidelity Fund. My understanding is that such loss is excluded by the LPLC policy.

2. National uniformity

While it may not be possible to establish a single, national fidelity fund at this stage, a national law should result in similar protections for consumers, regardless of where they live in Australia.

Broad protection by a fidelity fund is a key consumer protection issue. I am supportive of the taskforce's proposal to include minimum terms and conditions of cover. It may be appropriate for a national law to prescribe the minimum terms and conditions of fidelity fund coverage (or provide some detailed principles). These terms and conditions should be based on the best level of consumer protection provided by any of the States – and not involve a lower level of consumer protection for any State.

3. Adequacy of Fund

The law should reflect the primary principle that the size of the fund should be based on potential claims, not that the payment of claims is based on the size of the fund. Provisions for caps on claims and the discretion to pay only part claims are no substitute for an adequate fund.

The adequacy of reserves, which also varies from state to state, is often only evident when a large defalcation occurs.

In Victoria the Legal Services Board determines the adequacy of reserves based on actuarial advice.

The Fidelity Fund should hold an amount that is adequate to cover estimated annual claims as well as extraordinarily large claims – or otherwise hold insurance to cover such claims.

Funds for the payment of claims and administering claims should be held separately from funds for other purposes not related to compensation for defaults.

4. Caps on Claims

I am supportive of the Taskforce's proposal to eliminate or raise caps on claims.

A national fund should remove the necessity for caps on claims. I note that in some states the caps are quite low. For example a \$200,000 cap on individual claims would not compensate a person where the proceeds of the sale of their family home had been paid into a solicitor's trust account.

C Other issues

5. Claimant's Obligation to Pursue Other Avenues of Compensation

Current legislation (at least in some states) gives a broad discretion to the decision making body, to decide whether a claimant is required to pursue other avenues of redress before the claim is accepted.⁵ Claimants can face significant problems if required to pursue other avenues of redress

⁵ I understand that in South Australia there is no discretion, as claimants are required to pursue all other options first.

and these potentially limit the extent to which their losses are covered by the fidelity fund. Some, or all, of the fidelity funds do not compensate for legal costs incurred in pursuing other avenues of recovery. Therefore the claimant would be taking a risk – not only of losing the case but of winning the case but being unable to recover from the other party. This could mean that:

- Some claimants could be deterred from pursuing their claim at all;
- Claimants could be financially disadvantaged by the time taken to pursue payment;
- Claimants could suffer financial loss even if their claim is paid by the fund.

It may be reasonable to expect some claimants, for example large businesses, to pursue legal action prior to a claim being accepted. However, in relation to individual claimants, the fidelity fund is likely to be in a better position to pursue the practitioner (or another party) for recovery, under its right of subrogation, than the claimant is.

While the decision making body needs to have the power to protect the fund where appropriate, the legislation should provide clear guidelines about when it is appropriate to require a claimant to take their own action before a claim is paid.

If the decision making body retains the discretion to require the claimant to pursue their claim against other parties, the fund should be able to pay any reasonable costs incurred in pursuing the claim against the practitioner or other party in the event of the claim being returned to the fidelity fund.

6. Financial Services Exclusion

There appears to be little support for making any amendment to the exclusion of coverage for the loss of funds that are given to the practitioner for investment purposes and then are misused. This is understandable, because significant losses have been suffered in the past.

However, I believe that the extent of this exclusion should be reviewed.

While I understand that fidelity fund claims have reduced significantly since introduction of the exclusion, it is likely that other legislative changes have also contributed to the reduction in claims - for example licensing requirements for managed investment schemes and restrictions placed on lawyers from taking money for investment purposes.

Many clients who lose money as a result of leaving funds with their solicitor for investing have been clients of the solicitors prior to investing. Rather than an investment decision based on greed, the decision to invest is often an agreement with a proposal put to them by their solicitor. In some cases the loss is directly due to their solicitor urging them to invest money through the practice, and the solicitor stealing the funds immediately.⁶ While it can be argued that the investing transaction is outside the lawyer/client relationship, in many cases it is the fact that the client trusts his/her solicitor and the past solicitor/client relationship that leads to their loss.

It is not unreasonable for such consumers of legal services to ask why they might not be protected by the fidelity fund.

⁶ For example see Financial Review 9 October 2009, NSW case of John Bradfield misappropriating funds that were never put into a trust account.

Lawyer not licensed to provide financial services

I also understand that many, if not the majority of people who lose money in this way through a lawyer, do so through a lawyer who is not a licensed financial services provider and has no intention of investing the money. This would seem to be a clear example of fraud.

Timing

The following hypothetical situations illustrate how timing of events can effect whether a claim can be made to the fidelity fund. It also demonstrates the fine line between what may be included or excluded.

Mrs A has sold her home to move to a retirement village. Two days after the proceeds of sale are deposited into her solicitor's trust account, the solicitor withdraws the funds and uses them to pay off his personal debts. Mrs. A requests transfer of her funds one day later, however to delay the theft being discovered, the solicitor suggests she leave her funds with him to invest until she requires them for the purchase in 4 months. Mrs. A agrees.

Mrs. B is in exactly the same circumstances as Mrs. A, however her solicitor makes the suggestion of leaving the funds with him for investment just prior to settlement. She agrees. Her solicitor also steals the funds two days after the proceeds of sale are deposited.

While Mrs. A is likely to have a valid claim against a fidelity fund (because the funds were stolen before she agreed to the investment proposal), it is likely that Mrs. B's claim would be rejected because at the time the funds were stolen, she had agreed to the investment proposal.

It may not be appropriate to immediately review this exclusion, given the limited funds held in some states. However, a review of the extent of this exclusion should take place in the process of establishing a National fund.

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22nd January 2009