

立法會
Legislative Council

LC Paper No. CB(2)3321/03-04
(These minutes have been seen
by the Administration)

Ref : CB2/PL/AJLS

Panel on Administration of Justice and Legal Services

**Minutes of special meeting
held on Monday, 14 June 2004 at 4:30 pm
in the Chamber of the Legislative Council Building**

- Members present** : Hon Margaret NG (Chairman)
Hon Albert HO Chun-yan
Hon Martin LEE Chu-ming, SC, JP
Hon James TO Kun-sun
Hon Miriam LAU Kin-yee, JP
Hon Ambrose LAU Hon-chuen, GBS, JP
Hon TAM Yiu-chung, GBS, JP
Hon Audrey EU Yuet-mee, SC, JP
- Members absent** : Hon Jasper TSANG Yok-sing, GBS, JP (Deputy Chairman)
Hon CHAN Kam-lam, JP
Hon Emily LAU Wai-hing, JP
- Public officers attending** : The Administration

Mr Michael SCOTT
Senior Assistant Solicitor General

Miss Kitty FUNG
Senior Government Counsel

The Law Society of Hong Kong

Mr Michael Lintern-Smith
President

Mr Peter LO
Vice-President

Mr Patrick MOSS
Secretary General

Ms Vivien LEE
Assistant Director, Professional Indemnity Scheme

Professional Indemnity Scheme Action Group

Mr Larry KO

Ms Therese CHOW

Mr Benny YEUNG

Ms Lily LEE

Ms Hilary GORDELL

Mr Rene HOUT

Ms Phyllis KWONG

Mr Victor CHAN

Mr Sundara KRISHNAN

Ms May TAM

Clerk in attendance	:	Mrs Percy MA Chief Council Secretary (2)3
Staff in attendance	:	Mr Arthur CHEUNG Senior Assistant Legal Adviser 2
		Mr Paul WOO Senior Council Secretary (2)3

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I. Confirmation of minutes of meeting
(LC Paper No. CB(2)2425/03-04)

The minutes of the special meeting on 26 April 2004 were confirmed.

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II. Professional Indemnity Scheme of the Law Society of Hong Kong
(LC Paper Nos. CB(2)2582/03-04(01), 2700/03-04(01), 2701/03-04(01) - (03), 2724/03-04(01) and 2775/03-04(01) - (02)).

2. The Chairman welcomed representatives of the Administration, the Law Society of Hong Kong and the Professional Indemnity Scheme Action Group (PIS Action Group) to the meeting.

Administration's views on issues raised at the meeting on 26 April 2004

3. Senior Assistant Solicitor General (SASG) introduced the Administration's paper (LC Paper No. CB(2)2582/03-04(01)) which responded to the issues raised at the Panel meeting on 26 April 2004. The Administration's overall position was as follows -

- (a) the Administration was strongly of the view that a mandatory professional indemnity insurance should remain in place for the protection of users of legal services. From the perspective of the profession, an assurance that all solicitors were insured would enable small firms to compete with the larger firms for business, and a thriving legal profession was essential for promoting Hong Kong as an important legal services centre;
- (b) under the existing legislation and the mandatory Professional Indemnity Scheme (PIS), and consistent with the policy objectives, solicitors had a liability to pay for any shortfall in compensation. At present, the Solicitors Indemnity Fund (SIF) was required to provide indemnity against specified loss up to a sum not exceeding \$10 million (less deductibles) in respect of any one claim. Therefore, the liability of solicitors to pay for any shortfall was not of an unlimited amount;
- (c) any new PIS should provide adequate protection for both the solicitors and the public in the event that an insurer became insolvent. With regard to the proposed Master Policy Scheme (MPS) and the Qualifying Insurers Scheme (QIS) which the Law Society had put to its members for consideration, the Administration considered that they should not be supported unless the schemes were backed up by a mechanism such as a Policyholders' Protection Fund (PPF) or "insurance on insurance"; and
- (d) the Administration did not support the option of a scheme funded by levy imposed on certain transactions. In its view, the practical effect of a levy system was that the burden of levy would be borne by users of legal services. The Administration considered it

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unfair to make users legally liable for the payment of insurance in respect of their solicitors' default.

4. SASG added that the Administration had not rejected outright either the MPS or QIS. The suggested back-up arrangement of "insurance on insurance" was a preliminary thinking and the Solicitor General (SG) had requested both the Commissioner of Insurance and the Law Society to explore the possibility of introducing such a mechanism.

Verbal report by the Law Society of Hong Kong

5. At the invitation of the Chairman, Mr Michael Lintern-Smith reported on the progress of the Law Society's consultation with its members on the way forward for PIS and the intended course of action. The latest position was summarized as follows -

- (a) in view of the concerns expressed by members of the profession at the Extraordinary General Meeting (EGM) held on 21 April 2004, the Law Society issued a questionnaire on 12 June 2004 which sought to obtain solicitors' views on the preferred structure of the future scheme. The questionnaire included an explanatory note on the main elements of and advantages and disadvantages of three alternative schemes (namely, the current scheme, an MPS and QIS). Members of the profession were asked to rank their preferences for the three schemes, and to comment on the aspect of future mutual liability in respect of claims made by fellow practitioners. The Law Society had requested responses to the questionnaire by 30 June 2004 (a copy of the questionnaire was tabled for the information of the Panel and circulated after the meeting vide LC Paper No. CB(2)2800/03-04(01));
- (b) on the basis of the responses received, the Law Society would recommend an option for the future scheme to be put for formal resolution at a future EGM, with a view to seeking a mandate from its members to pursue the preferred scheme; and
- (c) the Law Society would then proceed with the drafting of the relevant amendments to the Solicitors (Professional Indemnity) Rules in consultation with the Department of Justice, and implement the proposed changes. The amended Rules would be submitted for the approval of the Chief Justice and subject to the negative vetting procedure of the Legislative Council (LegCo).

6. Mr Lintern-Smith said that the Law Society supported mandatory indemnity insurance for solicitors. Although some of its members had expressed the views that indemnity insurance should not be compulsory and that

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clients should be given an informed choice as to whether or not to engage a solicitor who was insured or not insured, these views did not represent the overall position of practitioners in the profession. The majority view was in support of mandatory insurance. This was borne out by the survey results shown in the Willis Report. However, the concern which had been voiced by the majority of practitioners was that unlimited mutual liability for the wrongdoings of individual practitioners was fundamentally unacceptable. In their view, the present system, which made solicitors responsible for the defaults of other solicitors and hence put them at risk in the event of failure of the insurers, would have to be changed.

7. Mr Lintern-Smith added that Hong Kong needed a strong and regulated legal profession, which was a highly important element in pursuing the Government's objective of promoting Hong Kong as a leading centre for legal services. A strong legal profession depended on talented new entrants into the profession, and experienced practitioners believing that there were sufficient rewards for them to remain in the profession. There were, however, worrying signs that this might not be happening. Mr Lintern-Smith pointed out that at present, about 33% of the solicitors firms in Hong Kong were sole-practitioners. This was a high figure compared to most of the other comparable jurisdictions. Out of 656 practising firms, 596 were firms of five partners or less. Traditionally, the smaller firms relied heavily on conveyancing work. With the downturn of the property market, and the abolition of the scale fees which resulted in sharp reduction in fees on conveyancing transactions, income of these firms had dropped significantly. Mr Lintern-Smith said that he was aware of examples of low income of solicitors. In one particular case, a practising partner of a firm received a monthly take-home pay of merely \$20,000.

8. Mr Lintern-Smith further said that low earnings, coupled with expensive overheads which included high insurance premiums, had posed serious questions to many smaller firms as to whether it was still economically worthwhile for them to continue practice. He cited his personal experience of practising in a medium-size firm of 20 lawyers, which had a no-claim record against the SIF. In 2000, the amount of the firm's contribution to the indemnity scheme was \$419,000. In 2001, the contribution went up to \$841,000. The amounts for 2002 and 2003 were \$834,000 and \$789,000 respectively. Nonetheless, the firm was required to make additional top-up contribution of \$507,000 in 2003 to meet the shortfall of the fund. Top-up contribution paid by his firm in 2000 was \$241,000, and \$229,000 in 2001. Reduced cover was taken out in 2004 and the premium was \$32,480. A quote for comparable top-up cover to that in 2001 was for more than \$500,000. The amount of insurance premium paid by the firm had risen by about 300% in four years. Insurance premium, together with salaries and rent, now ranked as the major expenses of practice. For a large number of firms, the cost of insurance already exceeded the rent payment. The cost, however, could not be automatically passed on to the clients. Mr Lintern-Smith said that he had been told by many practitioners that it was

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unfair for the solicitors profession to be the only profession whose members were mutually liable for the acts of other members, and to be exposed to unlimited risk of indemnity. If the existing situation continued, they could hardly remain in practice and would have to move into other areas of work which were less regulated and less financially burdensome.

9. Mr Lintern-Smith further informed the Panel that the number of practising certificates issued for solicitors in 2001 and 2002 was 5 070 and 5 173 respectively. The figure for 2003 was 5 301. These figures actually represented a diminution in the number of existing practitioners, taking into account the fact that over 400 newly graduated students entered into the legal profession each year. He called upon the Administration to take heed of the warning signs and assist the profession in addressing the problems in order to pursue the objective of developing Hong Kong as a competitive legal services centre with professional excellence.

The Law Society's views on the Administration's paper

10. Mr Lintern-Smith said that the Law Society did not agree with the Administration on the retention of the element of mutuality of liability and the back-up mechanism of a PPF or "insurance on insurance". He said that the majority view of solicitors was that mutuality should be dispensed with, and that it should not be subject to a PPF which, if approved, would need three to five years to come into existence. "Insurance on insurance", on the other hand, was an unusual concept. The general view of professional insurers was that such arrangement was unknown, and even if such insurance cover could be obtained, the cost would be prohibitively high.

11. Referring to paragraph 15 of the Administration's paper, Mr Lintern-Smith said that the possible default by solicitors who held large amount of clients' money in performing their duties was not the reason for mandatory insurance for the protection of the clients. Instead, it was more the potential risk of exposure to liability faced by solicitors resulting from their handling of commercial interests of significant amounts which necessitated the need for insurance. In the view of the Law Society, obligation to the public was fulfilled provided that solicitors took out the statutorily required insurance, and it would be unfair to require solicitors to pay for additional cover such as in the form of "insurance on insurance".

12. Referring to paragraphs 28 and 29 of the Administration's paper, Mr Lintern-Smith said that while the Law Society agreed that clients' interests should be adequately protected by insurance arrangements, it did not accept that the risk of compensation should be passed on to solicitors as a whole in the event of insurer failure.

13. Mr Lintern-Smith added that the Law Society did not accept the Administration's view that the proposed MPS would result in a large reduction in

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the protection presently available to clients. He said that under the proposed MPS, the only conceivable reduced protection in the event of insurer default was the share of the claim that would have been covered by the particular insurer who failed. In such a case, the responsible solicitor would be solely liable for that amount which was left uncovered. The other co-insurers, on the other hand, would be liable for their specified shares.

14. Regarding the proposed PPF, Mr Lintern-Smith said that the Administration should provide more details such as its operation and how it would be funded.

15. On the Administration's view that ways should be found to reduce the potential amount of claims against solicitors, Mr Lintern-Smith advised that the Law Society was in the course of organizing courses for its members which included a risk management course and a professional management course.

Views of the PIS Action Group

16. Mr Benny YEUNG introduced his letter dated 9 June 2004 to the Solicitor General, which contained a plea for the abolition of SIF (LC Paper No. CB(2)2775/03-04(02)). He appealed for LegCo's support for the plea.

17. Referring to the issue of adequate protection of clients' interests raised by the Administration, Mr Benny YEUNG said that adequate protection did not mean zero risk but the absence of a large degree of risk. There was general consensus within the profession that the indemnity scheme should operate in a manner which provided reasonable protection to the public. Both the existing scheme and the proposed schemes had mandatory insurance cover provided by licensed insurers who were monitored by the Insurance Authority. Hence, there was no reason to believe that there would be a substantially high degree of risk in the future scheme as far as protection of the interests of the clients was concerned. The existing mutual scheme, which made solicitors the insurers of last resort for each other in the event of collapse of the insurer, was unfair to the solicitors. In Hong Kong, no other profession, including doctors who took care of human lives, was subject to the same mandatory requirement.

18. Mr Benny YEUNG opined that the Administration's comment that an indemnity insurance scheme should protect clients from default by solicitors was wrongly applied, because the mandatory scheme required under existing legislation did not cover claims arising from frauds by solicitors. In fact, insurance to cover frauds by solicitors could not be obtained. Protection of solicitors' clients against moral hazard, therefore, was a separate issue.

19. Regarding the Administration's proposal on back-up arrangements of PPF and "insurance on insurance", Mr Benny YEUNG said that the former would not become operative in a few years' time even if it was to be implemented. The

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latter was not readily obtainable, and even if available, would be extremely expensive. On the proposed MPS, Mr YEUNG suggested that further safeguards might be introduced, such as -

- (a) having three or four participating co-insurers for the spreading of risks; and
- (b) limiting the single largest share of a co-insurer and introducing provisions to deal with merger of the co-insurers, and setting requirement of a minimum credit rating of the participating co-insurers.

20. Ms Hilary GORDELL expressed the view that apart from insurer insolvency, the high proportion of claims resulting from conveyancing matters was an important factor contributing to the present difficult situation faced by solicitors. She pointed out that during the period 1997 to 1999, 90% of the value of claims against SIF was related to conveyancing cases. The proportion had now dropped to 50% but the amount was still considerable. She remarked that the situation was related to the absence of land title legislation and the absence of a minimum fee for conveyancing. Of the total disputed cases, about 35% related one way or another to title issues. The situation in Hong Kong was that it was difficult to prove title conclusively, given the absence of a satisfactory land title system. An inadvertent error might give rise to a negligence claim. The present plan to introduce land title for primary properties only would not assist in a material way because the significant problem area was the secondary market properties, where solicitors were still facing great difficulties in obtaining proof of title. Therefore, the inherent risk to solicitors still had not been removed. The hardship of solicitors was further compounded by the very low conveyancing fees they charged for the transactions. Ms GORDELL considered that means to reduce the risks to solicitors connected with conveyancing transactions had to be examined in addressing the issue of professional indemnity of solicitors.

21. Mr Larry KO said that the bottom-line of the PIS Action Group was that it did not accept that solicitors should be made the insurers of last resort for each other and solicitors should be asked to make additional contributions to make up for any unexpected shortfall of SIF. He said that the PIS Acton Group might be prepared to accept mutuality of liability up to \$500,000 for each and every claim.

22. Ms Phyllis KWONG briefed the Panel on her written submission (LC Paper No. CB(2)2775/03-04(01)). The paper highlighted the following issues -

- (a) the principles for a professional insurance scheme and the framework of the solicitors' indemnity rules;

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- (b) the flaws of the existing PIS;
- (c) professional insurance arrangements in England and Wales, New South Wales, Ontario and Quebec;
- (d) features of an MPS, QIS and a "Captive" insurance model; and
- (e) suitability of replacing the existing scheme with a Captive model.

23. Ms Phyllis KWONG said that she had recommended the alternative of replacing the existing scheme with a Captive model. She explained that a Captive was similar in nature to a mutual scheme, conducted through the medium of a licensed insurer who was subject to similar regulation as that of other licensed insurers but with lower capital requirements. A Captive insurance insured only the profession which owned it and operated for the benefit of its owner. In the Willis Report, it was pointed out that -

"A captive insurer licensed under the Insurance Companies Ordinance and incorporated in Hong Kong could provide to the public and to solicitors all the benefits of the current scheme with the added benefits to the members of the profession that it would limit their liability for losses in the event of a reinsurer's insolvency of a catastrophic claims loss that had not been anticipated and for which there were insufficient assets." (page 132 of the Report); and

"The Government of the Hong Kong Special Administrative Region is encouraging the establishment of captive insurers in the territory to promote Hong Kong as a captive centre with the Asian Region." (page 133 of the Report).

Ms KWONG said that in her view, a Captive model was in line with public policy of protecting public interests and affording adequate protection to the profession, with the added benefit of limited liability and being regulated. She called upon the Law Society and the Administration to consider the merits of adopting the model to substitute the existing scheme.

24. Referring to the reference in Ms Phyllis KWONG's submission to practitioners' contribution to payment for defence costs to "Panel solicitors" defending claims against the SIF, Mr Peter LO drew members' attention to the information set out in the table in page 51 of the Willis Report. He explained that defence costs were incurred for defending and investigating claims. Average defence costs as a proportion of total losses from 1987 to 2000 was 29.2%. As at 30 September 2003, the amount of defence costs paid in relation to claims notified for the indemnity year ending September 2001 and September 2002 was about \$11.4 million and \$1.2 million respectively. Mr Peter LO advised that the figures would have to be updated when all the relevant claims had been decided.

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Issues raised by members

25. Ms Miriam LAU said that she felt extremely disappointed after reading the Administration's paper and the responses provided therein. She criticized the Administration for being "blind to the problems and deaf to the pleas of solicitors", stating its own position merely from the moral high ground of public interest but offering no constructive advice on practical means to save solicitors from the dire situation. She said that as the Law Society had pointed out, there were serious implementation difficulties regarding the back-up mechanism of a PPF and "insurance on insurance". Ms LAU urged the Administration to get down to detailed discussions with the Law Society without delay, with the purpose of working out viable solutions to the problems. She added that in the end, it would be difficult for LegCo to support any new scheme if the scheme was not supported by the Administration.

26. Ms Miriam LAU further asked the Law Society and the Administration to study the feasibility of the Captive insurance model suggested by Ms Phyllis KWONG. The issue of conveyancing fees, mis-management of the indemnity scheme and conflict of interests etc should also be examined carefully.

27. The Chairman said that the primary legislation imposed compulsory insurance and required solicitors to comply with the relevant rules made by the Law Society Council. She opined that as the solicitors profession was a self-regulating profession and the Law Society was in the best position to assess the difficulties and the best means to deal with them, the Administration was not expected to work out with the Law Society the form of the future indemnity scheme. Nevertheless, the Administration should take a positive and helpful attitude in assisting the profession in appropriate ways, particularly in matters involving policy and law drafting. LegCo also played an important role as legislative amendments to implement any changes would be subject to its scrutiny.

28. The Chairman and Mr Martin LEE asked whether the Administration and the Law Society had plans to discuss with each other on the relevant issues. SASG and Mr Lintern-Smith responded that there had already been dialogue between the Solicitor General and the Law Society and the discussions would continue. SASG said that the views expressed at meetings of the Panel on the various options concerning the future indemnity scheme would be taken into consideration by the Administration.

29. Mr Albert HO said that he hoped that members of the profession could soon reach a consensus on the future indemnity scheme and report the result to the Panel. Legislative amendments to implement any agreed changes could then be proceeded with as soon as possible. He opined that while it was accepted that the profession as a whole had a duty to protect the interests of the

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clients, whether or not the profession should continue to shoulder unlimited exposure to claims in the event of insurer failure was a separate issue which should be resolved urgently. Mr HO said that he personally supported the retention of an element of mutual liability, without which small solicitors firms might find difficulty in obtaining the insurance cover at affordable costs. However, for the protection of solicitors, mutuality should be limited to a certain level without the requirement for solicitors to make further contributions to meet any unexpected shortfall of the indemnity fund. Mr HO stated that he was in favour of the MPS option which featured an agreed level of retained mutual liability. He further opined that the alternatives of a Captive model and a fund established from levies should also be studied.

30. Mr Lintern-Smith advised that the Law Society had been looking into the matter of reducing mutuality of liability. At one stage, the possibility of removing mutuality was considered. However, it was recognized that to do away with mutuality altogether might result in prohibitively high insurance premium, or insurers refusing to provide cover at all. Under the MPS, there would be three to five co-insurers. Nonetheless, the risk of insurer failure would still exist. The possibility of making the co-insurers jointly and severally liable for that insured liability which was left uncovered by the failed insurer had been explored but such arrangement was found not viable. The current recommendation of the Law Society was that the agreed level of retained mutual liability under the MPS should not exceed \$1.5 million for each and every claim.

31. On the issue of limiting the liability of solicitors, Mr Lintern-Smith pointed out that there were statutory limits introduced in New South Wales. In England and Wales, a system existed under which limits on solicitors' liability for negligence claims by clients were set out in contractual agreements. He advised that the Law Society was currently studying the model of limited liability partnerships for solicitors practice and restriction of liability contractually in the light of the experience of England and Wales.

32. Mr Peter LO said that in considering the preferred future scheme, the Law Society had no pre-conceived views as to the level of retained mutual liability. The retention of \$1.5 million was proposed having regard to negotiation with commercial insurers and the reality of the insurance market. He further said that the previous shortfall in SIF resulting from the collapse of the HIH Group, the insurer, had been covered through top-up contributions to the fund made by members of the profession in 2003. At present, SIF was in a solvent state.

33. Ms Phyllis KWONG expressed the view that the possibility of a shortfall in the reserves of SIF could be reduced by more effective management of the fund resulting in lower management costs, as well as reducing the costs of defending claims.

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34. In response to the Chairman, Mr Lintern-Smith said that the suggestion of a Captive model of insurance would be further studied by the Law Society. With regard to the proposal on a fund financed by levy, Mr Patrick MOSS said that it was secondary to the three major options put forward by the Law Society in its questionnaire issued to solicitors but it could be factored into the future scheme for further consideration by members of the profession after the future basic scheme was decided.

35. Ms Hilary GORDELL said that in considering the future scheme to be adopted, it was necessary to look at whether the scheme was adequate for the protection of the interests of the public as well as whether it was affordable to practitioners of the profession. She hoped that the Law Society would adopt an open mind and analyse the different schemes so that solicitors could make an informed decision on the preferred scheme. In her opinion, once the basic structure of the new scheme was agreed and a mandate was obtained from members of the profession to pursue the scheme, the Law Society could proceed to work out the actual details of the scheme and the relevant legislative amendments with the Administration. She further commented that in view of the pressing timetable, it was important to get support of the Administration at an early stage for the development of a new scheme. The essential issues to be sorted out included whether mutual liability should be retained, or, given proper protection of the public interest, could be dispensed with.

36. Mr Sandara KRISHNAN said that public interest involved not only protection of the public but also the development and maintenance of a representative and vibrant legal profession comprising small, medium and large solicitors firms in Hong Kong.

Way forward

37. The Chairman said that the views expressed by the Law Society and solicitors had reflected the grave problems facing the profession which the legal community as a whole and the Administration should be seriously concerned about. She suggested and members agreed that she would write to the Secretary for Justice (SJ) on behalf of the Panel to bring SJ's attention the importance and urgency of resolving the problems. The Administration would be urged -

- (a) to consider whether it was essential for any proposed scheme to be backed up by a PPF or "insurance on insurance" arrangement; and
- (b) to respond without delay to any decision reached by the Law Society after its consultation with members of the profession.

(Post-meeting note - A letter from the Chairman to SJ was issued on 16 June 2004 (circulated vide LC Paper No. CB(2)2841/03-04(01)).

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38. The Chairman asked whether the Law Society could revert to the Panel on the updated position at the last regular meeting of the Panel in the current legislative session to be held on 28 June 2004. Mr Lintern-Smith replied that the Law Society might be able to give a broad indication on the preferred scheme, subject to the progress of its consultation with its membership. Members agreed that the Panel should follow up the issue, pending the response from the Law Society.

(Post-meeting note - The Law Society replied to the Panel in writing on 28 June 2004 that it was awaiting the responses to the questionnaire issued to all solicitors, the closing date for which was end of June 2004. The Law Society considered that it was not likely that it could conclude discussions with the Administration and report to the Panel before the end of the current legislative session. The Law Society's reply was circulated vide LC Paper No. CB(2)2992/03-04(01)).

39. The meeting ended at 6:30 pm.

Council Business Division 2
Legislative Council Secretariat
7 September 2004