LC Paper No. CB(2)725/03-04(03)

Professional Indemnity Scheme

1. Practising solicitors in Hong Kong are faced with two major questions in relation to professional indemnity cover, namely,

   (a) Under the present Professional Indemnity Scheme ("PIS"), is it correct for the Law Society Council to have resolved in asking its members to contribute, in what is referred to as "Call for the HIH deficit"?

   (b) Is our current PIS good enough, and if not, what sort of professional indemnity scheme should Hong Kong solicitors have in future?

   This paper seeks to address the first of these two questions.

Statutory basis

2. On 1st October 1989, the Solicitors (Professional Indemnity) Rules (the Rules") came into operation. It is believed that we can safely start from this piece of legislation in considering the subject under discussion.

The fund

3. Under rule 3(1) of the Rules, the Law Society (the "Society") is "authorized to **establish and maintain** a fund". The words in block letters should be heeded because, as we shall see further on, they are echoed in rule 4. The meaning of "maintain" will be more closely examined later in this paper.

4. With such authorization, a fund has indeed been established and maintained by the Law Society.

5. The purpose of the fund, according to rule 3(2), is to provide **indemnity** (with a small "i") against such loss as mentioned in section 73A of the Legal Practitioners Ordinance Cap.159.

6. Rule 5 provides that the fund shall be held, managed and administered by Hong Kong Solicitors Indemnity Fund Limited (the "Company"), "in accordance with the provisions of Schedule 2". The powers of the Company under Schedule 2

are subject to (a) such directions, conditions and requirements as the Society may from time to time issue to or impose upon it; and (b) such arrangements as the Society may from time to time agree with it.

"indemnity" (with a small "i")

7. To whom is "indemnity" provided? Answer: to "the indemnified" (rule 10). This term is defined in rule 2 and can be loosely said to encompass all contributing firms, their solicitors and trainee solicitors.

Indemnity (with a capital "I")

8. On the other hand, under rule 6(1), subject to certain exemption provisos, every practising solicitor "shall be required to have and maintain **Indemnity** (with a capital "I")".

9. There is a definition of this term, in rule 2 :-

> "Indemnity" means the indemnity to which the indemnified or a former solicitor is entitled under rule 10.

Rule 10 sets out a gist of what an "indemnified" is entitled to against losses arising from claim(s) brought against him, on condition that he shall have made "initial" contribution due in accordance with the provisions of Schedule 1 and gets a receipt issued to him for such contribution.

10. Rule 6(2) goes on to say that any current practising certificate which has been issued to a solicitor who is required to have and maintain Indemnity and who fails to have Indemnity shall be suspended and such person shall not be qualified to act as a solicitor pursuant to section 7 of the Ordinance while he shall fail to have Indemnity.

Maintenance of the fund

11. Rule 4 reads,

> "The fund shall be **established and maintained** by contributions which

shall be made or caused to be made by solicitors *in respect of the first and each subsequent indemnity period* in accordance with the provisions of Schedule 1 **and** by payment into the fund of the insurance fund". *(emphasis added).*

12. It follows that contributions are to come from two sources only, as specified. Let us now examine these two sources. First, what does Schedule 1 say?

Schedule 1

13. Schedule 1, as its title suggests, deals with "contributions to (the) fund". Paragraph 1 of Schedule 1 places the primary obligation to make contributions upon the Principal (partner or sole proprietor) of a firm.

14. In Paragraph 2 (calculation of contribution), sub-paragraphs (1) to (4) inclusive deal with "contributions for the first indemnity period and for each subsequent indemnity period", in other words, annual contributions. I shall refer to them as "normal contributions".

15. Sub-paragraph (5) of Paragraph 2 deals with contributions of a different nature. I shall call these "special contributions". Paragraph 2(5)(a) merits very careful examination. It is set out in full hereunder :-

> "Notwithstanding anything to the contrary in this paragraph, the Company may, with the authority of a resolution of the Council, at any time during an indemnity period demand in writing from every principal who is required to make contributions in accordance with paragraph 1 at any time during the indemnity period when the demand is made such further sum as may be authorized by the Council to make up a deficit or anticipated deficit in the fund, and such principal shall be bound to pay such further sum to the Company within 30 days after the date of issue of such written demand".

"insurance fund"

16. The other source of contribution for the purpose of rule 4 is "by payment into the fund of the insurance fund".

17. "insurance fund" is defined (in rule 2) as "the fund or funds established and maintained by the Society under the former Rules as part of the Professional Indemnity Insurance Scheme ("PIIS")".

18. PIIS is now out-of-date, obsolete and non-existent. What we have since 1st October 1989 is "Professional Indemnity Scheme ("PIS")". PIIS is expressly said to have been "replaced on 1 October 1989, by PIS" (see the definitions of PIIS and PIS in rule 2).

19. It can therefore be seen, and should be particularly noted at once, that the "insurance fund" mentioned in rule 4 has got nothing to do with any insurance policy maintained from and after 1.10.1989.

20. Such are the general background. I shall now proceed to examine more closely what were (or should presumably have been) the grounds upon which the Law Society Council has made the "Call for the HIH deficit".

Grounds for the Call

21. I have been provided with a paper by the President of the Law Society, entitled "Information and Issues relating to the Professional Indemnity Scheme" (the "President's Paper"). The President's Paper was enclosed with his letter to Members dated 17th October 2003, which he distributed "in an effort to assist [the Members] in considering the matter".

22. I have learned, from a letter dated 25.10.2003 from Ms Therese P.F. Chow to Mr. Patrick Moss, Secretary General of the Law Society, that the Law Society seemed to have obtained certain Counsel's Opinion on the subject. Ms Chow in her said letter referred to this counsel as "unknown Counsel", hence apparently his identity had not been disclosed. She said she had made numerous requests for disclosure of the Opinion, as well as the Instructions leading to it; that the President had personally promised (on 14.5.2003) that a copy would be made available to her; but that such documents had so far not been supplied.

23. In trying to put my mind to this matter, all the assistance I can get, in order to understand the actions (so far as can be seen) of the Council, is to read from the President's Paper. I apologize that, in the absence of further guidance from the

Law Society, in particular the said Counsel's Opinion, this paper may well contain points (factual or otherwise) of mistake on my part. I welcome any correction and/or constructive suggestions.

24. I shall first respond to the various points made in the President's Paper. After that, I shall venture to elaborate further on the subject as a whole.

"the current scheme is ... one which is hybrid in nature comprising part self-insurance and part re-insurance"

25. With respect, this statement contained in the President's Paper is not entirely correct. What we basically have is only a fund, not an insurance scheme. The fund is made up of contributions from members. On that level, the scheme does not even come close to anything that has to do with insurance.

26. It is only when Schedule 2 (management and administration of fund) comes into play that we see reference(s) to insurance. Schedule 2 gives the Company (in addition to a power to "deposit or invest" (sub-paragraph 2(b)), the power :-

> "(c) to arrange such insurances as the Company may determine in respect of the fund and its assets and the fund's liability under these rules and the former Rules to provide indemnity in respect of claims and costs and expenses; and to handle all aspects of any such insurances, including the payment of premiums thereon out of the fund and the making and recovery of claims thereunder; ...".

27. In other words, in dealing with the fund, the legislature gives the Company (under the supervision of the Society) no more than an "option", whereby the Company can (is allowed to) spend the contributions from members in maintaining (paying the premiums for) an insurance policy.

28. For all the Rules say, the Council could well have put all the contributions into buying the shares of Hong Kong Bank, and use the corpus of and dividends from such investment to pay claims (and probably we would have been better off that way).

29. There is another reason why I say that the notion of "insurance" must be

dispelled. This comes from the wording of rule 4.

What rule 4 really provides

30. In paragraph 4 of the President's Paper, it is said,

> "Rule 4 of the Rules provides that the fund 'shall be established and maintained by contributions which shall be made or caused to be made by solicitors'. Failure to comply with any of the Rules will result in disqualification (section 7(d) of the Ordinance and Rule 6(2) of the Rules)".

31. The first of the above two sentences is misleading (and therefore wrong) because it is an incomplete quotation of the rule (Rule 4).

32. Rule 4 actually says this :-

> "The fund shall be established and maintained by contributions which shall be made or caused to be made by solicitors ***in respect of the first and each subsequent indemnity period*** in accordance with the provisions of Schedule 1 and ...".

It can be seen immediately that the words in italics have been omitted from the quotation in the President's Paper.

33. These words, in italics, are of crucial importance. If we now refer to the contents of Schedule 1, in particular the first paragraph in 2(1)(a) thereof :-

> "Save in the cases referred to in subparagraphs (2) (when the amount of contribution shall be assessed by the Company as therein provided), (3) (which provides that the amount of the basic contribution shall be not less than the minimum amount as therein provided) and (4) (when the amount of contribution may be reduced as therein provided), the amount of all contributions ***for the first indemnity period and for each subsequent indemnity period*** shall be calculated –",

we can see that both **Rule 4** and **paragraph 2(1) of Schedule 1** talk about the

same thing, i.e., contributions in respect of "*the first and each subsequent indemnity period*", namely, the "normal contributions" only.

In other words, the "contributions by solicitors" under rule 4 are confined to those what I call "normal contributions" set out in paragraphs 2(1) to (4) of Schedule 1.

Those "special contributions" described in Paragraph 2(5) are expressly or impliedly ousted from rule 4, by the inclusion in rule 4 of the magic words "contributions which shall be made or caused to be made by solicitors ***in respect of the first and each subsequent indemnity period***".

34. It follows from the aforesaid that all that rule 4 does is no more than "to include solicitors' "normal" contributions as supporting the fund" such that, ***by rule 4 standing alone***

    (a) no other kind of contribution is anticipated, and
    (b) there is no obligation on solicitors to contribute to the fund.

35. There are four points, abundantly clear from the Rules, which support the proposition in the preceding paragraph.

36. The first point is based on a basic understanding of the English language. Take the example of the following expression. "My son's income comprises the pocket money that I give to him regularly on a weekly basis as well as what his grandmother contributes from time to time". The grandmother's contribution is here referred to only as a "source of income" – it certainly does not imply from the sentence that the grandmother is under an obligation to pay.

    Similarly, rule 4 refers to the contributions by solicitors as being a mere "source of fund". One cannot change that into an obligation imposed upon solicitors.

37. The second point is based on a fundamental rule of interpretation of statutes. The word "maintained" in rule 4 has a clear meaning in plain English. So long as that meaning is clear, no wider meaning can be imported into it. Hence "maintained" means no more than "supported" or "sustained". Such ordinary meaning of the word cannot be stretched to mean "underwritten" or "made good

with unlimited liability".

38. The aforesaid rule is applicable when the wording in the statute is clear. Where there is a doubt resulting from ambiguities in the words, there is a general presumption that the legislature does not interfere with vested rights nor create onerous obligations without saying so in a very clear and unambiguous way. Hence if solicitors were required to "foot the bill to the last penny", rule 4 would just have said so, in so many words. Since rule 4 does not say so, we can safely conclude that the ordinary meaning of the word "maintain" suffices.

39. Third, rule 6 makes it beyond any doubt what the legislature expects solicitors to do. They are required "to have and maintain **Indemnity**". They are not required "to maintain **the fund**", howsoever extensive (or restrictive) the word "maintain" can mean.

40. By making the "normal" contributions to the fund, solicitors discharge their duty under rule 6 (to have and maintain Indemnity). Whether the fund is adequate or not may well be a **matter of concern** for solicitors (as one can deduce from the provisions contained in paragraph 2(5)(a) of Schedule 1), but it is certainly not a **matter of obligation** on their part.

41. A fourth reason. The duty on the part of a solicitor to "maintain Indemnity" is provided in rule 6(1). Rule 6(1) has to be read in conjunction with the definition of "Indemnity", which leads us to rule 10. Rule 10 talks about a receipt "referred to in rule 9". Ultimately, if we look at rule 9, we can see that the receipt which is being talked about there is a receipt of "the **initial** contribution due in accordance with the provisions of Schedule 1".

42. Can there be any clearer indication of what the legislature intends? For a solicitor to "have and maintain Indemnity" as a pre-requisite to being permitted to practice, all he has to do is to make "**initial** contribution". Use of the word "initial" carries the message loud and clear: namely, those kinds of "non-initial" contributions envisaged in paragraph 2(5)(a) of Schedule 1 are not obligatory.

paragraph 2(5)(a) of Schedule 1

43. Let us now look more closely at what paragraph 2(5)(a) of Schedule 1 provides :-

> "Notwithstanding anything to the contrary in this paragraph, **the Company may**, *with the authority of a resolution of the Council*, at any time during an indemnity period **demand in writing from every principal** who is required to make contributions in accordance with paragraph 1 at any time during an indemnity period when the demand is made **such further sum** as may be *authorized by the Council* **to make up a deficit or anticipated deficit in the fund**, and such principal shall be bound to pay such further sum to the Company within 30 days after the date of issue of such written demand" (*emphasis added*).

44. Does this impose an obligation *per se* upon a principal to pay "further sum"? The answer is clearly in the negative.

45. This provision gives, first of all, the Company an option (neither a right nor a duty) to ask for more money. If it wanted that, it would have to ask for permission from the Council; and it would have to bring forward a reason, which would have to fall within the ambits of "to make up a deficit or anticipated deficit in the fund". No other reason would be valid.

46. Secondly, in response to this request, the Council would have to deliberate. I do not believe the Council can just toss a coin to come to a decision. It would have to make findings on facts, as well as to consider the matter as thoroughly and reasonably as it should.

47. The first question that the Council would be obliged to ask of the Company is "can you prove your reason?". In other words, "is there really a deficit, or an anticipated deficit in the fund?". Accounts would have to be scrutinized. Even if the Company was able to point to a sum in the accounts and described it an "anticipated deficit", the Council would still have to ask itself: "is this description correct?".

48. Let me quote an example. If there should be a court order compelling the Company to pay out from the fund a given sum at a future date, then although the due day has not yet arrived, it would be reasonable to conclude that payment of such sum was an anticipated liability, hence an "anticipated deficit". However, if the Company had in its hand no more than a High Court claim, the outcome of which would depend upon a lot of uncertain factors, then the liability

flowing from it, however likely, would be no more than a contingent one, and should not qualify for an anticipated deficit, still less a deficit.

49. The next question that the Council would have to ask itself is: "is this a suitable case for the Council to go out of the way to ask principals for more money?". In doing that, the Council would find it relevant to consider, among other things, "how much is the deficit (or anticipated deficit)?", "can we afford to make good such deficit?", "is this going to create an undesirable precedent?", "what other remedy is available to the indemnified?" and so on.

50. On the last of the aforesaid questions, it must be borne in mind that the fund's function is **to indemnify the indemnified**. There is not any provision anywhere which says that the fund is directly responsible vis-à-vis the claimant. True, rule 11 provides that sometimes payments can be made "to the order of the claimant making the claim". However, that is obviously intended as a form of mechanism of payment, on logistic considerations. Rule 11 does not enlarge the liability of the fund towards the indemnified into a direct or self-induced obligation towards the injured party (claimant).

"shortfall contribution"

51. The President's Paper uses the term "Shortfall contribution". With respect, this is entirely wrong. What the Company can ask for, under paragraph 2(5)(a), is not in the nature of a shortfall, but rather, an extra. An incident of shortfall contribution only occurs when, e.g., a principal is required, by calculation under paragraph 2(1), to pay a certain sum of money as his firm's "normal" contribution, and he pays something less than the figure demanded of him.

Conclusion

52. The aforesaid boil down to the following.

53. If a solicitor wishes to be qualified to practise in Hong Kong, he is obliged to contribute **under rule 4**, whereby he gets his receipt under rule 9, and in turn satisfies rule 10, thus discharging his duty to comply with the requirement "to have and maintain Indemnity". Once he does that, he bails himself out of the provisions of rule 6(2) (vide paragraph 10 above).

54. A call for *extra* contribution similar to the "Call for the HIH deficit" is possible **under paragraph 2(5)(a) of Schedule 1** (not relevant to rule 4), but it needs to be done properly. What have been set out in paragraphs 45 to 49 above are nothing more than my suggestions of matters to be considered under broad principles, and they are not meant to be exhaustive.

55. It appears to be sufficiently clear that if a principal fails or refuses to pay a demand under paragraph 2(5)(a) of Schedule 1 within 30 days of the demand, the sum demanded of him becomes a debt recoverable by action. However, it is doubtful if his failure or refusal would directly lead to disqualification to practise or suspension of his practising certificate, because such act is not caught under rule 6(2).

56. On the other hand, inasmuch as paragraph 2(5)(a) binds only the principal "to pay such further sum to the Company" on a personal basis, it seems that the other solicitors in his firm are not affected even if he did not pay.

57. Whether or not the Council and the Company did act properly (acting within the 2(5)(a) provisions) when they initiated the "Call for the HIH deficit" is a question of fact that needs to be investigated.

How do we go from here

58. There is no use crying over spilt milk. The keeping of an insurance policy with HIH was a mistake, a mistake in management of funds. We should just tell the "indemnified" frankly: "sorry, this is just too bad, we do not have sufficient funds to back you up". In that eventuality, what the claimants would want to do in going after the indemnified or otherwise, is something that we, all the other solicitors in Hong Kong as a group, are not able to interfere.

    Or we can show our "moral duty towards the community" (if ever there were such a thing), by going through what we can do under paragraph 2(5)(a) of Schedule 1, and ultimately (if we so decide) agreeing to make an extra and *ex gratia* contribution, depending on the amount needed, which probably should be of a lesser figure, say, 10 cents in the dollar. For that exercise, I believe many of us would want to have a say, rather than relying on the whims of the Council members.

59. On reflection, it seems fortunate that we have something like paragraph 2(5)(a) of Schedule 1, because it enables us, as a group, to have a decision based on majority vote, which once materialized, would make the resolved line of actions enforceable against anyone who would otherwise not have obliged voluntarily. If we did not have that provision in our rules, I believe all that could be done would be to pass a plate around for donations.

60. The mistake(s) in the past having been taken care of, we should now look to the future. I believe it was a correct decision for the Council to have resolved in commissioning an expert report. Whether Willis will live up to what they are expected to do is something that we just have to wait and see. Hopefully with the benefit of that report, we shall be able to devise a scheme that will, both conceivably and substantively, give all our members fairer treatment and better safeguards in the future.

(John Ku)

26th October 2003