Legal Expense Insurance at a CROSSROADS

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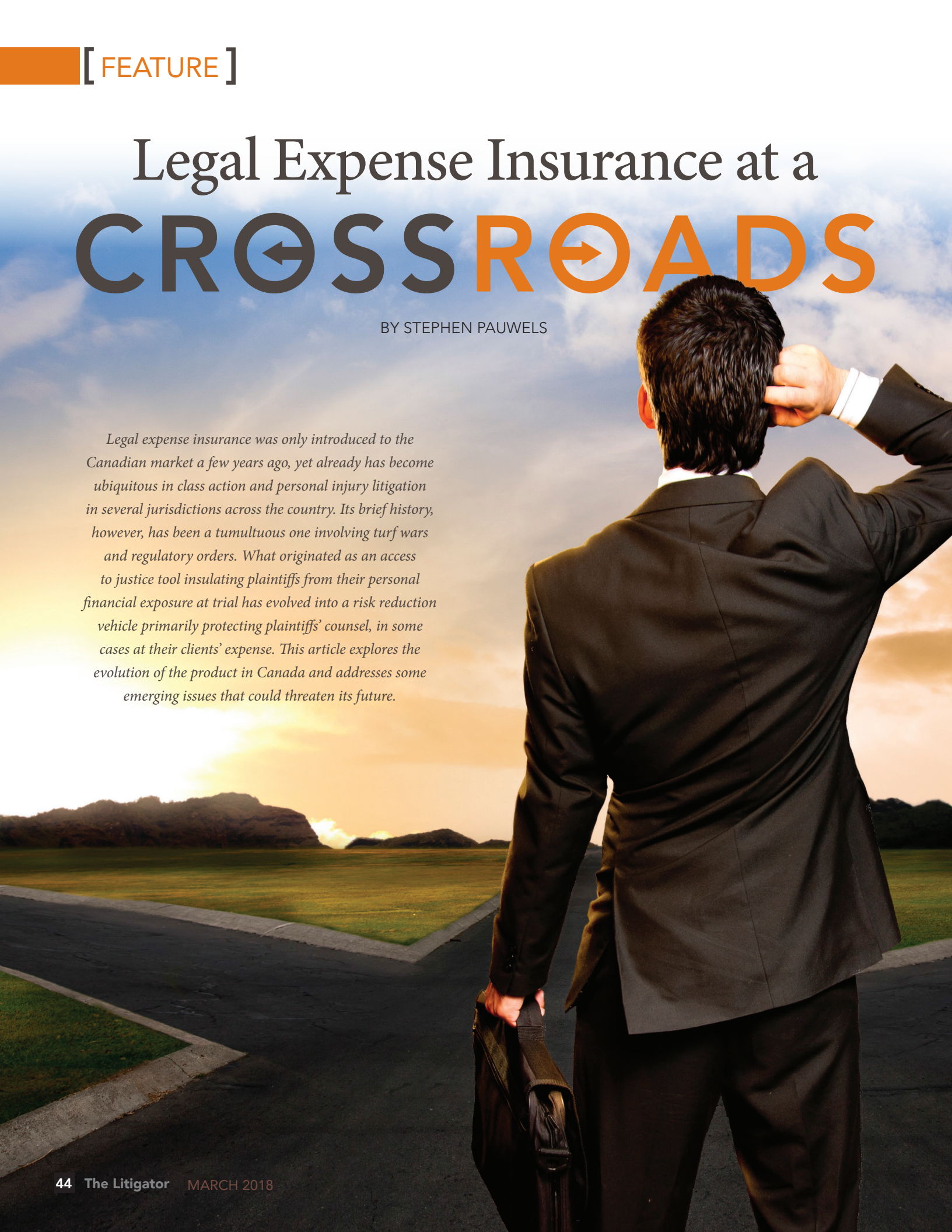

Legal expense insurance was only introduced to the Canadian market a few years ago, yet already has become ubiquitous in class action and personal injury litigation in several jurisdictions across the country. Its brief history, however, has been a tumultuous one involving turf wars and regulatory orders. What originated as an access to justice tool insulating plaintiffs from their personal financial exposure at trial has evolved into a risk reduction vehicle primarily protecting plaintiffs' counsel, in some cases at their clients' expense. This article explores the evolution of the product in Canada and addresses some emerging issues that could threaten its future.

The market for legal cost protection in Canada has evolved rapidly in recent years, offering plaintiffs and their counsel an invaluable resource to counter the traditionally uneven playing field between individual plaintiffs and the institutional defendants who oppose their legal claims.

The concept of legal cost protection – wherein a third party assumes all or part of a litigant's adverse cost exposure for a fixed or contingent fee - was originally envisioned as an access to justice tool, designed for the benefit of plaintiffs, to address the inherent flaw of our loser pays system: the ability of the litigant with the deepest pockets to leverage their financial advantage into a judicial one via the threat of legal cost consequences.

While contingency fee arrangements solve the more immediate problem for those who might not otherwise afford legal representation, the looming specter of a potential six-figure adverse cost award denies many plaintiffs the right to a trial they literally cannot afford to lose. Legal cost protection offers the solution.

The commercial market for legal cost protection in Canada was established in 2009. At that time, third party litigation funding companies began to offer legal cost indemnities - the forerunner of today's legal expense insurance, to shield representative plaintiffs in class action litigation from the significant cost exposure of the claim certification process. The court approval of these arrangements was vigorously contested by defendants at the time who were loathe to concede the traditional advantage their balance sheets afforded them. But ultimately it was the plaintiffs' access to justice argument which prevailed, and a strategic new tool for plaintiffs' counsel was forged.

In the intervening years, the market for legal cost protection in Canada has grown significantly, in size and into new areas of the law. The product has experienced its most profound growth in the area of personal injury litigation - not a surprise given the massive disparity in financial resources between individual accident victims and the insurance companies who fight their claims. A display of audience hands at a recent Toronto legal conference suggests that the product has already become the standard of care among the majority of personal injury lawyers in Ontario.

Ironically, it was insurers themselves who fueled this growth. Attracted by the profit potential of a fertile new market, and a source of premium revenue on the plaintiff side of the equation, *"After the Event"*, or "ATE" insurance debuted in Canada in 2013, a year after legal cost indemnities became available for personal injury litigation.[1]

ATE insurance offered a lifeline to the fledgling legal expense insurance market in Canada. Despite great hype surrounding the introduction of *"Before the Event"* ("BTE") legal expense insurance here in 2010, the product floundered from the outset. BTE insurance offered policy holders limited access to a panel lawyer in various specialty areas (excluding family and criminal law), but is largely geared to personal injury matters in the European markets from which it originates. What those offering the product failed to appreciate was the influence of contingency fee arrangements here, and the reservations Canadians would have over insurer-appointed lawyers. In a 2015 statement to the broker community announcing the closing of their BTE business, one insurer lamented that the product *"has not gained traction, and we've experienced adverse selection… resulting in very low volumes and lack of profitability"*.

ATE insurance, while restricted to the much smaller market of those who have already suffered a loss (the "Event"), and who wish to insure against their adverse cost exposure in the ensuing litigation, offered a second chance.

ATE insurance mirrored legal cost indemnities in many ways: both cover costs owed to a defendant as well as plaintiff counsel's disbursements (never legal fees) in the event of a lost motion or trial. *However,* as an incentive for the lawyers to review the product with their plaintiff clients, ATE insurance included certain features designed exclusively for counsels' benefit. For example, many policies cover 100% of a lawyer's disbursements in the case of abandoned or dismissed claims - disbursements that would otherwise traditionally be written off by the lawyer as a *'cost of doing business'*.

The brokers who sell ATE insurance have learned the strong appeal of such "walkaway" file coverage, and feature it prominently in their discussions with lawyers. The following "advantages" and "benefits" are noted in actual brokers' promotional materials:

- *"accept cases that would otherwise not be taken on due to the heavy burden and risk of disbursement costs"*
- *"take on more cases where liability isn't fully known and if it becomes apparent that a case should be discontinued [lawyers] can recover their disbursement costs"*

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It is a troubling message, essentially encouraging lawyers to take on cases they would not risk their own money on with the assurance that their clients' ATE policy will cover the risk. It is particularly attractive to lawyers who depend on high-volume client referral arrangements. Such scenarios are typically "all or nothing" deals wherein the acquiring firm has no discretion to accept or reject specific files, many of which are of questionable merit. ATE insurance covering the disbursements when the marginal cases are inevitably dismissed or abandoned has fueled this unfortunate practice. It also helps explain why the product has proven popular even amongst lawyers who rarely or never go to trial.

With an increasing number of insurers jockeying for market position, newer coverages are being offered under legal expense insurance policies with little discernable benefit for the actual plaintiffs. Examples include coverage for disbursements on transferred files that new counsel refuses to pay, as well as for claims dismissed as a result of counsel's own negligence. Again, these are not traditional plaintiff exposures, and lawyers who encourage their clients to consider buying such insurance, risk the appearance (if not the existence) of a conflict of interest.

It seems to be only a question of which insurer will be the first to cover notional legal fees on abandoned, meritless files.

The implications for the plaintiff bar may be far reaching. Contingency fee arrangements are facing intense scrutiny of late with a proposed Bill in Ontario seeking to significantly reduce the rate that lawyers can charge (to 15%). The justification for such arrangements has always been the mutual alignment of risk between counsel and client – risk to the lawyer not only in potentially uncompensated for time, but also in the disbursements incurred in advancing their clients' claims. Clearly, that equilibrium is altered when clients buy insurance which eliminates that risk.

It will likely fall to the courts to determine the ultimate impact of legal expense insurance on contingency fees as judges gain a better understanding of the product and certain policy features. This has already been evidenced in the evolution of the case law. The two most recent decisions at the time of writing involved court departures from the prevailing case law in (a) ordering a defendant to pay the plaintiff's insurance premium and (b) refusing disclosure of the insurance policy to the defendant. In *Jamieson v. Kapashesit*,[2] the court identified and accepted that a policy with the law firm as the insured was not subject to the same disclosure obligations as ATE policies where the plaintiff is the insured. At the same time, the court in *Armstrong v. Lakeridge Resort Ltd*[3] clearly and decisively rejected the existing cases which did not require the defendant to pay the legal expense insurance premium, noting that the coverage was instrumental in enabling the plaintiff's meritorious claim to proceed.

Meanwhile, natural market forces will likely also play a role in shaping the future of legal expense insurance in Canada. Like judges, defendants have developed a keen interest in the product and are increasingly demanding their costs even in the case of abandoned claims, particularly where they have access to the details of a plaintiff's policy. How long can insurers offering the above noted features withstand claim activity levels that have already caused one of the early insurers on the scene to increase its premiums by over 50%?

As these and other issues are inevitably resolved in the normal course of a market finding its legs, what can lawyers do to avoid the fallout while preserving the many benefits that legal cost protection can offer?

- To avoid a conflict, lawyers can acquire legal expense insurance specifically covering disbursement risk on their own account, with counsel as opposed to plaintiff as the insured, leaving the option of adverse cost coverage to individual clients.
- Lawyers should fully consider the actual cost protection needs for both themselves and their clients when determining the appropriate coverage. True to the product's origins, an increasing number of lawyers are electing to waive coverage for dismissed or abandoned

files, reserving it exclusively for adjudicated losses. Eliminating superfluous coverage reduces the risk to the insurer and premiums accordingly.

- Where coverage for abandoned or dismissed actions is required, counsel should consider a policy which restricts coverage to less than 100% of disbursement exposure in those scenarios – maintaining a risk-sharing alignment between counsel and client.
- If premiums are to be borne by the plaintiff, avoid policies which require coverage to be acquired at retainer or shortly thereafter. The decision to acquire legal expense insurance should coincide with pleadings when adverse cost exposure materializes and not before.
- Where blended adverse cost and (own) disbursement coverage is obtained under one policy, the apportionment and/or prioritization of each in the event of insufficient coverage for both should be set out clearly (irrespective of who pays the premium). A recent case wherein plaintiffs' counsel "claimed" the entire $100,000 limit of a client's ATE policy for their own disbursements while leaving the plaintiff fully exposed to the large outstanding adverse cost award has highlighted this problem.
- Choose an insurer with the most flexibility in their coverage options. Legal cost risk varies – by cost jurisdiction, by claim type and for each individual claim as it proceeds towards trial. Legal expense insurance must be responsive to these variations to be effective.
- Avoid providers who offer a "one size fits all" approach of standard coverage for all clients from the outset.

In its relatively short existence here in Canada, legal cost protection in its various incarnations has helped restore balance to a legal system that unfairly favours institutional defendants with their virtually limitless pockets. The market is now at a crossroads. What originated as an access to justice tool insulating plaintiffs from their personal financial exposure at trial is evolving into a risk reduction vehicle predominantly protecting plaintiffs' counsel. Much of the blame lies with ATE insurers who misappropriated the product's original design, adding alluring but poorly-considered selling features which upset the traditional risk-sharing balance between counsel and client. Without correction, these changes threaten to harm the very market the product was intended to serve.

With the market now well into its adolescence, and participants now offering a variety of terms and features, it is important for the legal community to take a step back to consider their options before deciding which path to choose.

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NOTES

[1] While legal cost indemnities are still offered in class action litigation by both third party commercial providers and publicly supported Class Proceedings Funds, all cost protection arrangements for personal injury litigation must now be provided as a regulated insurance product.

[2] *Jamieson v. Kapashesit* et al. 2017 ONSC 5784

[3] *Armstrong v. Lakeridge Resort Ltd.*, 2017 ONSC 6565