Professional Negligence and Poor Record Keeping

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This column was inspired by real cases experienced by the office of the syndic. Its purpose is to make you reflect on your practice in light of your ethical obligations.

What follows is a simple story, but it could happen to you or to the firm where you work. In this case, it should be noted that when the representative appeared before the discipline committee, he argued in his own defence that even though he had made a mistake, he had not intended to harm his client and had always acted in good faith. The discipline committee nevertheless found him guilty.

The Complaint

The president of a condominium corporation complained to the syndic's office that his representative had notified him, after the expiry of the insurance contract, that the building's insurance had not been renewed by the insurer of the risk, thus leaving the corporation without insurance coverage.

The Facts of the Case

The investigation that followed revealed that after inspecting the risk, the insurer notified the firm in writing in February that the insurance contract would not be renewed when it expired the following December, essentially due to the risk situated next door to the corporation, a residential building of seven condominiums held in undivided co-ownership.

Confident that he would be able to easily place the risk elsewhere upon its expiry, the broker did nothing and the notification was filed away. In keeping with normal procedures, 75 days before the expiry date, the file was taken out for processing. The firm representative responsible for processing renewals contacted the insurer and learnt that the risk had been inspected the previous year and was not going to be renewed due to the risk next door. After trying to change the insurer's mind, the representative set about trying to find a solution to the problem by contacting a number of other insurers and notifying the firm manager, who was also the representative in charge of the client's file.

Two weeks before the expiry date, and still without a contract, the firm's employee gave the file back to the representative responsible for it. The representative contacted the insurer of the risk and requested a one-week extension of the contract. The request was refused and it became urgent to find a new contract. A few days after the contract expired, the representative contacted the insureds and offered them a policy from the non-standard market with an extremely high-premium. The insureds refused the policy, however the representative did not explain to them their predicament. Since it was impossible to find an insurer on the standard market, the representative wrote a letter to the president of the condominium corporation informing him that he would be terminating his mandate. At that point, it had been ten days since the contract had expired.

Realizing that their building had already been uninsured for several days, the insureds found themselves faced with a "fait accompli". The new president of the condominium corporation did not know the exact renewal date, but had been expecting that his representative notify him concerning his insurance coverage in a timely manner.

The Formal Complaint

I filed a formal complaint before the discipline committee against the representative who was both in charge of the insured's file and the firm's manager. Although the complaint included four charges, I would like to discuss with you the committee's ruling regarding charges 1 and 3 of the complaint.

The first charge against the representative was failing to report to his client in a timely manner (in other words, between February and December) the fact that the insurer had refused to renew the policy. The third charge against the representative was that of having been negligent in his record keeping by failing to note in the client's file all the steps or actions taken or failing to ensure that the firm's employees did so.

The Discipline Committee's Ruling of Guilt

Two reasons in particular led the committee to find the representative guilty. First, the representative declared that he did not feel obliged to notify his client that the insurer had refused to renew the policy; and second, the fact that he felt he was acting in good faith, since he believed he would be able to place the risk elsewhere with little difficulty. The committee noted that *"the respondent's employees' or partners' inability or negligence with respect to placing the risk elsewhere in a timely manner do not constitute a valid defence. In fact, according to the legislation and the regulations, the representative takes ethical responsibility for the actions of his employees."*

The committee also handed down a guilty verdict on the third charge since *"the client-file did not contain all the telephone conversations that he had had with the insured and, in particular, it did not contain any summary of the steps taken to obtain a new insurance policy."*

At the hearing to impose sanctionary measures, I explained to the committee members that in keeping with proper professional practice with respect to making notes in the client's file[1], **all actions taken in the file, as well as all conversations with various individuals and advice given to insureds must be recorded in said file in an orderly manner, including noting the date the action took place, such that this information might be used by a firm employee other than the one who made the notes.**

In its sanction decision, the discipline committee commented with some severity on the offence relating to record-keeping, adding that *"it was the respondent's duty, as manager of the firm, to set an example for his employees in addition to ensuring that they kept their files in accordance with the provisions of the legislation"*.

[1] To find out more, please read the procedure for keeping client-files and notes in the file, available in french only, on the ChAD's website at **www.chad.ca**, In the "Members" section, go to "My Professional Practice" and then click on "Tools and Best Practices".

To Defend or Not To Defend: That is the Question!

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What is the scope of an insurer's obligation to defend its insured in the context of civil or professional liability proceedings, if the insurance policy only covers part of the acts or omissions alleged in the proceedings?

The Québec Court of Appeal answered this question in a judgment rendered on April 29, 2008 in the matter of *Groupe DMR Inc. v. Kansa General International Insurance Company Ltd.*[1]

The Facts

Group DMR Inc. ("DMR"), a company specializing in computer technology, was hired in 1985 by Groupe Promutuel ("PROMUTUEL") to implement various computer systems. DMR was insured under a professional liability insurance policy issued by KANSA. The project could not be completed in the timeframe or at the cost originally contemplated due to DMR's lack of familiarity with the insurance sector and PROMUTUEL's lack of familiarity with the computing sector. In September 1987, PROMUTUEL terminated the contract. DMR then claimed $1,553,367 from PROMUTUEL for breach of contract and unpaid fees. In February 1988, PROMUTUEL claimed damages of more than $4,000,000 from DMR.

KANSA assumed the defence of DMR, but reserved the right to withdraw if the investigation revealed the absence of coverage. In the spring of 1993, after PROMUTUEL amended its declaration, KANSA ceased to defend DMR on the ground that the facts alleged were not covered. DMR then instituted an action in warranty against KANSA, alleging that its withdrawal constituted an unjustified, unlawful and abusive decision. As for KANSA, it initiated winding-up proceedings under the *Winding-up and Restructuring Act* (the "Act"). In April 1999, PROMUTUEL and DMR arrived at a settlement, after KANSA had refused to participate in the discussions. On March 15, 2000, DMR filed a motion under section 135 of the Act, estimating its claim against KANSA at $4,271,033, namely, the reimbursement of the amount paid to PROMUTUEL ($1,500,000), the fees incurred to defend itself and damages for unjustified refusal.

The Judgment at First Instance

On August 5, 2004, the Superior Court dismissed DMR's motion and allowed KANSA's contestation. The judge stated that DMR had not committed a professional fault and that KANSA had therefore not been required to assume its defence.

Subsidiarily, the judge added that DMR was not entitled to reimbursement of the $1,500,000 paid to PROMUTUEL, because this payment had been made without KANSA's approval, such that the transaction could not be set up against KANSA by reason of the provisions of article 2504 of the Civil Code of Québec and of the policy.

The Judgment of the Court of Appeal

A) The Insurer's Obligation to Defend

The Court first pointed out that there is a distinction between the obligation to defend and the obligation to indemnify. With respect to the obligation to defend, the Court stated: [TRANSLATION] *"In fact, it arises from the mere possibility, which results prima facie from the allegations in the principal action and in the exhibits alleged in support thereof, that the insurance policy covers the alleged acts or omissions, while the obligation to indemnify is triggered only if the alleged acts or omissions are proven during the trial on the merits."* Four situations may then arise:

1° The claim seems to be totally covered by the policy. In such a case, the insurer must defend its insured, without the possibility of a recourse against the insured if the facts alleged are subsequently not proven.

2° It is clear that the alleged facts do not fall under the insurance coverage. In such a case, the insurer cannot be forced to defend its insured. If, subsequently, the facts introduced into evidence raise the possibility of coverage, the insured may once again ask the insurer to assume its defence, unless it prefers to proceed by way of an action in warranty or a recursory action against the insurer for the costs incurred in its own defence.

3° It is impossible to determine whether or not the claim is covered by the policy. In such a case, the insurer will have to defend its insured, because, at this stage, the mere possibility that the claim is covered is sufficient. However, the subsequent discovery of facts resulting in the exclusion of coverage could terminate the obligation to defend.

4° Part of the claim is covered, while another part clearly is not covered. In such a case, the insurer has the obligation to defend only with respect to the claim that is covered, and the insured must see to its own interests as regards the rest. If the insurer accepts, without prejudice, to defend the entire matter, the costs of the defence will be shared between the insurer and the insured, because the lawyer will be acting under two separate mandates. However, the insured will also have the right to designate its own lawyer for the portion that is not covered, and this lawyer will act as counsel. Nonetheless, it will be necessary to avoid creating an additional burden on the opposing party.

B) The Effect Against an Insurer of a Transaction Entered Into Without Its Consent

The Court of Appeal declared that if an insurer refuses to participate in discussions after having been invited to do so, it cannot subsequently complain about a settlement entered into by the parties, insofar as the settlement is reasonable.

In practical terms, in the case at bar, the Court of Appeal ruled that the portion of the claim that was covered represented 28% of the entire settlement, such that it determined that the insurer was required to assume 28% of the costs of the defence.

[1] C.A. Montréal, 500-09-014829-048, 2008 QCCA 807, AZ-50488250.