The Pitfalls of Adverse Cost Protection

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The courts and litigants continue to grapple with the evolving implications of after-the-event insurance ("ATE insurance").

The Ontario Superior Court just recently released its decision in *Peter B. Cozzi Professional Corporation v. Szot*, 2019 ONSC 1274, which addresses the issue of how such funds are to be distributed following an award of costs against an unsuccessful plaintiff at trial.

The underlying trial decision in *Cozzi* resulted from a personal injury matter. The plaintiff was awarded non-pecuniary damages for pain and suffering, but for an amount less than the statutory deductible. After the deductible was applied, the plaintiff's net recovery at trial was nil.

Furthermore, the trial judge ruled that the plaintiff's injuries did not exceed the threshold for recovery of non-pecuniary damages, and ruled that the plaintiff could not recover such damages in any event.

The defendant at trial was awarded costs against the plaintiff.

The plaintiff had in place a policy for ATE insurance. The insurance contract set out that it would cover the plaintiff for up to $100,000 in the event of an adverse costs award.

The policy also covered the plaintiff's own disbursements, payable again in the event of an adverse costs award. The policy set out that the proceeds of the insurance would be paid to the plaintiff.

The plaintiff's retainer agreement with his lawyer was a contingency fee-type agreement. One term of the retainer agreement was that the plaintiff agreed to pay all disbursements incurred by the plaintiff's lawyer in relation to the matter.

The retainer agreement included an assignment by the plaintiff of the proceeds of his ATE insurance to his counsel for the purposes of paying for the incurred disbursements.

The wrinkle in *Cozzi* is that the plaintiff was at all material times under a disability, including at the times when he executed the retainer agreement and various addendums to the retainer agreement.

Plaintiff's counsel at no time had the plaintiff's litigation administrator present when he executed the retainer agreements or addendums, including the assignment of his insurance benefits to his lawyer.

After being notified of the adverse costs award, the plaintiff's insurer, DAS, wrote to the plaintiff personally to advise that it would be paying out the proceeds of the policy to his lawyer, in trust.

After trial, the insurer for the tort defendant brought an application seeking an order that the proceeds of the policy are payable to the defendant in full, or in the alternative, on a pro-rata basis with the plaintiff's disbursements.

Plaintiff's counsel at the same time brought an application seeking an order that he was entitled to the insurance proceeds, based on the assignment by the plaintiff.

The court denied both applications, ruling that the funds belong to the plaintiff himself.

The court ruled that the assignment and retainer agreements were not valid, due to the plaintiff's disability, that the defendant's insurer had no privity of contract, and thus had no claim to priority over the proceeds.

Effect of Ruling

This is an unfortunate ruling for individuals who bring personal injury actions in the future.

One may be inclined to regard a ruling which grants agency over the proceeds of ATE insurance policies to the policy holders themselves as a win for those individuals.

However, the fact of the matter is that most members of the public are not aware of the legal implications of signing retainer agreements with their own lawyer, some of which may include assignments such that those at issue in *Cozzi*.

For a plaintiff who is the subject of a failed personal injury action, there is often a risk of personal exposure to adverse costs awards.

This is true whether or not the plaintiff has in place ATE insurance, because the cost consequences of even a short trial on a partial indemnity basis will typically exceed the insurance available to the plaintiff.

So, an unsuccessful plaintiff faces the prospect of the tort defendant's insurer seeking its remedies against this individual personally. If a plaintiff has assets, then the best protection against personal exposure is to hope that tort defendant's insurer avoids pursuing the plaintiff.

Insurers will avoid seeking personal recovery where the expense is too high compared with the potential payout at the end of the day. In other words, if the tort insurer is only entitled to a further $20,000 in costs, then it may not be interested in spending $10,000 on the chance of recovery.

If a plaintiff provides an assignment to her lawyer, however, for the proceeds of her ATE insurance, then that erodes that protection against personal exposure.

Suddenly it is worthwhile for the tort defendant's insurer to attempt to enforce the costs award, because the plaintiff spent a portion of her coverage on her own disbursements before paying out to the defendant. A tort defendant's insurer may be interested in spending $10,000 to pursue the plaintiff, now that the payout is $60,000.

The response to the above often comes as a variation of the following: that unsuccessful plaintiffs are aware that they owe money in disbursements and the opposing party's costs, and have insufficient insurance to cover both.

Individual Choice

Should it not be up to an individual to decide what should be paid first and in what quantities?

Answering 'no' to that question may smell of paternalism, but the fact is that individual plaintiffs are unfamiliar with the balance of risk when it comes to personal exposure following an unsuccessful trial.

They are inclined in these circumstances to turn to their own lawyer for advice, and may not be aware that their own lawyer has conflicting interests; as in *Cozzi*, a plaintiff's own lawyer has a clear interest in ensuring that disbursements incurred by the plaintiff and paid by or promised by the lawyer's office are paid by the plaintiff in full.

Furthermore, most retainer agreements specify that all disbursements incurred throughout the course of a file are the plaintiff's disbursements, rather than the lawyer's disbursements.

As such, it is unlikely that a court would permit a plaintiff's lawyer from seeking to recover from the plaintiff by way of an action or application, amounts for outstanding disbursements.

The result is that an unsuccessful plaintiff is faced with the option of directing her insurance proceeds to paying the defendant's costs, with effectively no risk of being pursued for unpaid disbursements, or paying her disbursements, with an increase in personal exposure to the tort defendant's insurer.

Put this way, it is very hard to understand why a plaintiff would sign an assignment of the kind seen in *Cozzi*.

If a plaintiff has indeed been properly educated by her lawyer on the risks to both options, why would she not choose the option that comes with less risk of personal exposure?

Assignments such as the one seen in *Cozzi* strongly suggest that lawyers are not properly and objectively educating their clients on these risks.

Increase in Personal Exposure

From a public policy perspective, the ruling in *Cozzi* is unfortunate for individual plaintiffs.

While some may laud the court standing up for the autonomy of individuals in choosing how they may disperse their own insurance proceeds, the reality is that most individuals, when left only with the legal advice of their own conflicted lawyer, will be led to choose the path that actually increases their personal exposure.

The *Insurance Act* does allow for a party to seek damages directly from another party's insurer (section 132), but this is limited to situations in which the damages sought arise from personal injury or damage to property. This would likely not include an action or application for costs.

As a result, the court in *Cozzi* is likely correct in finding that there is no privity in contract for a tort defendant's insurer in cases like this, and that successful defendants have no recourse to section 132.

Lawyer as Broker?

There are avenues, however, that future courts may take to protect individual plaintiffs where they face personal exposure as a result of a retainer agreement that includes an assignment.

Given that the court in *Cozzi* found that the contingency fee agreement and assignment between the plaintiff and his lawyer was of no force and effect, there was no need for the court to address the potential conflicts at issue where a lawyer in effect uses a retainer agreement to obtain priority of protection over the plaintiff's own increased risk exposure.

This is a conflict that could, in other circumstances, cause a court to question the enforceability of a retainer agreement. This conflict is even more pronounced if, as in *Cozzi*, the lawyer is also an "insurance intermediary."

Separate business agreements are commonly in place between plaintiff lawyers and after-the-event insurers.

The plaintiff's lawyer in *Cozzi* had entered into such an agreement with the insurer, DAS, the effect of which was to make the plaintiff's lawyer an "insurance intermediary," and to provide authority to the lawyer to issue insurance to the lawyer's clients.

The court in *Cozzi* did not examine the implications of the term "insurance intermediary," but in general parlance this position can best be compared to that of an insurance broker: a third party who is neither an insurer nor insured, and who acts in the placing and purchasing of an insurance policy, and who is authorized by the insurer to place such policies, often through delegated authority.

There is robust case law outlining the obligations of insurance brokers vis-a-vis their client insureds.

Much of the analysis in broker's negligence cases focuses on the duty owed by brokers to explain in sufficient detail to the insureds the choices available to them, the implications of policy exclusions and coverages, and to disclose issues of transparency regarding the fees and relationships that the broker has with the insurers for whom they are placing policies.

One may question to what extent lawyers who are acting as "insurance intermediaries" for ATE insurers are meeting these standards. Is it typical practice for such lawyers at present to, for example:

- explain that there is a business relationship between the lawyer and the insurer, and provide the details of that relationship;
- advise of other similar insurance products available from other ATE providers;
- explain that the proceeds of the insurance belong to the individual, and not to any other party, including to the lawyer;
- explain the personal conflict or potential conflict to the lawyer on the issue of disbursements; and most importantly,
- explain the implications of the individual's choices on her personal exposure to a tort defendant (as compared with the absence of such exposure by not paying disbursements), and how agreeing to an assignment with the lawyer may impact that exposure.

Perhaps there are lawyers who ensure that the above information is explained in detail to their clients. It is hard to understand the assignment in *Cozzi*, however, in the context of the plaintiff having been explained all of the above.

Security for Costs

Another impact of the *Cozzi* decision relates to the ability of plaintiffs to oppose motions for security for costs.

One line of case law that has developed recently stands for the proposition that if a plaintiff has a valid after the fact insurance policy, this can be a full answer to concerns by a defendant seeking security for costs.

The argument went that a defendant need not be concerned about not recovering costs from a plaintiff ordinarily resident in a jurisdiction other than Ontario, if that plaintiff has in place ATE insurance. This policy, the argument went, would cover all or some of a defendant's costs in the event that the defendant is successful at trial.

The *Cozzi* decision undermines that argument. It should be clear now that a defendant has no right to the proceeds of the policy; all a defendant would have following a successful trial is an order for the recovery of costs.

The proceeds of an ATE insurance policy belong solely to the plaintiff, and can be disbursed at the plaintiff's whim. There is nothing to stop a plaintiff, for example, from assigning her rights to the proceeds of that policy to her lawyer to cover disbursements, and even incurring the full value of the policy in disbursements.

It can be expected that defendants bringing motions for security for costs will rely on the *Cozzi* case to rebut any presumption that after-the-event insurance provides any assurance of recovery to the defendant.

Conclusion

The development of the case law on ATE insurance could be seen as a win for the autonomy of individual plaintiffs.

Adopting this interpretation, however, requires faith that lawyers are transparently and fully explaining to their clients the implications of their choices on this issue. The facts in *Cozzi* at the very least call into question such optimism.

Absent a fuller acknowledgment on the part of lawyers and the bench of the conflicts involved with ATE insurance, the *Cozzi* decision should be seen as one that will hurt future plaintiffs.