Indemnity Provisions in Outside Counsel Guidelines: A Tale of Unintended Consequences

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Client outside counsel guidelines ("OCGs") have been in existence for over a decade, but they are taking on increasing significance as more corporate and financial institution clients develop broad forms of OCGs and adopt policies requiring them for all outside counsel engagements. We provide an overview of the factors underlying the rise of OCGs generally and then discuss how OCGs, and particularly the provisions commonly included in OCGs that require law firms to indemnify clients, actually threaten the professional independence of lawyers and law firms and, more broadly, of the legal profession as a whole. After assessing the potential and real impact indemnity provisions in particular may have on both the lawyers and firms that agree to these provisions and on the clients who seek to include them, we conclude with some modest proposals for developing a dialogue with clients to address their concerns and satisfy them that indemnity provisions may negate the result they seek and in the long run be as harmful to the client as to outside counsel.

I. Background—The Rise of Outside Counsel Guidelines

A. The Balance of Power between Attorneys and Their Clients Has Changed

With little fanfare, we have arrived at a paradigm shift in the relationship—and the balance of power—between lawyers and their clients. Historically, even in relation to large institutional clients, in both appearance and fact the relationship was—and was seen by all the participants as being—one-sided, with the power being uniquely in the hands of the lawyer. Traditional lawyer regulation in both the United States and in England assumes that clients require protection from overreaching by their all-powerful attorneys.

This protection of client interests is manifested with particular clarity in the rules in the United States prohibiting or severely restricting the right of lawyers to limit their liability to clients, and the rules in both England and the United States governing conflicts of interest. In both sets of rules, the strong presumption is that clients should be protected from lawyers who, in the absence of these rules, may be expected to take unfair advantage of their clients. Even where conflicts may be waived or liability limited, the lawyer bears the duty of establishing a valid and effective waiver.

Until recently, the lawyer had the upper hand in the attorney-client relationship. If a client wanted top-notch legal services, it would have to pay what the lawyer asked and follow the lawyer's protocols for staffing and handling the matter. This has changed dramatically, as Outside Counsel Guidelines have evolved in the span of a few short years from a novelty to the norm, and from billing directives to all-encompassing terms of engagement.

B. Enter Comprehensive—And Often Inapposite—Outside Counsel Guidelines

How did this come about? Although outside counsel power may have begun to wane in the 1980s and 1990s as both the quantity and quality of in-house counsel increased, the real catalyst for change in the balance of power was the world-wide recession commencing in 2007. What had been reliably high demand for outside law firms to assist in strategy, paper cutting-edge deals and represent clients in huge litigations began to drop precipitously. Certain practice areas were busy (bankruptcy and workouts being obvious examples), but many practice areas simply dried up and went away.

This change in the balance of supply and demand for legal services was accompanied by the fact that, even within corporations, lawyers were losing power—a process that seems to continue in some companies. In-house general counsel have their own independence issues, also arising largely from their employer organizations' desire to manage and reduce legal costs. As a result of cost reduction efforts and expanded oversight, corporate general counsel have increasingly lost their autonomy in selecting and setting terms with outside counsel. Corporations are understandably responding to pressure from shareholders and boards, and as a direct result CFOs demand further expense reduction from outside counsel.

Experiencing the economic pinch and pressure from above, corporate legal departments eyed outside legal spend as a place to cut costs. In addition, inside counsel took advantage of the opportunity to impose some of their own rules on the outside counsel relationship and shift the balance of power, thus limiting outside counsel's independence.

Another way organizations handled the cost issue was to assign the documentation of the outside counsel hiring process to the procurement or purchasing department. After all, these are the people who hire other "vendors." To make the process more manageable internally, and therefore less expensive, uniformity is required. Accordingly, as corporate purchasing of law firm services moves within the purview of the client's procurement function, and away from the exclusive control of corporate general counsel, law firms tend to be treated as just one more in a line of vendors, with no differentiation between the supplier of paper clips and the provider of sophisticated legal services. This move towards uniformity of terms on the part of corporate clients is often reinforced by pressure from governmental regulators. Regulations frequently require that a company's vendors comply with the same regulations that govern the company (for example, Health Insurance Portability and Accountability Act mandates and data security, labor/employment, and anti-discrimination laws).

The resulting OCGs inevitably reflect this drive toward uniformity, often including provisions that, although standard or even desirable in other contexts, create significant problems for lawyers and law firms. Today, OCGs routinely presented to law firms by their corporate clients require that the firms agree to terms of engagement that are both comprehensive in nature and, in some cases, extraordinarily onerous.

C. The New Norm—Outside Counsel Guidelines as Comprehensive Terms of Engagement

Today, typical OCGs encompass all of the essential ingredients of the attorney-client relationship, from what constitutes a conflict (often in the client's definition—such as clauses that define working for competitors even in unrelated matters as a conflict—far exceeding the lawyer's obligations under the applicable Rules of Professional Conduct), to billing protocols (regarding the amount of and format of invoices, audit and payment terms), to staffing of matters (how many lawyers? what level?). Examples of other areas of law firms' activities encompassed by OCGs include compliance with the clients' internal policies (which often bear no relation to the practice of law), data protection protocols, and so on. The assumed need for uniformity also seems (to the clients) to require that indemnity provisions that apply to their other vendors should be applied as well to law firms.

It is thus apparent that OCGs may raise serious issues of lawyer independence and the ability—or even the availability—of a lawyer to provide competent legal services. For instance, although an expanded definition of conflicts may give the client the upper hand in the short term, it is unlikely that the client imposing such a definition has considered what impact this type of provision, entered into with a different client at a different law firm, could have on its own ability to hire its desired law firm for a particular matter.

Many OCG provisions have raised concerns among outside counsel. Even the largest, most powerful, and most profitable law firms often find themselves in the position of having to accede to some or all of a client's OCGs in order to receive coveted legal work. But unquestionably the most troubling manifestation of this change in the balance of power between law firms and their clients, and of paramount concern, has been the now commonplace demand requiring the outside lawyer or law firm to indemnify the client for anything that goes wrong in the engagement, often regardless of whether the lawyer was in any way responsible for or even involved in what went wrong. The indemnity provisions included in these "one-size-fits-all" OCGs may make sense when the vendor is a building services contractor, but they can have chilling consequences when applied to law firms. Notably, these indemnity provisions have not only kept law firm general counsel and risk managers awake at night but have also attracted the attention of law firm insurers faced with a new category of risk they have not bargained (or budgeted) for. Significantly, these terms, if accepted, also have the real potential to carry equally significant negative consequences for the clients themselves.

D. The Threat to the Independence of Lawyers and Law Firms Has Attracted Regulators' Attention

Even professional regulators are taking notice of the change in the balance of power between attorneys and their clients represented by OCGs generally, and indemnity provisions in particular. In a remarkable independent research paper commissioned by the Solicitors' Regulation Authority ("SRA") in Eng-

land and published late in 2015, the implications of this change for one of the cornerstones of the common law and constitutional legal systems in both England and the United States—the professional *independence* of lawyers—are closely examined.[2] That paper, referred to here as Smith & Vaughan, although not reaching definitive conclusions on this underlying issue, demonstrates expansively and with clarity the degree to which even major global law firms are under enormous pressure from clients to agree to terms and conditions of engagement that dramatically limit their freedom of choice, both within the engagements themselves and in terms of who they may—or may not—accept as clients, and under what circumstances.

In addition to the other OCG provisions described above, Smith & Vaughan found that a majority of firms reported that indemnity requests were "becoming commonplace."[3] Financial and public sector clients were the most likely to seek "wide-ranging indemnities." Notably, Smith & Vaughn found that despite objecting with varying degrees of success, many firms in the end agreed to indemnify their clients. Given the widespread inclusion of indemnity provisions in the OCGs presented to their lawyers by institutional clients, among the more troubling responses of firms surveyed for the paper were from firms that apparently "inadvertently agree[d] to indemnity clauses without properly reviewing terms." It is not far-fetched to assume that a survey of law firms in the United States would yield a similar result.

According to the Smith & Vaughan study, and anecdotally in our own research, indemnification provisions are widespread in the financial services industry and with public sector clients. These client groups were among the first to adopt indemnification provisions for vendors, often to protect against third-party bodily injury and property damage claims caused by vendors' products or services. And these sectors have been the most aggressive in expanding those indemnification provisions to law firms, despite the seemingly obvious differences between a law firm and a provider of paper clips, or plumbing or other services.

II. Implications of Indemnity Provisions

For the reasons that follow, it seems clear that corporate clients have not given appropriate thought to the potential harmful effect these provisions may have on the clients themselves.

Below is an example of an indemnity provision contained in a set of OCGs.[4]

> Outside counsel will indemnify, defend (with counsel satisfactory to the client) and hold harmless the client and all of its current or former officers, directors, employees, successors and assigns (each, a "Client Indemnified Person") from any and all losses, liabilities, damages (including taxes), costs and expenses, including without limitation reasonable legal fees and disbursements and costs of investigation, litigation, settlement, judgment, sanctions imposed by a court or any governmental body, interest and penalties (collectively "Losses") due to, arising from or relating to third party claims, demands, actions or threat of action (whether in law, in equity or in an alternative proceeding and whether groundless or otherwise) arising from or relating to: 1) any breach or violation of any term or condition of the Outside Counsel Guidelines, or any other instructions or directions provided by the client to Outside Counsel, or any ethical or professional obligations, by Outside Counsel or any Third Party Service Provider used by Outside Counsel, or any persons acting at the direction of Outside Counsel in the course of providing services to the client; 2) any lien or security

> interest on or against property or realty of the client that arises from any action or inaction by Outside Counsel or any Third Party Service Provider used by Outside Counsel in connection with providing services to the client, or any persons acting at the direction of Outside Counsel; 3) the negligent, willful or reckless acts or omissions of or by Outside Counsel or any Third Party Service Provider used by Outside Counsel in connection with providing services to the client, or any persons acting at the direction of Outside Counsel, or failure to comply with Applicable Law by the same in connection with the performance of services on behalf of the client; or 4) death, personal injury, bodily injury or property damage caused by Outside Counsel, or any Third Party Service Provider used by Outside Counsel, or any persons acting at the direction of Outside Counsel, in connection with the performance of services on behalf of the client ("Client Indemnified Claim").

Although this clause is among the most egregious (some would say outrageous) indemnification provisions we reviewed, we saw a variety of others that, to a greater or lesser extent, seek to reach the same result. Such a clause raises serious issues and potential consequences for any law firm that accepts it. [5]

A. Becoming a Guarantor of Outcomes and the Acts of Third Party Providers

This clause, and others like it, appear to establish lawyers as the guarantors to the client of the representation's outcome. It is not an extreme interpretation of this clause to say that if the client suffers any injury because of the lawyers' services—without regard to whether the services provided were proper, appropriate, adequate, or competent, or whether the law firm was even the cause of or actually responsible for the injury—the law firm will indemnify the client. Accordingly, this first aspect of the clause effectively makes the successful outcome of the engagement a contractual obligation entirely without reference to any "error or omission" that would even trigger a malpractice insurance policy, leaving the law firm to bear the entire burden of the obligation. From an insurance coverage perspective, this provision could make the firm liable for outcomes that have arisen from entirely non-negligent acts in the course of providing legal services.

The provision goes even further. It is so broadly worded that a law firm agreeing to this or a similar provision creates an argument that it has guaranteed that the client will not suffer injury from third party providers engaged in connection with the firm's legal services—irrespective of whether the law firm or the client selected the provider, or whether the law firm even had the power to supervise and oversee the provider. A short example illustrates the overreaching of this clause. Assume that a law firm is hired by a condominium developer to represent the condominium as seller of units and handle all related work from pre-contract through closing. A potential buyer will in all likelihood seek an inspection of the property, which is usually scheduled by the lawyers for the parties. If the seller's lawyer asks the builder to be present at the inspection, and she trips and injures herself, the wording of this clause requires the lawyer to indemnify the client. This is absurd.

B. Creating Conflicts and Changing the Role of the Lawyer

Rendering the lawyer and law firm responsible for all outcomes fundamentally changes the role of the lawyer and poses a thorny conflict. A lawyer's overall obligation in any matter is to represent the interests of the client competently and use her knowledge and skill to achieve the client's goals. An indemnity provision by its nature brings different considerations to the representation. The lawyer may find

herself analyzing two proposed courses of action (each of which is good for the client and represents a reasonable exercise of the lawyer's knowledge and skill) based not on which is best for the client, but on which is less likely to result in some loss to a third party for which the client might seek indemnification. To say the lawyer in this situation is conflicted is an understatement. And the client is not well served in these circumstances, either.

C. Malpractice Insurance Implications

The lack of insurance coverage for a large claim arising from a client's attempt to enforce these guarantees self-evidently threatens the law firm's financial stability and perhaps its very existence. But even as to claims under these provisions that might ordinarily be covered under firms' Lawyers' Professional Liability ("LPL") insurance policies, these clauses actually put that coverage at risk.

1. Liability for Acts not Covered by the Policy

Professional liability insurance is designed to protect the law firm from claims arising from negligence in providing professional services to a client. When drafted broadly, like the example above, and as most are, an indemnity agreement significantly expands the lawyer's liability to the client. Absent the indemnity agreement, the lawyer would be liable only for its negligence, and would have insurance coverage for that liability. Through an indemnification provision, and even aside from whether it constitutes a guarantee of outcomes, the law firm may be agreeing to become liable for all kinds of client losses that do not result from the firm's legal negligence, or that of its lawyers. Thus, by contracting to increase their exposure and accepting responsibility for uninsured liabilities, lawyers may create a serious coverage gap. The insurer is not a party to the client indemnity contract and presumably has not agreed to the expanded exposure. In fact, malpractice policies typically exclude coverage for obligations arising under contract.

2. Loss of Insurance Coverage that May Otherwise Exist

Apart from uninsured liabilities, of equal if not greater significance are the problems indemnity provisions create with respect to attempts to assert the indemnity for an alleged negligent act that a law firm may ordinarily expect to be covered by its LPL policy. In order to understand the interplay of typical LPL policies with these indemnity provisions, and why these provisions may prevent the law firm from receiving the insurance coverage that would be available but for the indemnity provision, we have identified three possible elements of those policies that may be implicated by the existence of the indemnity provisions. Here is language taken from a typical policy:

> "IV. EXCLUSIONS
>
> This Policy does not apply:
>
> . . .
>
> D. Contractual Liability

> to any **claim** on or arising out of an **Insured's** alleged liability under any oral or written contract or agreement, unless such liability would have attached to any **Insured** in the absence of such agreement;
>
> . . .
>
> V. CONDITIONS
>
> . . .
>
> E. Assistance and cooperation of the **Insured**
>
> 1. The **Insured** shall cooperate with the **Company** and, upon the **Company's** request, shall attend hearings and trials and shall assist in effecting settlements, securing and giving of evidence, obtaining the attendance of witnesses, and the conduct of suits and proceedings in connection with a **claim.**
>
> 2. The **Insured** shall assist in the enforcement of any right of contribution or indemnity against any person or organization who or which may be liable to any **Insured**in connection with a **claim.**
>
> 3. The **Insured** shall not, except at its own cost, voluntarily make any payment, assume or admit any liability or incur any expense without the consent of the **Company.**
>
> . . .
>
> H. Subrogation
>
> In the event of any payment under this Policy, the **Company** shall be subrogated to all the **Insured's** rights or recovery thereof against any person or organization. The **Insured** shall execute and deliver instruments and papers and do whatever else is necessary to secure and collect upon such rights. The **Insured** shall do nothing to prejudice such rights.

There are at least four ways in which these typical terms of the LPL insurance contract arguably may work to deprive a law firm of coverage under its LPL policy because of the very existence of an indemnification provision. Although these issues have not yet been taken up by a court and policy language differs, the risks certainly exist, and should be carefully considered.

(a) Policy Exclusions

Most policies exclude coverage for "damages by reason of assumption of liability in a contract or agreement," as exemplified in clause IV(D) above. But the indemnity is intended to, and does, precisely that. Indeed, the irony is that, by turning the recognized standard of care into a contractual obligation, the indemnity provision may abrogate coverage that would otherwise be available in the normal course.

(b) Violating the Cooperation Clause

Most policies include a provision requiring the insured law firm to cooperate in the defense provided by the insurer under the policy, as exemplified in clause V(E)(1-3) above. But an indemnity provision may violate the cooperation clause, since the obligations undertaken may require the firm to take steps to comply with the terms of the indemnity that, in the eyes of the insurer, impede the firm's—and the insurer's—ability and freedom to defend even claims that would otherwise be covered. For example, the indemnity may require the law firm to engage in mitigation of a loss which in turn may be deemed to involve an admission of wrongdoing, which may be viewed by the insurer as a breach of one or more of the terms of the insuring agreement set out above.

(c) Destruction of the Insurer's Subrogation Rights

Most malpractice policies require the insured law firm to assign any subrogation rights that may arise to the insurer, as exemplified in clause V(H) above. If the law firm agrees to contractual indemnification, the insurer may lose any subrogation rights it may have, either against the client or third parties.

(d) Uninsured Entities and Claims

OCG indemnity provisions contemplate lawyer responsibility for third parties. Although not directly addressed in the policy provisions set forth above, LPL policies do not cover such entities. Nor do LPL policies cover claims for sanctions or for punitive and exemplary damages. Nevertheless, many policies may cover the defense of those claims. An indemnity clause, depending on its terms, may give an insurer a reason to deny such coverage that would otherwise be available.

Finally, even aside from the threat to coverage these provisions create, many firms have large retentions on their policies. Even a nuisance suit under an indemnity clause could result in a significant out-of-pocket expense for a law firm. And insurers may argue that funds spent in responding to claims based on indemnity clauses should not be applied to claims under the policy even if it is eventually conceded to attach to all or some part of the claim.

D. Unintended Consequences for Clients

The downside of indemnity clauses for law firms is clear. Indemnity agreements potentially threaten law firms' existence. Because many engagements involve hundreds of millions or even billions of dollars, if the firm has no recourse to insurance, whether because of the nature of the claim or a denial of coverage by the insurer, all of a firm's assets may be spent in meeting the indemnity obligation and may still not cover the claim. Given an indemnity agreement and a sufficiently large matter, every engagement becomes a bet-the-firm proposition.

In addition to the possibility of financial disaster, the potential uninsured liability created by client indemnification agreements creates conflicts of interest among lawyers and within their law firms. The lawyer and the firm have two divergent interests at stake—to take in, perform and get paid for the engagement that is subject to the indemnification requirement, or to decline the engagement, thereby

avoiding the risks posed by the indemnity provision, but at the expense of a desirable client engagement. Because the potential exposure is so great, arguably this tension goes well beyond the ordinary questions that firms are accustomed to consider before accepting engagements.

Perhaps the most remarkable feature of these provisions is that they enlarge rather than reduce the potential harm to the client. By demanding such agreements, and thereby potentially depriving the law firm of the protection of the law firm's LPL insurance, the client may be left with significant uncovered losses. After all, law firms, almost all of which are limited liability ventures, do not have assets—other than their insurance policies—in anything near the scale that may be required to cover an indemnified loss. As noted above, lawyer negligence is covered by the standard LPL policy, while a contractual obligation is not. By demanding an indemnity clause, a client may negate the very protection it desires.

Clients may not understand that a law firm will in all likelihood not be able to negotiate coverage for liability undertaken in an indemnity clause. Insuring against lawyer mistakes is one thing. Insuring an open-ended obligation to everyone in the transaction or litigation is another and an obligation a prudent underwriter will likely not wish to assume. And any illusion that clients may have that law firms are wealthy entities that can shoulder the burden should have been dispelled by the spate of recent law firm failures. A client seeking to collect on a large indemnity amount could find itself trying to do so in bankruptcy court.

E. Enforcement Has Begun

A decision has been handed down interpreting and enforcing at least the duty to defend element of an indemnity clause in an "Attorney/Client Service Agreement," which the court refers to for short as the "Contract." The Contract appears to have been provided to the law firm by the corporate client and agreed to by the law firm, so that, in other words, it is a contractual form of Outside Counsel Guidelines. In Sephora USA, Inc. v. Palmer, Reifler & Associates, P.A.,15-cv-05750-JCS, (U.S.D.C. N.D.Cal, Order Denying Motion For Judgment On The Pleading filed May 13, 2016), the client sued the law firm pursuant to a claim made under the following provision:

> Section 5. Indemnification.
>
> Each party agrees to defend and indemnify the other party from and against any and all suits, judgments, or liabilities directly arising from the negligence or other improper conduct of such party.

The motion by the law firm for judgment on the pleadings (to dismiss the claim) was denied. The law firm's arguments focused on the proper application of Florida law as to whether, in the light of the facts of the underlying case for which the client demanded that the law firm pay its legal fees under the indemnity provision, the client had made out a claim either to be indemnified or to defend. In other words, the law firm did not assert any impropriety or overreaching with respect to the provision, merely that as written and on the facts it should not be found liable because the client hadn't pleaded a valid claim. The court found that, because of the law firm's duty to defend—which it analogized to an insurer's duty to defend under an errors and omissions policy—the client had properly pleaded a cognizable claim. Accordingly, the case will now move forward.

In the context of this article, the case is significant because it demonstrates that these provisions will be treated as valid and enforceable contractual agreements. While this is not surprising as a matter of law or common sense, it surely highlights the importance of considering what it is law firms are undertaking when they accept indemnity provisions as a term of their engagements.

III. Some Modest Proposals

What can law firms do to protect themselves—and ultimately their clients—against the increasing number of client requests for indemnity? There is no silver bullet. But there are steps a firm can and should take to ensure that it is not taking on an unmanageable and, worse, uninsured potential liability, at least not without considering its options carefully.[6]

A. Know What the Firm Has Agreed and Is Agreeing To

Because of the potential for disaster for both client and lawyer, one of the most troubling issues highlighted by the Coe & Vaughan study is the possibility (not necessarily surprising) that firms unknowingly agree to indemnify their clients. Because they appear in a variety of contexts, and may be seen only by partners wishing to introduce the business, indemnification agreements can be made despite being unknown to and unnoticed by the firm's management.

Notably, OCGs including indemnity clauses are inserted by some organizations in client-generated engagement letters. Other clients insert these provisions as part of a broader form in their requests for proposals ("RFPs"). RFPs are frequently contained in electronic documents that permit no modification, so even if the firm identifies an indemnification provision, no negotiation is possible. If the firm competes for the business, it may sign on to a set of risks and to an existential threat, with no ability to negotiate.

In some instances, clients insert an indemnification clause into the language of their management guidelines, which may only be provided by the client to the law firm after the engagement has commenced. Continuing the representation after receiving the guidelines may be asserted later by the client to constitute an acceptance of the indemnification clause.

Thus, the first step a firm should take, if it has not done so already, is identify what it has agreed to. To the extent that a firm has not previously kept careful records, it should collect what it has already agreed to (a good practice for all OCG provisions) and establish a database for informational purposes. This will enable a firm and its lawyers to have a baseline for future engagements. Many firms are already in the process of organizing this data.

The second step is to establish procedures to ensure that the firm does not unwittingly enter into such agreements in the future. Close oversight of the client intake process can improve firms' prospects of bringing these proposed arrangements to light before they are accepted. This responsibility cannot be left solely to the partners opening new matters. The firm's central risk management function must oversee the process. No OCG should be agreed to without review by the firm's general counsel or other risk

manager and, with respect to financial terms, the chief financial officer. Firms may want to consider being proactive and asking any corporate client it believes may be likely to have OCGs to present them up front.

These measures will also assist the firm in ensuring consistency in the arrangements it makes with its clients—or at least being aware of when it is not being consistent. It is not unheard of for a firm unknowingly to have different agreements with the same client, e.g., for fees, treatment of expenses, identity of client (are affiliates and subsidiaries included?) or indemnification. Entering into different agreements with a client is not necessarily a bad thing, but the firm should at least be aware that it has done so.

B. Educate Your Partners and Other Firm Personnel

Educating partners and other relevant firm personnel on the issues, and reminding them of their obligations to protect the firm's interests is obviously an important tool to support central review of OCGs. In addition to the potential liability risks, they need to understand that OCGs may sneak up on them, for example, in documents sent after the engagement has already commenced, and that anything of this nature received from the client must be sent immediately to the general counsel and whoever else is designated to review OCGs. Of course, as is always the case, firms may remain at risk from partners who deliberately ignore systems and policies intended to capture and review OGCs before they become binding, but a few training sessions should eliminate the partner who pleads ignorance.

These steps may not eliminate a "surprise" OCG, but they should serve to reduce their number and enable the firm to gain better control of the process.

C. Educate Your Clients

Leaving aside the necessity of negotiating OCGs with the client on a case-by-case basis (discussed below), firms should undertake a concerted effort to explain to their clients why the indemnity clause not only is detrimental to law firms, but also may undermine the very protection clients seek, for all of the reasons set out above. Whenever possible, this is not a conversation that should occur only when a matter is about to begin—when lawyers are anxious to take on the work and clients may take the matter elsewhere. Rather, it should occur when there is less urgency and should include the real decision makers or drivers of the OCGs, who may not be the client's general counsel. Any rational entity should at the very least consider the risks it is incurring in insisting on an indemnity clause. Having these discussions at a time when the client and the affected lawyers are not concerned about a particular matter may result in a much more informed client approach to the issue.

D. Negotiate OCGs

Nevertheless, unless a firm is completely successful in all of its client education efforts, OCGs will continue to arrive. Upon identifying or being asked for an indemnification agreement, and assuming that the firm believes that it has the ability to push back, its first step is to explain to the client's general counsel why the provision should be removed, using all the arguments set out above. Some firms expect

their own general counsel to take the lead in these conversations, others permit the lawyer seeking to introduce the matter to make at least the first attempt to have the provision removed, and some address each situation on a case-by-case basis.

Some firms have been successful in seeking to negotiate with clients to remove these provisions entirely. The client may not have appreciated the consequences of its requirements on the firm; or the general counsel may have been unaware of the existence of a clause inserted by the procurement department. By way of example only, one AmLaw 100 firm reported to the authors (on a not for attribution basis) that it had successfully negotiated a revision to the indemnity provision shown below contained in the OCGs it had received from a non-federal governmental agency. The additional language proposed by the firm and agreed by the agency is bold:

> The Firm shall defend, save, hold harmless, and indemnify the state of xxx, Department of yyy and the benefiting agency, their respective officers, employees, agents and members as applicable, from and against all claims, suits, actions, losses, damages and liabilities resulting from, arising out of or relating to the intentional or negligent tortious acts or omissions of the Firm or its officers, employees, subcontractors, or agents as applicable under this Agreement; **provided, however, that for professional services provided under this contract, the foregoing does not alter, and is limited by, the rights and remedies available to clients under applicable statutes and professional laws and rules.**

Other law firms report sometimes having achieved similar outcomes when they have negotiated OCG language with their clients.[7]

By explaining to clients that the risk they are asking the firm to assume is unfair and by attempting to work together to make the arrangement acceptable to both parties, some firms have successfully limited the scope of the indemnity provision to losses "to the extent that they are covered by the firm's malpractice insurance policy," or using language that voids the indemnification agreement if it invalidates the firm's professional liability insurance. It is important to note, however, that there is no case law as yet regarding whether such limitation language will be effective if the underlying indemnity provision is in the agreement, so that any such proposed solution is not yet certain to succeed. Sometimes in these discussions the client will, in the end, be most interested in confirming that the firm has sufficient resources to respond to potential claims. This can often be accomplished by verifying to the client the amount and coverage terms of the firm's insurance—perhaps including its general liability and cyber coverage as well as its malpractice insurance—in return for which verification the client may agree to remove the indemnity provision.

Some firms, both large and small, take the view that they cannot afford to completely dismiss the offered work, or to upset a relationship by even requesting that the client discuss the issue. We are aware of situations where the client pressing an indemnification provision was the source of a sufficiently large portion of the firm's business, that the firm reached the business decision to accept and agree to indemnity provisions without raising any concerns.

Common sense suggests that clients who refuse to negotiate the indemnity provision are the most likely to seek to enforce it later. Accordingly, firms considering agreeing to these provisions, in addition to weighing the potential costs and benefits of accepting the engagement and the indemnity provision should also consider the history of the client: Is it litigious? What is its reputation with its other vendors? What is the firm's ability to absorb the indemnity if it is asserted? The fact that these questions arise at all is the ultimate evidence of the shift in power between the client and the lawyer.

E. Work with your Malpractice Insurer

A general discussion of these clauses with the firm's malpractice insurer may serve to pinpoint what, if anything, the firm can safely agree to. A number of firms have had these discussions. We note, however, that the information we have received anecdotally indicates that insurers do not have a clear understanding as to how they will view an indemnification clause. Some have said that the clause is acceptable if it seeks indemnification for a claim that would have already been covered by the policy, e.g., a lawyer's negligence, while others have said that an indemnity clause will abrogate coverage.

When faced with a client that appears obdurate and unreceptive to the firm's arguments, but the business is too important to the firm to reject out of hand, it may be worthwhile to contact the firm's malpractice insurer to discuss the specific situation. If the client will not negotiate, the insurer may agree to vary the insurance contract language so as to enlarge coverage with respect to services provided to the particular client. We should note that we are not aware of specific instances where this has occurred.

F. Consult with Your CGL Insurer

It is possible that there may be coverage under the firm's Comprehensive General Liability ("CGL") policy for certain losses for which the client seeks indemnity in areas where such policies have traditionally covered similar claims. A few law firms have worked with their CGL insurers and secured coverage on a case-by-case basis by adding the client as a named insured.

IV. Conclusion

The question of the impact on the profession as a whole of the rising tide of client power remains unresolved, as does the question of whether, given the threat to lawyers' independence, the legal profession has a responsibility to take a position on OCGs in general and client indemnification requirements specifically. One potential approach would be to consider an ethical rule prohibiting lawyers or law firms from agreeing to terms of engagement that can reasonably be construed to place the lawyer in a conflicted position with his client in a representation, or to create an existential threat to the firm. Another approach may be for the professional organizations, or for groups of law firms acting together, to negotiate with the institutions and clients seeking to impose these obligations, similar to the successful negotiations leading to the treaty between the ABA and the accounting profession governing audit letter responses. However, both of these approaches may be impractical and the latter may raise antitrust problems that are beyond the scope of this article.

In the meantime, OCGs (and indemnity provisions) will not disappear any time soon. Although OCGs are usually considered in the heat of opening a new matter or responding to an RFP, law firms—and their clients—should take time to consider a more reasoned approach that will not result in fundamentally changing the relationship between a lawyer and its client and negating the protections already afforded the client in that relationship.

Appendix 1: Some Representative Client Indemnity Provisions

Below are examples of actual provisions requested by clients from a wide array of law firms. Some firms informed us that they were sometimes successful in negotiating amendments to the language of some of these provisions—or even sometimes in persuading clients to drop the provision entirely.

Example 1:

Subject to local, state, federal and international laws and regulations, Outside Counsel shall indemnify, defend, and hold harmless Client and its employees, officers, directors, or agents ("Representatives"), successors and permitted assigns from and against any and all claims or legal actions of whatever kind or nature that are made or threatened by any third party and all related losses, expenses, damages, costs and liabilities, including reasonable attorneys' fees and expenses incurred in investigation, defense or settlement ("Damages"), that arise out of, are alleged to arise out of, or relate to the following: (i) any negligent act or omission or willful misconduct by Outside Counsel, its Representatives or any subcontractor engaged by and acting under the supervision of Outside Counsel in the performance of Outside Counsel's obligations under this Agreement; or (ii) any breach in a representation, covenant or obligation of Outside Counsel contained in this Agreement.

Outside Counsel shall defend or settle at its expense any threat, claim, suit or proceeding arising from or alleging infringement, misappropriation or other violation of any intellectual property rights or any other rights of any third party by work product or services furnished by Outside Counsel, or third parties engaged and supervised by Outside Counsel, under this Agreement. Outside Counsel shall indemnify and hold Client, its subsidiaries and affiliates and each of their Representatives and customers harmless from and against and pay any damages, including royalties and license fees attributable to such threat, claim, suit, or proceeding.

1. If any work product or services furnished under this Agreement, including, without limitation, software, system design, equipment or documentation, becomes, or in Client's or Outside Counsel's reasonable opinion is likely to become, the subject of any claim, suit, or proceeding arising from or alleging facts that if true would constitute infringement, misappropriation or other violation of, or in the event of any adjudication that such work product or service infringes, misappropriates or otherwise violates, any intellectual property rights or any other rights of a third party, Outside Counsel, at its own expense, shall take the following actions in the listed order of preference: (i) secure for Client the right to continue using the work product or service; or if commercially reasonable efforts are unavailing, (ii) replace or modify the work product or service to make it non-infringing; provided, however, that such modification or replacement shall not degrade the operation or performance of the work product or service.

2. The indemnity in the preceding provision shall not extend to any claim of infringement resulting solely from Client's unauthorized modification or use of the work product or service.

Client shall give Outside Counsel notice of, and the parties shall cooperate in, the defense of any such claim, suit or proceeding, including appeals, negotiations and any settlement or compromise thereof, provided that Client must approve the terms of any settlement or compromise that may impose any unindemnified or nonmonetary liability on, or require any admission from, Client.

Comment: The first paragraph is objectionable for the reasons discussed in the body of the article. In addition, the indemnity with respect to intellectual property may have the effect of voiding other possible insurance policies carried by the law firm, in the same way and for similar reasons that indemnities may void LPL coverage as discussed in the body of the article. The last paragraph may destroy LPL coverage that might otherwise be available by violating the cooperation and subrogation rights clauses as discussed in the body of the article.

Example 2:
Law firms conducting work for Client agree that they will mitigate any harmful effects resulting from the improper use or disclosure of Client information by either the firm, or any party with which the firm shares Client information. The law firm further agrees that it will indemnify and hold Client harmless for any damages of any kind resulting from the law firm's failure to protect the confidentiality, integrity and availability of Client information.

Comment: This clause may impact a law firm's cyber insurance and have the effect of placing the coverage in jeopardy.

Example 3:
Notwithstanding any other provision in this Letter to the contrary, the Firm agrees to defend, indemnify and hold Client and its corporate parents, affiliates and subsidiaries harmless from and against all claims, liabilities, obligations, demands, actions, damages, penalties, costs and expenses, including, but not limited to, attorneys' fees, relating to or resulting from (a) any breach of any provision of this Agreement, or (b) any act or omission of the Firm or any of its employees, agents or contractors.

Comment: This clause may impose liability broader than any LPL policy coverage with respect to the firm, impose liability for acts of others, and may void LPL coverage for the reasons discussed in the body of the article.

Example 4:
The Panel Firm indemnifies and must keep indemnified Client and the relevant Client Group members from and against any and all Claims suffered or incurred by Client or the relevant Client Group member directly or indirectly in connection with any of the following:

a) any breach by the Panel Firm or its Personnel of the Panel Firm's obligations under this Agreement;

b) any negligence by the Panel Firm or its Personnel in relation to or in connection with this Agreement or the provision of the Services;

c) the use or possession of any Deliverables or the provision or receipt of any of the Services infringing the rights (including rights to Intellectual Property) of any person and any allegations of such infringements; or

d) fraud, or fraudulent misrepresentation, willful misconduct or repudiation of this Agreement by the Panel Firm or its Personnel in relation to this Agreement or the provision of the Services.

Comment: Paragraph b is unnecessary but unobjectionable. All of the rest is objectionable for the reasons discussed in the body of the article.

Example 5:
Operation and nature of indemnities

a) Each indemnity in this Agreement is a continuing obligation of the Panel Firm, whether or not legal proceedings are instituted, and despite any settlement of account or the occurrence of any other thing, and survives the termination or expiry of this Agreement.

b) Each indemnity in this Agreement is an additional, separate and independent obligation of the Panel Firm and no one indemnity limits the generality of any other indemnity.

c) Client may recover a payment under an indemnity in this Agreement before it makes the payment in respect of which the indemnity is given.

d) The indemnities in this Agreement:

i. apply whether the Claim arises in connection with negligence, misrepresentation, or other cause; and

ii. include legal expenses on a full indemnity basis and damages and other compensation paid on the advice of legal advisers to compromise or settle any claim, whether of Client or another person; and,

iii. only apply to the extent that any loss or damage was reasonably foreseeable as a consequence of the breach or act of negligence; and

iv. are subject to a duty on the part of Client to mitigate any loss arising from a Claim.

Comment: Note the confusing language as to the express enlargement of the indemnities beyond negligence, but the limitation as to loss and damage. Surely the scope and meaning of this provision could invite a subsequent dispute among the client, the law firm and its LPL insurer.

Example 6:
Firm agrees to defend, indemnify and hold harmless from and against any and all claims, actions, losses, deficiencies, damages, penalties, liabilities, costs, and expenses (including but not limited to, reasonable attorneys' fees and all related costs and expenses), as incurred, arising out of, or in connection with the negligence, recklessness, fraud or misconduct of Firm or its employees, agent, subcontractors or affiliates in carrying out its professional responsibilities on behalf of [client].

Agreements with third-party service providers must include provisions protective of rights, including but not limited to confidentiality, intellectual property, information security, data privacy, assignment, material breach, dispute resolution, indemnity, limitation of liability, termination and transition upon termination, and service levels. To the extent any third party service provider receives material nonpublic, proprietary or confidential information, that service provider is subject to and must comply with the terms and conditions set forth [in Section 26 below]; the law firm must supervise that service provider and is responsible for that service provider's actions.

Business Associates shall indemnify and hold harmless Covered Entity and any of Covered Entity's affiliates, directors, officers, employees and agents from and against any claim, cause of action, liability, damage, cost or expense (including reasonable attorneys' fees) arising out of or relating to any non-permitted use or disclosure of Protected Health Information, failure to safeguard Electronic Protected Health Information, or other breach of this Agreement by Business Associate or any affiliate, director, officer, employee, agent or subcontractor of Business Associate.

Comment: Note the indemnity as to losses under HIPAA goes beyond the law firm (which the firm may be subject to under any event) but also covers breaches by any of its subcontractors.

Example 7:
Law firm warrants that its work will be done by competent attorneys with the appropriate experience and specialty, and that it will indemnify and hold Client harmless for any damages arising from any error or claim of error in the Work.

Comment: This language is reasonably limited to duties owed by counsel under common law and doesn't expand liability. It is unnecessary but unobjectionable.

Appendix 2: Specific Indemnity Language
The examples above illustrate types of indemnity language typically sought by clients. The following phrases are potentially the most harmful and should be carefully considered before agreeing to them, with the language modified by negotiation, or removed if possible.

"... shall indemnify, defend, and hold harmless..."
The obligation to defend requires that the lawyer pay for the client to defend against the possible loss, before going on to indemnify the resulting loss. This creates a mountain of costs that could eclipse the actual loss, particularly if the client retains control over the defense. If the loss arose from non-negligent

acts, there is no coverage under a legal malpractice policy and the insurance company will almost certainly refuse to pay to defend the client. If negligence occurred, the client's defense costs might be covered.

"... Client and its employees, officers, directors, or agents ("Representatives"), successors and permitted assigns..."
This is a list of additional parties the lawyer is agreeing to represent, and should be removed if at all possible. If the client is adamant, obtain a finite list of parties to permit evaluation of the type and size of risk the lawyer is undertaking. Even if the indemnity agreement is limited to negligence, agreeing to third party coverage almost certainly expands the group of possible plaintiffs. Before negotiating this provision, check the law of your jurisdiction to determine whether privity is an element of legal malpractice liability, and if not, to which third parties liability may already extend.

"... all claims, liabilities, obligations, demands, actions, damages, penalties, costs and expenses..."
Claims, demands, actions, and suits are not damages. This language significantly increases the breadth of the indemnification obligation. Indemnification addresses costs, liabilities, expenses, or losses, not the vehicles that bring those losses to the indemnitor's door. Additionally, penalties are almost certainly not covered by malpractice insurance.

"... directly or indirectly in connection with any of the following..."
Typically, common law makes lawyers responsible only for the direct consequence of their negligence. By agreeing to "indirect" results, a lawyer's obligations expand almost limitlessly.

"... any act or omission of the Firm..."
This is the phrase that moves lawyers from being responsible for the results of their negligence to guaranteeing the outcome of their services. Lacking a limit on the breadth of the lawyer's obligation, a court could easily decide that the lawyer guaranteed everything related to the legal services. LPL insurers, however, will cover losses resulting only from negligence. In addition, the language of the agreement does away with the standard of care and the defense of reasonable judgment.

"... or any of its employees, agents or contractors..."
Some indemnity agreements require that the firm indemnify the client against the actions of the firm's subcontractors. Many subcontractors won't agree to indemnify the firm, and the firm is left holding the bag. Adding insult to injury, many clients now require law firms to use subcontractors chosen by the client.

". . . any negligent act or omission or willful misconduct by Outside Counsel, its Representatives or any subcontractor engaged by and acting under the supervision of Outside Counsel in the performance of Outside Counsel's obligations under this Agreement. . ."

Most states do not permit vicarious liability for an agent's intentional bad acts, unless the principal controlled or was aware of the conduct. Accordingly, this phrase likely increases a lawyer's liability. However, the client's argument is likely to be that these are actions or harm the lawyer can (or should) control. This indemnification agreement, if agreed to by the law firm, should lead the firm to require the same agreement from its vendors and subcontractors.

". . . claim, suit, or proceeding arising from or alleging facts that if true would constitute infringement, misappropriation or other violation of, or in the event of any adjudication that such work product or service infringes, misappropriates or otherwise violates, any intellectual property rights or any other rights of a third party. . ."

Copyright, trade secret, and patent infringement claims require no allegation of intent or negligence. The client can (and will) argue that it did not infringe, the lawyer did, and that the loss should fall on the lawyer. The lawyer cannot control this risk and should not be expected to assume it.

". . . breach of any provision of this Agreement. . ."

The proper remedy for breach of contract is contract damages, not indemnification for any resulting loss. In conjunction with the indemnification language, this language makes the lawyer responsible for losses in addition to those caused by the breach.

Endnotes

1. The authors are indebted to Stuart Pattison, Senior Vice President of Endurance Specialty Holdings Ltd., who requested that they write the article to assist both his company's insured law firms and his colleagues in understanding the implications of indemnity provisions in client engagements, to our partner Janis Meyer, and to John Barr, the former General Counsel of McGuire Woods LLP, for their invaluable comments. However, the views expressed are entirely our own.

2. *See* Claire Coe & Steven Vaughan, *Independence, Representation and Risk: An Empirical Exploration of the Management of Client Relationships by Large Law Firms* (2015), https://www.sra.org.uk/sra/how-we-work/reports/independence-report.page.

3. *Id.* at 72.

4. In preparing this article, the authors obtained examples of indemnity clauses from a diverse group of law firms. Because of the method used to gather this information, the authors do not know the identity of the requesting clients nor do they know which firms supplied information. Section D below discusses ways in which law firms may seek to respond to these provisions. However, in order to protect the identity of the firms that provided information to the authors, and the confidentiality of their respective clients' confidential information, with one exception described under the heading 'Negotiate OCGs,' we do not include any specific details as to whether, when, or to what extent firms have been successful in pushing back against clients' demands for agreement to these provisions.

5. Some of the other provisions we have reviewed are set out, in whole or part, with comments, in Appendix 1 attached hereto. Appendix 2 sets forth an analysis of some of the language frequently contained in these indemnification provisions

6. For the reasons explained in footnote 4, in order to protect the anonymity of the firms that provided information to the authors, and to protect their clients' confidences, with one exception described under the heading 'Negotiate OCGs,' we do not discuss in any detail the degree to which firms actually either try to, or are successful in challenging these provisions.

7. *See alsosupra* notes 4 & 6.