Client Indemnification Agreements—Look Before You Leap

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Professional Liability Litigation

By Peabody & Arnold on July 6, 2017

Historically, the balance of power between attorney and client arguably tilted in favor of the attorney, with the terms of the representation defined by an engagement letter drafted by the attorney and accepted by the client. With the recession of 2008, however, large clients became more cost-conscious and more aggressive in their cost saving measures. Procurement officers began supplanting general counsel–and detailed client guidelines, not attorney-prepared engagement letters, increasingly set forth the terms of the engagement. The requirements imposed by such guidelines can often create administrative and billing headaches and sometimes complicate an attorney's exercise of independent professional judgment. One increasingly common, and concerning, provision is a requirement that counsel indemnify the client for losses arising from the representation, even in the absence of fault on the part of the attorney.

A panel at the Spring 2017 National Legal Malpractice Conference outlined the issues arising from such provisions. The moderator, Anthony E. Davis, a partner at Hinshaw & Culbertson LLP, was joined by Stuart Pattison, Senior Vice President at Endurance, and Lori Roeser, General Counsel of Seyfarth Shaw LLP. The panel described how client indemnification provisions could expand the scope of attorneys' liability and some of the possible consequences these provisions might have on attorneys' liability insurance coverage. The panel also provided practical tips on how to navigate the issues arising from these client indemnification agreements.

Expansions of Liability

Indemnification provisions in clients' outside counsel guidelines vary in terms of their scope and complexity.

Davis explained that under many such provisions, however, an attorney will not merely be responsible for damages arising from his or her malpractice, but also for third-party claims related to the engagement, regardless of fault—expanding the attorney's liability beyond that which would otherwise exist under the law. Moreover, such provisions often impose liability on attorneys for the conduct of third-party vendors hired by the attorney, even if the service providers were selected by the clients themselves.

The terms of a client indemnification provision may be severe, but at least one court has concluded they are enforceable. The panel discussed a recent case, *Sephora USA, Inc. v. Palmer, Reifler & Assocs.*, 2016 BL 153846, N.D. Cal., Case No. 15-cv-05750-JCS, 5/13/16, which held that a client indemnification provision is enforceable against a law firm even in the absence of fault.

The firm sought to defend against the client's claim for indemnification relating to a purported class action suit, arguing that the indemnification agreement required some fault on the part of the law firm and that the dismissal of the class action validated the firm's conduct as neither negligent nor improper. The court rejected this argument, analogizing the indemnification agreement with an insurer's duty to

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defend. The court concluded that the firm was required to provide a defense based on the allegations of the class action complaint, and that its failure to defend was not excused or vitiated by the subsequent dismissal of the suit. The panel cautioned that this ruling puts attorneys on notice that client indemnification agreements are enforceable and can have real consequences.

Insurance Implications

The expansion of liability should concern any attorney. The problem is compounded by the fact that, as Pattison explained, the attorney's professional liability insurance may not cover this expanded liability.

For example, claims for indemnification under a client guidelines agreement might be excluded from coverage under contractual liability exclusions. Similarly, punitive damages exclusions may foreclose coverage for the attorney's indemnification of punitive damages assessed against a client. Moreover, even if coverage would otherwise attach, an attorney's agreement to indemnify the client might frustrate the insurer's right of subrogation, resulting in a loss of coverage.

Dealing with Indemnity Provisions

Nobody likes to turn down business, even business freighted with expanded risk of liability. But, as the panel stressed, an attorney should not agree to an indemnity provision without considering the risks and benefits of the client engagement. And a firm cannot engage in meaningful risk assessment unless it knows whether its partners have agreed to client indemnification. The risk/reward calculus for an individual attorney may not be the same as that for the firm as a whole. Accordingly, Roeser advised that law firms would be well- served by having procedures in place for screening, or at the very least, tracking, client indemnification agreements.

Some clients offer their client guidelines on a ''take it or leave it'' basis, but not all. The panelists identified several practical tips for addressing indemnification provisions with clients. One productive tack for pushing back against indemnification agreements is to explain the potential insurance consequences. Most clients *want* their counsel to be covered by liability insurance. Some clients will agree to qualify the scope of the attorney's liability so that it does not go beyond the liability that would have otherwise existed under applicable law or assent to a clause that limits the indemnification ''only to the extent covered by the insurance policy.'' Attorneys may also persuade the client that it does not actually need the indemnification provision because the attorneys remain liable for their negligence, even in the absence of an indemnification provision. Regardless of approach, the panel advised that a client will usually have better results if he or she can reach an attorney rather than a procurement officer. The panel also cautioned attorneys against succumbing to the refrain that ''all the law firms'' are agreeing to these provisions. They aren't.

