

Discussion Paper: Obtaining Indemnities and Advance Waivers of Malpractice Claims from Clients

*By Anthony E. Davis, Of Counsel, Clyde & Co US LLP
and Janis M. Meyer, Of Counsel, Clyde & Co US LLP*

INTRODUCTION

Law firms frequently consider whether or not to seek prospective indemnities or waivers from their clients in two situations: indemnities against the costs of complying with third party subpoenas and other discovery requests that are presented after the client engagement has ended, and waivers of potential future claims for malpractice. Obtaining agreement to either of these requests can save law firms from potentially enormous exposures. It is by no means uncommon that when transactional matters of all kinds handled on behalf of clients go sour later (sometimes a long time after the deals were concluded), litigation ensues. In that litigation, the law firm that previously represented the client faces subpoenas and other discovery requests in connection with the matter – which often will have long been closed as far as the firm was concerned. In the case of responding to subpoenas and discovery requests, absent clients' agreement to be responsible for paying the firm reasonable fees for the time involved in complying, as well as the actual out of pocket expenses involved, firms may face significant financial loss. Since disputes with clients – or former clients – about fees all too often lead to malpractice claims, it is important for law firms to consider how to deal with these situations, preferably before they arise. Avoiding the risk of a malpractice claim in these as in any situation has obvious benefits.

Whenever law firms contemplate seeking an indemnity or a waiver of either kind, they face two distinct sets of issues. First, what are the applicable professional responsibility considerations that must be addressed; and second, (assuming there are no ethical prohibitions that preclude such a request), what are the pros and cons of actually seeking them. This Memorandum will address each of these issues.

INDEMNITIES FROM CLIENTS AGAINST THE COSTS OF COMPLYING WITH THIRD-PARTY SUBPOENAS AND OTHER DISCOVERY REQUESTS THAT ARE PRESENTED AFTER THE CLIENT ENGAGEMENT HAS ENDED¹

PROFESSIONAL RESPONSIBILITY ISSUES

If the request for indemnity for legal fees and the out-of-pocket costs of complying with subpoenas and other discovery requests made after the engagement is over is made at the outset of the original engagement, presumably in the engagement letter provided to and (hopefully) countersigned by the client, the only ethical issue is whether the request is reasonable under Rule of Professional Conduct ("RPC") 1.5 (a) dealing with legal fees. The ABA Model Rule states that [a]

lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses.”

Accordingly, provided that the fee arrangement is appropriate within the meaning of “not unreasonable,” such an indemnity in advance is perfectly acceptable from the perspective of legal ethics. Prior to the commencement of an engagement, clients have complete freedom to select any lawyer in the jurisdiction; if they are unhappy with any part of the proposed engagement letter they are free to take their legal business to any other lawyer of their choice. Accordingly, if they agree to such a provision at the outset, it poses no ethical obstacles.

However, the situation changes dramatically if the law firm seeks such an indemnity after the engagement has commenced. Now, instead of being free to select any lawyer in the jurisdiction, the client may have invested extensive monetary and non-monetary resources – in terms of having created a working relationship, and of the knowledge and experience in the particular matter developed by the firm, as well as the fees paid and payable for the work performed – related to the firm’s representation. Accordingly, any change to the fee arrangement, which is what enlarging the client’s obligations beyond those originally agreed to is, creates a special conflict of interest under RPC 1.8. For these purposes, such changes are viewed as transactions with the client. ABA Model Rule 1.8 provides:

- (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:
 - (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
 - (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
 - (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer’s role in the transaction, including whether the lawyer is representing the client in the transaction.

In these situations therefor, before obtaining a client’s agreement to give such an indemnity, the law firm must request, and receive a written consent, signed by the client, after the firm has complied with the requirement to make full disclosure in accordance with the Rule. Commonly, law firms seeking such consents will recommend, or even require the client to consult independent counsel (which can be a corporation or legal entity’s own in house counsel) prior to agreeing to or actually providing the consent.

THE PROS AND CONS OF SEEKING INDEMNITIES FROM CLIENTS FOR FEES AND EXPENSES OF RESPONDING TO SUBPOENAS AND DISCOVERY DEMANDS AFTER THE END OF THE ENGAGEMENT

In order to understand the pros and cons, it may be helpful to see a typical provision from a law firm’s form engagement letter that seeks these indemnities:

“Services In Conjunction With Legal Proceedings. In the event either that (i) [Law Firm] or any of its members is required to respond on their own behalf to a subpoena or discovery requests or (ii) any attorney or employee of [Law Firm] is required to testify as a witness in any proceeding by virtue of [Law Firm’s] representation of you under this agreement, all resulting attorney and paralegal time, including that incurred for an attorney of [law Firm] as counsel for the attorney or employee being required to testify, you agree to be responsible for such professional services and costs incurred, at [Law Firm’s] then-current rates. This obligation shall apply if such services are required and provided either during or after the termination of the Engagement, but the provision of any such services after the termination of this Engagement shall not constitute a continuation or renewal of this Engagement.”

From the firm's point of view, the benefits of having the client agree to this arrangement at the outset are obvious – it has a legally enforceable contract that the client will pay for the services, including the firm's fees, in the event that such demands are made. But these benefits are offset in the minds of some lawyers and firms by the concern that this may appear to the client to be an unreasonable imposition, not necessary to the fulfilment of the firm's obligation to provide services under the agreement, and in an indeterminate – and potentially – very significant amount – and at an indeterminate time in the future. The shorthand for this argument is often stated as “the client would be *offended* if we include this provision, and likely will decide not to engage us at all if we insist on its inclusion.” As a result, some firms are reluctant to include these provisions in their form engagement letters. But failing to do so means that the firm will be completely at the now former client's mercy if the situation later arises in fact. Then, although it is perfectly possible for the firm to request that the client pay its reasonable fees for complying with the obligation – that only exists because of the now completed engagement – the client has absolutely no obligation to pay.

ADVANCE WAIVERS OF FUTURE MALPRACTICE CLAIMS

PROFESSIONAL RESPONSIBILITY ISSUES

Although waivers of this kind are common and permissible for other service providers, including other professionals, notably accountants, lawyers are either not permitted to request such waivers in advance at all – the situation in some states – or are permitted to do so only under strictly limited conditions.² The governing RPC is 1.8(h). The ABA Model Rule provides that:

“A lawyer shall not:

- (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement;” ...

By contrast and as an example of a state that absolutely prohibits such provisions, New York's version of this rule provides that:

“A lawyer shall not:

- (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice;” ...

THE PROS AND CONS OF SEEKING ADVANCE WAIVERS OF MALPRACTICE LIABILITY

Again, the benefits of such provisions for law firms – in states where they are permissible – is immediately obvious. And in some jurisdictions outside the United States, including England and Wales, they are quite commonplace, and are customarily enforceable unless the allegedly injured client can demonstrate gross negligence. These waivers in general take two forms: a complete waiver of malpractice claims or a limit on recoverable damages. However, in the United States, they are very rarely requested – even in states where they are permissible – except in highly unusual circumstances, as, for instance, where the client is relying on advice which both the law firm and the client recognize in advance is uncertain as to its correctness.

CONCLUSION

There are evident benefits to law firms to seeking indemnities against the cost of responding to subpoenas and discovery requests after the end of engagements. Since these are perfectly permissible under the ethics rules when set out in the initial engagement letter, they indeed belong there. And the answer to the objecting lawyers that the clients will be “offended”, and “will go elsewhere if presented with such a provision” is also straightforward: if the prospective client does indeed object, the firm can decide at that point whether or not to delete it. Notably, however, the firm placed in that situation is almost by definition henceforth on notice that if the eventuality does subsequently arise, it will be unlikely in the extreme either to recover legal fees or even the costs associated with the obligations then faced. Nevertheless, resistance to the inclusion of these provisions is sometimes strong

enough that, despite their obvious benefit to firms that include them, these provisions are not included in a number of firms' form engagement letters.

Despite the commonplace use of advance waivers of future malpractice claims in jurisdictions outside the United States, and by other professionals in the United States, these provisions are extremely uncommon here, and used only under special circumstances even in states where they are permissible. Whether to request such a waiver is a decision to be made on a case-by-case basis.

¹ Subpoenas and discovery requests may also be served on a law firm during a representation, but they are usually handled as part of the ongoing matter.

² Waivers of malpractice claims should not be confused with indemnity for third-party claims which may be permitted in appropriate circumstances.

If you have additional questions about related issues beyond those outlined above, please feel free to contact us directly.

John Muller

Senior Vice President
U.S. Professional Lines, Sompo Pro
T +1 917 421 4961
E jmuller@sompo-intl.com

Stuart Pattison

Senior Vice President
U.S. Professional Lines, Sompo Pro
T +1 917 281 0744
E spattison@sompo-intl.com

Sompo International does not make any representations or warranties as to the technical accuracy or compliance with any law or professional standards. We recommend retaining experienced counsel knowledgeable about engagement letters and ethical standards, your firm, and the laws of the jurisdiction where you practice.