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A PRACTITIONER'S PERSPECTIVE ON EMERGING LEGAL TRENDS

Fighting the Trojan Horse: Managing Outside Counsel Guidelines

If there is one thing keeping law firm general counsel awake at night, it is the myriad of outside counsel guidelines (OCGs) that may be floating around the firm. OCGs are documents sent by the client (generally, large corporate clients and insurers) to the lawyer setting forth various terms of the engagement. These OCGs differ from client to client, may be dozens or hundreds of pages in length and, as shown below, may incorporate requirements that the firm cannot meet. Moreover, many firm lawyers treat the OCGs in a cavalier manner, neglecting either to read them or to send them to their firm's general counsel. Even where the firm requires review and approval of OCGs as part of its client intake process, the firm may fail to keep track of the precise terms to which it has agreed with any specific client, or may fail to follow up to ensure that each OCG is followed.

All of these issues represent a symptom of the shift in the legal marketplace. Where lawyers traditionally controlled the terms of each engagement, the post-recession landscape has given a great deal of power and control in this area to clients. Therefore, lawyers and law firms bear the responsibility for paying careful attention to the OCGs sent by any given client, as the OCGs may be inconsistent with – and indeed may eviscerate – the terms of the law firm's standard retainer. Moreover, the OCGs may contain terms or conditions that the law firm cannot satisfy, because those terms and conditions either exceed the firm's resources or are inconsistent with ethical or other legal obligations.

In this article, we will discuss five common issues that can arise with OCGs and what firms can do to address them.

1. Expanded Conflicts Policies

Most OCGs contain a section relating to conflicts of interest, which tend to expand the law firm's ethical duties to the client. Under the ethics rules, a lawyer may not represent a client with interests "directly adverse" to another current client. *See ABA Model R. Prof. Cond. ("MRPC") 1.7.*[1] The comments to *MRPC 1.7* explain that "directly adverse" means that a lawyer "may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated" unless the client gives informed consent. Nor may a lawyer represent the seller in a transaction against a buyer when the lawyer represents the buyer in another unrelated matter. *See MRPC 1.7 Cmnt. [6]-[7].* Comment 7 to *MRPC 1.7* goes on to state that "[o]n the other hand, simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients."

Where lawyers traditionally controlled the terms of each engagement, the post-recession landscape has given a great deal of power and control in this area to clients.

1 *New York Rule of Professional Conduct (NYRPC) 1.7(a)* prohibits a lawyer from representing clients with "differing interests", instead of using the "directly adverse" standard in the MRPC. Although the New York standard is slightly broader, as outlined below, the conflicts provisions in OCGs often require the lawyer to agree to go well beyond either standard.

Clients, however, tend to use OCGs to try and expand the law firm's duty of loyalty, asking the firm to agree to refrain from representing industry competitors or entities adverse to other members of the client's corporate family even if no actual conflict of interest exists. Consider the following example:

> It is the responsibility of the Firm to identify and disclose to [Client] any existing or prospective engagement by another client that could create an actual or potential conflict of interest with the Firm's representation of [Client]. For the avoidance of doubt, the following circumstances shall be considered (but not be limited to) an actual or potential conflict . . . .:
>
> 1. *Representation or prospective representation of any company, firm, person or body engaged (whether wholly or partly) in the manufacture, packaging, storage, marketing, importation, co-packing, consultancy, supply, sale or distribution of [relevant product] in any territory; or*
> 2. Representation or prospective representation of any company, firm, person or body *in any matter in which [Client] has or can reasonably be anticipated to have a direct or indirect interest.*

This conflicts standard is obviously much broader than what the ethics rules articulate. The above-quoted OCGs acknowledge this inconsistency and "encourage" the firm to "err on the side of caution and discuss with [Client] any possible issues regarding conflicts even if the Firm considers that there is no issue under any applicable professional regulations governing law firm's activities."

Such broad conflicts provisions in OCGs can be problematic, especially for firms with multiple practice areas. For example, a law firm that regularly defends banking institutions in litigation also may negotiate transactions for its corporate clients against a subsidiary owned by the bank, which the firm has never directly represented. Similarly, a law firm may perform real estate work for a subsidiary of a large holding company but may be asked to represent another client in a licensing deal against the parent company which the firm has never directly represented. Although this type of representation would not create a conflict under the ethics rules, the firm may violate the client's OCGs.

Law firms should, therefore, pay special attention to any provisions in OCGs that address conflicts and determine whether any requirement that expands the firm's duty of loyalty to the client is workable based on the firm's core practice areas. If the firm believes that the conflicts policy in the OCGs is too broad and unworkable, the firm should try to negotiate the scope and do its best to limit the definition of a conflict of interest to align with applicable ethics rules.

2. Cyber Security Requirements

There is no question that lawyers have a duty to safeguard clients' confidential information. *See MRPC 1.6.* Moreover, a lawyer's duty of competence includes keeping abreast of technological developments in the legal profession and taking steps to protect client information. *See MRPC 1.1 Cmnt.* [8]. In an age where data breaches are becoming commonplace, many OCGs place additional cyber security requirements on law firms. Consider the following example:

> Firms shall use their best efforts to maintain administrative, technical, and physical safeguards that are no less vigorous than industry best practices to ensure the security and confidentiality of [confidential information], protect against any anticipated threats or hazards to the confidentiality, availability or integrity of [confidential information], and protect against unauthorized access, use, or alteration of [confidential information]. *At a minimum, Firms shall maintain, in writing, reasonable security procedures and practices ("Written Information Security Program" or "WISP") consistent with the International Organization for Standardization's ISO/IEC 27001 and ISO/IEC 27002 standards and that are necessary to protect [confidential information] and [client's network and computing systems] within its control from unauthorized access, destruction, use, modification, or disclosure. Without limiting the generality of the foregoing statement, the WISP shall at a minimum encompass each of the elements set forth below.*

The above example then delineates twenty minimum standards that the firm must implement in order to comply with the OCGs. This standard includes: (i) designating an individual who is responsible for maintaining the written security program; (ii) conducting background checks on employees and subcontractors; and (iii) annually conducting a "vulnerability scan and a penetration test with the results provided to [the client] upon completion of the tests."

OCGs often give the client the right to audit the firm's cyber protections at any time in order to determine if the policies comply with the OCGs. In other words, it is no longer sufficient for the firm to simply assure the client that its information is safe. Clients now seek to know *how* their information is being kept secure, as well as the firm's procedures for responding to a breach.[2]

Before signing any OCGs, law firms should conduct a comprehensive review of the cyber security and data privacy protections in place at the firm. If the firm does not believe it has the ability to analyze its privacy and data security issues, much less to comply with the standards imposed by the client, it should consult with an outside professional. Not only does this protocol represent sound risk management, it will deter the potential of an inability to comply with the privacy and security demands of the client. If the firm cannot comply, it should notify the client and ask if the client will deem the firm's data security systems acceptable, or try to negotiate some other solution. The firm also should consult its own "cyber insurance" policy to make sure there is adequate coverage in the event of a breach.

3. Billing Guidelines

One of the most frequent sources of frustration for law firms in OCGs is the client's "billing guidelines." This portion of the OCGs is essentially a laundry list of rules regarding the time charges for which a client will and will not pay. Although many of these rules do not lead to substantive issues in the representation (*e.g.*, refusal to pay for administrative tasks or overhead costs), others do. For example, many OCGs state that lawyers may not perform substantive legal research without prior approval from the client and may not bill for reviewing a colleague's work product. OCGs also may prohibit lawyers from conferring with one another and may generally limit the number of lawyers working on a matter.

The practical effect is that some of the more onerous billing restrictions in OCGs may conflict with a lawyer's ethical duties to the client. *See, e.g.*, *ABA Formal Op. 96-403* (Aug. 2, 1996); *ABA Formal Op. 01-421* (Feb. 16, 2001); *NYSBA Ethics Op. 721* (1999). For example, OCGs that restrict a lawyer's ability to perform substantive legal research may place the lawyer in a situation where he is unable to competently represent the client. *See MRPC 1.1*. Similarly, a lawyer could develop a conflict of interest if he is forced to balance his need to be paid for the representation with his duties to the client. *See MRPC 1.7(a)(2)*. Also, in the context of a third party payor, OCGs that are too burdensome could place undue pressure upon the lawyer from a third party, who is not the client. *See MRPC 5.4*.

Although a client's desire to control costs is understandable, a law firm must reconcile this desire with its ethical obligations to the client. It is therefore important to review the billing guidelines *before* the representation starts, rather than wait until the first bill is ready for transmittal. If the firm believes that the billing guidelines are too rigid or not appropriate for a particular matter, the firm should discuss this issue with the client at the outset and arrive at a resolution.

4. Indemnity Provisions

A recent trend in OCGs also requires that the law firm agree to indemnify and hold the client harmless from certain damages, including those related to the law firm's breach of the OCGs. For example, OCGs may require the firm to indemnify and hold the client harmless from any cost or damage related to a breach of the client's privacy and data security guidelines. OCGs may also require the law firm to indemnify the client for any injury the client suffers as a result of a third party service provider, even a provider over whom the law firm has minimal or no control (*e.g.*, off-site document storage facilities; e-discovery companies, etc.).

As two commentators have already noted, these types of clauses are fraught with risk. *See* Anthony E. Davis and Noah Fiedler, *Indemnity Provisions in Outside Counsel Guidelines: A Tale of Unintended Consequences*, ABA Ctr. for Prof. Responsibility, The Professional Lawyer, Vol. 23, No. 4 (2016). The most obvious risk is that these provisions require the law firm to agree to a standard of liability far lower than the prevailing standard for legal malpractice. As a result, the firm may be exposing itself to liability that is not covered by the firm's malpractice insurance. For example, most professional liability policies cover only errors and omissions that result from a law firm's negligent acts. Thus, if a law firm agrees to indemnify a client for non-negligent conduct, the firm could find itself in a situation where the client is seeking damages from the firm, although the firm's insurer will deny coverage because the claim is contractual. This indemnification clause also may result in a substantial amount of alleged damages.

2 This is not necessarily unreasonable given the recent reports of large-scale data breaches at major law firms around the world.

Notably, the statute of limitations for a claim on an indemnity agreement is generally longer than on a claim for negligence. *Compare N.Y. Civ. Prac. Law & Rules § 213(2)* (six-year limitations period for "an action upon a contractual obligation or liability") *with § 214(6)* (three-year limitations period for malpractice action). Thus, by agreeing to the indemnification, the firm dramatically increases its risk.

Agreeing to this type of coverage also may place the firm in violation of its own professional liability policy – another reason why the firm's insurer may decline coverage for an event related to the client in question. Many professional liability policies exclude from coverage contractual agreements between the insured and third parties regarding the insured's alleged liability. These policies often exclude acts of third parties hired by the firm. *See* Davis and Fiedler, *supra*. Moreover, a firm that agrees to a broad indemnification provision in a set of OCGs could find itself without coverage or in a situation where its insurer declines to renew coverage based upon the amount of risk the firm has assumed with third parties.

In order to avoid this situation, law firms should carefully scrutinize any demand for indemnification by the client and consult the terms of the firm's professional liability policy. If the firm finds that it may be placing itself in jeopardy of agreeing to indemnify the client for events not covered by the firm's policy, the firm should consult with its insurance broker, and it should agree to indemnify the client solely for otherwise covered events.

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5. Erecting the Dam: Controlling the Flow of OCGs into the Firm

Finally, the law firm should erect safeguards to control how OCGs come into the firm. In most instances, OCGs serve as a substitute for the law firm's retainer agreement and become the governing contractual document in the representation. As a result, OCGs should be reviewed in a comprehensive manner and approved by the firm's general counsel or management committee. Although this protocol sounds like common sense, OCGs can find their way into law firms without ever crossing the general counsel's desk. This is most common in two ways.

(a) The "Rogue" Lawyers

In a perfect world, any contract between a law firm and a third party should be reviewed and approved by the firm's general counsel, just as an engagement letter is reviewed and approved by the client's general counsel or in-house legal department. In practice, however, such oversight often is not performed. In many firms, the originating lawyer for a matter is responsible for ensuring that the client signs the engagement letter and that the representation is otherwise solidified. If the client is signing the firm's standard engagement letter, this approach is acceptable. However, the risk equation changes when the client comes back to the lawyer and asks the lawyer to agree to a set of OCGs. As experience has demonstrated, the individual lawyer may simply agree to the OCGs without sending them to the firm's management committee or general counsel for approval. The individual lawyer may fail to seek review and approval for numerous reasons, including the client's express desire to have the lawyer initiate professional services expeditiously, the desire to appease the client, or the genuine belief based upon the personal relationship with the client that the OCGs are simply "guidelines" and will not be enforced rigorously. Despite the lawyer's best intentions, she should not agree to bind the entire firm to the OCGs without first checking with firm management. In order to avoid this scenario, law firms should establish a clear policy that any OCGs must first be reviewed and approved by the firm's general counsel or management committee. Thus, a firm may assess its exposure and understand its contractual obligations to its respective clients. It also permits the firm to push back on any unnecessary or unfair provisions in the OCGs before an issue arises.

(b) OCGs from Lateral Lawyers

Another means by which OCGs can surreptitiously enter a firm is through lateral partners. For example, assume a law firm is actively recruiting a commercial litigation partner with a national practice. On her Lateral Partner Questionnaire (LPQ), the partner provides the names of her clients and adversaries for conflict checking purposes and also the recent billings. The firm does not ask about, and the prospective partner does not volunteer, any information about OCGs that attach to any of the prospective partner's client matters. After conflicts clear, the firm extends an offer to the partner, which she accepts. It is not until four months into the new partner's employment that the firm learns it is in violation of the OCGs of one of the new partner's clients. As a result of the breach, the client threatens to withhold payment of the firm's invoices. The law firm subsequently learns that the partner brought with her five other clients who each have their own OCGs which the partner incorporated by reference into the firm's standard engagement letter when she joined the firm.

This scenario is common yet avoidable. If the law firm had been aware of the OCGs, it could have taken protective measures. Such strategies include: i) internal steps to come into compliance with the OCGs, ii) attempts to negotiate the OCGs with the client, or iii) making a business decision that the amount of additional liability from the OCGs did not justify hiring the partner. To avoid situations similar to the one described above, law firms should consider asking potential lateral hires to disclose whether any of the clients listed on the LPQ require the firm to agree to OCGs. We do not believe that this procedure contravenes the incoming lawyer's confidentiality obligations, and forms a necessary part of the routine lateral transition process. *See ABA Model MRPC 1.6 Cmnts*. [13]-[14].

Conclusion

OCGs can contain a number of risk management landmines for law firms. As outlined above, OCGs can significantly alter the power dynamic between the lawyer and client and may expose the firm to additional liability that may not be covered by the firm's malpractice insurance. Law firms should, therefore, ensure that any OCGs are reviewed and approved in advance by the firm's general counsel or management committee so that the firm can address any problematic provisions prior to the representation and also monitor what the firm has agreed to with a particular client. This strategy will help ensure a successful and constructive professional relationship.

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