

## **Contractual Limitations of Liability to Clients and Others.**

From the Committee on Professional Responsibility, William Freivogel, Chair

As transactions get ever bigger, law firms are concerned that their potential liability could far exceed their insurance coverage. For example, it would not be unusual for a U.S. law firm with insurance coverage of \$150 million per occurrence to handle transactions worth billions of dollars. This exposure is complicated by the increasing practice of clients asking for “due diligence reports” on certain aspects of transactions. These reports may be relied upon by other parties to the transaction, that are not clients, including the myriad of people and entities providing financing for the transaction. We will first discuss liability to clients, followed by a brief discussion of non-clients.

### **Clients**

One thought is that a law firm might ask its client to agree to a cap on the law firm’s liability in a given transaction. Presumably, the cap would be equal to, or within, the law firm’s malpractice coverage.

ABA Model Rule 1.8(h) provides as follows:

(h) 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*; . . . (Italics, ours. We shall refer to the italicized clause as the “unless clause.”)

Thus, in a state with this rule, if the law firm asks the client to consult with other counsel about signing such an agreement, the agreement should not be unethical. Presumably, the client’s inside counsel, where available, could serve this function. Approximately forty states have the “unless clause,” or something close to it. Approximately ten states have an outright prohibition - that is, no “unless clause.” Unfortunately for national law firms, among the ten are California, the District of Columbia, and New York. At a recent meeting of the Committee on Professional Responsibility, a leading ethics and lawyer liability expert stated that the choice of law rules are complex enough that a law firm with lawyers admitted in those three jurisdictions could never be sure that the limitation on liability would be effective.

### **Non-clients**

Let’s discuss a transaction in which the law firm is asked to provide its client with a “due diligence report” on some aspect of the transaction. We are told that other parties to the transaction, including institutions providing financing, regularly require that they be provided such reports, in part so that they do not have to hire counsel to do the same due diligence. That raises at least two issues: (1) Can the law firm ethically obtain a limitation of liability (or cap) from these non-clients, and (2) assuming such an agreement is ethical, as a contractual matter, how can the law firm do this?

We will dispense with the second question first, by saying that we do not know. Certainly obtaining a signed, written agreement from a non-client specifying a cap on the law firm's liability would seem to do the trick. Some have suggested that merely stating in the report that anyone other than the client relying on the report is deemed to have agreed to a cap would be effective. We have no confidence that such a "self-executing" cap would be effective. Nor do we believe that a law firm can, with confidence, rely upon a statement within the report that only the client can rely on the report. Those are large subjects, outside the purview of this column and for another day.

What we can say with some confidence is that a lawyer may *ethically* ask a *non-client* to agree to a limitation of liability. First, note that the prohibition contained in Model Rule 1.8(h) pertains to clients. It says nothing about non-clients. Nor are we aware of any other ethics rule that prohibits an agreement limiting a lawyer's liability to a non-client. Thus, one is left with contract (and other) issues, including those mentioned in the prior paragraph.

*Disclaimer: one or more states may have prohibitions in their ethics rules or laws of which we are unaware; this discussion does not cover other laws or regulations that may affect the validity of liability caps, including, but not limited to, tort law.*