

4A's MSA Guidance Series
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Allocation of Risk, Indemnification & Limitations on Liability

A Guidance Directive from the American Association of Advertising Agencies



4A's Agency-Client MSA Provisions Guidance Series: Allocation of Risk, Indemnification & Limitations on Liability

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Section I: Guidance Overview

Agency and Client management need to understand the importance of negotiating appropriate and equitable allocations of risk and limitation of liability provisions in every business arrangement. Management teams, including subject matter experts from legal, finance, human resources, risk management and information technology disciplines, should be aligned on the principles, nuances and thresholds for all indemnity obligations and limitations.

Management decision makers—those who are empowered to accept or reject terms and contractual provisions—should insist that every Agency-Client arrangement:

- (1) Fairly reflect the scope of services being provided to the Client,
- (2) Recognize the Agency's operating business practices and
- (3) Fit within the economic parameters of the engagement with the Client.

In today's fast-moving and changing environment, simply by engaging in emerging media channels, utilizing new technology or advancing the way one analyzes marketing activity there are new risks that have emerged that did not exist one, five or ten years ago. While it is appropriate for an Agency to assume responsibility for activities that are solely within an Agency's control, it is not the Agency's role to insure a Client against marketing risks that emanate from activities that are within the Client's control or arise from work performed by third parties or reflect systemic risks that are not routinely and readily determinable. Agencies are not insurance companies.

Although some of the risks may have changed, the underlying rationale for seeking a fair agreement has not. Agency management has a fiduciary obligation to its stockholders, employees and to all of its clients to precisely define and equitably negotiate contractual terms related to Agency contractual responsibility (such as indemnification) and to negotiate appropriate limitations of liability with every Client. This guidance, which primarily pertains to USA relationships (although it may have some relevance to global and foreign agreements as well), seeks to provide a fair and appropriate framework to assist Agency-Client MSA (Master Service Agreement) negotiations.

Section II: Introduction: Why Are Allocation of Risk and Limitation of Liability Important?

The marketing landscape is fast paced, dynamic, multichannel and multidimensional. The marketing application of emerging technology is accelerating. There has been a dramatic expansion of communications platforms, media outlets, data sources and marketing systems and services specialists. The opportunity to innovate is seemingly unlimited.

The evolving marketing ecosystem has become increasingly complex and challenging to navigate. This complexity brings opportunity, however, it also carries potential risk. The interdependence among agencies, advertisers and other members of the marketing ecosystem can make the assignment of responsibilities and obligations more complicated and less obvious than in the simpler past.

It is increasingly important for an Agency and a Client to discuss the service arrangements, economics, rights and responsibilities of each party. A comprehensive Agency-Client discussion of responsibilities should include discussion of Agency contractual responsibilities (including indemnity) and limits on Agency exposure.

Indemnification provisions of Agency-Client agreements are extremely important, and they can be quite complex.

Even in situations where an Agency's services are limited, some Clients may nonetheless endeavor to broadly and unilaterally shift marketing risks beyond the scope of the Agency's involvement and to seek to have the Agency take on the risk as if it were an insurance company. In all situations, it is prudent business practice to ensure that the nature and scope of the Agency's services for the Client dictate the parameters of obligations agreed by the Agency for the Client and the Client for the Agency.

Reaching an understanding of the roles and responsibilities of the Client and the Agency—at the earliest possible time—can only serve to strengthen the Agency-Client relationship.

Client marketing activities increasingly feature multiple media channels, diverse technology platforms, interactive content creation and fluid geographic implementation and are happening in real time. Client marketing elements often involve input from multiple suppliers, intermediaries, specialists and in certain instances, the general public. Stewardship of Client marketing programs and contractual documentation of legal compliance responsibilities and obligations need to reflect the respective processes, business methods, control parameters and authorization responsibility of the parties.

Inappropriate or inequitable allocation of risk in a contract can damage your Agency, and failure to establish reasonable limitations on your Agency's liability can upend your financial results, which, in turn, will disrupt your ability to retain your talent, invest in Client services and provide a reasonable return to your shareholders.

This paper reviews frequently discussed elements of Agency-Client conversations with respect to allocation of risk and limits on liability in an Agency-Client contract and provides guidance on best-practice considerations.

Section III: Allocation of Risk: What Is Fair and Reasonable?

Clients and agencies collaborate on a broad spectrum of marketing development and execution activities. The parties are well served to agree upon expectations, processes, organizational expertise and control responsibilities related to development of critical advertising elements such as copyright, trademark, patents, union obligations, etc.

Based on the division of expertise and control responsibilities, the parties can begin to determine how to equitably and rationally allocate risk avoidance parameters in a contract as well as indemnification obligations.

The fundamental premise of this guidance is that no party should bear an indemnification responsibility where it does not control the underlying conduct or cannot reasonably protect itself against the risk.

It should be noted that this guidance and allocation of risk discussion recognizes that not every risk inherent in the Agency-Client relationship needs to be the subject of an indemnification obligation.

The template that follows provides a checklist of potential topics that are frequently discussed when reviewing an Agency-Client agreement. The template frames industry allocation of risk responsibilities based upon activity that is typically within Agency's control or typically within the Client's control and includes commentary on the subject matter. This discussion is an overview and should not be construed to address each and every issue that arises with respect to the negotiation of indemnification provisions in Agency-Client agreements.

Section III: Allocation of Risk: What Is Fair and Reasonable?

Allocation of Responsibilities, Control and Risk

Indemnification

An indemnification is a promise by one party to the other to take financial responsibility for third-party claims resulting from specified actions or inactions of the indemnifying party. The grid that appears below, which relates to indemnification, outlines those actions/inactions that could give rise to a third-party claim, summarizes customary control responsibilities and shows where indemnification is appropriate.

Topic	Typically Within Agency's Control	Typically Within Client's Control	Commentary
Copyright, right of privacy, right of publicity and other common law rights (e.g., piracy, plagiarism, idea misappropriation)	If Agency creates and produces the material, Agency is responsible to obtain releases for use of artwork, photos, music and other copyright materials, as well as the use of the name and likeness of persons owned by others in materials produced in final form for Clients. Agency, however, is not responsible for elements within Client control or for those provided by a third party not within Agency's control.	Client is responsible if: <ul style="list-style-type: none">– Client uses materials that have not been produced in final form, since Agency will not clear rights until it knows something will be produced;– Client alters the materials, which causes them to be infringing;– Client provided or directed a third party to provide the materials for use in the materials being produced;– Material is created and/or produced by a third party that is not within Agency's direct control;– Client agreed to obtain rights to certain elements or to be responsible for rights review;– Client uses the materials in a manner not permitted by the applicable license or agreement, provided Agency has advised Client of the limitations;– Agency advises Client that using certain materials without obtaining rights is risky and the Client assumes the risk;– Client directs Agency to take or to refrain from taking certain actions;– Agency is a media Agency that is not responsible for creative services.	Parties should address any other carve-outs.

Topic	Typically Within Agency's Control	Typically Within Client's Control	Commentary
Trademark	Third-party trademarks of items that appear in Agency-created advertising (other than trademarks/tag lines provided by Client).	Trademarks provided and/or cleared by Client.	<p>Typically, Agency will perform a preliminary trademark search for taglines, etc. Either Agency or Client will perform the full search.</p> <p>If Client performs the full search, the Client should be responsible.</p> <p>If Agency performs the full search, Agency may offer its opinion but typically will defer to Client's trademark counsel for final determination.</p>
Patent	The 4A's recommends that Agencies should not indemnify Clients for patent claims. However, in light of the uncertainties of the current patent landscape and in very limited circumstances related to the breadth and nature of a unique Client relationship, if an Agency decides to contribute to settlement of a patent infringement claim, the Agency should limit its contribution to an equitable and proportional share of the reasonable settlement cost, and the Agency should further limit its contribution to settle patent assertions arising solely from use, prior to the receipt of the claim, of work product developed and produced entirely by the Agency for specific Client properties, and then only for a specific period of time and with respect to specified uses.	Most marketers recognize the need to fully indemnify the Agency and assume patent risk. However, due to the unpredictable nature of patent assertion entity activities, the Agency-marketer ecosystem is being forced into a debate over indemnification responsibilities related to patent assertions.	<p>Agencies and Clients should also consider specifically excluding any liability for claims made or asserted related to patents for commonly used features or functions such as commonly used interactive codes, designs or methods.</p> <p>4A's patent guidance recommendations for Agencies are available in the patents section of the 4A's website, which includes: June, 2013: 4A's Patent Guidance Recommendation: Digital Functions, Patent Liability and the "Wayback Machine"</p>
Product Disparagement		Product disparagement is a Client responsibility.	
Personal Defamation claims (including slander and libel)	If Agency is responsible for engaging models/performers, Agency is responsible for obtaining appropriate releases.	If the Client has approved Agency materials prior to broadcast, publication or other distribution, the Client is responsible.	
Negligence	If Agency's negligence, gross negligence or willful misconduct causes loss or damage to a third party, Agency should be responsible.	If Client's negligence, gross negligence or willful misconduct causes loss or damage to a third party, Client should be responsible.	
Breach of Contract by Agency or Client			It is inappropriate to include claims for breach of contract (including breach of representations and warranties) in indemnification obligations because the parties are already fully protected by their contractual remedies for breach.

Representations and Warranties

Representations and warranties are, more specifically, guarantees or “promises” that specific facts are true or will happen. So, a party to a contract can be liable (i) for failure to perform an obligation under the agreement (e.g., the Client fails to pay the Agency’s fee) or (ii) if a representation or warranty made by such party is “broken” or is “untrue” (e.g., Agency represents that its work product does not infringe a third party’s copyright and the Client is sued for infringement by a third party). Therefore, all of the Agency’s representations and warranties must be reviewed carefully to ensure that the Agency is comfortable making the guarantee or promise requested and can control (or is in a relatively better position than the Client to control) the obligations at issue. It is not uncommon for Clients to request that agencies make a number of representations and warranties. The mere fact that an obligation is delineated as a representation or a warranty does not mean that the Agency needs to or should indemnify the Client for each and every obligation.

The table below discusses various representations and warranties and ascribes the fair allocation of responsibility between Agency and Client for each.

Topic	Typically Within Agency’s Control	Typically Within Client’s Control	Commentary
Compliance with law	The Agency can agree to make commercially reasonable efforts to comply with the predominant laws, rules, and regulations applicable to the services being provided to the Client pursuant to the agreement.	Client should be responsible for all laws, rules, regulations, industry codes and guidelines, etc. applicable to its own business, products and services. (For example, Clients in highly regulated categories such as financial services, health care, alcohol, tobacco sectors should be responsible for compliance with all laws and regulations related to their products and services.)	Overly broad promises in regard to compliance should be avoided. In certain instances, assuming risk for compliance with law is void if it is against public policy. For example, neither the Agency nor the Client can indemnify the other for violations of the FTC Act.
Professional Standards (e.g., perform in a professional manner in accordance with industry standards; employees possess experience, skill, etc.)			Agencies should be wary of this provision because a determination as to whether an Agency has achieved this representation is highly subjective.

Topic	Typically Within Agency's Control	Typically Within Client's Control	Commentary
Security Standards	The Agreement may require Agency to maintain certain reasonable security standards, particularly with respect to its IT systems. Agency IT should have an opportunity to review a written description of what Client expects in this regard and to determine whether the requested standards, based on the materials received, are overly onerous. In the event of a security breach, if the Agency systems comply with the agreed articulated standards, then Agency should not be responsible. However, if Agency fails to maintain the agreed-upon security standards and if, as a result, the Client's confidential information (including Personal Information as that term is defined by applicable law) is compromised, the Agency should be responsible.		In some cases, the Agency may comply with all contractual security requirements and there is still a breach. Agency should not bear the responsibility. Increasingly, hackers are finding creative ways to compromise security.
Privacy	Many agencies stipulate that they will not accept Personal Information (that may also be referred to as "PII" as defined by law), however, if the Agency has agreed to handle PII, either by the very nature of its services or as described in a project or SOW, the Agency can agree to protect the PII in accordance with predominant applicable laws.	If the Agency-Client agreement provides that the Client cannot provide PII without Agency's approval or by complying with certain other procedures and the Client forwards this information without complying with the agreed-upon procedures, Client should be responsible for the breach. Additionally, the Client should warrant that Client is and shall comply with such laws with respect to any PII it provides to Agency.	Agency should not be liable for theft of PII through methods out of Agency's control (e.g., despite appropriate, agreed-upon Security and handling of PII). Also, Agency should not be responsible for the acts of third parties, such as analytic technology companies, that are not under Agency's direct control.
Performance in accordance with specifications	If there are objective performance specifications (e.g., a website must accommodate a certain amount of traffic), the Agency should be responsible if those specifications are not met (so long as neither a third party [that is not under Agency's direct control] nor the Client is responsible for the failure due to some act or failure to act).	Client should be responsible if a specification cannot be met due to Client act or failure, changes to the work product by Client, specific instructions provided by the Client, or use of the work product in a manner for which it was not intended, etc.	Agency should be wary of aspirational specifications or specifications that are excessively subjective.

Topic	Typically Within Agency's Control	Typically Within Client's Control	Commentary
Breach of third-party contracts	If entering into or performing an agreement will breach a third-party contract Agency entered into on behalf of a Client, Agency should be responsible.	If entering into or performing an agreement will breach a third-party contract Client entered into, Client should be responsible. Similarly, if the Client is subject to a consent order or other order that would restrict their ability to enter into an agreement, Client should be responsible.	
Foreign Corrupt Practices, UK Bribery Act Compliance	The Agency needs to take responsibility for its employees.	The Client needs to take responsibility for its employees.	
Responsibility for Third-Party Vendors and Subcontractors	<p>If an Agency selects and pays a third party without input from the Client and pays the third party out of the Agency's own operating expense pool (i.e., the expense is not payable by the Client as an out-of-pocket expense), the Agency is typically responsible.</p> <p>Agency and Client should limit liability to amount recoverable from the third party.</p>	With respect to performance by any third-party vendors or sub-contractors designated by the Client, Client is responsible.	If the third party fails to perform, the Client should look to the third party, not the Agency (unless the Agency's negligence is responsible for the issue).

Other Contractual Responsibilities

There are a number of other contractual responsibilities that agencies are asked to assume by their Clients. The table that follows includes certain key provisions that Clients often include in their contracts and guidance as to the appropriate allocation of responsibility for the obligations underlying such provisions.

Topic	Typically Within Agency's Control	Typically Within Client's Control	Commentary
Independent Contractor	Agency is responsible for the actions of its own employees in the course of providing services to its Clients, for payment of wages, benefits, etc., and for any claims if it fails to do so.	If a Client's acts lead to claims (e.g., sexual harassment), Client should be responsible.	One area of concern relates to background checks. For example, if a Client requires background checks and/or restricts the Agency from assigning people to their account who have any felony or misdemeanor charges. Agencies should not agree to perform background checks or other requirements to the extent that they are against state laws or EEOC guidelines.
Payment to third parties (including taxes, if required)	If the Client has paid Agency, Agency should be liable if Agency fails to pass such payment on to the relevant third party.	If Client fails to pay Agency in a timely manner and as a result there are interest charges, penalties, etc., Client should be responsible. If Client claims they are exempt from sales, use and other taxes, and that turns out to be challenged by the authorities, Client should be responsible for taxes and all associated costs.	
Product Claims	If Agency releases materials to the public that were not approved by the Client, Agency is responsible.	Client is responsible for checking that claims concerning its products or services (and if there are competitive claims, the Client is responsible to confirm that claims related to their competitors) are true and correct.	The Agency should ask for support of claims and not solely rely on the Client saying claims are true. If the Agency has reason to know that a claim is false before materials are released and the claim is challenged, Agency may also be held liable as a matter of law.
Product Liability Claims		The Client needs to be responsible for any damage or injury caused by its products or services.	
Damage to Client's products while in Agency's custody and control	Agency should be responsible if its negligence causes the damage.		If there is damage when the products are in the custody and control of a third party (even if the Agency retained the third party), Agency should not be liable. The Client's or third party's insurance should cover the loss.

Topic	Typically Within Agency's Control	Typically Within Client's Control	Commentary
Claims that Client's products or services are infringing and that advertising those products/services also infringes simply by the act of engaging in advertising		This is a Client obligation. In this situation, but for the Client's infringing product, the Agency wouldn't have infringed. For example, the mere creation/publication of an advertisement depicting an infringing product that is marketed by the Client may also give rise to a claim of infringement.	
Advertising and other materials provided by Client		Client must be responsible for any advertising it provides to an Agency that is only providing media buying services (not creative services). Similarly, where a Client wants its creative or direct marketing or Agency to use materials created by Client or another Agency on behalf of Client, Client must be responsible for such materials (e.g., images, music, etc.) provided to the Agency.	
Performer Union Contract Obligations	If the Agency is a signatory to any of the performer union agreements (SAG-AFTRA, AFM) that cover the production of advertising/marketing materials, Agency is responsible for managing the process of employing and paying such union performers in adherence with the rates, terms and provisions of such agreements subject to the Client paying Agency and providing Agency with necessary media schedule information.	<p>If the Client is a signatory to any of the performer union agreements (SAG-AFTRA, AFM) that cover the production of advertising/marketing materials, Agency will act in such regard to the production of that material at the direction of the Client. Client will retain full responsibility for adherence to the terms, provisions and payment obligations under such agreements.</p> <p>Whether or not Client is a signatory, Client is responsible for payments and claims asserted by the union or the union's pension and health funds for non-payment or underpayment of fees due performers in connection with the production and/or use of any materials produced by Agency on Client's behalf, regardless of whether such claims arise or are asserted during or after the term.</p>	<p>1) If a Client uses material that is subject to the terms of performer union agreement(s) and uses such material either outside of the permitted use rights or directs the Agency in a manner that could result in the underpayment or improper payment to performers—for example, uncertainty or disagreement as to performer classification such as principal vs extra—Client should be responsible for any outstanding payment due performers as a result of a union claim.</p> <p>2) In the event that a performer union files a claim based on union's subjective interpretation of the union contract and such claim cannot be resolved in favor of the Client, Client should be liable for any additional payments due to performer(s) as well as any legal fees incurred for resolution of the claim.</p>

Section IV: Limitation of Liability

Marketing executions are the by-product of collaboration between a Client and the Client's agencies. Clients understand that the business benefits and economic rewards associated with marketing activity primarily accrue to the Client. Furthermore, virtually all Agency-Client agreements stipulate that the Client has sole authority to control, amend, approve and authorize any and all execution elements.

Given the economic framework and ultimate control parameters of the Agency-Client relationship, an Agency's indemnification obligations and liability responsibilities should include appropriate and proportional limitations.

The Limitations of Liability discussion that follows outlines examples of some, but not all, customary industry practices related to crucial limitations on Agency contractual and indemnity obligations:

(i) Liability Cap for Direct Damages – Agencies should seek to cap their aggregate or even per-claim liability for direct damages. Direct damages are monetary damages resulting directly from a failure to perform the Agency's obligation under the agreement and would exclude special or consequential damages (discussed below). There are many different avenues by which an Agency can agree on limitations of liability in a Client contract. A few examples are provided below:

Overall Liability Cap – Agencies customarily include caps on overall liability under a contract, and such caps can be accomplished using a myriad of structures which include: (i) identifying a fixed monetary amount; (ii) relating the cap to a proportion of the fees (excluding any media and other third-party costs) paid to the Agency during a fixed period (prior to the claims); (iii) relating the cap to an amount of the fees paid for the particular work or project from which the claim resulted; (iv) proportionally sharing liability with the Client (for example, 90/10; 80/20; 70/30 or based on ratio of Agency fee to Client marketing spend, based on proportional sales or whatever other basis as may be agreed); and (v) having the Agency responsible for an initial fixed amount and then a proportional sharing of responsibility with Client for any amount above such initial fixed amount.

Examples of contract language to accomplish the goal of providing a liability cap for direct damages are noted below:

"Notwithstanding any other claim or provision of this agreement, Agency's liability to Client for any cause whatsoever shall be limited to ____% of the amount paid by Client to Agency as Agency's fee under this Agreement within the [negotiated time period] preceding the event (or last in a series of events) which gave rise to the claim. Direct damages subject to this limit shall be Client's sole and exclusive remedy."

"Agency's and its affiliates' total aggregate liability for any claim of any kind arising as a result of or related to the interactive services performed hereunder, whether based in contract, warranty, or any other legal or equitable grounds, shall be limited to the amounts received by Agency from Client for the particular project(s) which form(s) the basis of such claim. Direct damages subject to this limit shall be Client's sole and exclusive remedy."

“Agency shall not be liable for damages which exceed the amount of fees paid by Client that is directly related to the particular services under the project scope of work from which the claim at issue arises.”

(ii) Limitations on Indemnification Obligations. Consistent with the discussion regarding indemnification, it is reasonable to clarify in a Client agreement that the Agency’s indemnification obligations will not apply to (and the Client should be responsible for) any materials that are: (i) used in any territory not specified by an SOW unless otherwise specifically agreed in writing by the Agency; (ii) modified by the Client or otherwise used by the Client for a purpose that was not intended by the Agency (or for a purpose that was either not specified in the SOW and/or was specifically prohibited by the SOW); (iii) based on material created or supplied by the Client or a third party (including any subcontractors that the Client has required the Agency to engage), or known by the Client to be created by a third party and not disclosed to the Agency; (iv) used by Client where Agency has identified a risk and Client has elected to proceed notwithstanding such risk; and (v) user-generated content (UGC). (User-generated content is content that is created by third parties – typically the intended audience of the deliverables – and should never be the responsibility of the Agency, whether or not the advertising/marketing strategy to employ user-generated content in connection with a campaign was developed by the Agency. Some of the reasons that Agency should not be responsible for UGC include: (1) it is impossible for the Agency to determine whether the individual who created the content has the legal right to use all of the IP (music, talent, etc.) included in such content; and (2) any indemnity or other protection provided by such individual may not have any financial value.

Examples of contract language to accomplish the goal of establishing appropriate limitations on indemnification obligations are noted below:

“The foregoing indemnification by Agency shall not apply where such claim, suit, or proceeding arises out of matters as to which Agency has advised Client of the risks involved and Client has agreed to accept those risks; nor shall such indemnity apply to materials provided by Client to Agency or to materials as to which Client undertook the responsibility to obtain the usage or other rights.”

“Notwithstanding the indemnification obligations in this Agreement, Agency’s indemnity and defense obligations as provided herein will not apply to any materials that are (a) used in any foreign territory including use of such materials in any foreign territory on the Internet, unless otherwise specifically agreed in writing by Agency; (b) are modified by Client or otherwise used by Client for a purpose that was not intended by Agency; or (c) based on material created or supplied by Client, or known by Client to be created by a third party and not disclosed to Agency.”

“Agency does not warrant that the web site will meet Client’s requirements or that the operation of the website will be error free or uninterrupted. Agency shall not be liable to Client or any third party for any unavailability or inoperability of the service, telecommunications systems or the internet, third party subcontractors, technical malfunction, computer error, corruption or loss of information or other injury, damage or disruption of any kind beyond the reasonable control of developer. In no event will Agency be liable to Client for any special, indirect, incidental or consequential damages (including without limitation loss of use, data, business or profits.) Agency’s liability shall in no event exceed ____% of the fee paid by Client pursuant to this agreement for the most recent ____ months.”

“Except as expressly provided herein, neither party makes any warranty, express or implied, regarding the products or services to be provided hereunder, and the warranties of title, merchantability and fitness for a particular purpose are expressly excluded.”

(iii) Liability Cap for Patent Infringement Claims. Agency responsibility for patent liability, if any, should require proportional and equitable sharing of costs, as well as time and use limitations. The 4A’s recommends that agencies should not indemnify Clients for patent claims ([4A’s Patent Guidance Recommendation](#)). However, in very limited circumstances related to the breadth and nature of a unique Client relationship, if an Agency decides to contribute to settlement of a patent infringement claim, the Agency should limit its contribution to an equitable and proportional share of the reasonable settlement cost, and the Agency should further limit its contribution to settle patent assertions arising solely from use, prior to the receipt of the claim, of work product developed and produced entirely by the Agency for specific Client properties, and then only for a specific period of time and with respect to specified uses. Consider also (i) including carve-outs to the indemnity for known NPE’s (Non-Practicing Entities) that assert specious patents and/or for functions that have been subject to assertions and (ii) requiring as a condition of any Agency indemnity Agency’s ability to control/limit Client use of the Agency work product in the event of an assertion. See Overall Liability Cap section for suggestions on how to structure patent infringement liability caps.

Examples of contract language to accomplish limitations on Agency liability for patent infringement claims are provided below:

“Agency indemnification liability in relation to any patent infringement claim will be mitigated by Client’s obligation to pay directly or reimburse Agency for (1) the initial (\$T/B/D) of defense costs, settlement costs and/or damages awards and thereafter (2) ____% of any further defense costs, settlement costs and/or damages awards in excess of \$T/B/D.”

“If in Agency’s opinion any Deliverable (or any portion thereof) is likely to become the subject of a third-party claim of infringement of any Indemnified Property, Client will cease using such Deliverable upon Agency’s request. In addition, Agency will either procure the right for Client to continue using the Deliverable, or will replace or modify the same to be non-infringing; if neither of the foregoing options is reasonably available, Agency will refund to Client amounts paid for the Deliverable at issue as Client’s sole remedy. Agency’s indemnification obligations related to patents, as set forth in this section, only apply to Liabilities that Agency has received notice of within _____ months of delivery to Client of the applicable Deliverable. Notwithstanding the foregoing, this indemnification may be limited in scope or totally nullified to the extent that the Client knew of, or had been specifically advised of, any risk in connection with the use of such materials, and elected to use such materials despite such risk.”

(iv) Indirect Damages Waiver. Indirect damages waivers seek to exclude liability for incidental, indirect, consequential, punitive, special or exemplary damages, including damages for lost profits, lost revenue or lost business. These clauses help to eliminate uncertainty as to the amount of risk a party is taking on. For example, if a Client were sued for infringement in connection with an Agency-created ad that included infringing artwork that had been procured by the Agency, the Client could argue that in addition to the actual direct damages it suffered as a result (such as the direct cost of pulling the ad and finding a quick

replacement), it also incurred “consequential” damages – that is, the fact that it was forced to pull the ad adversely impacted its potential sales and it should thus also be entitled to recover damages for its lost business and profits.

Examples of potential indirect damage risk triggers are referenced below:

- Risk of Making an Exception for Breaches of Confidentiality Obligations—A data breach could be deemed to be a breach of a confidentiality obligation under the contract and lead to uncapped exposure for indirect, consequential damages.
- Risk of Making an Exception for Gross Negligence—Whether or not specific conduct would amount to *gross* negligence as opposed to simple negligence is not a bright-line test. It would ultimately have to be determined by a court, and such findings can vary from jurisdiction to jurisdiction, depending on local contract law, but *gross* negligence would typically be conduct that deviates *significantly* from the ordinary standard of care, based upon applicable industry standards.

For example, in the above infringement example, if the Agency had procured the infringing artwork from a street vendor for \$10, such conduct might be considered to have been grossly negligent.

Exceptions for willful misconduct and fraud pose the same risk. The difference between a fact pattern of negligence vs. willful misconduct vs. fraud is not always black and white.

- Risk of Making an Exception for Indemnification/Third-Party Claims—The risk is the uncertainty of the damages that fall outside the direct control of the Agency, such as a Client’s lost profits.

An example of indirect damages waiver contract language follows:

“Notwithstanding anything to the contrary in this Agreement, in no event shall either party be liable to the other party or any third party for any indirect, incidental, special, consequential, exemplary or punitive damages, or other similar type of damages, including, but not limited to, obligations, losses, damages, penalties, claims, actions, causes of action, suits, judgments, settlements, out-of-pocket costs, expenses and disbursements (including, but not limited to, reasonable costs of investigation, and reasonable attorneys’, accountants’ and expert witnesses’ fees) of whatever kind and nature arising by reason of any act, omission, matter or event relating to this Agreement or arising out of any default or breach thereof (collectively, “Losses”), whether or not either party is informed, knew or should have known, of the possibility of such Losses in advance.”

(v) Laws. Note that laws may vary on permissible limitations on liability.

Section V: Best Practices

This Section outlines overall industry dynamics rather than the elements of a specific Agency-Client agreement. The 4A's acknowledges that specific contract provisions (such as indemnification, representations and warranties and limitations on liability) need to be customized to reflect the service activities, operating practices, control parameters and economic framework of the relationship. That being said, there are broadly considered industry practices related to evolving prudent and equitable contract provisions with Clients.

The best practices discussion that follows represents a few limited but significant principles that Agency management, commercial staff, Client service teams and legal advisors may want to use as a catalyst for aligning your Agency's approach to discussing agreements with Clients.

The Importance of Negotiating Fair Terms

In negotiating an Agency-Client agreement, it is important that the parties work together to make sure the contract ultimately reflects each party's actual responsibilities, processes or ways of doing business. Agencies spend a great deal of time negotiating a compensation structure that will result in a profit to the Agency that is fair and reasonable in light of the services to be performed. If the Agency then signs an agreement that imposes unfair and excessive liability on the Agency, the Agency may find itself never realizing the profits that it anticipated and negotiated or even potentially losing money on the Client relationship which can be detrimental to the Agency-Client relationship. It is better to invest the time up front to negotiate a contract that is fair to both sides than to rush to enter into a contract that does not reflect how the Agency and Client will operate in reality.

No party should present its form agreement to the other and claim that the agreement is "non-negotiable." Negotiations are needed to ensure the agreement is properly tailored to the business relationship at hand. There may be many reasons why a party may initiate discussions with a form agreement that is not properly crafted to the requested services. The party may want to save legal costs, time and effort in negotiating an agreement, an attorney may want an agreement that complies with company policies, or they may want to intimidate, for negotiating purposes, the other party into believing that no agreement will be reached unless they are on the proffered terms. However, the advantages of negotiating an agreement that fits both parties' needs far outweigh the disadvantages. It is far better to go through the effort of negotiating an agreement during which each party learns of the other's capabilities and processes, and ultimately to enter into an agreement that covers risks and liabilities based on each party's responsibilities and the economics of the particular deal, than just to sign an agreement that does not reflect how the parties intend to operate in reality. For example, SAG signatory agencies have certain obligations they must follow in securing and paying talent, which the Clients need to understand and agree upon; and agencies use various methods for communicating to Clients limitations on use of third-party materials included in advertising.

It will not do either party any good to impose burdens on the other that are not customary. The imposition of these type of burdens on a party that is not accustomed or equipped to handle them will inevitably lead to mistakes and additional costs that will not serve either party's interest.

The focus of the Agency-Client agreement should be to help avoid mistakes and prevent the damage or the reputational harm that results from errors.

To provide comfort to agencies, we haven't yet heard of a Client taking away business from an Agency simply because the Agency insisted on negotiating the agreement, rather than signing the Client's form document.

Negotiating Strategies

While each party's lawyers often take the lead in negotiating the agreement, it is generally important to have business people, finance and other relevant stakeholders directly participate in the negotiations. For example, if the Client's form agreement includes terms that are not in line with the Agency's processes, it can help to have the Agency's account director explain to his/her Client counterpart the process the Agency in fact uses to address the issue. Similarly, payment terms, billing processes, audit provisions and tax questions are often handled best by a member of the finance department or accounting department. Insurance questions should be brought to the attention of the Agency's risk managers, and IT/data security questions should be handled by an IT expert. Matters involving individual Agency employees should include input from the Agency's human resources group. The process the Agency already has in place often satisfies the Client's needs, and the agreement can then be revised to reflect the actual process, rather than the one the Client has used in the past. It is far preferable and more efficient (for both parties) to have a contract that allows for processes that the Agency already has in place, but that still accomplishes the Client's goals, rather than endeavoring to adapt multiple Client-specific procedures that impose on the Agency new or additional processes for which the Agency does not have the infrastructure.

Guidance on How to Approach Certain Agency-Client Provisions

Agencies should understand the provisions of the Agency-Client agreement and be prepared to provide examples and context as to why requests from the Client and, if applicable, the Client's procurement department are unfair, impractical or not economically viable to the Agency.

A few examples:

- Indemnity for Performer Union Employment (SAG-AFTRA, American Federation of Musicians/AFM): Some Clients have difficulty understanding why the Client should indemnify the Agency for union performer claims when the Agency manages the employment and production process. The performer unions take a very restrictive approach when interpreting the provisions of the union agreements and will only file

claims that are economically advantageous to their members. Such claims may not be able to be resolved in favor of the Client, and the legal costs involved to pursue further resolution may exceed the amount(s) in dispute. The Agency needs the assurance that in the event of a dispute with the unions, the Client will indemnify the Agency and cover the performer costs that are owed as well as any interest, penalties and legal costs incurred. If a Client does not indemnify the Agency for talent union disputes, then the Agency will likely adopt conservative interpretations of any ambiguous union obligations, which may lead to higher costs for the Client.

- **Acceptance testing, or conditioning payment upon Client's satisfaction with the materials or services:** Some procurement departments are more accustomed to contracts for goods where acceptance clauses are common. It helps to explain that advertising services are creative services and that the Client is involved in the creative process every step of the way. It is not reasonable for the Client that has approved the brief and preliminary materials upon which the creative is based to reserve the right to not pay for the creative materials and services once the work is completed, simply because the Client is subjectively "not satisfied." The Client has a heavy hammer at its disposal already (i.e., the Client has the right to fire the Agency), which is sufficient incentive to get the Agency to give the Client its best work.
- **Indemnification:** The Agency should not agree to indemnify for all claims arising out of the Agency's services or materials created. Instead, the Agency should only indemnify Clients for the risks the Agency is reasonably able to mitigate (e.g., certain IP claims for materials that the Agency has produced in final form and then only if those materials are not altered and used in accordance with third-party agreements). The Agency also needs to carve out from its indemnification obligations those elements that the Client supplies or for which the Client is otherwise responsible. See Section III, Allocation of Risk: What Is Fair and Reasonable, for a more detailed discussion of indemnification obligations.

If, in light of the economics of the particular Client arrangement, the Agency is willing to take on risk, the Agency should negotiate caps on the Agency's liability that make sense in light of the revenues and profits that the Agency realistically anticipates receiving from the Client. See Section IV, Limitation of Liability, for a more detailed discussion of appropriate caps on liability.

- **Blanket Provision:** Beware of blanket provisions that do not recognize the division of legal responsibility between the Client and the Agency in creating advertising materials. For example, an advertising Agency cannot agree to responsibility for compliance with all laws generally, because the laws related to the production and use of advertising materials and programs involve a division of responsibilities between the Agency and the advertiser. Although both parties wish to create an end product that is in compliance with all laws, the advertising Agency looks to the advertiser for primary responsibility for compliance with certain laws, including, for example, laws related to the advertiser's products, services, programs or industry or advertiser-provided materials or information or with respect to which the advertiser has more control or information (e.g., laws related to truth in advertising, privacy, CAN SPAM, or COPPA compliance).
- **Third Parties:** The Agency can and should take responsibility for freelancers and subcontractors who provide core Agency services that the Agency engages on its own behalf and pays from its own resources (i.e., from the Agency fee). However, where the Agency has no control over and cannot guarantee or take

full responsibility for those third-party vendors or suppliers engaged by the Agency on the Client's behalf, the Agency should not bear the responsibility (for example, media and technology vendors and production companies). In many cases, the choice of third parties is dictated by the Client or by the Client's budgets. Very often, especially for large-budget items, both the Agency and the Client are actively involved in reviewing, selecting and approving -party vendors and terms. To ask the Agency to then provide a guarantee for the third party's performance is asking the Agency to provide a service for which the Agency is has limited or no control.

With respect to performance by any third-party vendor or subcontractor designated by the Client, the Client is responsible.

- **Agency Tools:** If the Client has paid a sufficient fee in order to own the work product that the Agency develops for the Client, the Agency nonetheless should ensure it retains rights to any methodologies, strategies, inventions, concepts, ideas and software that may be incorporated into or underlie the work product (this is often referred to as a "toolkit provision"). This is important for the Agency because it will need to use these elements over and over again for other Clients. Insofar as the Agency's rights are concerned, the Agency can grant the Client a license to use the Agency property in order to for the Client to be able to use the work product as intended.
- **Social Media:** The production of advertising is moving at the speed of light in order to keep up with the demands of digital media, in particular social media. Often this means that there isn't time for materials to go through the usual legal review and clearance process. In those instances, the Client should assume responsibility for any legal or public relations issues that arise from those materials. Some Clients may have social media guidelines that they share with agencies. Assuming the guidelines are clear and easy to follow, then the Agency may agree to follow those guidelines in producing quick turnaround materials and only take on liability in the event that it didn't follow the guidelines or otherwise failed to receive approval from the Client.
- **Patents:** Software patents remain an intractable issue for both clients and agencies with respect to digital work product. You should refer to the 4As prior guidance on patents, found in [The 4A's Patent Website](#).
- **Data Security.** Data security breaches are becoming a very important issue for Clients. If the Client includes a data security section in its form agreement, the Agency should have that section reviewed by its IT/data security expert and that expert may need to negotiate directly with the Client counterpart to ensure that the provisions reflect the Agency's data security capabilities.

Final Thoughts on Agency-Client Negotiations

Not every situation is the same. The Agency should determine what risks and liabilities it is willing to assume on behalf of a particular Client based on an economic analysis of the Client relationship and the fee arrangement. The Agency should not sign an agreement without determining if the fee to which it has agreed with the particular Client is adequate to compensate the Agency not only for the services it performs, but also for the intellectual property rights it is granting and the potential liabilities it is assuming. If the fee is not adequate to cover all of these rights and obligations, the Agency should negotiate the agreement accordingly.

Agencies need to understand that different types of advertising involve different risks, and the risks associated with an advertisement can be very dependent on the advertiser's budgets. For example, more cutting-edge advertising is likely to be riskier than more traditional advertising. If a Client wishes to engage in this type of advertising, the Client needs to appreciate the risks associated with that decision. There also is likely to be more risk associated with advertising when a Client is trying to cut costs and reduce budgets. For example there is a greater likelihood of an intellectual property claim arising out of an inexpensive stock photograph or piece of music licensed on behalf of a Client than from an original photograph or piece of music for which the Agency engages more expensive and experienced companies and individuals directly on a work-for-hire or buy-out basis. Although it is up to the Agency to make recommendations on potential advertising and to communicate to the advertiser any risks associated with that advertising, it is and should be up to the advertiser to determine the type of advertising in which it ultimately wishes to engage, how aggressive it wishes to be, how it wishes to spend its budget and the level of risk with which it is comfortable in light of its corporate culture. It does not make sense for the advertiser to be able to decide that it wants to engage in risky or low-budget advertising and then look to the Agency if a problem arises. Agencies need to negotiate a fair agreement based on this reality and the actual way the parties operate.

Agencies should also recognize that there is no one-size-fits-all solution with respect to the language used to express each point in the agreement. The Agency should be prepared to offer alternative language that addresses the Client's concerns while still being fair to the Agency.

Agencies should keep in mind that having no contract is better than having a contract that imposes excessive and unreasonable liability on the Agency.

Agencies may instead be able to get a work authorization, purchase order or other short-form agreement in place to make it easier to begin work and ensure payment while the larger agreement is being negotiated. Some Clients insist that the master agreement needs to be signed in order for the Client to pay the Agency. While that may be the Client's internal policy, the law provides that if a Client requests work from an Agency and the Agency performs the work, the Agency is entitled to get paid for that work. So taking the time to negotiate a fair agreement should not be a stumbling block for the parties to begin what everyone hopes will be a long and fruitful relationship.

Agencies should take the time to negotiate fair and equitable arrangements and never sign an agreement with which the Agency ultimately is not comfortable.

Section VI: Guidance Summary

The subject matter contained in this 4A's Agency-Client MSA Provisions Guidance paper is complex. In order to reinforce the key communications concepts that are embodied in this guidance, we have summarized ten key guidance elements that you should discuss with your management team members:

- (1) Management decision makers—those who are empowered to accept or reject terms and contractual provisions—should insist that every Agency-Client arrangement:
 1. Fairly reflect the scope of services being provided to the Client
 2. Recognize the Agency's operating business practices and
 3. Fit within the economic parameters of the engagement with the Client.
- (2) It is increasingly important for an Agency and a Client to discuss the service arrangements, economics, rights and responsibilities of each party. A comprehensive Agency-Client discussion of responsibilities should include discussion of Agency contractual responsibilities (including indemnity) and limits on Agency exposure.
- (3) Inappropriate or inequitable allocation of risk in a contract can damage your Agency, and failure to establish reasonable limitations on your Agency's liability can upend your financial results, which in turn will disrupt your ability to retain your talent, invest in Client services and provide a reasonable return to your shareholders.
- (4) Based on the division of expertise and control responsibilities, the parties can begin to determine how to equitably and rationally allocate risk-avoidance parameters in a contract as well as indemnification obligations. The fundamental premise of this guidance is that no party should bear an indemnification responsibility where it does not control the underlying conduct.
- (5) Not every risk inherent in the Agency-Client relationship needs to be the subject of an indemnification obligation.
- (6) Given the economic framework and ultimate control parameters of the Agency-Client relationship, an Agency's indemnification obligations and liability responsibilities should include appropriate and proportional limitations.
- (7) No party should present its form agreement to the other and claim that the agreement is "non-negotiable." Negotiations are needed to ensure the agreement is properly tailored to the business relationship.
- (8) The focus of the Agency-Client agreement should be to help avoid mistakes and prevent the damage or the reputational harm that results from errors.
- (9) Agencies should keep in mind that having no contract is better than having a contract that imposes excessive and unreasonable liability on the Agency.
- (10) Reaching an understanding of the roles and responsibilities of the Client and the Agency – at the earliest possible time – can only serve to strengthen the Agency-Client relationship.

Acknowledgment

This Allocation of Risk, Indemnification & Limitations on Liability guidance was developed by a task group comprised of members of the 4A's legal affairs, commercial practices and finance communities. We thank the task group members for their contribution to this best practice guidance.