Indemnification Clauses

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Stafford Matthews

Stafford Matthews is a technology transactions and licensing lawyer and the managing partner of the Palo Alto office of Dentons, a global law firm with over 2,500 lawyers and 79 offices in 52 countries, including key offices in New York, Washington D.C., Silicon Valley, San Francisco, London, Hong Kong, Shanghai, the Middle East and Africa.

Mr. Matthews represents technology and industrial companies in the strategic development and exploitation of intellectual properties and products, complex contract negotiations and dispute resolution. His practice focuses on the licensing and transfer of IP rights and technologies in domestic and international markets; providing forensic advice on contentious contractual issues; establishing and enforcing distribution systems for products and services; antitrust and unfair competition matters in the US and the European Union; and the negotiation of cross border alliances and other business structures.

He is dual qualified as an English solicitor and a US lawyer and has extensive experience in both European and Asian markets.

Mr. Matthews recently completed his term as the Chairman of the Board of Legal Specialization for the State Bar of California. He has degrees from the University of California at Berkeley, where he earned an A.B. in Rhetoric, the University of Michigan Law School, and King’s College London, where he holds a post-graduate diploma in European Union Competition Law.
INDEMNIFICATION CLAUSES
Basic principles*

- **Indemnification** is a contractual obligation by one party [X] to pay or compensate for the losses or damages or liabilities incurred by another party to the contract [Y] or by some third person.


- An **indemnitor** is the party who is obligated to pay another. An **indemnatee** is the party who is entitled to receive the payment from the indemnitor.

* Note that the following presentation deals with agreements and licenses between corporate or other commercial parties generally, and does not cover contracts in regulated industries such as insurance.*
Basic principles

Common **types of losses** subject to contractual indemnification:

- Breach of representation or warranty by [X].
- Breach of agreement or covenant by [X]
- Losses incurred by [Y] under specified conditions
- Third party claims against [Y] for specific subject matter, such as (1) claims of infringement or misappropriation of IP, (2) use of goods by the indemnitee, (3) product defect or liability claims, (4) claims arising out of death or personal injury.
Indemnification provisions are a means of shifting risk between parties to an agreement. Part of an integrated risk allocation system also comprised of:

- Representations and warranties of the parties, including disclaimers of implied warranties and exclusions and limitations based on disclosure schedules.
- Limitations of liabilities such as consequential and related damages and contractual “caps” on liabilities.
- Contractual statutes of limitation.
- Insurance.
Function of indemnification – Adjustment of value

In addition a mechanism to **reallocate economic value** in a transaction, even when neither party is culpable:

- In an acquisition transaction, adjusts purchase price by reallocating consideration based on issues that arise after deal is signed or closed.
- In licensing or commercial transactions, apportions risk where there may be uncertainty as to scope or enforceability of rights or the potential for claims.
Issue [1]: Warranties versus Indemnities

- A **warranty** is an assurance to the other party that a fact, condition or quality is and will be true.

[CBS, Inc. v. Ziff-Davis Publishing Co., 75 N.Y.2d 496, 553 N.E.2d 997 (1990) (other party “purchased” a promise as to the existence and truth of the warranted facts)].

- The warranty is an **integral part of the contract**, and in the event the warranty is not true, the other party has the full range of rights and remedies under law for breach of contract.
For example, the main attributes of a noninfringement warranty by a licensor:

- Substantive liability for breach of contract.
- In addition to damages the licensee may withhold performance and terminate the contract for cause, depriving the licensor of the benefit of the contract.
- No obligation of the licensor to pay damages until infringement established.
- If licensee is successful in defending against the infringement claim, no breach and no right of the licensee to legal fees or other compensation for having to litigate the issue.
Issue [1]: Warranties versus Indemnities

Warranty contrasted with indemnity:

- **Indemnity** under the same facts is not a breach of the contract with usual remedies such as termination or right to withhold performance, provided the indemnity obligation itself is discharged.

- Particularly relevant in intellectual property issues: for example, if a licensor -- consider indemnity but not warranty on scope or non-infringement if there could be issues regarding validity or enforceability of IP or other risks of third party claims.
Issue [2]: Abnormal risks or costs

- Note further that certain proposed terms for a warranty or indemnification will or should be fundamentally **non-negotiable** from the position of the indemnifying party [indemnitor].

- The greater the risk versus the expected return to a party, the more nonnegotiable its position.

**Example**: Party A demands that Party B provide an unlimited warranty and indemnity against third party patent claims, when economics of transaction do not justify either an investigation as to possible claims or a “bet the business” exposure in patent litigation.
II. Indemnification – Sample Clause
Indemnification Clause Example

“Company shall fully indemnify, hold harmless and defend (collectively “indemnify” and “indemnification”) ABC and its directors, officers, employees, agents, stockholders and Affiliates (collectively, “Indemnified Parties”) from and against all claims, demands, actions, suits, damages, liabilities, losses, settlements, judgments, costs and expenses (including but not limited to reasonable attorney’s fees and costs), whether or not involving a third party claim, which arise out of or relate to (1) any breach of any representation or warranty of Company contained in this Agreement, (2) any breach or violation of any covenant or other obligation or duty of Company under this Agreement or under applicable law, (3) (4) (5)] [other enumerated categories of claims and losses], in each case whether or not caused by the negligence of ABC or any other Indemnified Party and whether or not the relevant Claim has merit.”
III. Scope of Indemnification Clause:

What is Covered?
The indemnification provision of an agreement is interpreted under the same rules governing any other contracts, with a view to determining the intent of the parties. The rights and duties of the indemnitor and indemnitee are generally determined from the express terms of the contract itself.

[E.g., Crawford v. Weather Shield Mfg., Inc., 44 Cal. 4th 541, 552 (2008); Gibbs-Alfano v. Burton, 281 F.3d 12, 15-16 (2d Cir. 2002); Weissman v. Sinorm Deli, 88 N.Y.2d 437, 446 (N.Y. 1996)].
Rules of construction

- Each word in the clause is given meaning by the court, in their ordinary sense. For example, see *Goldman v. Ecco-Phoenix Electric Corp.*, 62 Cal. 2d 40 (1964) and *Applied Indus. Materials Corp. v. Mallinckrodt, Inc.*, 102 F. Supp. 2d 934, 943 (N.D. Ill. 2000) respectively for [electron] microscopic dissections of the indemnity clauses by the courts there.
Rules of construction

- In the case of California, the California Civil Code section 2778 provides specific rules of interpretation for a contract of indemnity, unless a contrary intention appears in the agreement. Cal. Civ. Code §2778.

- Note that obligations of the indemnitor and rights of the indemnitee generally are narrowly construed, in part under the theory that in normal commercial contracts, the indemnitee often has superior bargaining power.

Scope of indemnification

“indemnify, hold harmless and defend”
Issue [3]: Indemnify

- **“indemnify”**: to pay or compensate the other party for its own legal liabilities or losses.

  [E.g., Rexam Bev. Can Co. v. Bolger, 620 F.3d 718, 735 (7th Cir. 2010); Cal. Civ. Code §2772 (to “save another from a legal consequence” of an act)].

- The obligation to indemnify does not occur until the end of a case or other resolution, when indemnitee has had a judgment entered against it for damages, or has made payments or suffered actual loss.

  [E.g., Mizuho Corporate Bank (USA) v. Cory & Assoc., 341 F.3d 644, 650 (7th Cir. 2003); McDermott v. New York, 50 N.Y.2d 211, 216 (N.Y. 1980); Cal. Civ. Code §2778(1), (2)].
Issue [3]: Indemnify – Fees and Costs

- **Attorney’s Fees:** The right to indemnity includes the reasonable costs of defense incurred in good faith, payable as part of the indemnified amount. [*Klock v. Grosodonia*, 251 A.D.2d 1050, 674 N.Y.S.2d 187 (N.Y. App. 1998) (“any and all” – 3d party claims)].


- **Caution:** (1) The laws of some other states [such as Illinois] do not permit attorney’s fees or other costs of defense as part of the indemnity, where not expressly stated and there is no duty to defend. (2) The costs of e-discovery and experts fees are open to question.
Issue [3]: Implied or Equitable Indemnity

- **Implied or Equitable Indemnity:** Note that a right of “implied” or “equitable” indemnity can arise where (1) the parties have failed to include an indemnity provision in an agreement or there is no agreement, and (2) one party [implied indemnitor] is considered "at fault" while the other party [implied indemnitee] is blameless though liable: such as in cases of strict liability, implied warranty, or some other legal principle that imposes liability regardless of fault.

Issue [3]: Implied or Equitable Indemnity

- Where the parties have entered into an express indemnification clause, the extent of their rights and duties generally are determined under the terms of the contract and not under the doctrine of equitable indemnity.


- However risk exists in situations where (1) there are express mutual indemnification clauses but some matters are not covered, or (2) only a one-way indemnification clause exists and the other party has no express indemnification obligations, or (3) the contract contains no indemnification clauses at all.
Issue [3]: Implied or Equitable Indemnity

- **Implied or equitable indemnity** therefore should be expressly disclaimed to avoid unintended application of the doctrine. For example:

  “No party to this Agreement shall be entitled to any form of implied or equitable indemnification at any time, whether based on a theory of contract, torts (including negligence), strict liability or otherwise, and any right thereto is hereby irrevocably waived and disclaimed by each of the parties.” or

  “No indemnitee or any other person or entity shall be entitled to any form of equitable or implied indemnification at any time.”
Duty to “defend”: The duty to defend is separate from and independent of the duty to indemnify.

In contrast to the obligation to indemnify, a contractual obligation to defend requires the party to immediately and actively defend or fund the defense of any claim at the outset of the claim or litigation.

The contractual duty to defend thus arises first in time before the duty to indemnify.

Unless expressly limited by contract, obligation to defend includes all claims potentially subject to indemnification. [E.g., Crawford v. Weather Shield Mfg., Inc., 44 Cal. 4th 541, 553-554, 559 (2008)].
Issue [3]: Indemnify versus Defend

- Under the **common law** of most states, including New York, an indemnitor generally has **no duty to defend** unless the contract specifically requires such defense.


- **Caution: Opposite rule in California:** Unless a contrary intention is stated in the contract, indemnitor has the immediate statutory obligation to defend or fund the defense against all indemnified claims. [Cal. Civ. Code §2778(4)].
Issue [3-1]: Defense considerations

- In negotiating contractual terms in connection with the right to defend, it must be determined whether the indemnified claims represent only a finite financial obligation in a particular case, perhaps in conjunction with a limitation on liability clause – or instead pose a more existential risk for your company if the claims are not aggressively and directly defended by the company.

- In the case of material risks, the company should claim right to defend regardless of status as indemnitor or indemnitee.
Issue [3-1]: Defense considerations

- For example, a company should affirmatively provide for the exclusive right and power to defend third party infringement claims against its own intellectual property or other disputes affecting the scope or ownership or validity or enforceability of its IP or other property rights.

- This is the case whether the company is the indemnitor [breach of IP warranty] or the indemnitee [Company as licensor - the licensee indemnifies Company for infringement claims from licensed use of Company IP in Field A or Territory B].
Issue [3-1]: Defense considerations

- Alleged versus actual breach: consider indemnity language to nail down duty of indemnitor to defend such as:

  “any third party claim resulting from any actual or alleged breach of this Agreement, or which is based on a claim that, if true, would be a breach of this Agreement by [X]”.

- Note that any duty to defend should include separate procedural provisions setting out the respective rules regarding notice, control and participation to be followed in connection with defending the relevant claims [discussed below].
Scope of indemnification

“hold harmless”
Issue [4]: Hold harmless

What does "hold harmless" mean?

- Conflict in authorities as to whether a “hold harmless” clause is or is not a form of indemnification provision per se. Many courts hold that "indemnify" and "hold harmless" are synonymous or duplicative and tend to use the terms interchangeably.

[E.g., Medcom Holding Co. v. Baxter Travenol Lab., Inc., 200 F.3d 518, 519 (7th Cir. 1999); Praetorian Ins. Co. v. Site Inspection, LLC, 604 F.3d 509, 515 (8th Cir. 2010). See generally the discussion at Majkowski v. American Imaging Mgmt. Servs., LLC, 913 A.2d 572, 588 (Del. Ch. 2006)].
Issue [4]: Hold harmless

- However a number of recent courts have held that the term "hold harmless" acts only as an **exculpatory** provision that **releases** the indemnitee **from** liability **to** the indemnitor.

Issue [4]: Hold harmless

- Under this more restrictive rule, "hold harmless" does not give the recipient a right of indemnity against the claims of third parties, but only provides a defense against direct claims against it by the other party to the contract.

- "One is offensive and the other is defensive—even though both contemplate third party liability situations. 'Indemnify' is an offensive right—a sword—allowing an indemnitee to seek indemnification. 'Hold harmless' is defensive: The right not to be bothered by the other [contract] party itself seeking indemnification." Queen Villas Homeowners Assn. v. TCB Property Management, 149 Cal. App. 4th 1, 9 (2007).
Issue [4]: Hold harmless

Caution: “Hold harmless” standing alone is not necessarily an indemnity or duty to defend:

- A contractual provision only stating that [A] will “hold [B] harmless” from claims based on [A]’s breaches or other factors may not indemnify [B] from 3d party claims and in most states will not provide a duty of defense under such terms in any event. The “hold harmless” language in a strict sense technically releases [B] from liability to [A] with respect to claims covered by the clause.

- [B] may have a right to implied indemnity under certain circumstances, but not necessarily a contractual indemnification right.
Issue [4]: Hold harmless

Example: Ambiguous Hold Harmless:

“8. **Indemnification.** [Supplier] [Licensor] hereby ...holds harmless.... [Purchaser][Licensee] from and against....any and all claims of infringement or misappropriation based on the use of all or any part of the Technologies within the Territory at any time....

[continued]
Example (continued):

“14. Effects of Termination. Upon the termination of this Agreement at any time, the License and all other rights and obligations of the respective parties hereunder shall cease, *provided however* that notwithstanding any contrary provision hereof, all of the rights and obligations of the respective parties under Section _____ hereof, Section ___ hereof, Section 8 hereof (Indemnification), and Section _____ hereof, shall survive expiration or termination (for any reason) of the Agreement and remain in full force and effect.”
Counterpoint:

- Exculpatory clauses are disfavored and strictly construed against the released party.


- The issue nonetheless remains one of intent based on the particular facts and circumstances and on the specific language of the agreement. This is not a debate you want to have if it can be avoided by focused drafting.
Issue [5]: Collective definitions

- **Defined Terms:** Since the terms “indemnify”, “hold harmless” and “defend” have distinct and separate meanings, consider using “indemnification” and “indemnify” as collective defined terms in the contract.

- **Example:** “Each party agrees to fully indemnify and hold harmless and defend (collectively ‘indemnify’ or ‘indemnification’)”.

- This is to avoid ambiguities in other inevitable references to “indemnification” obligations in the contract, such as in procedural or limitation on liability clauses, referring only to the “indemnification obligation” of the parties.
Scope of indemnification

“all claims, actions, suits, demands, damages, liabilities, obligations, losses…”
Issue [6]: Claims or damages versus liabilities

- **Different standards:** An indemnity for “claims” or “losses” or “damages” or similar terms is generally considered distinct from an indemnity for “liabilities”.

- The issue in part is one of timing – affecting when the indemnitor is obligated to pay the indemnitee under the indemnification clause and when the statute of limitations period commences for any breach of the indemnification provision.

- The interplay between the obligations to indemnify and defend and the applicable statute of limitations furthermore is frequently complex and multi-leveled and can require immediate attention.
Issue [6]: Claims or damages versus liabilities

- **“Damages”**: In general an indemnity for damages – demands – costs – losses is not payable by the indemnitor until the indemnitee suffers **actual loss** by being compelled to pay the claim or damages.

Issue [6]: Claims or damages versus liabilities

- **Compare "Liabilities":** An indemnity for “liabilities” is broader and requires the indemnitor to pay as soon as the indemnitee becomes liable. No payment or actual loss is required.


- If your company is the indemnitee – considering adding the term “liabilities” to the indemnification clause to maximize the scope of protection.
Issue [6]: Claims or damages versus liabilities

- Timing Issues – a two-edged sword:

  The event of loss or damage versus the event of liability can be **substantially different** in time: indemnitee can "become liable" much earlier, (1) triggering the obligation to pay indemnification amounts much sooner than might otherwise be expected by the relevant parties, but also (2) triggering the running of the statute of limitations for the indemnification against liability if the indemnifying party fails to perform.
Issue [7]: Statutes of Limitations

Applicable Statutes of Limitation:

- **Separate Action**: An indemnity action is considered separate and distinct from the underlying tort or contract action and the statute of limitations runs separately from the underlying action.

  [E.g., People ex rel. Dept. of Transportation v. Superior Court, 26 Cal.3d 744, 751 (1980); see generally McDermott v. New York, 50 N.Y.2d 211 (1980)].

- **Express Indemnity SOL**: The general statute of limitations period for enforcing contracts applies to an action based on a written indemnity agreement. [Globe Indem. Co. v. Larkin, 62 Cal. App. 2d 891, 892 (1944)].
Issue [7]: Statutes of Limitations

- **Equitable Indemnity SOL:** The limitations period for equitable indemnity is much shorter and based on the statute of limitations for tort claims.


- **Duty to Defend SOL:** In addition, the running of the statute of limitations for a duty to defend claim will separately commence **immediately upon breach** of the duty to defend, which will be **substantially earlier** than either the obligation to indemnify for liabilities or damages.
Issue [7]: Statutes of Limitations

- **Contractual SOL:** A contractual statute of limitations can radically shorten the period in which indemnification claims can be brought irrespective of an otherwise applicable statute.

Issue [8]: Scope of indemnification

“which arise out of or relate to (1) any breach of any representation or warranty of Company contained in this Agreement, (2) any breach or violation of any covenant or other obligation or duty of Company under this Agreement or under applicable law, (3) (4) (5) [other enumerated categories of claims and losses]”
Issue [8]: Types of indemnified claims

- The type and scope of claims - damages - liabilities being indemnified is a matter of contract.

- All subject matter or classes of subject matter to be covered by the indemnity should be expressly set forth in the clause. *See, e.g., International Minerals & Chem. Corp. v. Avon Prods.*, 889 S.W.2d 111, 115 (Mo. Ct. App. 1994) (“The language of an indemnity contract should be construed so as to encompass only that loss and damage which reasonably appear to have been within the intent of the parties”, applying New York law).
Issue [8]: Types of indemnified claims

- Customary indemnified claims include (1) breach of representations or warranties; (2) breach of other contractual obligations; (3) violations of law; (4) losses incurred by indemnitee under specified conditions; and (5) third party claims for specific matters such as IP infringement or misappropriation.

- Consider “backstop” provision such as “any other breach of any obligation or duty under this Agreement or under applicable law.”
Issue [8]: Types of indemnified claims

- In the context of an acquisition transaction, in addition to standard indemnities the indemnified claims can include such matters as (1) tax liabilities, (2) environmental, health and safety liabilities, (3) known or assumed liabilities, (4) intentional misrepresentation or fraud, and (5) violations of law.

- Indemnification clauses in acquisition transactions in particular must be closely coordinated with the representations and warranty clauses and limitation on liability provisions, including liability “caps” and “baskets” for different categories of claims and contractual statutes of limitations for claims.
Issue [9]: Overbroad or defective indemnified claims

- Be alert to overbroad or ambiguous indemnified clauses, in particular where the indemnitor will have not breached the contract or otherwise been at fault. These are sometimes intentional but frequently result from poor or no lawyering.
Issue [9]: Overbroad or defective indemnified claims

Examples of such indemnified claims:

- “any act or omission” of Distributor or any of its employees or agents in whole or in part, including but not limited to (a) or (b)”

- “any intentional acts” of [A] in connection with the production and distribution of the Products”

- “any use” of the Licensed Rights in the Territory by Licensee”

- “any liability” arising out of or connected with the performance of work under this Agreement”. 
Issue [10]: Exclusions and limitations

- Consider indemnity **carve-outs** and **exclusions** for (1) negligence [see below], (2) wrongful or unlawful acts, (3) other contributing acts or omissions of indemnified party, (4) consequential and related damages, (5) general limitations on liability, and (6) other exclusions relevant to the contract.

- In the case of mutual indemnity clauses dealing with the same or related subject matter, “tie breaker” carve-outs are necessary to avoid conflicting provisions.
Issue [10]: Exclusions and limitations - Example

[A] indemnifies [B] from “any third party claim that the Product infringes a patent or copyright enforceable in the United States, **except to the extent** the claimed infringement is based on or results in any material part from (a) any use of the Product other than in accordance with [this Agreement][the Specifications], (b) any unauthorized modification or alteration of the Product, (c) any combination or use of the Product with any other product or system or technologies not supplied by [A], (d) any refusal to accept or use suitable modified or replacement Products provided by [A] to avoid infringement, (e) the negligence or unlawful or wrongful acts of [B] or any Affiliate or other person acting in concert with [B], **or (f) any Losses otherwise expressly subject to indemnification hereunder by [B].**”
Issue [11]: Consequential damages exclusion

- An indemnification clause covering “any and all claims, damages, losses....” can be deemed to include consequential damages and similar damages incurred by the indemnitee or third party claimant, unless such damages are expressly excluded from the indemnified claims.

- **Must coordinate any exclusion under the indemnification clause with any general consequential damages exclusion in the contract.** Primary issue will be whether third party claims representing consequential damages are to be excluded from indemnification.
Issue [11]: Consequential damages exclusion

- Example:

  “EXCEPT FOR LIABILITIES ARISING UNDER SECTION _____ HEREOF (INDEMNIFICATION) IN THE CASE OF THIRD PARTY CLAIMS, TO THE FULLEST EXTENT NOT PROHIBITED BY APPLICABLE LAW….”

- Note: If the qualifier above is *not* limited to third party claims and the general indemnification clause includes both direct and third party claims, then this kind of qualifier renders the consequential damages clause ineffective.
Issue [12]: Limitations on liability provisions

- The parties also must coordinate the indemnification clause with any limitations on liability in the contract, including agreed “caps” and “baskets”. Common example [but watch out for the use of "indemnify" only if not defined to include hold harmless and defense]:

“Notwithstanding any contrary provision hereof, including Section ___ (Indemnification), Company shall not be required to indemnify ABC under this Agreement or applicable law (1) unless the aggregate amount of Claims during [time period] exceeds $_______ [basket], in which case only the excess shall be indemnified, or (2) to the extent the aggregate amount of all Claims during [time period] exceeds $_______ [cap]; subject to [exceptions].”
Issue [12]: Limitations on liability provisions

- Also consider whether the indemnification provisions are intended to be the **exclusive rights and remedies** of the indemnitee, therefore barring any other rights or remedies in the case of third party or even direct claims. For example:

  "The foregoing provisions set forth the exclusive rights and remedies of any Indemnitees and any related persons and the exclusive obligations of Indemnitor with respect to any Claims or other matters of indemnification or responsibility which are part of the subject matter of this Agreement; and the cumulative remedies provision in Section _____ shall be not applicable to such Claims or matters."
Issue [13]: Force majeure provisions

- Consider the effect of any force majeure clause in the Agreement and coordinate with the indemnification clause, to avoid a suspension of the obligation to indemnify and defend:

“A party shall not be deemed in breach in its performance of an obligation under the Agreement to the extent that such performance is temporarily prevented or delayed as the result of (1) ……….; provided however that the foregoing shall not be applicable to (x) any obligation of such party to pay monies under this Agreement, or (y) any obligations of such party pursuant to Section _____ hereof (Indemnification).”
Issue [14]: Survival provisions

- Indemnification provisions do not necessarily survive termination or expiration of the Agreement.

- Be certain that the survival of the indemnification rights and obligations is an express provision in the Agreement, at least if the company is the indemnitee.
Negligence

“whether or not caused by the negligence of ABC”
Issue [15]: Negligence

- **Matter of Contract:** A party generally can be indemnified and held harmless from its own negligence under the laws of New York, California and most other states.

Issue [15]: Negligence

- Under the more modern rule, which varies by state, express reference to “negligence” may not be required if clause provides indemnification for “any and all” losses or claims, and context consistent with intent to indemnify negligence. Not a best practice however.

"Negligence" Limitations: California law distinguishes between “passive” and “active” negligence.

- Passive negligence: In California, if indemnity clause does not expressly provide for an indemnity for negligence, still construed as including indemnity for “passive negligence” [such as mere nonfeasance for failure to discover a defect or perform a duty imposed by law] if intent can be shown under the particular circumstances. This is known as a “general indemnity clause”.

[E.g., E. L. White, Inc. v. Huntington Beach, 21 Cal. 3d 497, 507 (1978); Rossmoor Sanitation, Inc. v. Pylon, Inc., 13 Cal. 3d 622, 629 (1975)].
Issue [15]: Negligence

- **Targeted language:** A contractual exclusion for negligence can be more targeted; for example, excluding only active negligence or the sole negligence of the indemnitee from indemnification: “excluding Claims [to the extent] resulting from the [sole] [active] negligence of Indemnitee”.

- **Caution:** Because a “hold harmless” clause can be an exculpatory release from liability, a hold harmless clause against negligence of the indemnitee can mean that the indemnitee is prospectively released from direct damages of the indemnitor caused by such negligence, if the “hold harmless” is not limited to third party claims.
Issue [15]: Negligence

- **Active negligence:** The strict rule of construction in California is that an indemnity for “active negligence” requires a plain, clear and explicit statement in the clause that negligence is to be included in the indemnity, and such language will be strictly construed against the indemnitee.  
  
  [Crawford v. Weather Shield Mfg., Inc., 44 Cal. 4th 541, 552 (2008)].

- Categories of “active negligence” include personal participation of the indemnitee in affirmative acts of negligence, and failure to perform a precise duty agreed to be performed.  
  
  [See Rossmoor Sanitation, Inc. v. Pylon, Inc., 13 Cal. 3d 622, 628 (1975)(active negligence defined)].
Issue [15]: Negligence - Limitations

- Statutory Exceptions:

- In most states regulated businesses providing essential services to the public, such as hospitals are subject to statutory or public policy restrictions against being indemnified for their own negligence.

[E.g., 215 ILCS 134/95 (health care); Tunkl v. UC Regents, 60 Cal.2d 92 (1963) (hospital admission forms)].
Issue [15]: Negligence - Limitations

- **Statutory Exceptions: Construction contracts**

  In most states, including New York, any obligation in a construction contract to indemnify or hold harmless another person from that person's own sole or active negligence or willful misconduct is void as against public policy and wholly unenforceable, subject to certain limited exceptions.

  [N.Y. Gen. Oblig. Law § 5-322.1; 740 ILCS 35/0.01 et seq.; Cal. Civ. Code §2782 et seq.]

- **Note** that the California statute was substantially amended and expanded in 2011 and prior forms are no longer in compliance.
In various jurisdictions, indemnification for wrongful acts or most forms of punitive damages are generally not permitted as against public policy.

In **New York**: "[I]f punitive damages are awarded on any ground other than intentional causation of injury -- for example, gross negligence, recklessness or wantonness -- indemnity for compensatory damages would be allowable even though indemnity for the punitive or exemplary component of the damage award would be barred as violative of public policy."

Note that this can potentially include indemnification against claims of **willful patent infringement**, since damages for willful infringement can be considered punitive in nature.

Direct versus third party claims

“whether or not involving a third party claim”
Issue [17]: Direct versus third party claims

- While indemnification is often associated with third party claims, the obligation to indemnify can exist for direct claims between the two parties to the contract.

Issue [17]: Direct versus third party claims

- Must determine whether indemnification will cover both direct claims between the parties and unrelated third party claims, or only third party claims. Express language to limit indemnification to third party claims is advisable to establish intent.

- If direct claims are permitted, must consider in particular the effect of the “hold harmless” clause on potential releases of direct liability for acts of the indemnitee. If the indemnitor, consider restricting any hold harmless clause to third party claims only.
Issue [17]: Direct versus third party claims

- If indemnification clause includes **only third party claims**, further consider limiting ability of indemnified party to use an assignee or affiliate or other intermediary under its control or direction as a nominal “third party” or straw person.

For example:

“For purposes hereof, ‘third party’ shall mean a person or entity wholly unrelated to the indemnified party or any Affiliate thereof, and shall not include any Affiliate or assignee of the indemnified party or any other person or entity under the control of or acting in concert with the indemnified party, whether directly or indirectly.”
Different procedures for handling direct claims. It is good practice for the indemnitor to reserve the right to contest any claim of the other party. One example:

“Direct Claims. Any direct claim by the Indemnified Party for indemnification for any breach of this Agreement by the Indemnifying Party (a “Direct Claim”) shall be asserted by giving the Indemnifying Party written notice thereof, and the Indemnifying Party will have a period of sixty (60) days from such notice to respond in writing to such Direct Claim. If the Indemnifying Party does not respond (or does so respond but does not agree to pay or discharge such Direct Claim in full) within such period, the Indemnifying Party will be deemed to have rejected such claim, and subject to the other provisions of this Section, both parties shall be entitled to pursue their respective rights and remedies.”
IV. Indemnifying Party

“Company”

- Determine whether Company is a sufficient indemnifying party, and whether joint indemnitors [such as a corporate parent] would be appropriate.

- In merger or other acquisition transaction, Company will be owned by the Buyer after the closing and cannot function as an indemnitor. Principal selling stockholders commonly act as indemnitors post-closing subject to negotiated limits on liability.
V. Indemnified Parties

“ABC, its directors, officers, employees, agents, stockholders and Affiliates”

- Scope of coverage a matter of negotiation. Other parties may be appropriate: “permitted assignees and successors in interest”, “licensors”, “licensees”, “distributors”, “customers”.

- Third parties such as suppliers or licensors or distributors not covered by indemnification provision unless expressly included. The assumption of risk inherent in indemnification clauses is a matter of express agreement and such clauses generally do not apply to nonparties.

[E.g., Knight v. Jewett, 3 Cal.4th 296 (1992)].
V. Indemnified Parties

- Consider expanding the class of indemnified persons in particular if your company has corresponding upstream or downstream indemnification obligations with distributors or licensees (for example), to counter the potential for direct claims by the other party or multiple claims by third parties at the upstream or downstream level.

- Also consider the legal status of the indemnified entities. For example, if an LLC the parties should include “managers” and “members”; if a Delaware corporation should include “stockholders”, and if a California or Illinois corporation, “shareholders”; if a partnership should include “partners”.
V. Indemnified Parties

- Also consider the effect of a “no third party beneficiary” clause in the Agreement and coordinate with the indemnification clause:

“This Agreement shall inure to the benefit of and be binding upon each of the parties hereto and their respective Affiliates, successors and assigns. Except for the rights of Related Persons under Section _____ (Indemnification) hereof, there shall be no third party beneficiaries of this Agreement.”
VI. Procedural Rules

- Indemnification section should include procedural rules for handling third party claims. Such rules should include:
  - Notice by indemnified party of claims
  - Right to control defense of claims
  - Right of other party to participate with own counsel
  - Right of other party to control if [example] (1) failure to defend or inadequate financial resources to defend, (2) scope or validity or enforceability of IP at issue, or (3) adverse judgment of third party claim would establish a precedent that would be materially damaging to the continuing business interests.
VI. Procedural Rules

- Obligation to advance or periodically reimburse legal fees and costs during litigation.
- Compromise and approval rights, including consents to judgment.
VI. Procedural Rules

Example:

“The indemnified party shall promptly notify the indemnifying party of any Claim for which indemnification is sought, following actual knowledge of such Claim, provided however that the failure to give such notice shall not relieve the indemnifying party of its obligations hereunder except to the extent that such indemnifying party is materially prejudiced by such failure. In the event that any third party Claim is brought, the indemnifying party shall [have the right and option to] undertake and control of the defense of such action with counsel of its choice, provided however that (i) the indemnified party at its own expense may participate and appear on an equal footing with the indemnifying party in the defense of any such Claims, (ii) the indemnified party may undertake and control of such [continued]
VI. Procedural Rules

Example [continued]:

defense in the event of the material failure of the indemnifying party to undertake and control the same; and (iii) the defense of any Claim relating to the Intellectual Property Rights of ______ or its affiliates or licensors and any related counterclaims shall be solely controlled by ______ with counsel of its choice. The indemnified party [A party] shall not consent to judgment or concede or settle or compromise any Claim without the prior written approval of the indemnifying party [other party] (which approval shall not be unreasonably withheld), [unless such concession or settlement or compromise includes a full and unconditional release of the indemnifying [other] party and any applicable Related Persons from all liabilities in respect of such Claim.]”
VII. Indemnification Clause Checklist
VII. Indemnification Clause Checklist (1)

- Does the clause include not only an indemnity but also hold harmless (release of liability) and duty to defend clause?
- Is the duty of defend expressly stated?
- Are the indemnitee’s legal fees and costs of defense included within the scope of indemnity?
- What losses are indemnified? (Breach of representation or warranty, breach of agreement or covenants, losses, third party claims for specified subject matter).
- Who is being indemnified? (Indemnitee’s affiliates, officers, directors, employees, agents, contractors, et cetera).
VII. Indemnification Clause Checklist (2)

- Does the indemnity cover both claims between the parties and third party claims, or only third party claims?
- Does the indemnity extend to “liabilities” in addition to losses or damages?
- What is the applicable statute of limitations for the indemnification or duty to defend claims, and when does the limitations period commence?
- Does the duty to defend language contain language clarifying notice procedures and defining control of, and participation in the defense?
VII. Indemnification Clause Checklist (3)

- Are there carve-outs and exclusions to indemnitor’s obligations?
  -- the negligence of indemnitee?
  -- the wrongful or unlawful acts of the indemnitee?
  -- the contributing acts or omissions of the indemnitee?
  -- exclusion of indemnitee’s consequential and/or punitive damages?
  -- exclusion for punitive damages permitted?
  -- exclusions for force majeure?
VII. Indemnification Clause Checklist (4)

- Is the indemnitee entitled to the indemnity notwithstanding:
  - indemnitee’s own negligence?
  - indemnitee’s passive or active negligence?
  - indemnitee’s sole negligence?
  - Indemnitee’s wrongful acts?
  - other language excluding “Claims to the extent caused by Indemnitee . . .”
  - what statutes might impact the validity of these exclusions?

- Are the exclusions under the indemnification clause coordinated with general consequential damages?
VII. Indemnification Clause Checklist (5)

- Are there “caps” on liabilities?
- Is the clause the exclusive source of rights and remedies of the indemnitee?
- Do the indemnity obligations survive the term of the agreement?
- Is the indemnity clause consistent with relevant insurance programs?
- Is the indemnity clause consistent with other contractual provisions (respecting insurance, default, damages, personal liability, et cetera)?
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