

Interpreting Indemnities, Damages & Limitations of Liability



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Topics We'll Cover Today

- Indemnities
- Damages
- Limitations of Liability
- Questions

Contract Negotiation



Jurisdictions We'll Discuss

- New York
- North Carolina
- Delaware



Indemnities

What is an Indemnity?

An “indemnity” is a collateral contract or assurance by which one person engages to secure another against an anticipated loss or to prevent him from being damnified by the legal consequences of an act or forbearance on the part of one of the parties or of some third person.

- Black’s Law Dictionary

How Do Courts Interpret Indemnities?

- Generally, courts will narrowly construe indemnification obligations.



How Do Courts Interpret Indemnities?

- “Indemnity contracts are to be **strictly construed** to avoid reading into them duties which the parties **did not intend** to be assumed.” *Quality King Distribs., Inc. v. E & M ESR, Inc.*, 827 N.Y.S.2d 700 (App. Div. 2nd Dept.) (emphasis added).
- “Words in a contract are to be construed to achieve the apparent purpose of the parties. Although the words might ‘seem to admit of a larger sense, **yet they should be restrained** to the particular occasion and to the particular object which the parties had in view’. **This is particularly true with indemnity contracts.**” *Hooper Assocs., Ltd. v. AGS Computs., Inc.*, 74 N.Y.2d 487, 549 N.Y.S.2d 365, 548 N.E.2d 903 (1989) (emphasis added).

How Do Courts Interpret Indemnities?

- “Our primary purpose in construing a contract of indemnity is to ascertain and give effect to the intention of the parties, and **the ordinary rules of construction apply**. The court must construe the contract as a whole and an indemnity provision must be appraised in relation to all other provisions.” *Schenkel & Shultz, Inc. v. Hermon F. Fox & Assocs., P.C.*, 362 N.C. 269, 658 S.E.2d 918 (2008) (*emphasis added*).
- “Contracts must be **construed as a whole**, to give effect to the intentions of the parties. Where the contract language is clear and unambiguous, the parties' intent is ascertained by giving the language its ordinary and usual meaning. Courts consider extrinsic evidence to interpret the agreement **only** if there is an ambiguity in the contract.” *Nw. Nat'l Ins. Co. v. Esmark, Inc.*, 672 A.2d 41 (Del. 1996) (*emphasis added*).

First Party vs. Third Party Indemnities

- “...the term ‘indemnify’ in standard indemnity clauses applies to **third party actions**. Standard indemnity clauses are **not presumed** to apply to first-party claims.” *Deere & Co. v. Exelon Generation Acquisitions, Ltd. Liab. Co.*, No. N13C-07-330 MMJ CCLD, 2016 Del. Super. LEXIS 588 (Super. Ct. Nov. 22, 2016) (*emphasis added*).
- “...we are **wary** of the inference that indemnification clauses apply to litigation between the parties **in the absence of express wording**...Where, as here, the contract does not ‘exclusively or unequivocally refer to claims between the parties themselves’ we will presume that indemnification extends **only to third-party disputes**.” *Bank of N.Y. Tr. Co. v. Franklin Advisers, Inc.*, 726 F.3d 269 (2d Cir. 2013) (*emphasis added*).

Claims vs. Losses

- “**Claim**” means any demand, allegation, claim, cause of action, suit, action, court or tribunal order, or legal, administrative, arbitration, governmental or other proceeding or investigation, whether actual or threatened.
- “**Loss**” means any and all losses, damages, fines, penalties, deficiencies, liabilities (including settlements and judgments) and expenses (including interest, court costs, reasonable fees and expenses of attorneys, accountants and other experts or other reasonable expenses of litigation or other proceedings or of any claim, default or assessment).

Claims vs. Losses

- You **defend** against Claims and **indemnify and hold harmless** against Losses.
- The obligation to **defend** requires the indemnifying party to defend against the Claims in court (or conduct settlement negotiations) and to pay for such defense (including any costs already incurred by the indemnified party related to such defense).
- The obligation to **indemnify and hold harmless** requires the indemnifying party to reimburse the indemnified party for Losses incurred and pay for any Losses awarded by the court (or agreed to in a settlement).

Typical Contract Language: Scope

- First-party Claims ***and*** third-party Claims?
- Defense obligation?
- Claims and threatened claims?

Typical Contract Language: Full Contract Coverage vs. Breach Coverage

- **Broad Contract Indemnity:**

*“Customer will [defend,] indemnify and hold harmless Company [and its Affiliates, and their respective directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Company Indemnified Party’)] from and against any and all [first and] third-party claims, suits, actions, causes of action, demands or proceedings (‘Claims’) asserted [or threatened] against [Company/any Company Indemnified Party] and any and all damages, liabilities, costs and expenses (including reasonable attorneys’ fees incurred in connection with [investigating or defending] any Claims), judgments, fines, penalties and settlements (‘Damages’) in each case arising out of or related to **THIS AGREEMENT**, except for such Damages as are directly caused by Company’s fraud, gross negligence or willful misconduct.”*

- **Breach of Contract Indemnity:**

*“Customer will [defend,] indemnify and hold harmless Company [and its Affiliates, and their respective directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Company Indemnified Party’)] from and against any and all [first and] third-party claims, suits, actions, causes of action, demands or proceedings (‘Claims’) asserted [or threatened] against [Company/any Company Indemnified Party] and any and all damages, liabilities, costs and expenses (including reasonable attorneys’ fees incurred in connection with [investigating or defending] any Claims), judgments, fines, penalties and settlements (‘Damages’) in each case arising out of or related to **ANY BREACH** of this Agreement by Customer.”*

Typical Contract Language: Coverage Only for 3rd Party Claims & Damages from Such Claims

- **Broad Breach Indemnification for Third-Party Claims and Resulting Damages:**

*“Customer will [defend,] indemnify and hold harmless Company [and its Affiliates, and their respective directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Company Indemnified Party’)] from and against: (a) any and all claims, suits, actions, causes of action, demands or proceedings (“Claims”) asserted [or threatened] against [Company/any Company Indemnified Party] by a third-party and that **ARISE OUT OF OR RELATE TO** any breach of this Agreement by Customer; and (b) any and all damages, liabilities, costs and expenses (including reasonable attorneys’ fees), judgments, fines, penalties and settlements **INCURRED IN CONNECTION WITH ANY SUCH CLAIM** (‘Damages’).”*

- **Narrow Breach Indemnification for Third-Party Claims and Resulting Damages:**

*“Customer will [defend,] indemnify and hold harmless Company [and its Affiliates, and their respective directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Company Indemnified Party’)] from and against: (a) any and all claims, suits, actions, causes of action, demands or proceedings (“Claims”) asserted [or threatened] against [Company/any Company Indemnified Party] by a third-party and that **ARE ATTRIBUTABLE TO** any breach of this Agreement by Customer; and (b) any and all damages, amounts, costs and expenses **FINALLY AWARDED BY A COURT OR TRIBUNAL OF COMPETENT JURISDICTION WITH RESPECT TO, or OTHERWISE AGREED TO IN SETTLEMENT OF, ANY SUCH CLAIM** (‘Damages’).”*

Typical Contract Language: Coverage for 3rd Party Claims Related to Only Certain Contract Breaches

- **Broad Section-Based Breach Indemnification for Third-Party Claims and Resulting Damages:**

*“Customer will [defend,] indemnify and hold harmless Company [and its Affiliates, and their respective directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Company Indemnified Party’)] from and against any and all [first and] third-party claims, suits, actions, causes of action, demands or proceedings (‘Claims’) asserted [or threatened] against [Company/any Company Indemnified Party] and any and all damages, liabilities, costs and expenses (including reasonable attorneys’ fees incurred in connection with [investigating or defending] any Claims), judgments, fines, penalties and settlements (‘Damages’) in each case arising out of or related to any breach of the **PROVISIONS OF SECTION [X] (‘CONFIDENTIALITY AND DATA SECURITY’) OF THIS AGREEMENT** by Customer.”*

- **Narrow Section-Based Breach Indemnification for Third-Party Claims and Resulting Damages:**

*“Customer will [defend,] indemnify and hold harmless Company [and its Affiliates, and their respective directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Company Indemnified Party’)] from and against: (a) any and all claims, suits, actions, causes of action, demands or proceedings (‘Claims’) asserted [or threatened] against [Company/any Company Indemnified Party] by a third-party and that **ARE ATTRIBUTABLE TO** any breach of the **PROVISIONS OF SECTION [X] (‘CONFIDENTIALITY AND DATA SECURITY’) OF THIS AGREEMENT** by Customer; and (b) any and all damages, amounts, costs and expenses **FINALLY AWARDED BY A COURT OR TRIBUNAL OF COMPETENT JURISDICTION WITH RESPECT TO, or OTHERWISE AGREED TO IN SETTLEMENT OF, ANY SUCH CLAIM** (‘Damages’).”*

Typical Contract Language: Fraud, Gross Negligence & Willful Misconduct

“Company will [defend,] indemnify and hold harmless Customer [and its Affiliates, and their respective, directors, managers, officers, employees, representatives, agents, successors and assigns (each a ‘Customer Indemnified Party’)] from and against any and all [first and] third-party claims, suits, actions, causes of action, demands or proceedings (‘Claims’) asserted [or threatened] against [Customer/any Customer Indemnified Party] and any and all damages, liabilities, costs and expenses (including reasonable attorneys’ fees incurred in connection with [investigating or defending] any Claims), judgments, fines, penalties and settlements (‘Damages’) in each case arising out of or related to the fraud, gross negligence or willful misconduct of Company [or its Affiliates, or their respective directors, managers, officers, employees, representatives, agents, successors or assigns].”

Typical Contract Language: Infringement Claims

• Infringement Indemnity:

“Company shall: (a) defend or settle at its expense any Claim asserted [or threatened] against Customer [and its Affiliates, and their respective, directors, managers, officers, employees, contractors, representatives, agents, successors and assigns (each a ‘Customer Indemnified Party’)] and that arises from or alleges infringement, misappropriation or other violation of any [Intellectual Property Rights] of any third party in connection with Products or Services furnished under this Agreement (each an ‘Infringement Claim’); and (b) indemnify and hold [Customer/the Customer Indemnified Parties] harmless from and against and pay any Damages, including royalties and license fees, attributable to such Infringement Claim.”

• Infringement Indemnity Exclusions:

“Company will have no liability for an Infringement Claim [asserting or alleging patent infringement] [solely to the extent such Infringement Claim is] attributable to: (i) combination of the Product or Service giving rise to such Infringement Claim (the ‘Subject Product’) with any product or service not provided by [or on behalf of] Company [except (A) as otherwise expressly specified in this Agreement, (B) to the extent such combination is necessary or reasonably contemplated for the use of such Subject Product (e.g., the use of a third-party computer or operating system for the installation and execution of software), (C) such combination is taught, suggested, or disclosed by the documentation provided by or on behalf of the Company, or (D) the other product(s) or service(s) that [is/are] part of such combination are conventional, generic and/or standardized in the field of use]; (ii) modifications to the Subject Product [made by Customer without authorization][other than those made by or on behalf Company]; [(iii) use of other than the current release or version of the Subject Product if the infringement would have been avoided by using the current release or version, provided Company made the current release or version available to Customer [and informed Customer that the use of such release or version was necessary to avoid an Infringement Claim]; or (iv) use of the Subject Product in violation of the express provisions of the Agreement.”

Typical Contract Language: Infringement Claims

- The Indemnified Parties will **inevitably** use the Indemnifying Party's products/services with third party products, software, services, *etc.* – for example:
 - ✓ the Internet;
 - ✓ a general use computer or server; or
 - ✓ an operating system.
- With this language, the Indemnifying Party has a good argument that it is **not required to indemnify**.

Typical Contract Language: Infringement Claims

- *American Family Life Assurance Co. v. Intervoice, Inc.*, 560 Fed. Appx. 931 (11th Cir. 2014).
 - ✓ Aflac used an IVR system provided by Intervoice in its customer call center.
 - ✓ Aflac was sued by an NPE alleging that the IVR system and other components of Aflac's call center (e.g., its computers and corporate mainframe), when used together, infringed the NPE's patents.
 - ✓ Aflac tendered the claim to Intervoice for defense.

Typical Contract Language: Infringement Claims

- *American Family Life Assurance Co. v. Intervoice, Inc.*
 - ✓ The contract between Aflac and Intervoice stated:

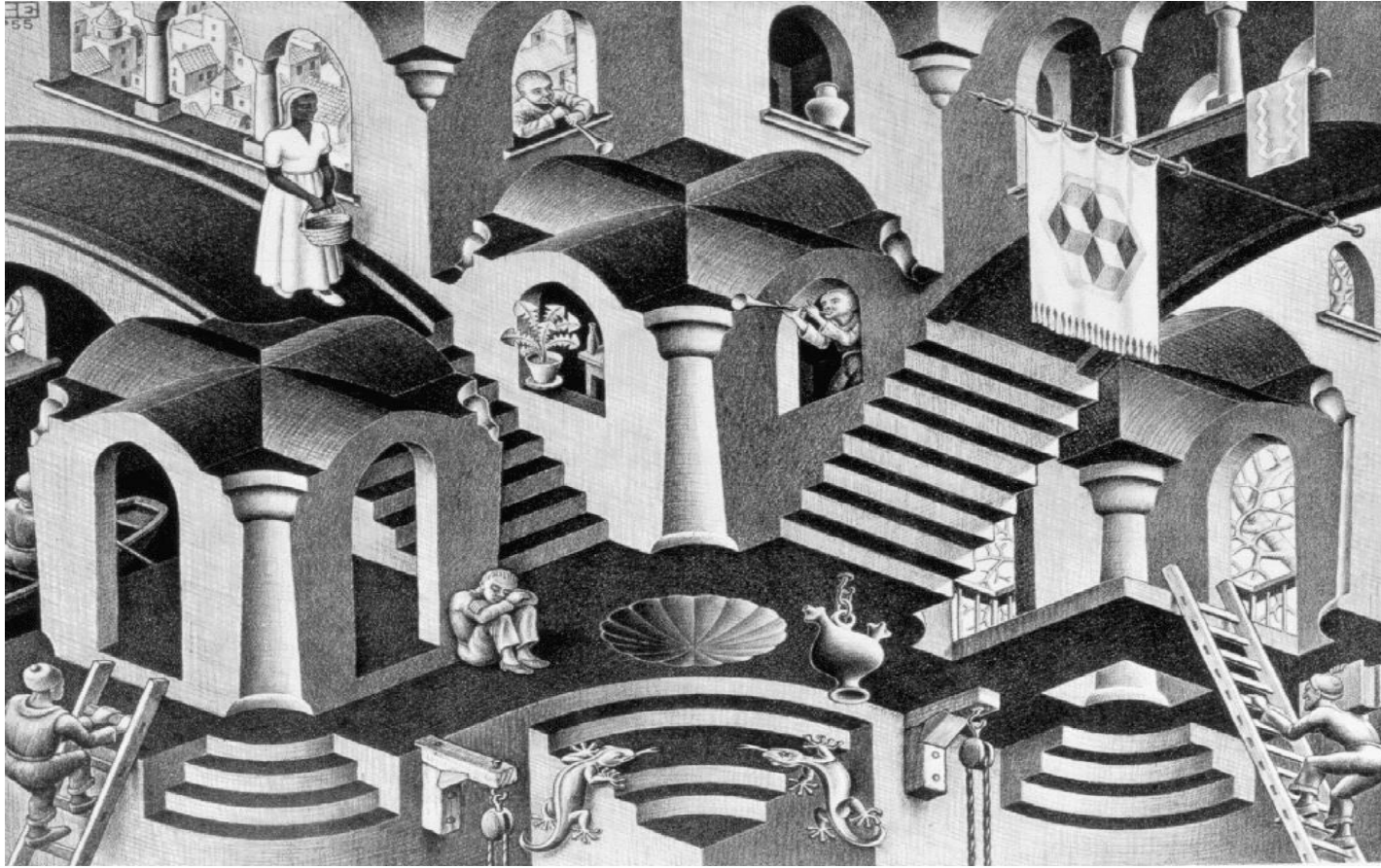
*“Intervoice shall have **no obligation** with respect to any such claim of infringement based upon Customer’s modification of any System or Software **or their combination, operation or use with apparatus, data or computer programs not furnished by Intervoice.**”*
 - ✓ Intervoice refused to defend the claim; the district court granted Intervoice’s motion for summary judgment.

Typical Contract Language: Infringement Claims

- *American Family Life Assurance Co. v. Intervoice, Inc.*
 - ✓ The Eleventh Circuit agreed with the district court that the infringement claims fell “unambiguously” into the exception and affirmed.
 - ✓ Both Aflac and Intervoice acknowledged that the NPE’s claims arise only when the IVR system is combined with one or more components not provided by Intervoice.
 - ✓ The Eleventh Circuit noted that the IVR system is “only one (albeit an important one) of the necessary elements of the claims”.

Damages & Limitations of Liability

Damage Classifications: A World of Confusion



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Examples of Typical Contract Damages: General/Direct & Expectation Damages

- **General/Direct Damages** – Damages that:
 - are the natural and probable result of the breach; and
 - compensate for the value of the promised performance. See *Latham Land I, LLC v. TGI Friday's, Inc.*, 96 A.D.3d 1327, 1330-31 (N.Y. App. Division 3rd Dept. 2012).
- **Expectation Damages** –
 - compensation designed to put injured party in same position as if contract had been performed;
 - targeted at giving injured party benefit of their bargain; and
 - often described as a subset of general/direct damages. See *First Union Nat'l Bank of N.C. v. Naylor*, 102 N.C. App. 719 (1991); *Medfusion, Inc. v. Allscripts Healthcare Solutions, Inc.*, 2015 NCBC LEXIS 34, *17.

Examples of Typical Contract Damages: Consequential Damages

- **Consequential Damages: Common Law**
 - ***Indirect*** and compensate for additional losses incurred due to breach; and
 - “do not so directly flow from the breach [as direct damages and] are recoverable only upon a showing that they were foreseeable and within the contemplation of the parties at the time” of contracting. See *Latham Land I*, 96 A.D.3d at 1330-31.
- **Consequential Damages (for Buyer): UCC**
 - Loss resulting from buyer’s general or particular requirements of which the seller at the time of contracting had reason to know **and which could not reasonably have been prevented by cover or otherwise**; and
 - injury to person/property proximately resulting from warranty breach. See UCC 2-715(2).

Also referred to as special or indirect damages.

Examples of Typical Contract Damages: Incidental Damages (UCC)

- **Incidental Damages – Seller (UCC § 2-710):** commercially reasonable charges incurred
 - in stopping delivery,
 - in the transportation, care and custody of goods after the buyer's breach, or
 - in connection with return or resale of the goods or otherwise resulting from the breach.
- **Incidental Damages – Buyer (UCC § 2-715(1)):** expenses reasonably incurred
 - in inspection, receipt, transportation and care and custody of goods rightfully rejected,
 - in connection with effecting cover, or
 - incident to the delay in performance or other breach.

Other Types of Damages Referenced in Contract Limitation Clauses

- **Lost profits**
 - Can be direct or consequential damages depending on context. See *Tractebel Energy Mktg. v. AEP Power Mktg.*, 487 F.3d 89, 109-10 (2d Cir. 2007).
- **Loss of business**
- **Loss of data**
- **Exemplary/punitive damages**
 - Non-compensatory damages awarded for wanton, reckless, malicious, or oppressive conduct. See 22 AM JUR 2D DAMAGES § 556.
 - Generally not recoverable for breach unless breach also constitutes a tort. See RESTATEMENT (SECOND) OF CONTRACTS, § 355.

Proving Damages: Show me the Money!



Proving Damages

- Damages must be of a type that is recoverable.
- The non-breaching party bears the burden of proving its damages.

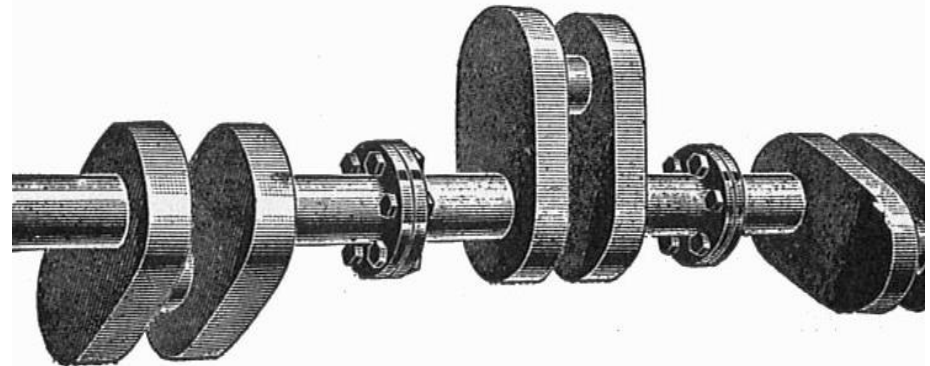
“The burden of proving damages is on the party seeking them ... [a]s part of its burden, the party seeking damages must show that the amount of damages is based upon a standard that will allow the finder of fact to calculate the amount of damages with reasonable certainty.”

Olivetti Corp. v. Ames Bus. Sys., Inc., 319 N.C. 534, 547-48 (1987).

Hadley v. Baxendale: The History



cc-by-sa/2.0 - Buildings at Gloucester Docks by Derek Harper - geograph.org.uk/p/1937649



156 Eng. Rep. 145 (1854)

Hadley v. Baxendale: Key Takeaways

- *“Where two parties have made a contract... the damages which the other party ought to receive in respect of [a] breach ... should be such as may fairly and reasonably be considered either arising naturally ... from such breach of contract itself, or such as may **reasonably be supposed to be in the contemplation of both parties**, at the time they made the contract.”*
- The Hadleys’ loss of profit from the delay in fixing the crankshaft “cannot reasonably be considered such **a consequence** of the breach of contract as could have been fairly and reasonably contemplated by both parties when they made this contract.”
- Court believed that on the facts Pickford & Co. had no reason to know that City Flour Co. would not be able to operate without the crankshaft.

First Union Nat'l Bank v. Naylor

102 N.C. App 719 (1991)

- Trial court ordered husband to indemnify wife against bank debt and related costs incurred due to his breach of separation agreement.
- On appeal, N.C. Ct. of Appeals cited to Restatement (Second) of Contracts and indicated that wife was entitled to her expectation interest due to his breach – *i.e.*, the wife was entitled to:

- Loss in value to her of her husband's failure to perform,

PLUS

- other losses (*e.g.*, incidental or consequential damages) caused by breach,

LESS

- any costs the wife avoided from not having to perform under the separation agreement.

- N.C. Ct. of Appeals remanded for determination of costs avoided by wife due to husband's non-performance under the contract.

Lamm v. Shingleton, 231 N.C. 10 (1949)

- Widow contracted with funeral home to inter her deceased spouse in an airtight vault.
- Funeral home failed to lock vault, and water and mud entered vault and casket.
- Widow sued for breach of contract and sought damages for mental anguish.
- N.C. Supreme Court held that:
 - *“A party to a contract who is injured by another’s breach ... is entitled to recover ... damages for all injuries ... as are **the direct, natural and proximate result of the breach** which ... can **reasonably** be said to have been **foreseen, contemplated and expected** by the parties when they made the contract[.]”*
 - For contracts that are commercial in nature, damages for mental anguish are generally not recoverable as they are not within the contemplation of commercial parties.
 - For contracts that are predominantly personal in nature (such as a contract for burial), mental anguish damages would be within the reasonable contemplation of the parties at the time of performance.

Schonfeld v. Hillard, 218 F.3d 164 (2d Cir. 2000): The Facts

- **1988** – The Hillard brothers form INN to distribute BBC programming into U.S.; Hillards invite Schonfeld to become a shareholder in INN.
- **March 1994** – INN and BBC enter into 20-year agreement for distribution of news programming into U.S (the “March Agreement”).
- **June 1994** – Cox Cable and INN enter into a letter agreement setting forth a proposed buy-out of the March Agreement by Cox (the “Cox Agreement”) for approx. \$1.7 million, plus a 5% equity interest in Cox’s proposed BBC channels.
- **Aug. 1994** – Hillards decide to abandon the Cox Agreement.
- **Dec. 1994** – INN and BBC sign (1) interim agreement for early access to BBC programming (the “Interim Agreement”) and (2) 20-year agreement for supply of BBC “Americanized” programming (the “December Agreement”). Schonfeld agrees to replacement of March Agreement by Interim Agreement and December Agreement due to the Hillards oral promise to provide \$20 million in funding for Interim Agreement.
- **Jan. 1994 to Feb. 1995** – Hillards fail to provide funding and default under Interim Agreement. BBC agrees to (1) dissolve Interim Agreement and December Agreement and (2) grant a release to INN and the Hillards.

Schonfeld v. Hillard: The Court's Ruling

- **The Claim**: Schonfeld sued the Hillards for (1) lost profits, (2) market value of the March Agreement & the December Agreement, and (3) punitive damages.
- **“Proof” of Lost Profits**: To support lost profits, Schonfeld relied on (1) INN business plan, (2) Cox’s projection of revenues for its BBC channel(s), (3) the beliefs of the BBC, the Hillards and Schonfeld that INN would be profitable, and (4) expert testimony of potential lost profits of up to \$269 million.
- **The Ruling**: 2nd Circuit held that:
 - Lost profits could ***not*** be proven with reasonable certainty, and it was not reasonably contemplated that the Hillards would be liable for \$269 million in lost profits.
 - ***There was sufficient evidence for Schonfeld to claim “lost asset” damages*** (i.e., the market value of the March Agreement and December Agreement) based on the Cox Letter Agreement.
 - Schonfeld was not entitled to punitive damages because the Hillards conduct was not sufficiently egregious.

Sabbeth Indus., Ltd. v. Penn. Lumbermens Mut. Ins. Co., 656 N.Y.S. 2d 475 (N.Y. App. Div. 1997)

- Sabbeth Indust. (“Sabbeth”) owned and operated a sawmill that was insured by Pennsylvania Lumbermens Mutual Insurance Co. (“Penn”).
- Insurance contract included coverage for mill’s property/contents & business interruption.
- Mill destroyed by fire.
 - Penn denied insurance claim, and
 - Sabbeth went out of business.
- Sabbeth asserted contract breach claim and damages equal to (1) policy coverage ***AND*** (2) the lost value of the business.
- Trial court did ***not*** allow recovery for consequential damages (the lost value of the business).
- Appellate court ***reversed*** and held that the damages for the lost value of the business ***were recoverable*** in this case, ***as the business interruption insurance demonstrated that consequential damages were within the parties’ reasonable contemplation.***

Typical Contract Language

- Exclusion on indirect damages:

“Neither party shall be liable for indirect, consequential, special, incidental, collateral, exemplary or punitive damages, howsoever caused, regardless of the form of the action or the theory of recovery, even if such party has been advised of the possibility of such damages.”

- Monetary liability cap:

“Neither party’s liability in connection with this Agreement shall exceed...”

Typical Contract Language

- Exceptions to limitations on liability:

“The limitations on liability set forth in Section [X] shall not apply with respect to: (i) either party’s breach of its confidentiality obligations, (ii) the vendor’s breach of its information security obligations; (iii) either party’s fraud, gross negligence, or willful misconduct; or (iv) either party’s indemnification obligations and resulting liability.”

Typical Contract Language

- Why are the exceptions important?
 - The exceptions address the issues that can lead to the largest amount of damages.
 - The exceptions address risks that are better addressed by the party taking on the liability, or address liabilities that would be “unfair” for the other party to take on.
 - The exceptions take into account breaches/risks that are very likely to result in *indirect* damages.

Any Questions?



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Thank you!