Monday, October 1, 2012
4:30 PM - 6:00 PM

303 – Contract Drafting, Part 2 - Addressing Liability Issues: Indemnification and Insurance

Lynne Durbin
VP, GC and Secretary
Adhesives Research, Inc.

Ronald Hicks
Parner
Meyer, Unkovic & Scott

David Munn
General Counsel
Pramata Corporation

Elizabeth Taylor
Executive VP and General Counsel
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Faculty Biographies

Lynne Durbin

Lynne M. Durbin is vice president, general counsel and secretary for Adhesives Research, Inc., a privately-held global manufacturer of specialty adhesives and films. She is responsible for the global legal affairs of the corporation, with primary focus on corporate, intellectual property and regulatory issues. She also counsels two affiliated corporations, which are involved in label printing and the manufacture of conductive membranes. Ms. Durbin previously managed the human resources department.

Prior to joining Adhesives Research, Inc., Ms. Durbin served as division counsel and director of environment, health and safety for the Grace Davison unit of W.R. Grace & Co.-Conn., an inorganic chemical manufacturer. She provided counsel on general corporate and commercial matters, environmental, health and safety issues, intellectual property matters, antitrust matters and acquisitions. Prior to working in-house, Ms. Durbin was in private practice in the Baltimore area.

Ms. Durbin has been a frequent panel speaker at the Association of Corporate Counsel Annual Meetings and at other professional seminars. She is a former president of the ACC's Baltimore Chapter. She is active on the boards of the Girl Scouts of Central Maryland and Parks and People Foundation and is a former president of Network 2000, Inc.

Ms. Durbin received a BA from Yale University and a JD from the Boston University School of Law.

Ronald Hicks

Ronald L. Hicks, Jr., is a partner of the Pittsburgh firm of Meyer, Unkovic & Scott LLP. As a member of its litigation section since his start out of law school with the firm and the current vice-chair of its business and tort litigation practice group, he is a seasoned trial lawyer whose practice focuses primarily on complex business litigation matters, including representing companies and individuals on matters involving indemnification and insurance coverage. Recently, as co-lead counsel, he obtained a $12.8 million verdict after thirty days of trial in New Jersey state court against a client’s legacy insurance companies for damages related to the environmental cleanup of its former metals manufacturing site.

Mr. Hicks is a frequent speaker and author on a variety of issues involving business litigation. He has been invited to participate in several events sponsored by the Association of Corporate Counsel, including as a co-presenter on implementing an effective insurance bid program at the 2010 Annual Meeting and on electronic

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information retention and destruction policies and procedures at the 2008 Annual Meeting.

Mr. Hicks serves as co-chair of the litigation section of Meritas, an association of select independent law firms in principal cities worldwide. Mr. Hicks received a BA from the College of Liberal Arts at Pennsylvania State University and is a graduate of Wake Forest University School of Law.

David Munn

David Munn is general counsel for Pramata Corporation, a provider of contracts intelligence systems and services that help companies organize, find, and manage contracts and contractual information.

Prior to joining Pramata he spent seven years with FICO, a data analytics and decision management company best known as the developer of FICO® credit scores, where his practice focused on software licensing and services contracts, as well as intellectual property, Internet, privacy, and advertising law. He also led several process reengineering initiatives and technology implementations relating to contracting and other processes. Previously he served as the first general counsel at Pella Corporation. He began his legal career in the Minneapolis office of Faegre & Benson (now Faegre Baker Daniels). Prior to law school he worked as a mechanical engineer for Monsanto and 3M.

He has been an ACC member for more than 20 years and has a longstanding interest in using technology to improve the practice of law, particularly in the areas of contract drafting and contract management. He also has a special interest in improving the quality of contract drafting. He has written articles and participated as a panelist in many seminars, including previous ACC Annual Meetings. He is the author of "Creating a Matter Management System Using Outlook® Public Folders," *ACCA Docket*, July/August 2002. He is on the ACC's Minnesota Chapters board of directors as well as serving as its treasurer.

Mr. Munn received a BS in mechanical engineering from Iowa State University and his JD from Yale Law School.

Elizabeth Taylor

Elizabeth C. Taylor is the executive vice president and general counsel of TIMCO Aviation Services, Inc., one of the largest, independent aircraft maintenance, repair and overhaul (MRO) providers in the world, supporting global aircraft operators and owners with comprehensive aircraft care services. In that role, she manages all of the company's legal matters and she has executive responsibility for the human resources and training functions. TIMCO's corporate office is located in Greensboro, NC.

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Prior to joining TIMCO, Ms. Taylor was a member of the law firm of Brooks Pierce McLendon Humphrey & Leonard, LLP, where she concentrated her practice in the areas of taxation and corporate transactions.

She has served as a member of the Grantmaking Committee for the Future Fund of Greensboro and pro bono legal advisor to several start-ups and nonprofits in the Piedmont Triad region of North Carolina.

Ms. Taylor received a BA from University of North Carolina, Greensboro, and an MBA from the Babcock School of Management at Wake Forest University. She received her law degree from the University of North Carolina School of Law.

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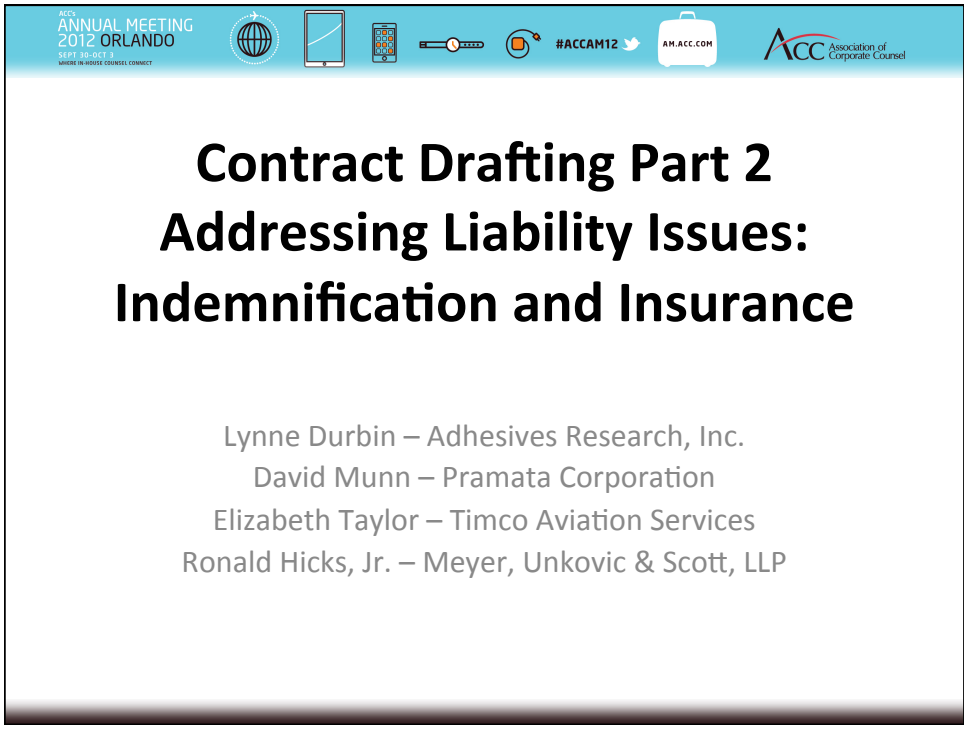

Contract Drafting Part 2 Addressing Liability Issues: Indemnification and Insurance

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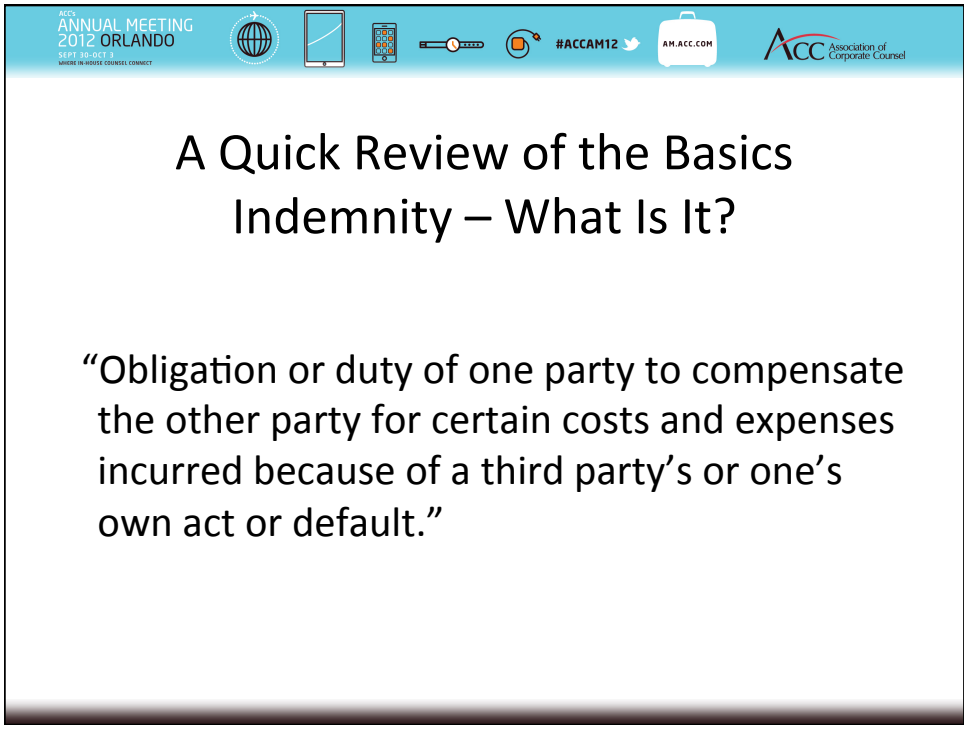
David Munn – Pramata Corporation
Elizabeth Taylor – Timco Aviation Services
Ronald Hicks, Jr. – Meyer, Unkovic & Scott, LLP



A Quick Review of the Basics Indemnity – What Is It?

"Obligation or duty of one party to compensate the other party for certain costs and expenses incurred because of a third party's or one's own act or default."

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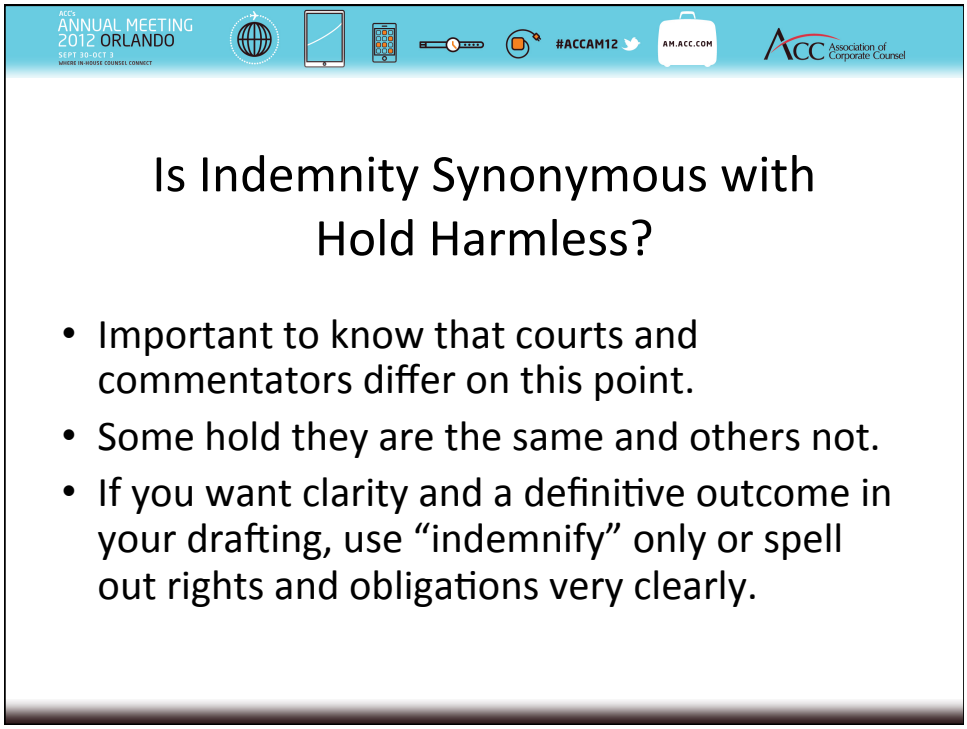

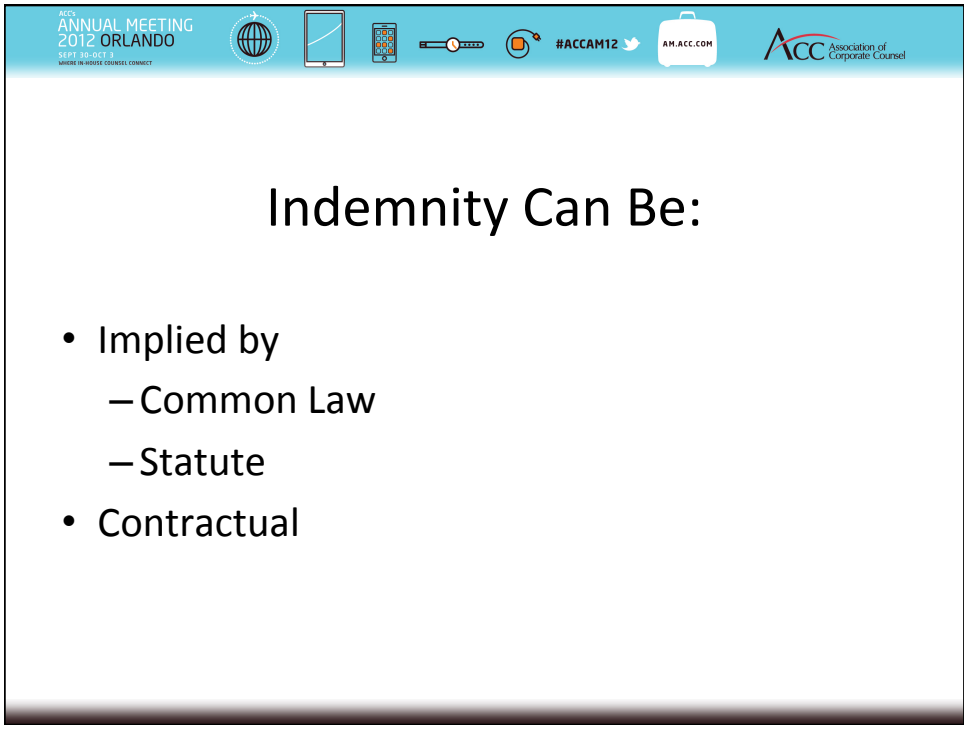

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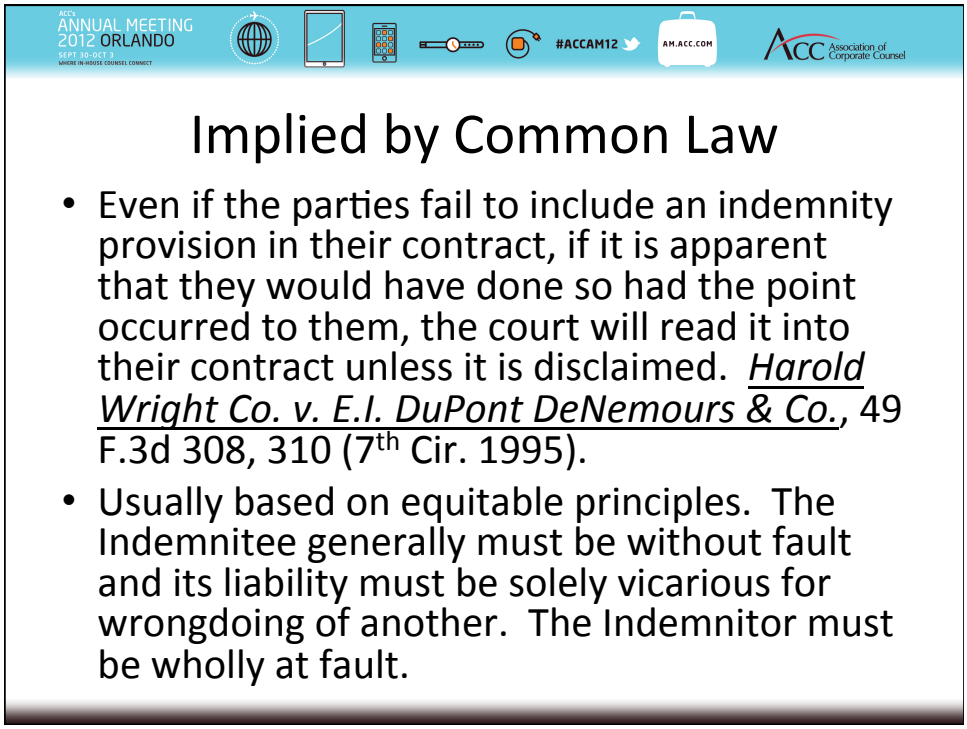

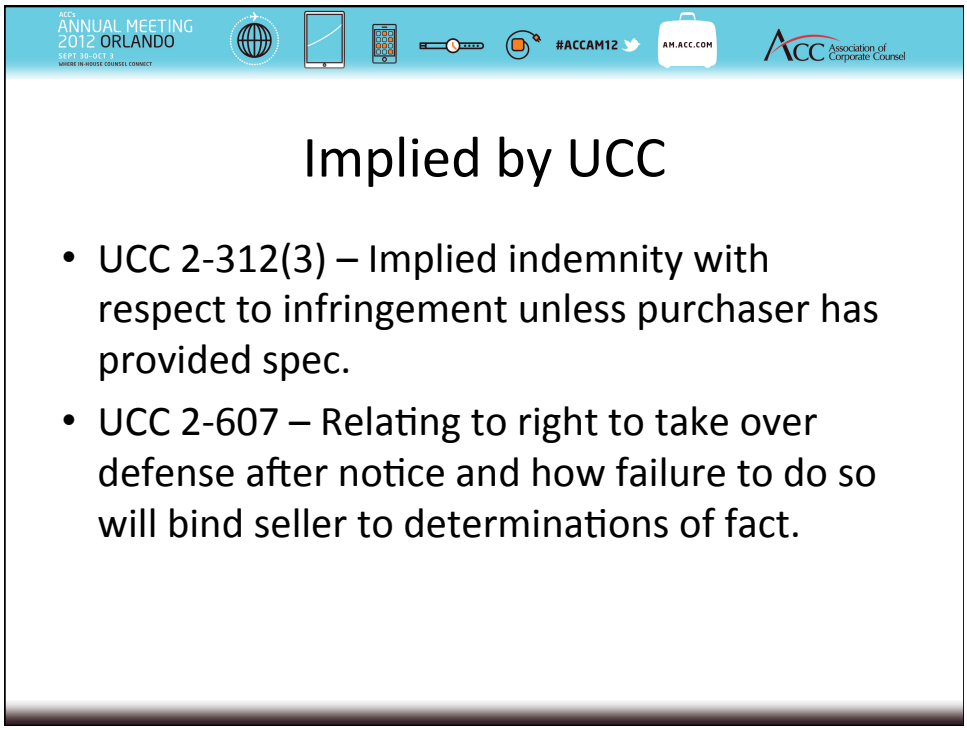

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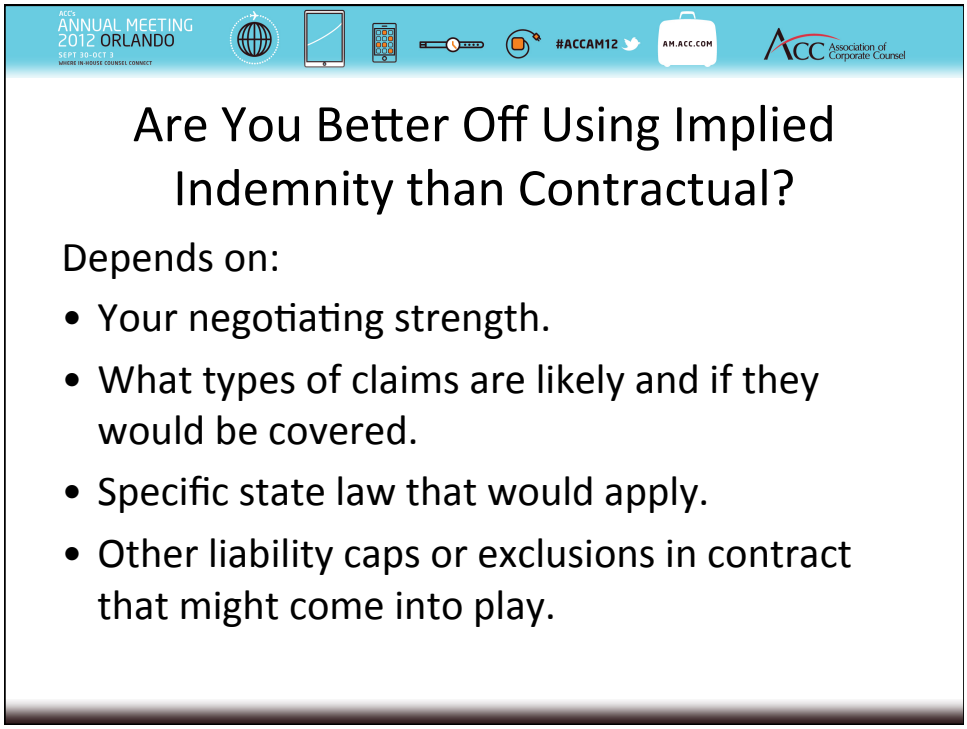

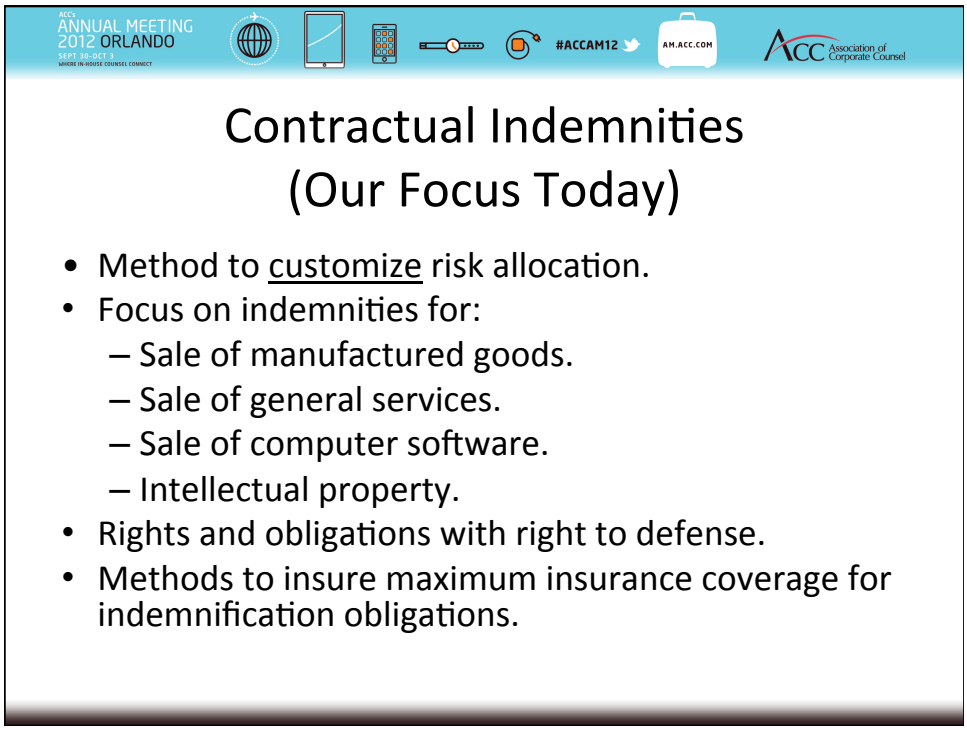

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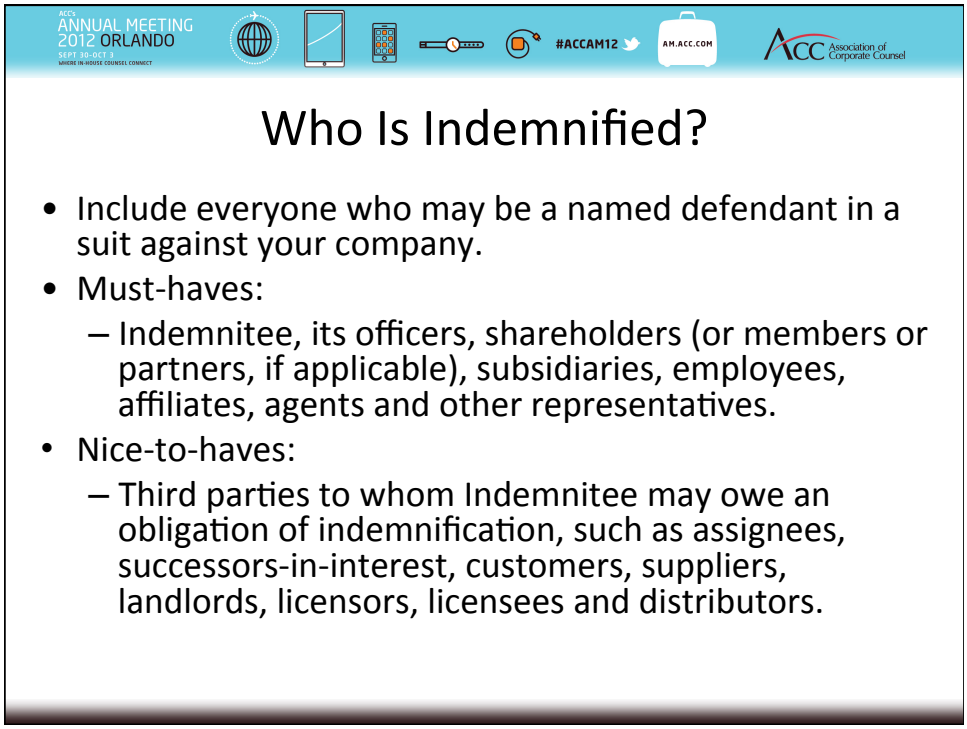

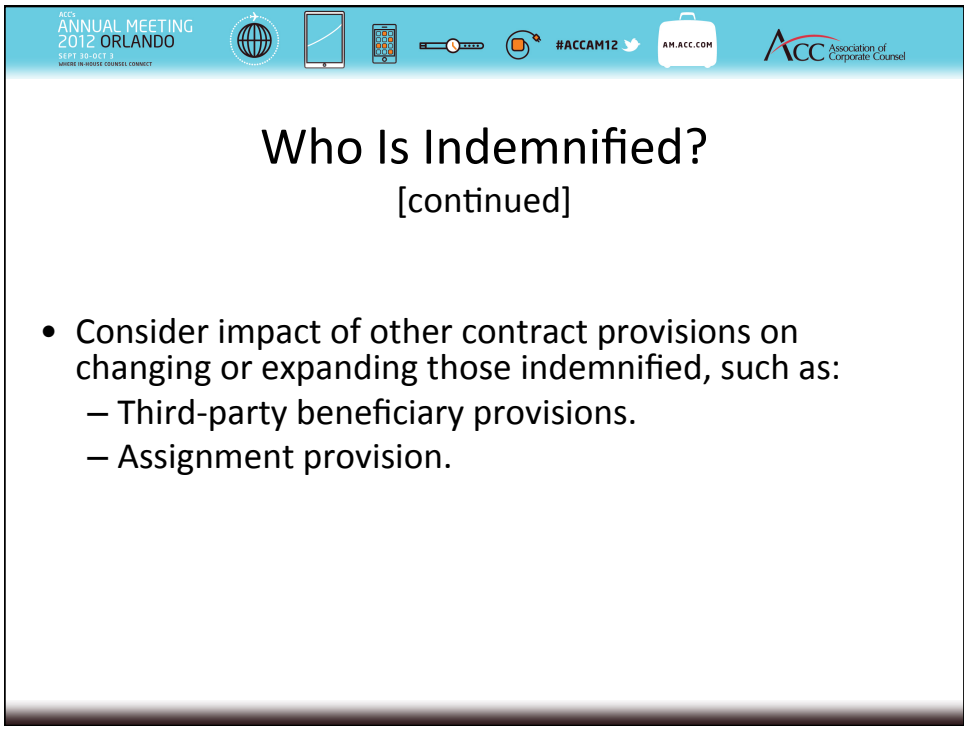

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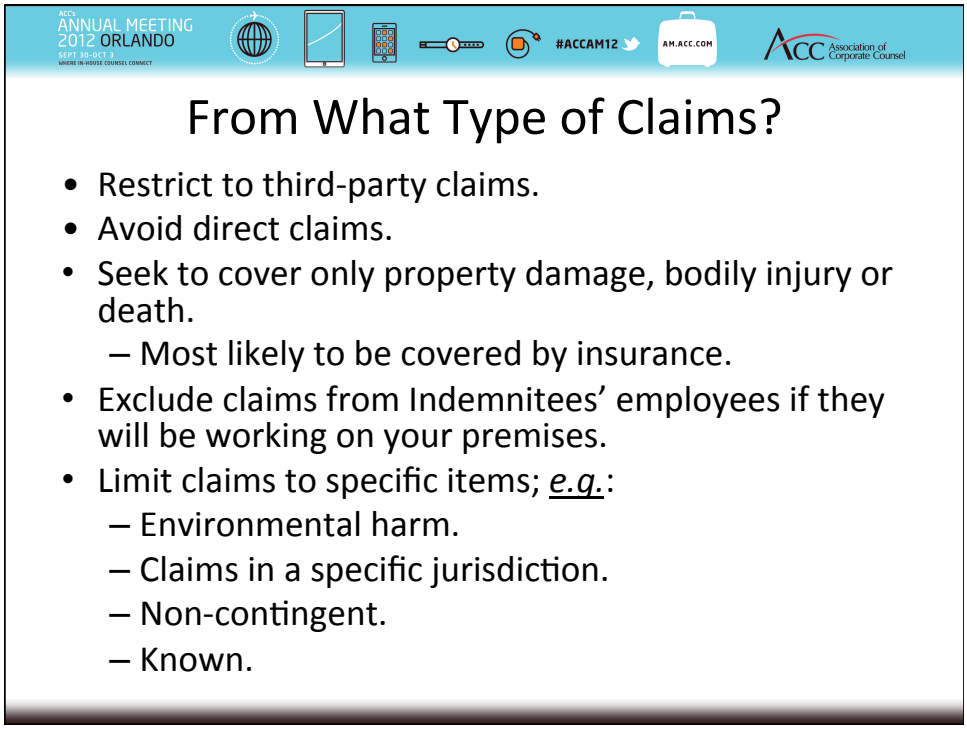

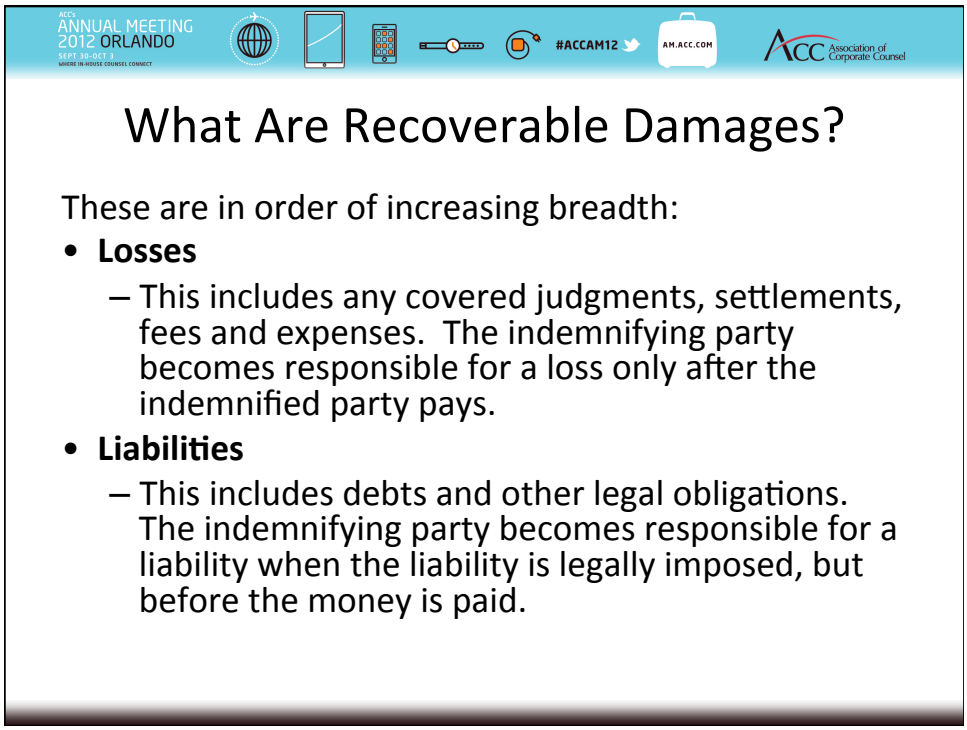

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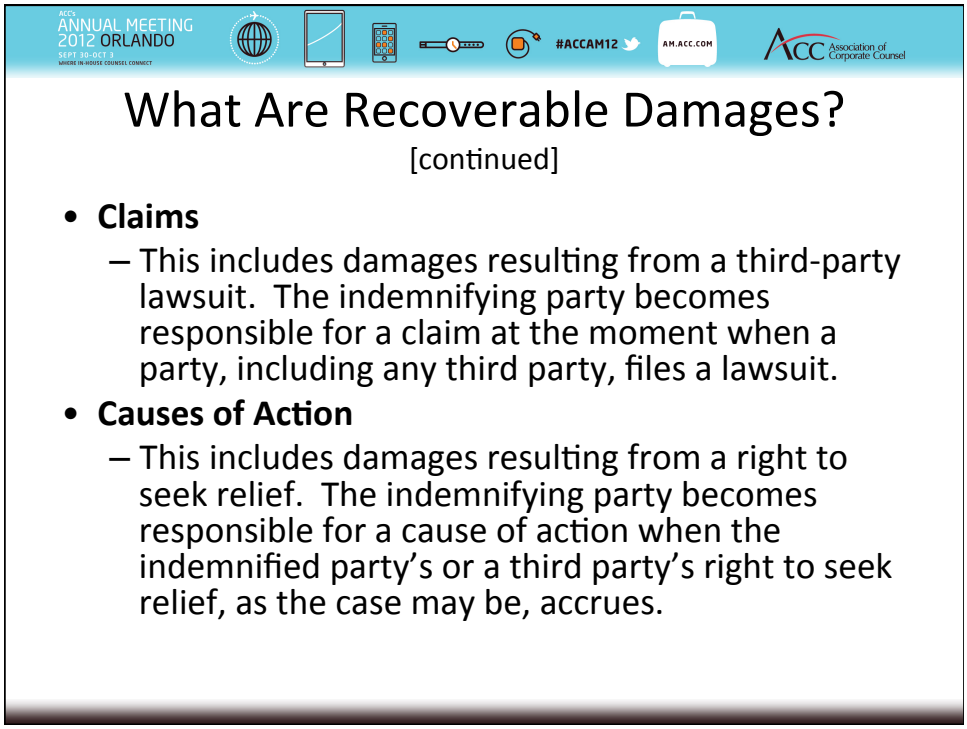

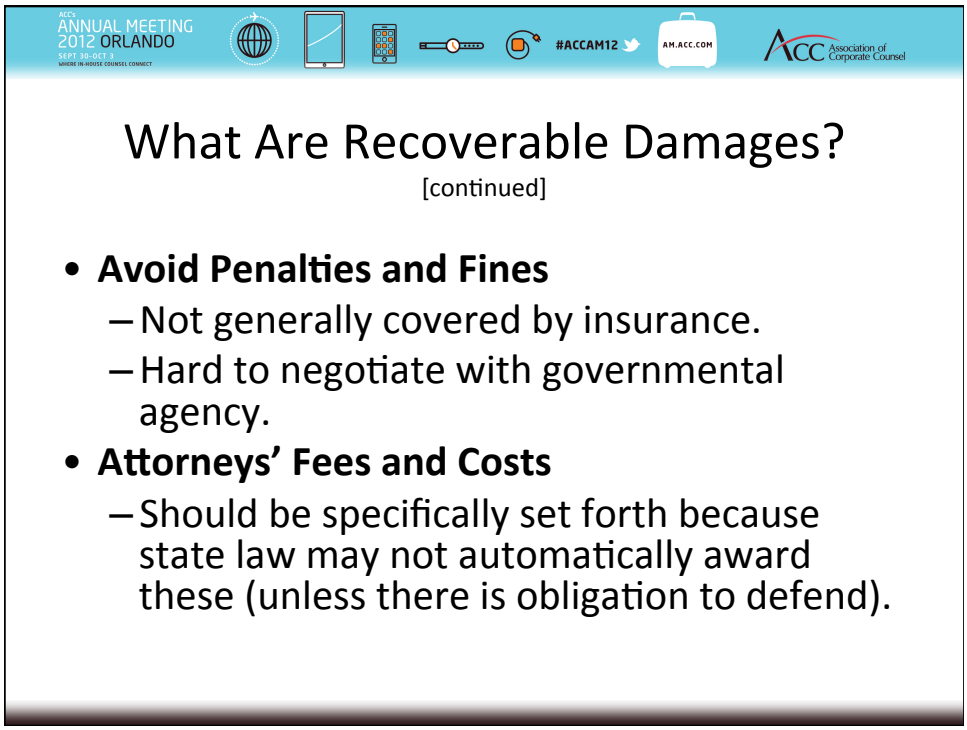

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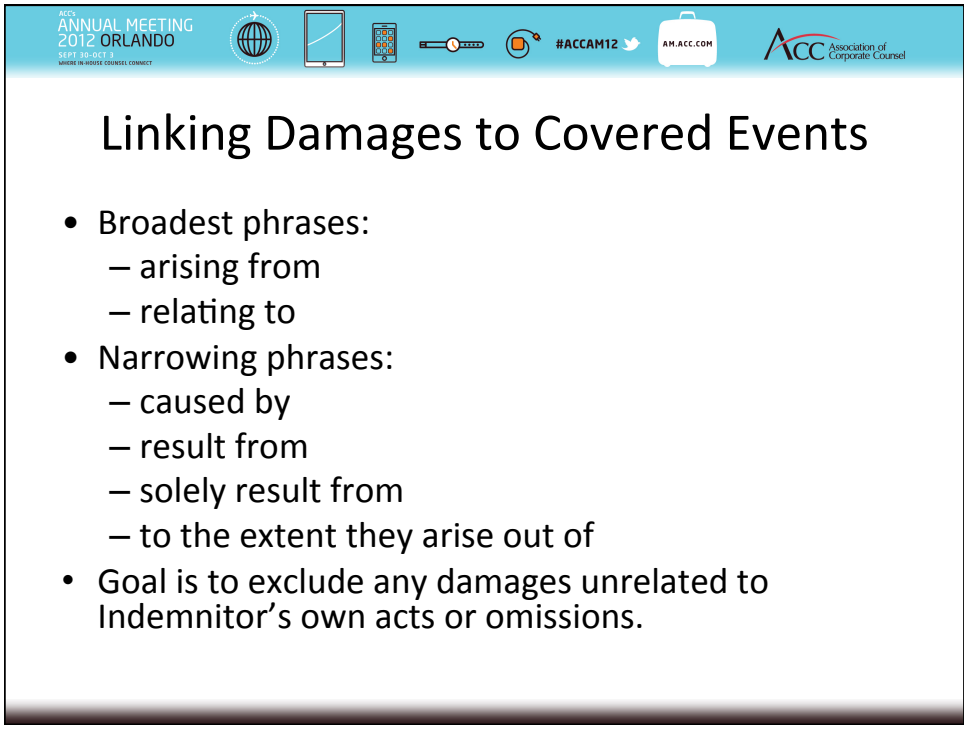

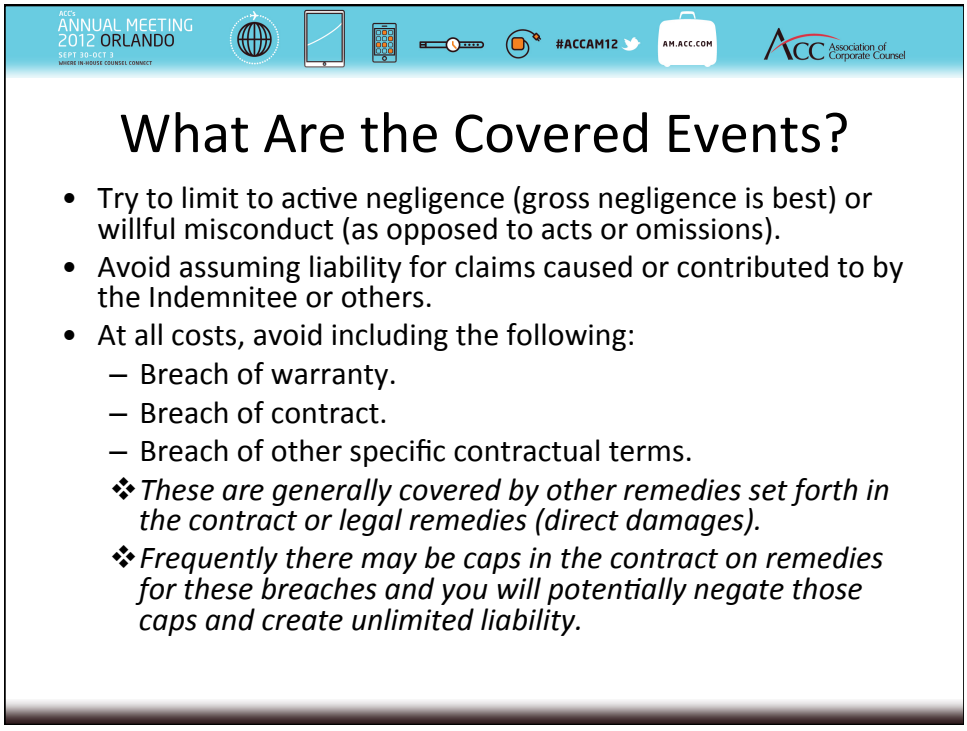

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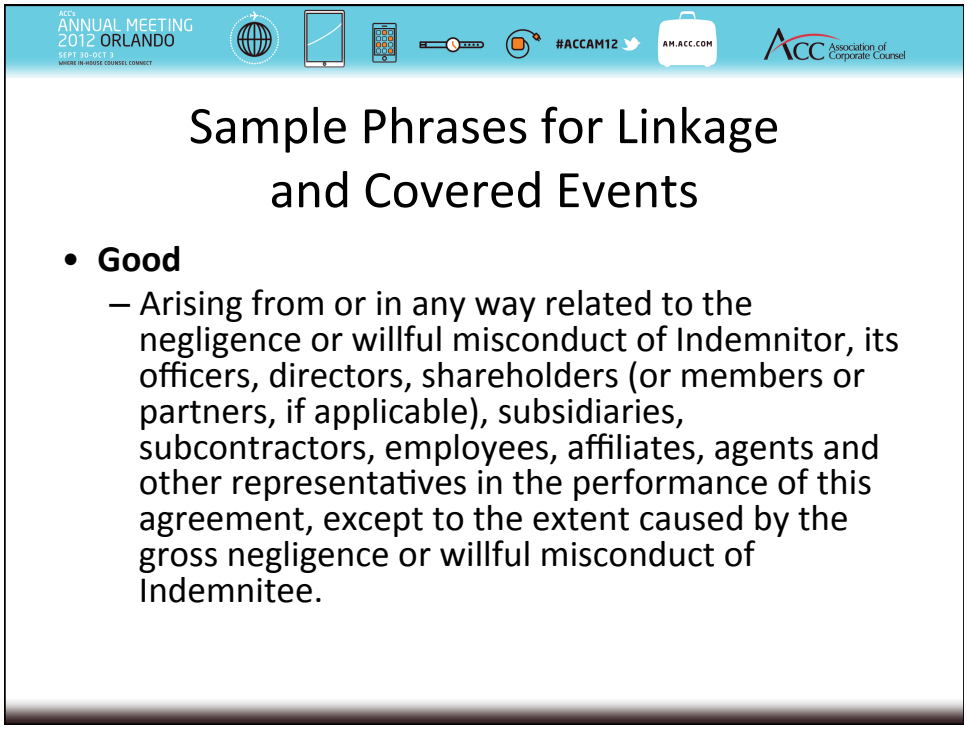

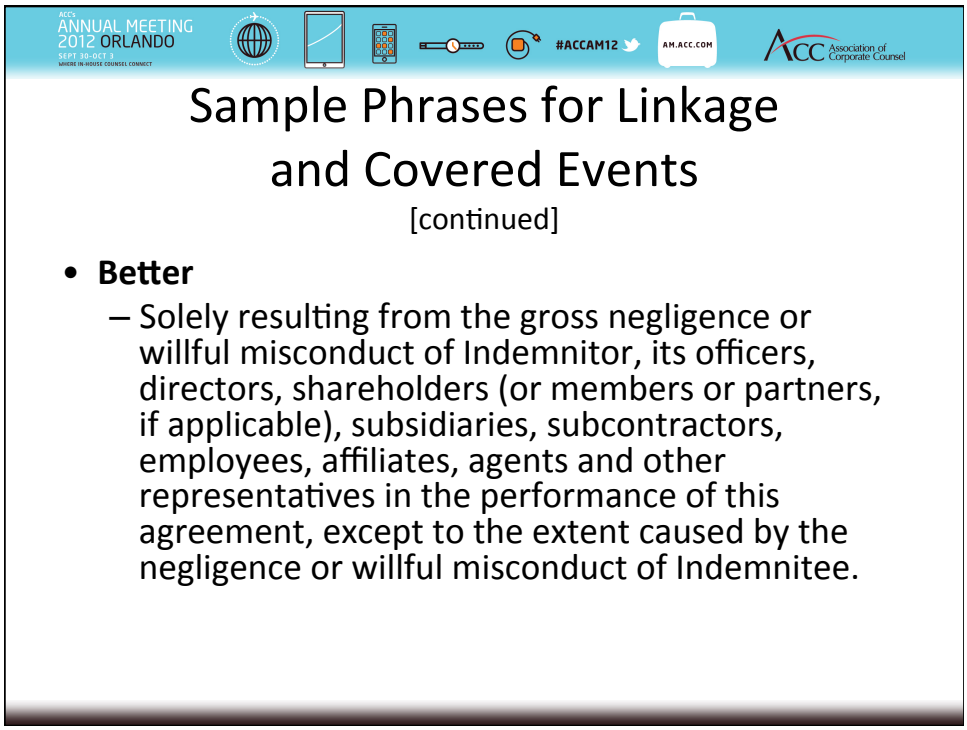

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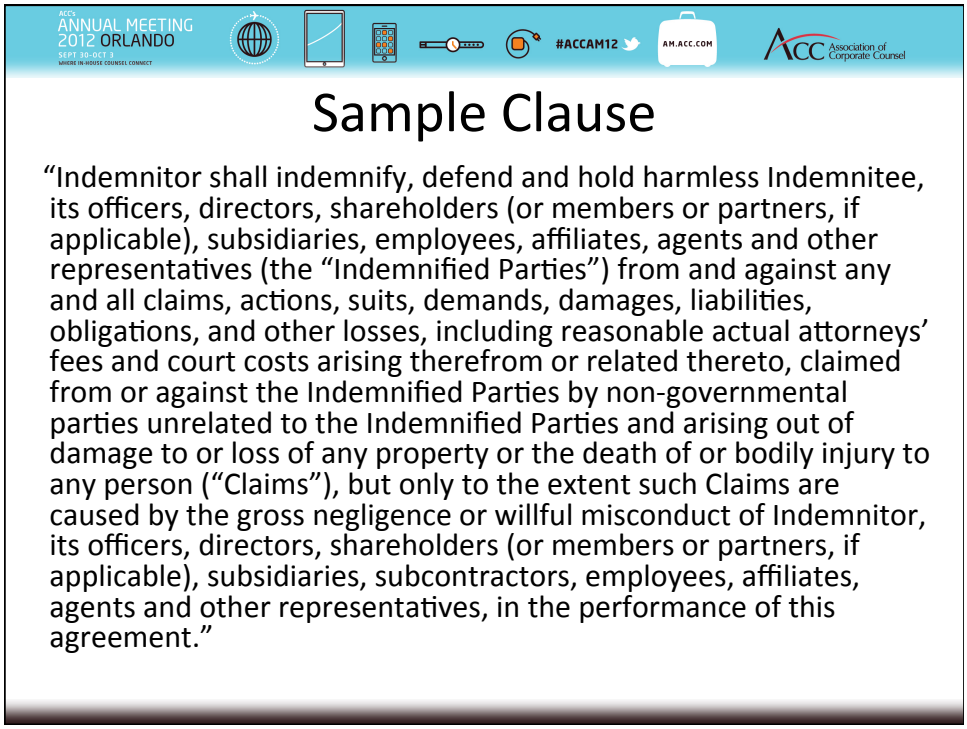

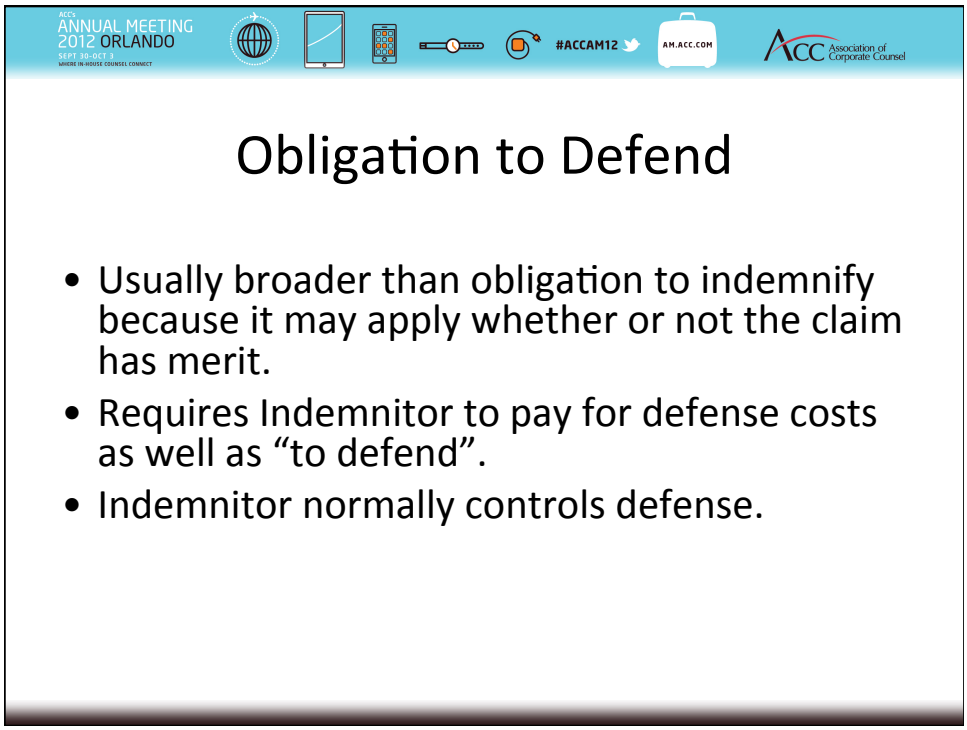

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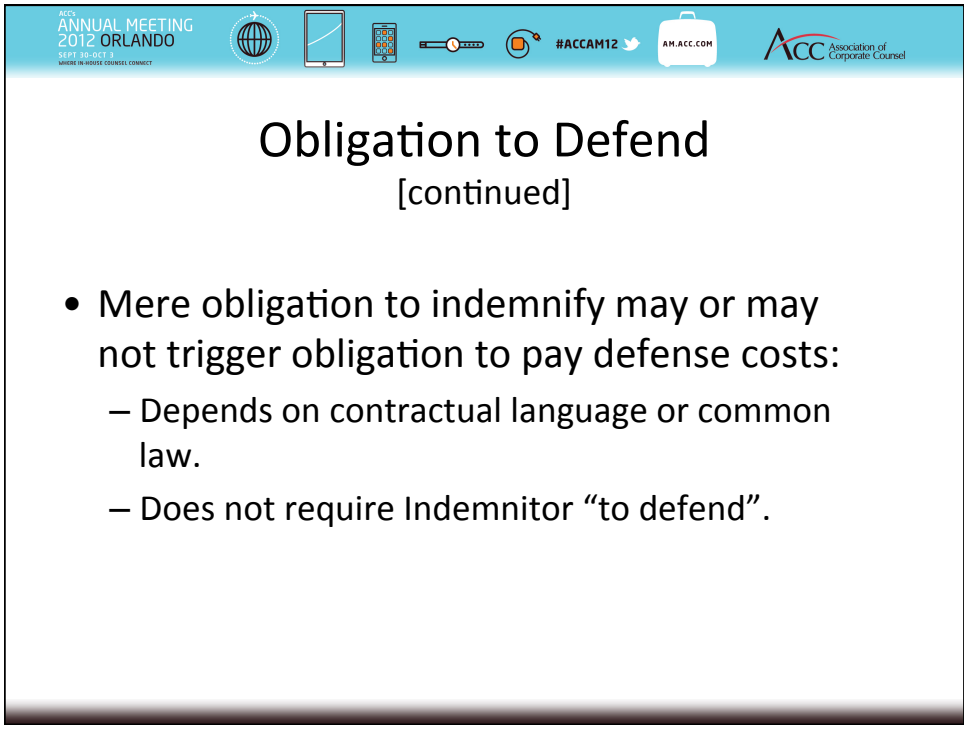

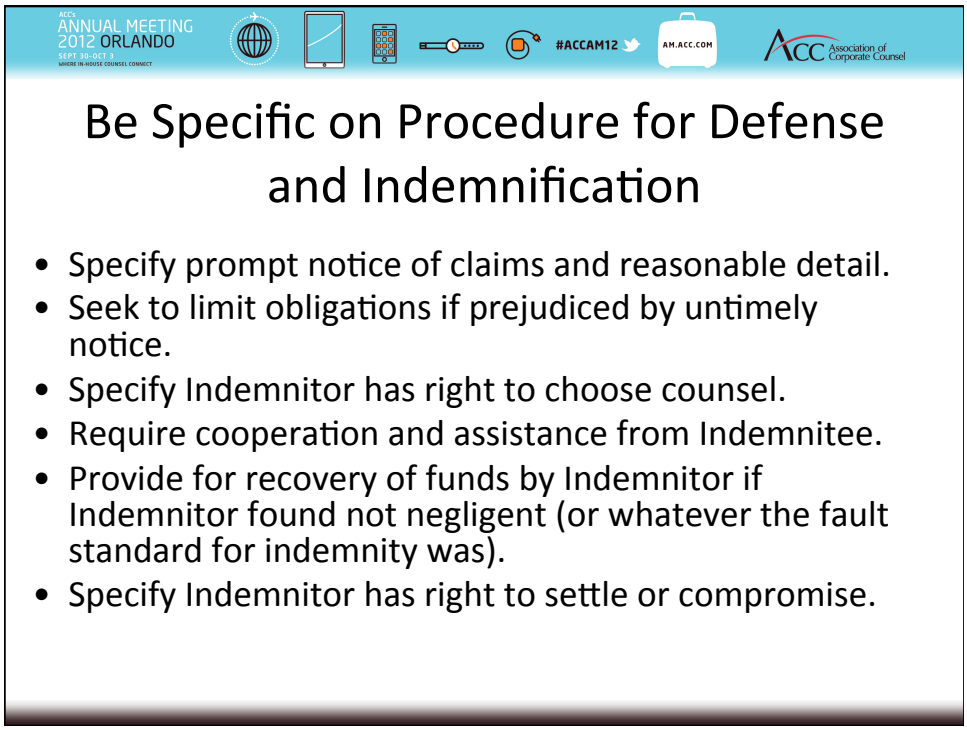

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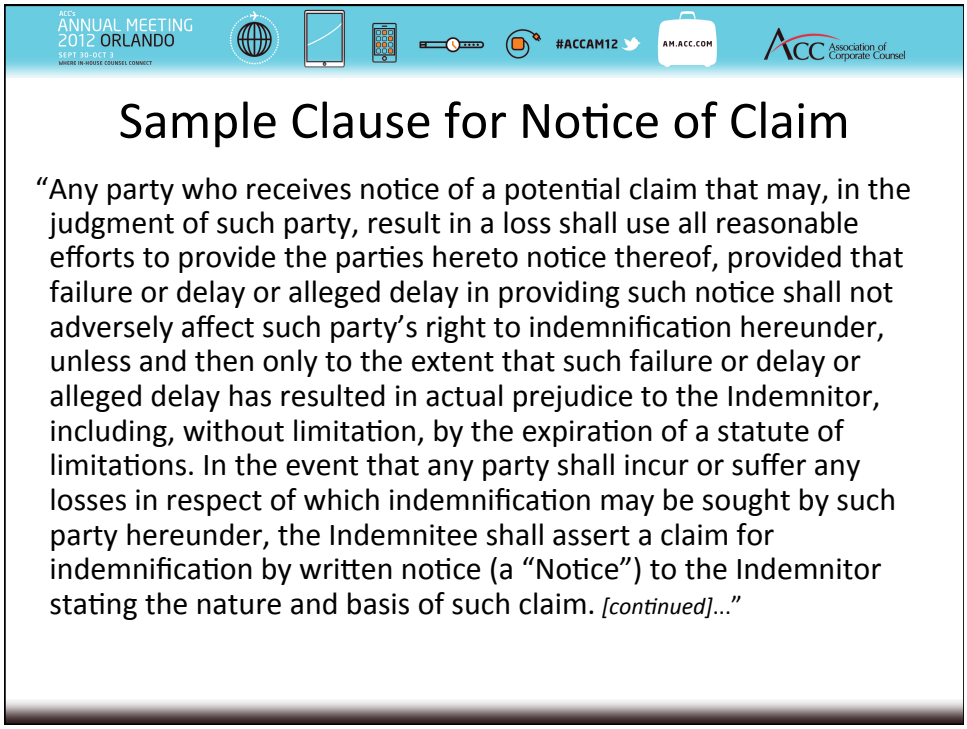

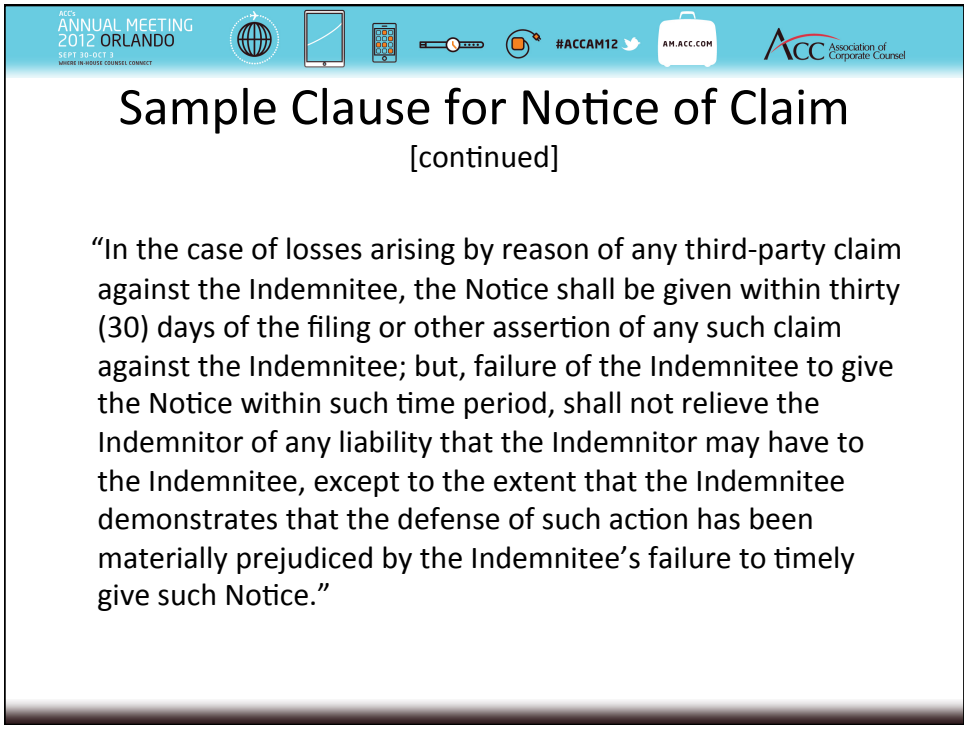

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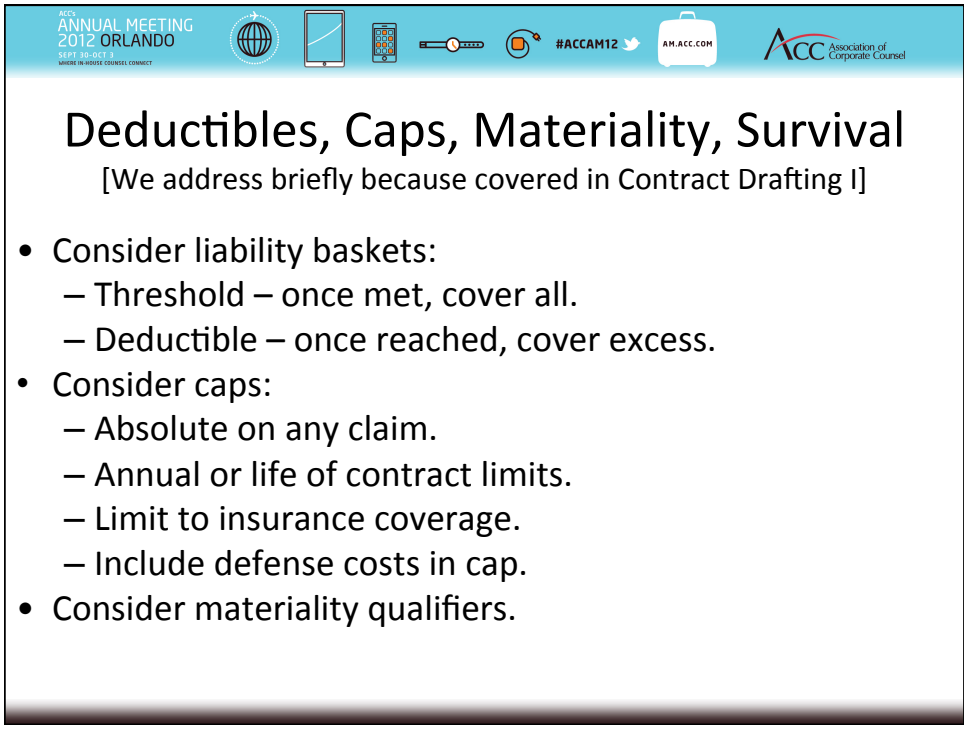

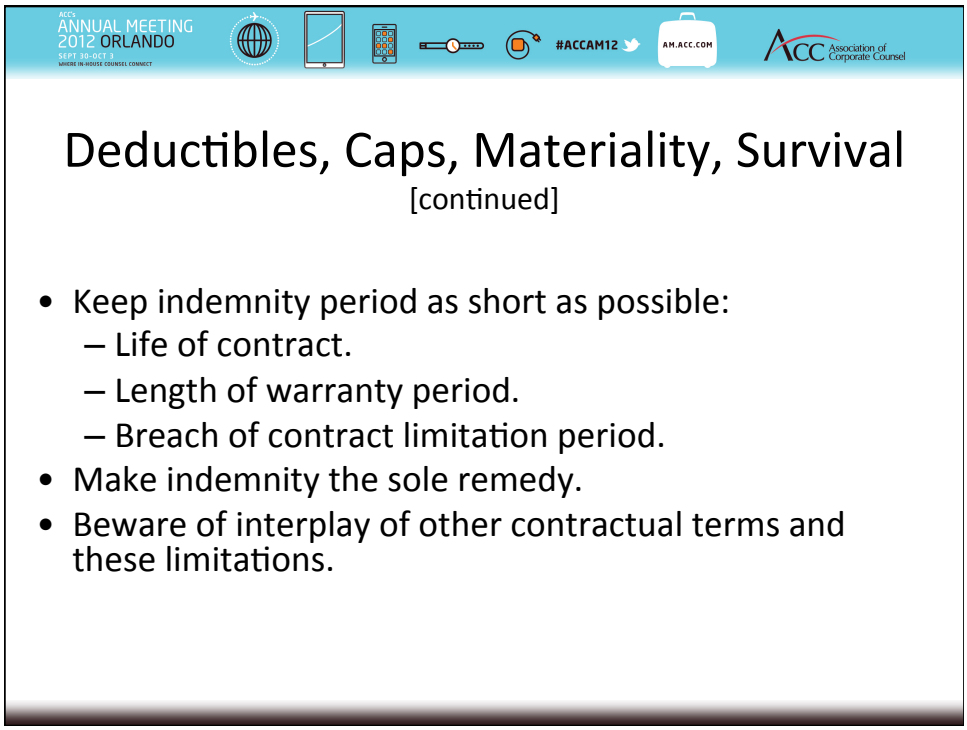

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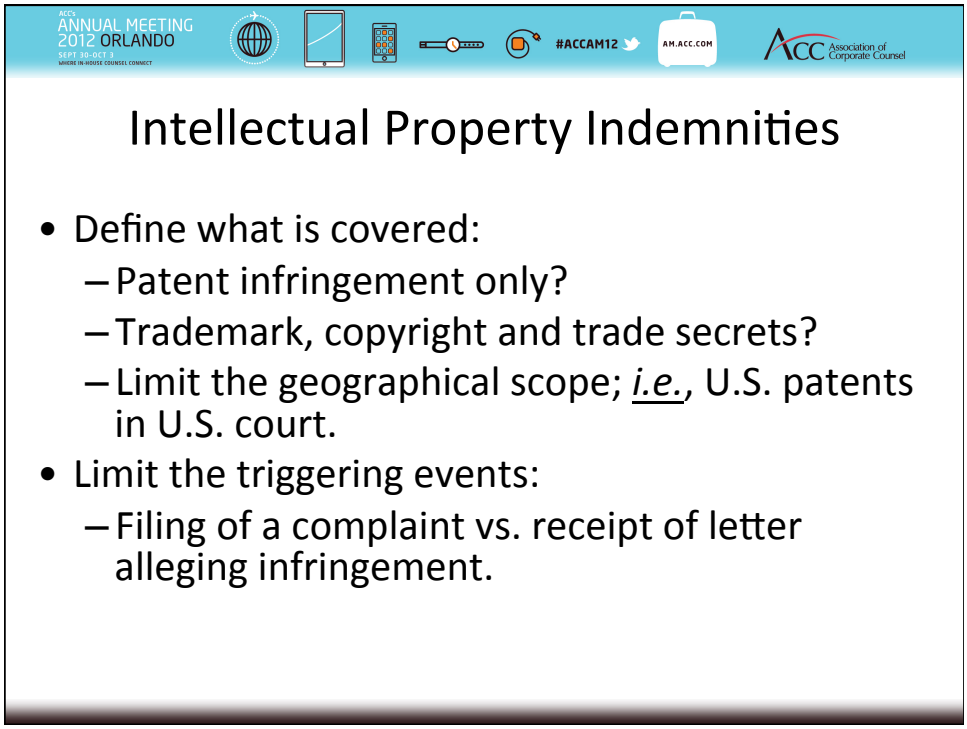

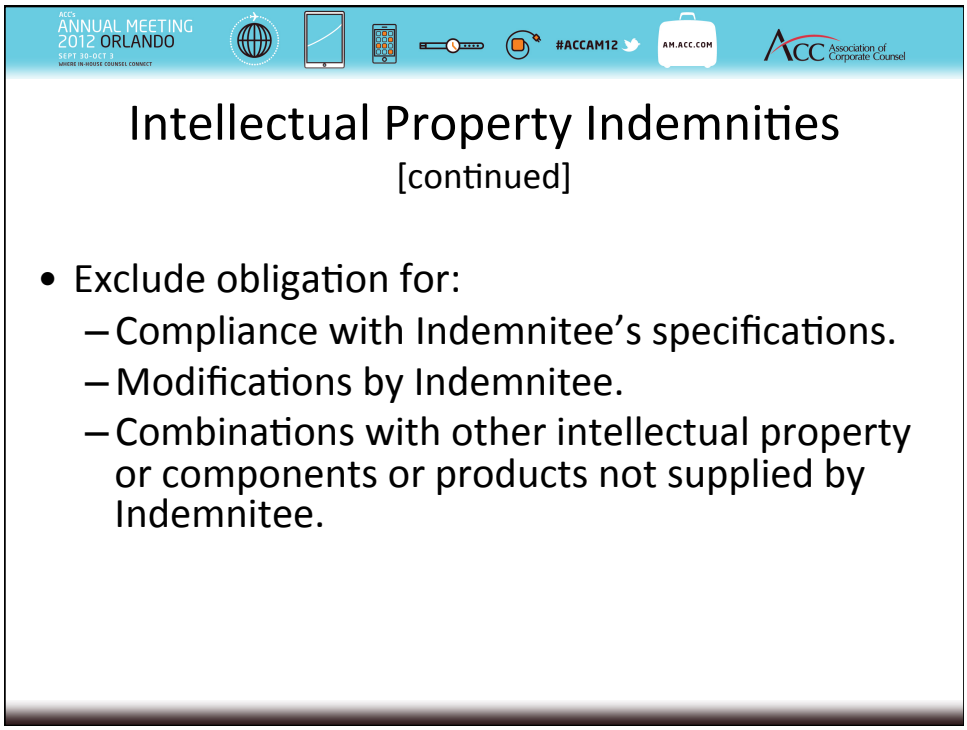

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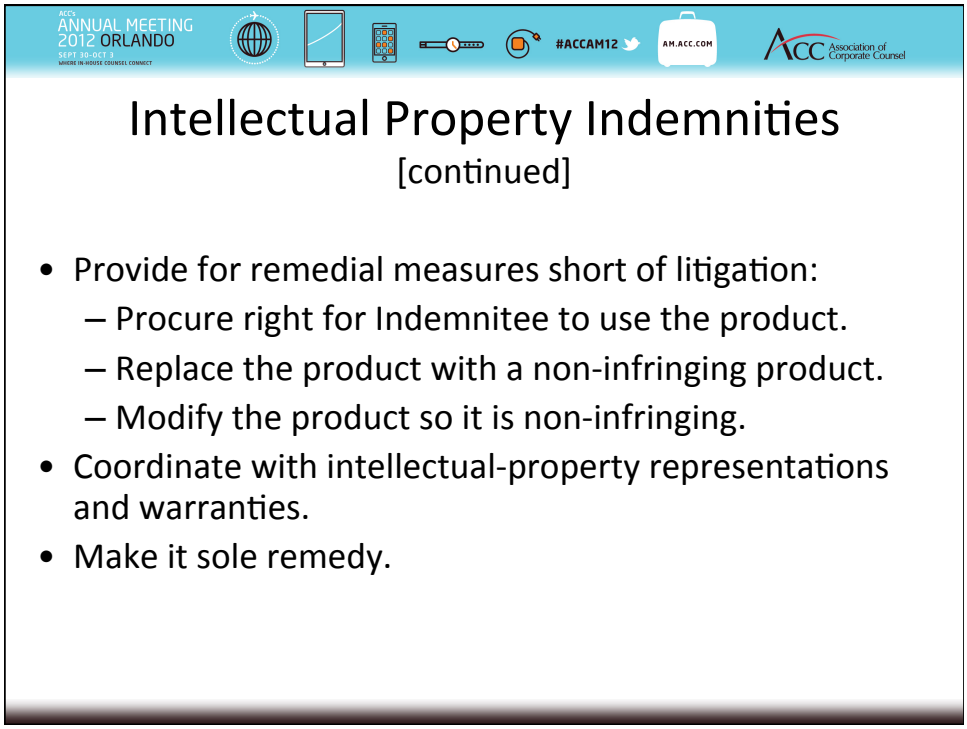
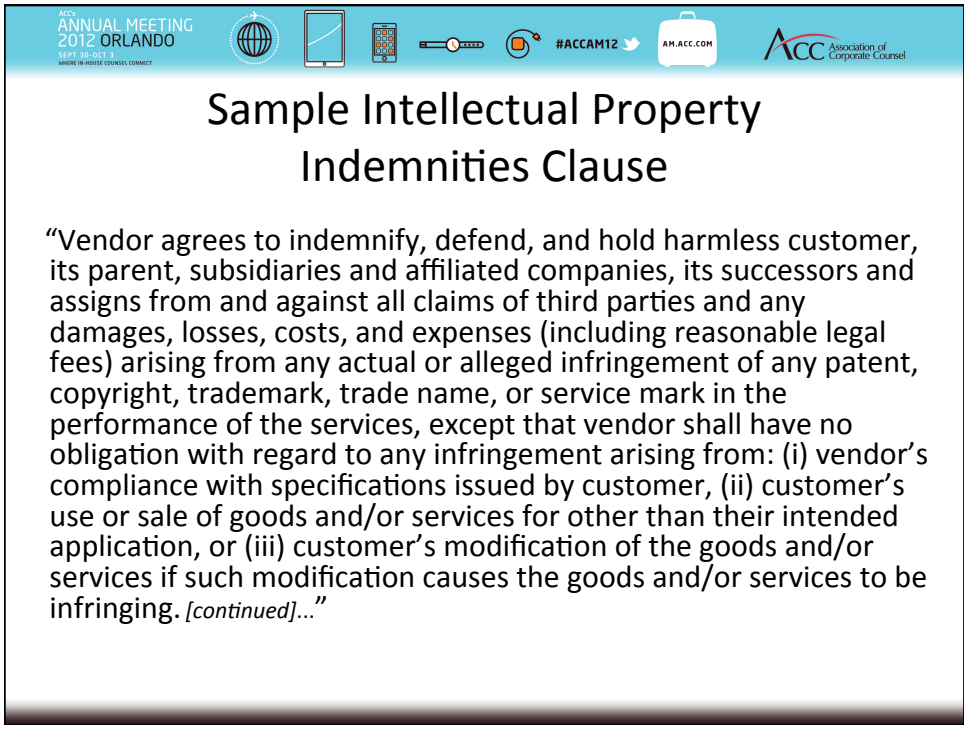


Intellectual Property Indemnities
[continued]

- Provide for remedial measures short of litigation:
  - Procure right for Indemnitee to use the product.
  - Replace the product with a non-infringing product.
  - Modify the product so it is non-infringing.
- Coordinate with intellectual-property representations and warranties.
- Make it sole remedy.



Sample Intellectual Property Indemnities Clause

"Vendor agrees to indemnify, defend, and hold harmless customer, its parent, subsidiaries and affiliated companies, its successors and assigns from and against all claims of third parties and any damages, losses, costs, and expenses (including reasonable legal fees) arising from any actual or alleged infringement of any patent, copyright, trademark, trade name, or service mark in the performance of the services, except that vendor shall have no obligation with regard to any infringement arising from: (i) vendor's compliance with specifications issued by customer, (ii) customer's use or sale of goods and/or services for other than their intended application, or (iii) customer's modification of the goods and/or services if such modification causes the goods and/or services to be infringing. *[continued]...*"

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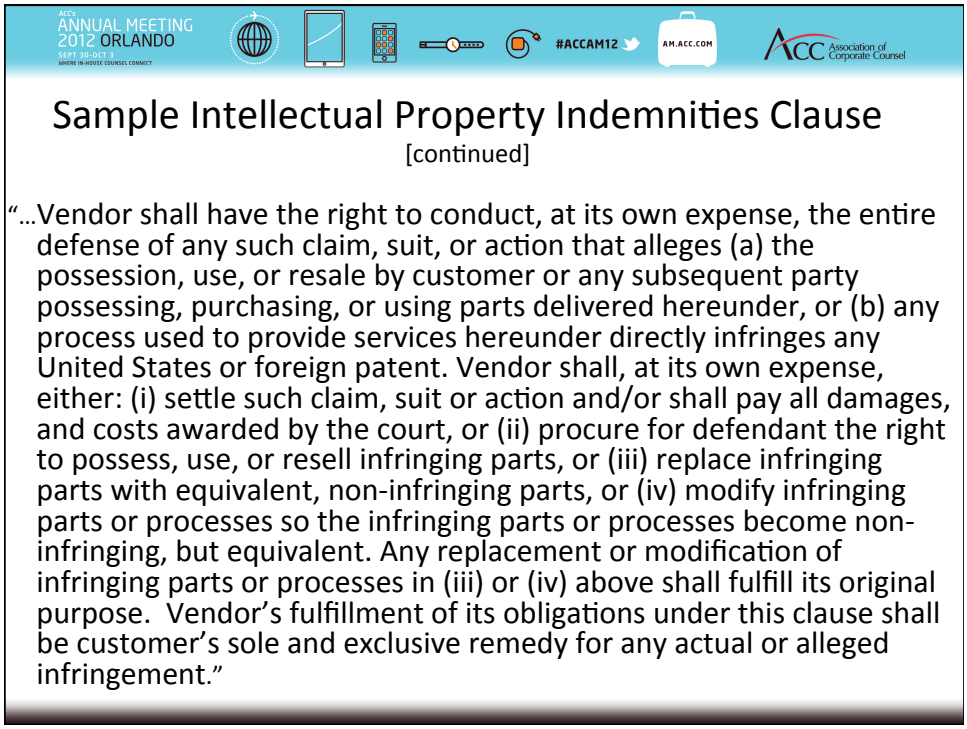

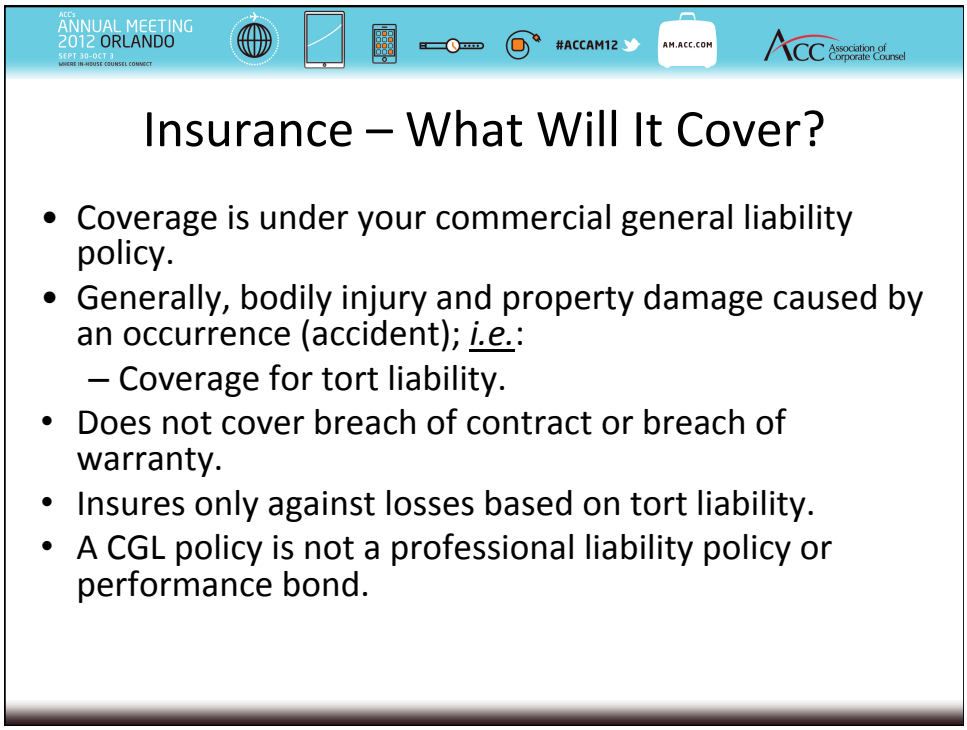

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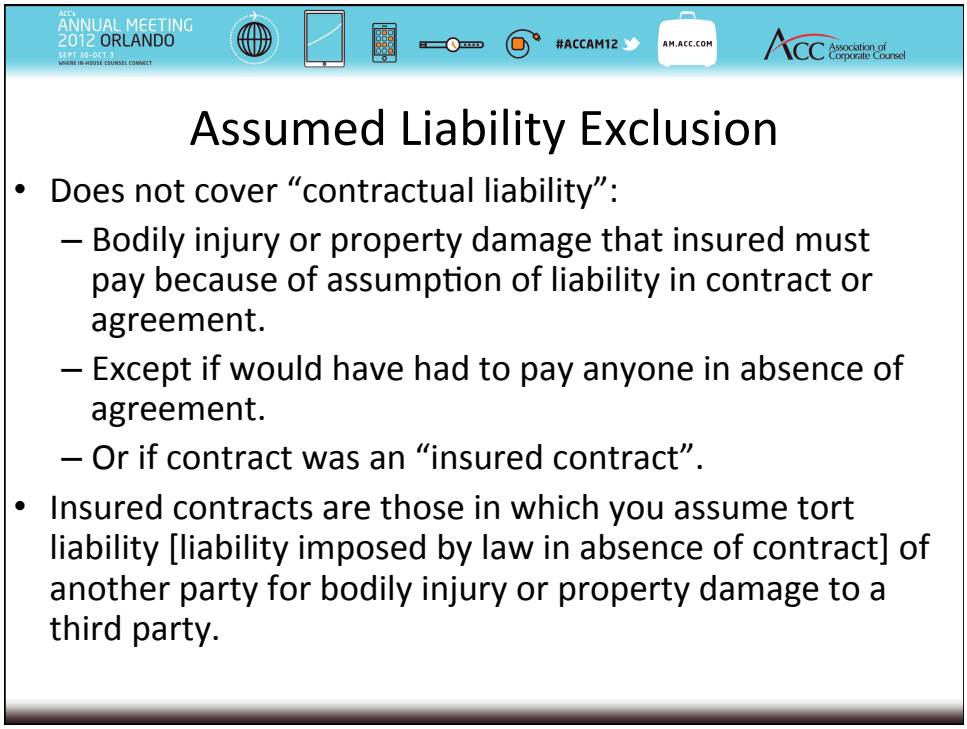

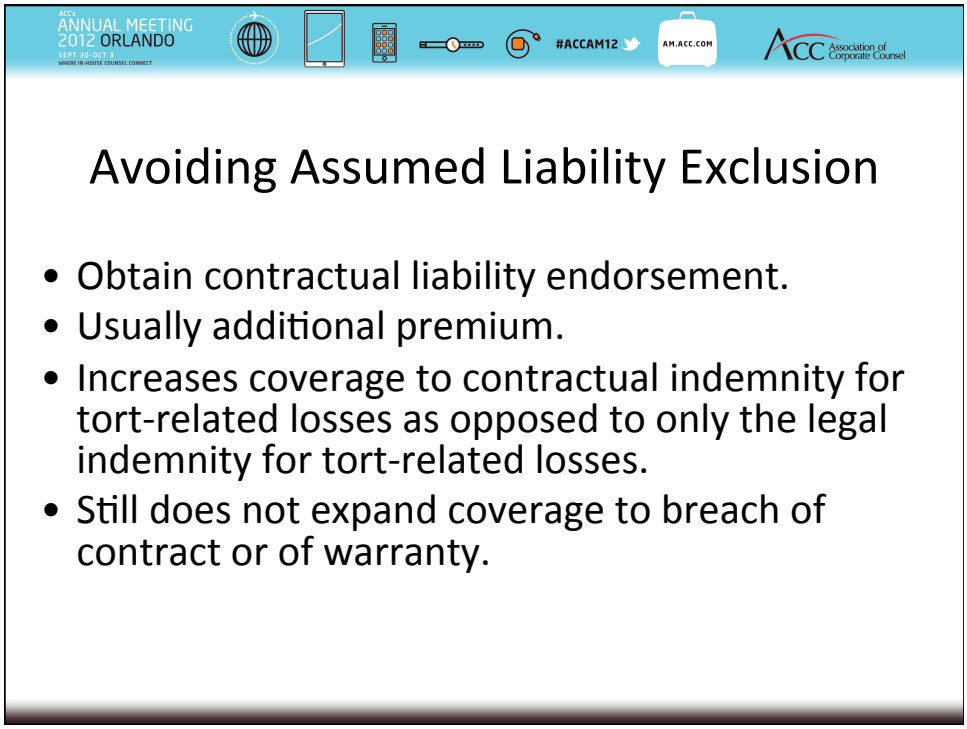

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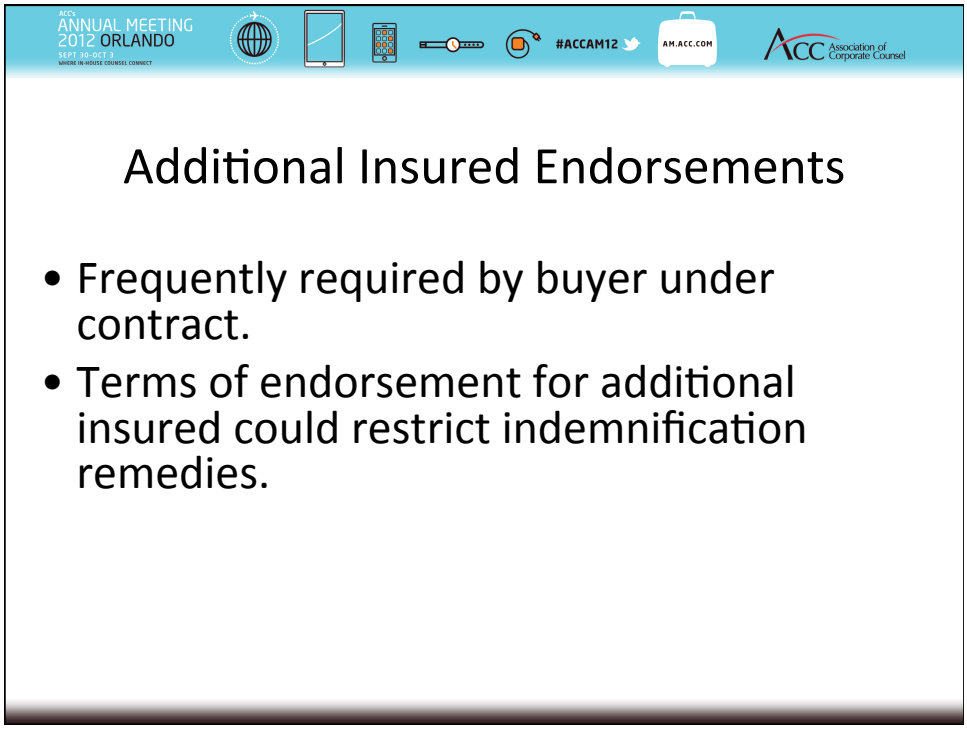

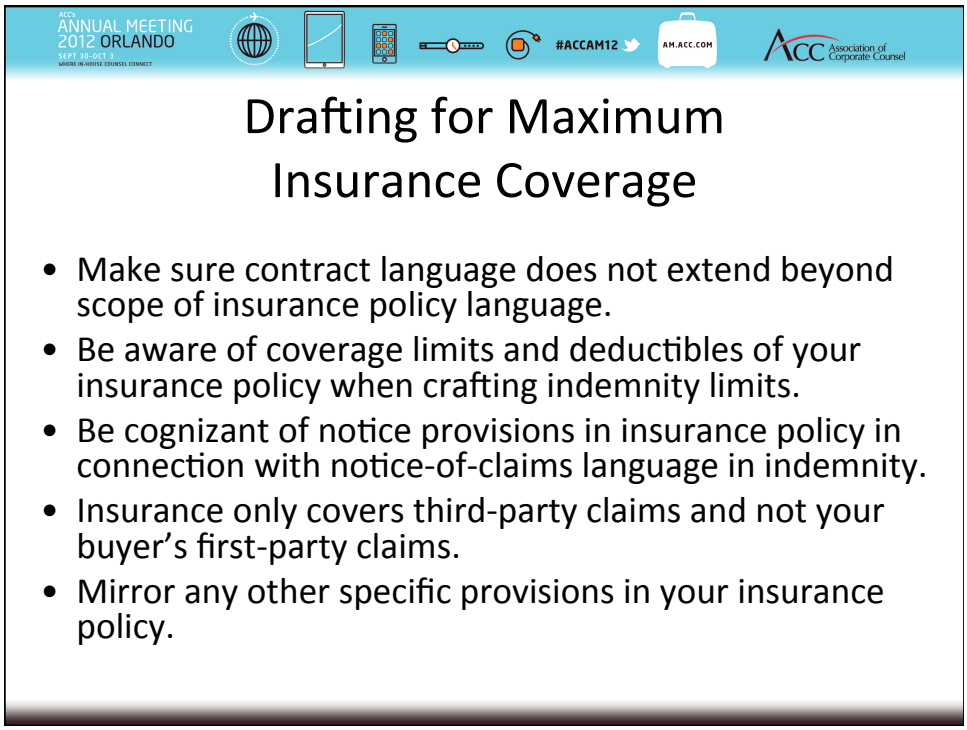

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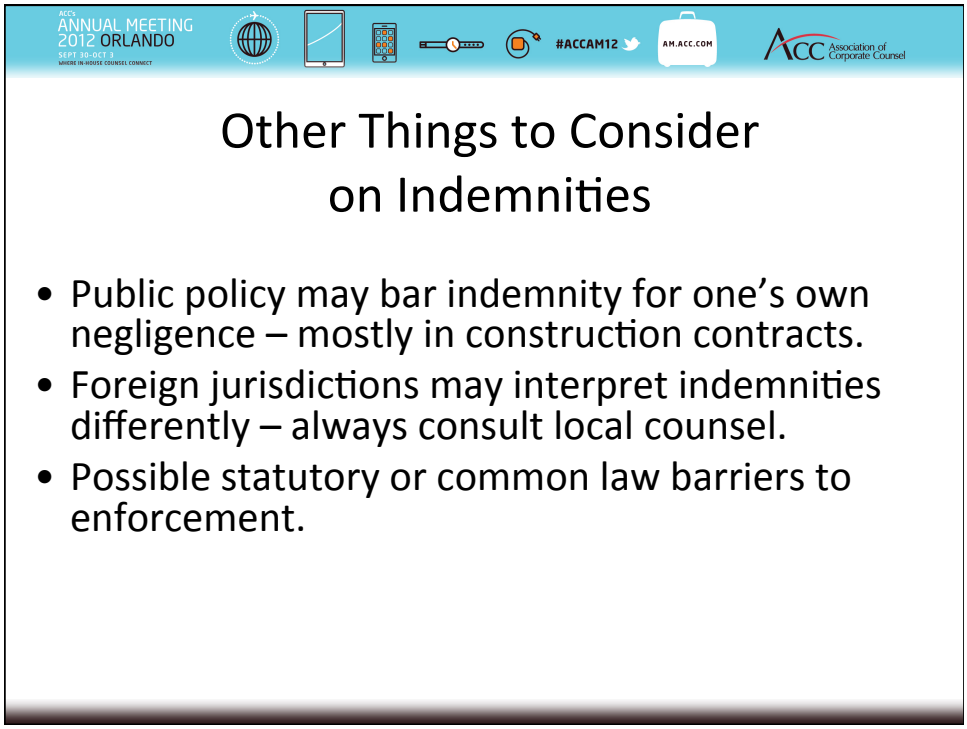

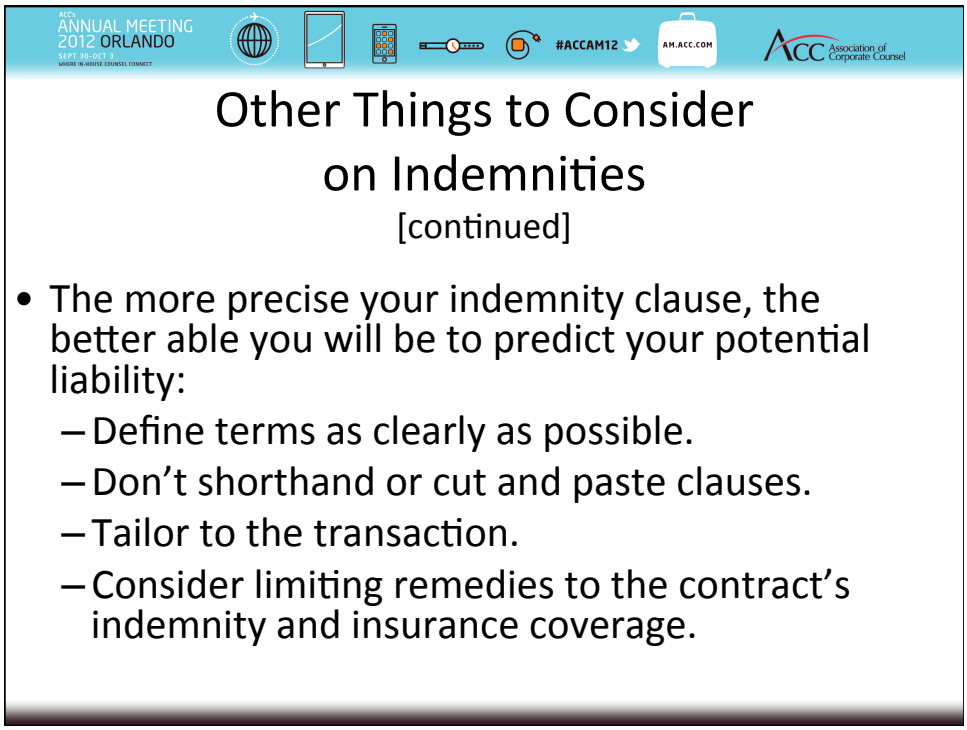

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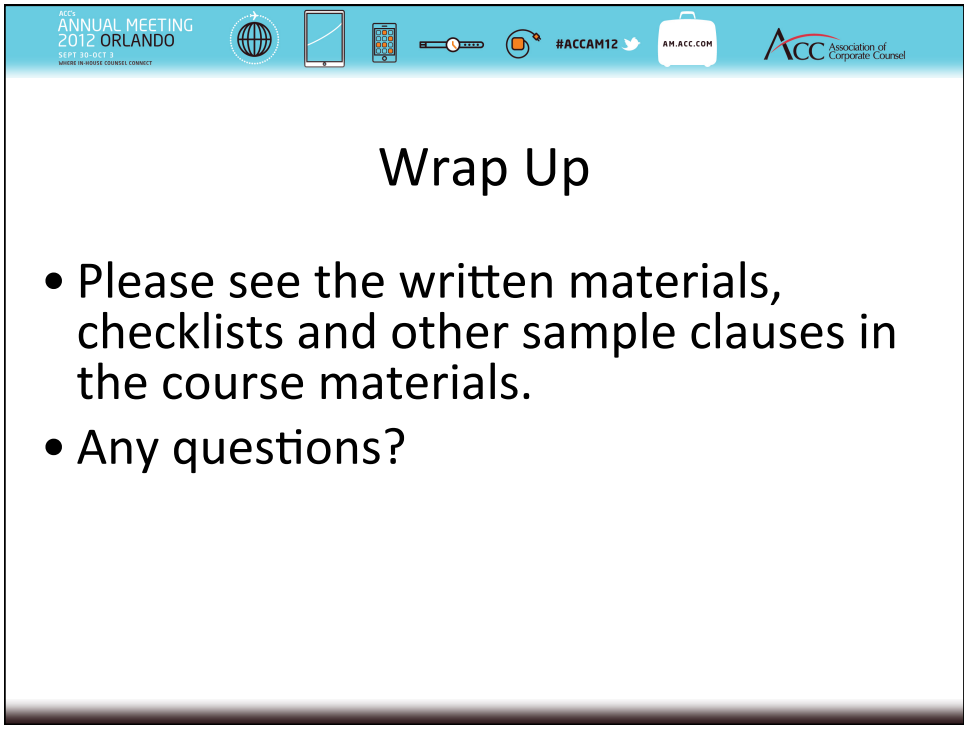

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Session 303 - Contract Drafting, Part 2 - Addressing Liability Issues:

Indemnification and Insurance

ACC 2012 Annual Meeting

Indemnification, Hold Harmless, Subrogation – What does it all mean and why should I care?

David Munn, General Counsel, Pramata Corporation

"It is hard to imagine another set of legal terms with more soporific[1] effect than indemnity, subrogation, contribution, co-obligation and joint tortfeasorship. Perhaps because the words describe legal relationships between multiple parties, they are vaguely reminiscent of complex mathematical equations which, after all, also describe relationships, except in numbers rather than words-and for most of us, they are about as easy to understand. Even lawyers find words like 'indemnity' and 'subrogation' ring of an obscure Martian dialect." Herrick Corp. v. Canadian Insurance Co., 29 Cal.App.4th 753, 756 34 Cal.Rptr.2d 844 (1994).

Surely no self-respecting lawyer would ever use words in a contract that she didn't completely understand, would she? Well, in the case of the words "indemnify" and "hold harmless," even though most lawyers have some idea what they mean, it's likely that very few have seriously considered the actual meaning of the words. [2]

Lawyers also may not appreciate that indemnification rights and obligations can arise outside of express contractual clauses, and a better understanding of noncontractual indemnification may allow you to dispense with contractual indemnification altogether under certain circumstances.

1. Let's first consider "indemnify."

From Black's Law Dictionary: "Indemnify: To reimburse (another) for a loss suffered because of a third party's or one's own act or default. 2. To promise to reimburse (another) for such a loss. 3. To give (another) security against such a loss." [Emphasis added]

Although this definition seems relatively straightforward, in practice indemnification can be extremely complex. [3] Note that although indemnification is often thought of as applying to

[1] Tending to induce drowsiness or sleep.
[2] "By the mid-20th century, transactional lawyers were accustomed to seeing the phrases constantly, and they seemed rarely to inquire into their precise meanings." Bryan A. Garner, Indemnify; and hold harmless; save harmless http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf, page 22.
[3] By 2010, it was possible for a book on effective contract drafting to include a 23-page discussion of drafting indemnities . . . *See* Robert A. Feldman & Raymond T. Nimmer, *Drafting Effective Contracts: A Practitioner's Guide* 5-113 to 136 (2010)" Garner http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf, page 22.

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claims by third parties, this definition clearly contemplates that indemnification could cover a loss suffered due to a breach of contract.[4] That makes it important to ensure that indemnification obligations in any contract clearly state exactly what is covered.

a. Implied indemnity under the common law

Indemnification is commonly provided through express contractual provisions, and most lawyers are familiar with indemnification provisions in contracts; but many lawyers don't understand that in some cases the common law will provide for indemnification to protect an innocent contracting party from liability to third parties resulting from actions of the other contracting party, even if the contract is silent on the issue of indemnification. This concept of "implied indemnification" can also apply to tort claims in the absence of a contract.

"The word 'indemnity' is from a Latin word that means 'security from damage.' The most common form of indemnity in modern life is an insurance contract: A is harmed by conduct covered by an insurance contract issued by insurance company B; the contract secures A from the harm by shifting its cost to B. But indemnity is not limited to insurance contracts (indemnity provisions are frequently found in other contracts, as in HK Systems, Inc. v. Eaton Corp., 553 F.3d 1086 (7th Cir.2009))—or, more to the point, to contracts, period. For there is a tort doctrine of indemnity, which shifts the burden of liability from a blameless tortfeasor . . . to a blameworthy one. American National Bank & Trust Co. v. Columbus–CuneoCabrini Medical Center, 609 N.E.2d 285, 287–88 (Ill .1992); Frazer v. A.F. Munsterman, Inc., 527 N.E.2d 1248, 1251–52 (Ill.1988); Schulson v. D'Ancona & Pflaum LLC, 821 N.E.2d 643, 647 (Ill.App.2004); Restatement (Second) of Torts § 886B (1979). The tort doctrine is sometimes called 'implied indemnity' to distinguish it from contractual indemnity, but a clearer term is 'noncontractual indemnity.'"[5]

"Indemnity is another name for insurance, and it is common for the parties to a contract to provide that in the event that one is held liable the other shall indemnify it for the consequences. For example, contracts between authors and publishers invariably require the author to indemnify the publisher should the latter be held liable for defamation contained in the author's book. The underlying principle is that the party that is in the better position to avoid liability is given an incentive to do so by being made responsible for the consequences. McMunn v. Hertz Equipment Rental Corp., 791 F.2d 88, 91 (7th Cir.1986); cf. Marvin A. Chirelstein, Concepts and Case Analysis in the Law of Contracts 10 (3d ed.1998). But even if the

[4] This paper is generally limited to US law. Indemnification concepts may be different in jurisdictions outside the US. For example, a case from Canada (Mobil Oil Canada Ltd. v. Beta Well Service Ltd.) has been interpreted by some to limit indemnification to third-party claims only.

[5] Wilder Corporation of Delaware v. Thompson Drainage and Levee District Case No. 11-1185, (7th Cir. decided September 27, 2011) http://caselaw.findlaw.com/us-7th-circuit/1581179.html

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parties fail to include an indemnity provision in their contract, if it is apparent that they would have done so had the point occurred to them the courts will read it into their contract unless it is disclaimed. Contract completion is a standard function of common law courts. Harold Wright Co. v. E.I. DuPont De Nemours & Co., 49 F.3d 308, 310 (7th Cir.1995); Wisconsin Real Estate Investment Trust v. Weinstein, 781 F.2d 589, 593 (7th Cir.1986); Lisa Bernstein, 'Social Norms and Default Rules Analysis,' 3 S. Cal. Interdisciplinary L.J. 59, 62 (1993). It reduces transaction costs and gives the parties an approximation to what, if they were omniscient, they would have provided respecting every possible contingency that might arise in the course of performance of the contract."

"For indemnity to be thus 'implied' in a contract, the Illinois cases require . . . that the parties must have already had a relationship when the tort giving rise to the liability occurred-for remember that the function of the doctrine of implied indemnity is to fill out the parties' contract; it is not to create a contract where none existed. In addition, the party on whom the duty to indemnify is sought to be imposed must have been in some (though often an attenuated) sense 'at fault' and the other party blameless though liable-that is to say, only strictly liable, by virtue of respondeat superior, implied warranty, strict products liability, or some other legal principle that imposes liability regardless of fault. E.g., Frazer v. A.F. Munsterman, Inc., 123 Ill.2d 245, 123 Ill. Dec. 473, 527 N.E.2d 1248, 1251-52 (1988); Kerschner v. Weiss & Co., 282 Ill.App.3d 497, 217 Ill.Dec. 775, 667 N.E.2d 1351, 1355-56 (1996)."[6]

b. Indemnity under the UCC

Indemnification obligations can also arise under the UCC in connection with the sale of goods. UCC Section 2-312(3) covers a seller's obligations with respect to infringement and provides "Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications."

UCC Section 2-607 provides:

> (5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over
>
> > (a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two

[6] *JinwoongInc. v. Jinwoong, Inc.* , 310 F.3d 962 (7th Cir. 2002) http://caselaw.findlaw.com/us-7th-circuit/1343376.html

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litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of Section 2-312).[7]

Contract Drafting Points:

- Because the common law and the UCC will often provide a reasonable indemnification for third-party claims, in some cases you might be better off leaving any mention of indemnification out of your contract because (i) including indemnification language may invite extensive negotiation where the value of the transaction doesn't warrant it, or (ii) the other side has superior bargaining power and you know that any indemnification you end up with is likely to be less favorable to your client than the indemnification that would be provided by the common law or the UCC. However, both the common law and the UCC vary from state to state. Additional factors to consider could include what types of claims are likely, the specific state law that would apply, and any liability exclusions or limitations expressed in the contract that might work to limit a party's right to recover. Appendix 1 contains additional discussion and references regarding common law indemnification.
- At least one state has statutory rules governing the interpretation of indemnification agreements ("unless a contrary intention appears"). Appendix 2 - California Civil Code Section 2778.

c. Indemnification for breach of contract and a party's own negligence

Common law indemnification could be described this way:

If I enter into a contract with you, and a third party sues me because of something you did, you should take care of it. I should not be responsible and should not incur any costs or liability for harm you caused. On the other hand, if I do something that causes a third party to sue you, I should take care of it. You should not be responsible and should

[7] http://www.law.cornell.edu/ucc/2/2-607.html

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> not incur any costs or liability for harm I caused. If it was partly my fault I should only be responsible for the harm I caused; not the harm you caused.

At its most basic level that is what contractual indemnification is about as well. This description of indemnification is limited to protection from claims of third parties. This makes sense, because the law provides a separate mechanism to compensate contractual parties for breach of contract. But in the Black's Law Dictionary definition there is nothing that necessarily limits its application to third-party claims, and nothing that prevents a party from requesting indemnification for breach of contract.

For example, this is what buyers of goods or services often ask for:

> If I enter into a contract with you and I incur any losses or liabilities (even if caused by my fault or negligence), whether from your breach of contract or a claim from a third party, I want you to take care of it and make me whole. I don't want to be responsible for anything, and I want all of your indemnification obligations (including breach of contract) to be excluded from any liability caps or exclusions.

Sellers of goods and services generally do not want to provide indemnification for their breach of contract. If a seller is unable to avoid providing an indemnification for breach of contract it may still be possible to limit the indemnification in such a way that it doesn't provide the buyer with any rights that it wouldn't have for a normal breach of contract claim, but that can be challenging, especially because standard contracts drafted for buyers commonly contain language that substantially broadens the scope of damages and limits the application of consequential damage waivers or limitations of liability where indemnification is involved.

In some cases indemnification for a party's own negligence may be unenforceable as against public policy. "[A]bout 40 states have anti-indemnity statutes that place some restrictions on allowable risk transfers in specified construction and/or design contracts. Some states forbid only the transfer of liability for one's negligence when it is the sole cause of a loss. Others prohibit any transfer of liability for one's negligence."[8] Appendix 3 contains additional information on shorthand terminology used primarily in the construction industry regarding the shifting of liability for a party's own negligence.

Contract drafting points:

- Where a contract provides for indemnification for breach of contract and you are representing a party that could be an indemnitor (the party providing the indemnification), if you can't negotiate that out of the contract, be careful to

[8] Indemnification Provisions, by Michael Anderson and John Mitby http://axley.com/articles/indemnification-provisions-070709

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understand the interplay between indemnification, foreseeability of harm, consequential damages, and limitations of liability.

2. "Hold harmless" : A controversial topic

From Black's Law Dictionary: "Hold Harmless: To absolve (another party) from any responsibility for damage or other liability arising from the transaction; INDEMNIFY."

The term is commonly used as "X agrees to defend, indemnify, and* hold Y harmless *from and against . . ."

Some variation of this phrase is fairly standard in commercial agreements. You've probably used or seen this dozens or even hundreds of times if you've drafted or reviewed many commercial contracts.

You might assume that "indemnify" and "hold harmless" mean something different. Otherwise why use both terms? On the other hand, lawyers are notorious for using traditional but redundant synonyms in contracts, so maybe they're similar to "right, title, and interest" or "true and correct" and could be collapsed into a single term without changing the meaning.

Maybe we just assume that courts have given them clear meanings, even if we aren't exactly sure what those meanings are. This is just the way contracts are drafted, isn't it? Everybody drafts their contracts that way. And very few contracts end up in litigation anyway, so is it really worth worrying about? Well, in this case it might be.

It turns out there is no clear consensus about whether "indemnify" and "hold harmless" mean the same thing or something different.[9] Some courts and experts say the terms are synonymous.[10] Others say they have different meanings.[11] A couple of recent decisions

[9] "Are these phrases – *indemnify* and either *hold harmless* or *save harmless* – synonymous? This is a crucial question that has frequently arisen in American litigation, with varying results." Garner http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf, page 17.

[10] "The evidence is overwhelming that *indemnify* and *hold harmless* are perfectly synonymous." Garner http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf, page 21. Kenneth Adams, "Indemnify" and "Hold Harmless" http://www.adamsdrafting.com/2006/10/21/hold-harmless-and-indemnify/

[11] "But the courts . . . were charged, as is commonly said, with 'giving effect to every word.' That's not a bad rule when legal drafters abstain from larding their contracts with surplusage, but it's a horrible rule when they do." Garner http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf, page 22. See also Ken Adams, *Yet More on "Indemnify" and "Hold Harmless"* http://www.adamsdrafting.com/2007/04/08/yet-more-on-indemnify-and-hold-harmless/

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supporting that position may just serve to further illustrate how problematic this wording can be and how much trouble courts and commentators have with it.[12]

The bottom line is that there's no guarantee that just because a court in one jurisdiction, given one set of facts, decides that "hold harmless" and "indemnify" mean the same thing, that another court, even in the same jurisdiction, given different facts, would decide the same way. Judges get confused over these terms, as shown in the California case of *Queen Villas Homeowners Association v. TCB Property Management.*[13] Here's what contract drafting guru Ken Adams had to day about that case: "If you use both *indemnify* and *hold harmless*, you're simply asking for trouble. You're giving the other side a chance to argue to a court that *hold harmless* has some unanticipated meaning. And if the provision comes before a zombie court that mindlessly follows rules of construction instead of attempting to discern the intent of the parties, the court may well bend over backwards to needlessly distinguish *hold harmless* from *indemnify*."[14]

The lesson from all of this is that it's dangerous to rely on shorthand terms like "indemnify" and "hold harmless" to convey a clear meaning in a contract. If the terms are synonymous then we shouldn't include both of them in our contracts "because some court, somewhere, some day, will find extra meaning where there isn't any."[15] Because courts are inconsistent in their interpretation of these terms it's usually better to spell out the parties' rights and obligations very clearly in the contract.[16]

Of course, how you draft an indemnification clause may depend on which side of the transaction you're on. So if you're representing the party receiving the benefit of the indemnification (the "indemnitee"), why not include both "indemnify" and "hold harmless"? Maybe you can gain an advantage by having a chance of making the argument that there's some additional magic to "hold harmless" if a dispute ever arises. [17]

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[12] "In particular, two recent decisions have indicated that a duty to *indemnify* obligates the indemnitor to reimburse the indemnitee, while a duty to *hold harmless* limits the indemnitee's liability and effectively bars the indemnitor from bringing suit against the indemnitee." Charles Brocato, Jr. The Transactional Lawyer, Vol. 1 (Oct. 2011) http://www.law.gonzaga.edu/Centers-Programs/Files/clc/Transactional_Lawyer_2011-10.pdf

[13] *Queen Villas Homeowners Association v. TCB Property Management*, 2007 Cal. App. Lexis 470 (Cal. Ct. App. Feb. 28, 2007)

[14] Ken Adams, *Yet More on "Indemnify" and "Hold Harmless"* http://www.adamsdrafting.com/2007/04/08/yet-more-on-indemnify-and-hold-harmless/

[15] Garner http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf, page 24.

[16] For a contrary view, see Guberman, Are "Indemnify" and "Hold Harmless" the Same? http://www.legalwritingpro.com/articles/D05-indemnify-hold-harmless.php

[17] "Most lawyers unthinkingly use *indemnify* and *hold harmless* as synonyms. And I've found that lawyers who instead think those concepts can be distinguished don't agree on what they actually mean. So using both *indemnify* and *hold harmless* is not only wordy, it's pernicious, in that an unhappy contract party might be tempted to take advantage of uncertainty over meaning by claiming that *indemnify* or *hold harmless*, or both, convey some

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The problem with that line of thinking, of course, is that you could end up getting your client into litigation that could have been avoided had the contract been drafted more clearly. When words and phrases that do not have universally agreed-upon meanings are used in a contract, that contract does not clearly express the bargained-for intent of the parties. Clients are generally not well-served by contracts that require a third-party to decide what the contract means. Even though few contracts end up in litigation, do you really want one you drafted or agreed to to be one of those few?

Contract drafting points:

- Draft to avoid contractual disputes – contracts should be clearly drafted so the parties understand their rights and obligations and the interpretation of the contract doesn't depend on a judge or jury. Don't use words that don't have a clear meaning without defining them and don't insert unnecessary words.
- Although the meaning of "indemnify" is broad enough to cover losses incurred as a result of a breach of contract, contractual indemnification should be limited to protection from claims by third parties and should not cover breach of contract. If one party is agreeing to reimburse the other for specific types of damages for breach of contract spell them out. Because lawyers have such a hard time agreeing on what "indemnify" means, do not leave it to a vaguely worded indemnification clause to define damages for breach of contract.
- From contract drafting guru Ken Adams who recommends eliminating "hold harmless": "Here's a clearer approach: Instead say *indemnify against any losses and liabilities* and address in separate provisions the procedures for defending nonparty claims. That would ensure that you've addressed whatever meaning might rationally, or not-so-rationally, be attributed to *indemnify* or *hold harmless*."[18]
- Ensure that indemnification doesn't create unintended consequences (e.g., a limitation of liability that excludes indemnification for breach of contract).

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unlikely meaning that bolsters that party's case." Ken Adams, *Revisiting "Indemnify and Hold Harmless"* http://www.adamsdrafting.com/2009/05/10/revisiting-indemnify-and-hold-harmless/. . See also Ken Adams, *Yet More on "Indemnify" and "Hold Harmless"* http://www.adamsdrafting.com/2007/04/08/yet-more-on-indemnify-and-hold-harmless/

[18] Ken Adams, *Revisiting "Indemnify and Hold Harmless"* http://www.adamsdrafting.com/2009/05/10/revisiting-indemnify-and-hold-harmless/. See also Ken Adams, *Yet More on "Indemnify" and "Hold Harmless"* http://www.adamsdrafting.com/2007/04/08/yet-more-on-indemnify-and-hold-harmless/

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3. Subrogation – stepping into the shoes of another party

The case of Wilder Corporation of Delaware v. Thompson Levee and Drainage District[19] provides a lesson for contract drafters. Wilder sold land to The Nature Conservancy that turned out to have been contaminated by fuel stored on the land by Thompson Levee and Drainage District. Wilder was found liable to The Nature Conservancy for breaching a warranty that the land was free from contamination by petroleum. Wilder then sought to use the doctrine of common law indemnity to hold the Levee and Drainage District liable for the contamination. The court held that common law or "noncontractual" indemnity could not be invoked to hold the Levee and Drainage District liable for the contamination because the Levee and Drainage District was not a party to the contract between Wilder and The Nature Conservancy. So Wilder did not involve a classic indemnification scenario between two contracting parties. Rather, Wilder was attempting to shift liability for its breach of contract to an entity that was not a party to the contract. Unfortunately for Wilder its contract with The Nature Conservancy did not contain a right of subrogation that could have allowed Wilder to pursue a case against the Levee and Drainage District based on nuisance. "Alternatively, Wilder could have insisted on the inclusion in its contract with The Nature Conservancy of a subrogation clause, whereby if forced to make good on its warranty Wilder would step into the Conservancy's shoes as plaintiff in a nuisance suit against the district."

Contract drafting points:

- The most important contract drafting lesson from Wilder is that it may be advisable to include a subrogation clause in any contract in which your client could be liable for a breach of contract caused by actions of others outside of its control.
- Example: "If Wilder is found liable to The Nature Conservancy for breach of any warranty under this agreement, Wilder will be subrogated to all of The Nature Conservancy's rights of recovery against any person or organization to the same extent as The Nature Conservancy could have pursued those rights."

[19] Wilder Corporation of Delaware v. Thompson Drainage and Levee District Case No. 11-1185, (7th Cir. decided September 27, 2011) http://caselaw.findlaw.com/us-7th-circuit/1581179.html

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Appendix 1

Common Law Indemnification

Parties to a contract often include express indemnification provisions in the contract. However, even if the contract is silent on indemnification state common law may provide an innocent contracting party with an implied indemnification remedy if that party is subject to third-party liability as a result of the negligence of the other contracting party.

From http://axley.com/articles/indemnification-provisions-070709:

Contractual indemnity is distinguished from common law indemnity, which is an equitable remedy arising out of obligations imposed through special relationships. In order to prevail on a common law indemnity claim, the following two-pronged test must be satisfied:

1. The party seeking indemnity (the indemnitee) must be without fault and its liability must be solely vicarious for the wrongdoing of another, and
2. The party against whom indemnity is sought (the indemnitor) must be wholly at fault.

Under New York law "It is well settled that where a party's liability is solely vicarious, so long as that party has no independent negligence, that party is entitled to common law indemnity from the party who is actually at fault. [citations]. *Dole v. Dow* has left intact the basic principles of implied indemnity which permit one who is held vicariously liable solely on account of the negligence of another to shift the entire of the burden of the loss to the wrongdoer." *Trustees of Columbia University v. Mitchell/Giurgola Associates,* 109 A.D.2d 449, 452, 492 N.Y.S.2d 371, 375 (1st Dept. 1985)." Most cases cited in this memorandum concern construction since it is in the field of construction that these issues are most prevalent. The holdings of these cases are, however, equally applicable to premises liability and other factual scenarios in which the parties have oral or written contractual obligations to each other. From http://www.wff-law.com/html/articles/additinsur.html

Florida law is similar. See Continental Cas. Co. v. City of S. Daytona, 807 So. 2d 91, 93 (Fla. Dist. Ct. App. 2002). http://www.5dca.org/Opinions/Opin2001/081301/5D00-1709.op.cor.pdf

"Further, under Florida common law indemnity, "an indemnitee is entitled to indemnification not only for the judgment entered against it, but also for attorney's fees and court costs." Hiller Group, Inc. v. Redwing Carriers, Inc., 779 So. 2d 602, 604 (Fla. Dist. Ct. App. 2001). An indemnitee's insurer is also entitled to recover those expenses."
http://www.irmi.com/expert/articles/2008/rawls08-liability-insurance-coverage-law.aspx

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"The Iowa Supreme Court has recognized a civil action for common law indemnity10 based on equitable principles"
http://www.simmonsperrine.com/docs/Indemnity_in_Iowa_Construction_Law.pdf

California recognizes common-law or "equitable" indemnity in a form that resembles contribution among jointly liable parties based on their comparative fault. Where parties expressly contract with respect to the scope and boundaries of the duty to indemnity, equitable indemnity is not available. Instead, California law gives effect to the parties' contractual indemnification provisions. http://www.constructionrisk.com/2011/07/third-party-claim-for-indemnification-survives-sj-motion/

Also:

Legacy Liability Management: The Role of Common Law Indemnification
http://www.butlerrubin.com/web/br.nsf/0/7068CE6904C33CE58525707F006C0212/$FILE/Feb+2003.pdf "The recent decision in Jinwoong Inc. v. Jinwoong, Inc., 310 F.3d 962 (7th Cir. 2002), discusses several potentially applicable common law indemnification rules. These common law rules create opportunities for gains or losses, and the outcomes that occur depend in part on knowing the rules and when to invoke them. This article discusses seven of the common law rules."

"The common law may supply indemnity terms even if the contract does not. The applicable rules depend on the type of transaction, state of incorporation, place of sale, contract law selected, nature of the pre-sale relationship between the parties and other similar facts."

Article discussing a manufacturer's duty to indemnify under Texas law, including discussions of common law indemnification. http://www.cowlesthompson.com/userfiles/articles/carboy2.pdf

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Appendix 2

California Civil Code Section 2778

In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears:

1. Upon an indemnity against liability, expressly, or in other equivalent terms, the person indemnified is entitled to recover upon becoming liable;

2. Upon an indemnity against claims, or demands, or damages, or costs, expressly, or in other equivalent terms, the person indemnified is not entitled to recover without payment thereof;

3. An indemnity against claims, or demands, or liability, expressly, or in other equivalent terms, embraces the costs of defense against such claims, demands, or liability incurred in good faith, and in the exercise of a reasonable discretion;

4. The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses, if he chooses to do so;

5. If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former;

6. If the person indemnifying, whether he is a principal or a surety in the agreement, has not reasonable notice of the action or proceeding against the person indemnified, or is not allowed to control its defense, judgment against the latter is only presumptive evidence against the former;

7. A stipulation that a judgment against the person indemnified shall be conclusive upon the person indemnifying, is inapplicable if he had a good defense upon the merits, which by want of ordinary care he failed to establish in the action.

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Appendix 3

Terminology specific to the construction industry

The concept of indemnification is particularly well developed in the construction industry because of the amount of litigation in that industry. Certain shorthand terminology is commonly used in the construction industry that may not be widely understood outside of that industry. Note that in the following references “indemnify” and “hold harmless” appear to be used interchangeably.

From the IRMI term Glossary, http://www.irmi.com/online/insurance-glossary/terms/h/hold-harmless-agreement.aspx:

Hold Harmless Agreement: A provision in a contract that requires one contracting party to respond to certain legal liabilities of the other party. For example, construction contracts typically require the contractor to indemnify the owner with respect to the owner's liability to members of the public who are injured or whose property is damaged during the course of the contractor's operations. There are a number of types of hold harmless clauses, differentiated by the extent of the liabilities they transfer. The most commonly used types of clauses are the "broad," "intermediate," and "limited" form hold harmless clauses.[20]

- ***Limited form***—Where Party A holds Party B harmless for suits arising out of Party A's sole negligence. Party B is thus protected when it is held vicariously responsible for the actions of Party A.
- ***Intermediate form***—Where Party A holds Party B harmless for suits alleging sole negligence of Party A or negligence of both parties.
- ***Broad form***—Where Party A holds Party B harmless for suits against Party B based on the sole negligence of A, joint negligence of A and B, or the sole negligence of B. Broad form hold harmless agreements are unenforceable in a number of states.

[20] Additional information can be found in Indemnity Provisions: Mean What We Say and Say What We Mean, Blake S. Evans, Schubert & Evans, P.C. http://tinyurl.com/c7no4nk

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DRAFTING YOUR INDEMNIFICATION PROVISION
A Quick Primer on the Biggest Issues
Elizabeth C. Taylor

I. Is the provision for your benefit, or the other party's?

A. It's for your benefit: You are the **Indemnitee** (watch for software spellcheckers to try to change that word to "Indemnity"). As the Indemnitee, your goal is to transfer as much risk as possible to the Indemnitor through broad indemnification language. You want everyone and everything included except what you explicitly state is excluded.

1. *Who* will be indemnified? At a minimum, make sure you include everyone who may be a named defendant in a suit against your company.

(a) Must-haves: **Indemnitee, its officers, directors, shareholders (or members or partners, if applicable), subsidiaries, employees, affiliates, agents and other representatives**.

(b) Nice-to-haves: Third parties to whom Indemnitee may owe an obligation of indemnification, such as **assignees, successors-in-interest, customers, suppliers, landlords, licensors, licensees and distributors**.

2. *What* claims are covered? Be aware that your Indemnitor will not be able to get insurance coverage for every type of claim, especially those claims that are for purely economic losses (see Section IV below), so a very broad indemnity is only as good as the Indemnitor's bank account will allow.

(a) Types: **Any and all claims, actions, suits, demands, damages, liabilities, obligations, losses, fees, penalties, fines and other expenses of any type whatsoever, whether consequential, direct or indirect, foreseeable or not foreseeable, punitive or otherwise, including, without limitation, actual attorneys fees and court costs arising therefrom or related thereto or arising from Indemnitor's refusal or failure to comply with its obligations under this indemnity caused by, arising from or in any way related to . . .**

(i) Must-haves: **Damage to or loss of any real or personal property or the death of or bodily injury to any person, [or] . . .**

(ii) Nice-to-haves: **the breach or violation of any provision of this Agreement by Indemnitor, its officers, directors, shareholders (or members or partners, if applicable), subsidiaries, subcontractors, employees, affiliates, agents and other representatives, or the violation or breach of any law or duty applicable to this Agreement or Indemnitor's performance hereunder . . .**

(b) Origins:

(i) Good: **Arising from or in any way related to the negligence or willful misconduct of Indemnitor, its officers, directors, shareholders (or members or**

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partners, if applicable), subsidiaries, subcontractors, employees, affiliates, agents and other representatives in the performance of this Agreement, except to the extent caused by the negligence or willful misconduct of Indemnitee.

(ii) Better: **Arising from or in any way related to the negligence or willful misconduct of Indemnitor, its officers, directors, shareholders (or members or partners, if applicable), subsidiaries, subcontractors, employees, affiliates, agents and other representatives in the performance of this Agreement, except to the extent caused by the gross negligence or willful misconduct of Indemnitee**.

(iii) Best: **Arising from or in any way related to Indemnitor's performance under this Agreement, except to the extent caused by the gross negligence or willful misconduct of Indemnitee**.

B. It's for the other party's benefit: You are the **Indemnitor**. You want exactly the opposite of what the Indemnitee wants. An important point about negotiating indemnifications from the Indemnitor's perspective is that the Indemnitor wants to avoid getting into a discussion about what's *fair*. Indemnification (and warranty, by the way) is not about what's fair, it's about the most efficient way to allocate risk. So, you may hear the Indemnitee's counsel say, "But it's only fair that your company should stand behind its performance and take care of any expenses that my company has because of some failure in your performance." Your response – in your most agreeable and deal-making tone -- should be something along the lines of, "The prices we have agreed to are based on my company taking on only part of the exposure your company has if we don't perform perfectly. I'm not sure your company wants to pay us to take on more." At the very least, you should try to narrow the scope of the indemnification to (i) third party claims against the Indemnitee, (ii) liabilities for which you have or could get insurance coverage, and (iii) liability for activities that you control.

1. *Who* will be indemnified? Once you've agreed to indemnify the other party to the contract, it's hard to argue that the persons or entities directly controlling or acting on behalf of the Indemnitee are not also entitled to indemnification. As a result, I believe you're better off giving on that point and arguing against adding the third party language found in Section I.A.1(b) above. Your negotiating stance will be based on the fact that the Indemnitee has already negotiated a risk allocation scheme with those third parties and it will not be cost-effective for your firm to assume the risk the Indemnitor has presumably already been paid to take on (especially because the Indemnitee's knowledge of those third parties and the attendant risk is superior to yours, allowing the Indemnitee to price the risk more efficiently).

2. *What* claims are covered? I often ask the management of my company whether we're willing to risk the whole company on this one deal. If you agree to indemnify for claims that aren't insured or otherwise subject to a cap, that may be exactly what you're doing. Don't be influenced by the Indemnitee's assertion that companies much smaller than yours have agreed to broad indemnification provisions: that's exactly what you'd expect from a company that is likely judgment proof against big claims. If you're a company that can answer the door when the bill collector comes knocking, then pay close attention what types of claims you're indemnifying against.

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(a) Types: With respect to what types of claims are covered, one of your first goals should be to restrict your company's indemnification to third party claims only, rather than to claims between the parties to the agreement. Otherwise, you run the risk of a conflict in the agreement between, for example, a provision which excludes consequential damages or a limited warranty and the indemnity which appears to require the Indemnitor to pay all expenses arising out of a breach of the agreement. Second, you should try to limit your company's indemnification obligation to those liabilities which will be covered by your liability insurance, usually property damage and bodily injury. This acts as a pseudo-cap on your company's liability. Also, unless your firm is knowingly accepting responsibility -- and pricing -- for the other party's compliance with governmental regulations, avoid agreeing to indemnify for penalties or fines, as your firm will have little or no ability to mitigate those damages through a negotiating process with the governmental agency and the Indemnitee may have little or no incentive to make an attempt to negotiate a lower penalty or fine.

(b) Origins: Here, the goal is to limit your indemnity to a cause or causes of claims over which you have sole control – usually, that's your own performance of the contract. So, argue for a clause that limits your liability to the extent of your active – as opposed to passive -- negligence (gross negligence is even better) or willful misconduct. Whatever you do, avoid assuming liability to the Indemnitee for claims caused or contributed to by the Indemnitee's or others' negligence. Your proposed language may look something like this:

Indemnitor shall indemnify, defend and hold harmless Indemnitee, its officers, directors, shareholders (or members or partners, if applicable), subsidiaries, employees, affiliates, agents and other representatives (the "Indemnified Parties") from and against any and all claims, actions, suits, demands, damages, liabilities, obligations, and other losses, including reasonable actual attorneys fees and court costs arising therefrom or related thereto, claimed from or against the Indemnified Parties by non-governmental parties unrelated to the Indemnified Parties and arising out of damage to or loss of any property or the death of or bodily injury to any person ("Claims"), but only to the extent such Claims are caused by the gross negligence or willful misconduct of Indemnitor, its officers, directors, shareholders (or members or partners, if applicable), subsidiaries, subcontractors, employees, affiliates, agents and other representatives, in the performance of this Agreement.

3. *What else* should you consider?

(a) Cap on Liability. Try to negotiate a limit to the amount of money you firm will have to pay under the indemnity. This is especially important if you don't have or can't get insurance coverage for the type of claim that is covered. Ideally, the cap should include the costs of defense. Many Indemnitees in long term contracts don't want to agree to an overall cap, but may agree to an annual limit of liability. Also, if you have liability caps elsewhere in the agreement, make sure you reference them so that no ambiguity is created.

(b) Specify Known Exclusions. Even if you believe your indemnity language is tight and you know exactly what it includes and excludes, it never hurts to go ahead and

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specifically identify claims that you intend to exclude. These may be IP infringement claims, claims for professional malpractice or other claims for which your firm is not insured.

(c) Consider Relief Clauses. You may want to ask for relief for indemnity in the event that the Indemnitee or one acting on its behalf commits a negligent, wrongful and intentional or unlawful act which causes or contributes to the damage.

(d) Survival after Termination/Expiration of Agreement. As the Indemnitor, your ideal scenario is that your firm's indemnification obligation is coterminous with the agreement (after all, who wants to pay money to a former customer or supplier?). Except in the rarest of circumstances, Indemnitees will insist on a survival period longer than the term of the agreement. Your mission is, of course, to keep that as short as possible and to explicitly state when the indemnification obligation terminates. Many industries have a customary period; if yours doesn't, consider whether the warranty period, if applicable, or the limitations period for breach of contract is an appropriate survival period for your agreement.

II. Dual Indemnities and Liability for Employees.

A. Break the "mirror" habit. Often, whether for practical or psychic reasons, both parties to the contract want to be indemnified by the other for certain claims. The most common mistakes attorneys make is to use the same language – with the names reversed – for both provisions or to use a provision that starts with, "Each party shall indemnify, defend and hold harmless the other for . . . ." The problem with those solutions is that each party has (or should have) unique concerns and potential damages and the language should be tailored to reflect those differences.

Consider, for example, the case of a car repair shop entering into a long term contract with an auto leasing company, pursuant to which the repair shop agrees to perform inspections and maintenance on the leasing company's fleet to prepare the vehicles to be leased and upon return from lease. The leasing company wants to be indemnified for claims by lessees or buyers caused by the repair shop's negligent maintenance and so agrees to an indemnification ending with "to the extent of the repair shop's negligence or willful misconduct in the performance of the Agreement." The repair shop wants to be indemnified for the lessees' or owners' negligence in driving or maintaining the vehicle after the repair shop performs its work. If repair shop's attorney uses the same indemnification that indemnifies the leasing company (with the names changed), then all the repair shop will be indemnified for is the negligence of the leasing company. What kind of negligence could the leasing company have? It will not operate, possess or maintain the vehicle after it leaves the repair shop; in fact, if the vehicle is a lease return, it may be sold as soon as the repair shop finishes its work. Thus, the repair shop will not receive an indemnification for its expenses in defending a suit by the victim of an auto accident where the brakes failed (because the lessee tried to repair them himself); in fact, the repair shop really didn't gain anything by the "mirrored" provision.

B. No overlap. Additionally, well-drafted dual indemnities do not overlap. If all the possible claims that could arise from either party's negligence were written in a pie chart, no possible claim would fall into both parties' pieces. The provisions should slice the pie in a way that there will never be an occasion where the parties indemnify each other for claims arising from the same incident. So, part

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of your negotiation should include a discussion about who gets paid – if anyone – if both parties contribute to a claim. Most of the time, if only one party is entitled to indemnification for a given claim, it will be the customer in the relationship.

C. Responsibility for Outsiders on your Premises. The performance of many contracts, including many contracts for services, require that one party's employees or representative visit or work at the other party's premises. If the other party's representatives are going to be on your firm's premises, be sure to obtain an indemnity for injuries to those employees. The employer should even indemnify your company against its own negligence, especially if the representatives will have unescorted access and it is an industrial environment. At a minimum, you should carve injuries to the other party's representatives while on your premises out of your indemnification of the other party. The rationale is this: you are going to allow the representatives to have the run of your facility, which has steps, machines, and other common instruments of workplace injuries, and you don't have the protection of the workers compensation laws. If the other party's representative trips on a frayed piece of carpet or gets a finger caught in the shredder, the other party should indemnify your company for any claims from that representative. Otherwise, you could be faced with a suit by that person (who may think she can make out better because she won't be tied to the statutory compensation scheme). This is an important point and you should think twice about allowing outside folks to work on your premises if you don't get this.

III. Procedure for Defense and Indemnification

A. Notice. Both the Indemnitor and the Indemnitee should pay close attention to the procedure for indemnification. Such procedures are usually proposed by the Indemnitor and the Indemnitor may try to use the Indemnitee's failure to strictly follow them as a shield to deny indemnification. From the Indemnitee's perspective, any procedure should include a clause stating that failure to adhere to the process will not be a reason to deny indemnification, but if a failure materially adversely prejudices the Indemnitor's ability to defend the claim, then the Indemnitor's remedy will be a reduction in liability commensurate with the prejudice. From the Indemnitor's perspective, the procedure should require very prompt notice and cooperation and assistance from the Indemnitee. As might be expected, when the agreement contains dual indemnities, the provision is usually negotiated in a fairly balanced manner and might look something like this:

Any party who receives notice of a potential claim that may, in the judgment of such party, result in a Loss shall use all reasonable efforts to provide the parties hereto notice thereof, provided that failure or delay or alleged delay in providing such notice shall not adversely affect such party's right to indemnification hereunder, unless and then only to the extent that such failure or delay or alleged delay has resulted in actual prejudice to the Indemnitor, including, without limitation, by the expiration of a statute of limitations. In the event that any party shall incur or suffer any Losses in respect of which indemnification may be sought by such party hereunder, the Indemnitee shall assert a claim for indemnification by written notice (a "Notice") to the Indemnitor stating the nature and basis of such claim. In the case of Losses arising by reason of any third party claim, the Notice shall be given within thirty (30) days of the filing or other written assertion of any such claim against the Indemnitee, but the failure of the Indemnitee to give the Notice within such time period shall not relieve the Indemnitor of any liability that the Indemnitor may have to the Indemnitee, except to the extent that the Indemnitor demonstrates that the

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defense of such action has been materially prejudiced by the Indemnitee's failure to timely give such Notice.

B. Control of Defense and Settlement. The Indemnitor should seek to control the defense of the claims. This is customary and should receive little resistance from the Indemnitee, so long as the Indemnitee is entitled to participate (but not interfere) at its own expense. In addition, the Indemnitor should try to obtain the right to settle the case as and when it sees fit, so long as it obtains the full release of the Indemnitee and the settlement does not require any action or agreement to refrain from acting by the Indemnitee. Further, it should include a mechanism to recoup moneys spent if it's ultimately determined that the Indemnitor was not negligent (or whatever the fault standard for the indemnity was). The Indemnitee, on the other hand, should make certain that the Indemnitor is required to keep the Indemnitee reasonably informed about the progress of the case and any settlement. It should also negotiate to retain the right to conduct the defense under certain circumstances. Here is some language that illustrates these points:

In the case of claims for which indemnification is sought, the Indemnitor shall, if necessary, retain counsel reasonably satisfactory to the Indemnitee, and have the option (i) to conduct any proceedings or negotiations in connection therewith, (ii) to take all other steps to settle or defend any such claim (provided that the Indemnitor shall not settle any such claim without the consent of the Indemnitee which consent shall not be unreasonably withheld) and (iii) to employ counsel to contest any such claim or liability in the name of the Indemnitee or otherwise. In any event, the Indemnitee shall be entitled to participate at its own expense and by its own counsel in any proceedings relating to any third party claim, so long as such participation does not interfere with or otherwise prejudice the Indemnitor's ability to defend or settle such claim. The Indemnitor shall, within 15 Business Days of receipt of the Notice, notify the Indemnitee of its intention to assume the defense of such claim. If (i) the Indemnitor shall decline to assume the defense of any such claim, (ii) the Indemnitor shall fail to notify the Indemnitee within 15 Business Days after receipt of the Notice of the Indemnitor's election to defend such claim, (iii) the Indemnitee shall have reasonably concluded that there may be defenses available to it which are different from or in addition to those available to the Indemnitor (in which case the Indemnitor shall not have the right to direct the defense of such action on behalf of the Indemnitee), or (iv) a conflict exists between the Indemnitor and the Indemnitee which the Indemnitee has reasonably concluded would prejudice the Indemnitor's defense of such action, then in each such case the Indemnitor shall not have the right to direct the defense of such action on behalf of the Indemnitee and the Indemnitee shall, at the sole expense of the Indemnitor, defend against such claim and (x) in the event of a circumstance described in clause (i) and (ii), the Indemnitee may settle such claim without the consent of the Indemnitor (and the Indemnitor may not challenge the reasonableness of any such settlement) and (y) in the event of a circumstance described in clause (iii) and (iv), the Indemnitee may not settle such claim without the consent of the Indemnitor (which consent will not be unreasonably withheld or delayed). The reasonable expenses of all proceedings, contests or lawsuits in respect of such claims shall be borne and paid by the Indemnitor if the Indemnitee is entitled to indemnification hereunder and the Indemnitor shall pay the Indemnitee, in immediately available funds, the amount of any Losses, within a reasonable time of the incurrence of such Losses; provided, however, that if a court of competent jurisdiction issues a final, non-appealable judgment which, if available at the time the claim was made, would have negated the Indemnitor's obligation to defend and indemnify the Indemnitee under this Article, then the Indemnitee shall reimburse the Indemnitor for all court costs, reasonable attorneys fees and other out-of –pocket expenses incurred by the Indemnitor in defending such claim. Regardless of which

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party shall assume the defense or negotiation of the settlement of the claim, the parties agree to cooperate fully with one another in connection therewith. Anything in this Article to the contrary notwithstanding, the Indemnitor shall not, without the Indemnitee's prior written consent, settle or compromise any claim or consent to entry of any judgment in respect thereof which imposes any future obligation on the Indemnitee or which does not include, as an unconditional term thereof, the giving by the claimant or plaintiff to the Indemnitee, a release from all liability in respect of such claim.

IV. The Indemnitor's Insurance: BEWARE

The only coverage for indemnity in an insurance policy is the "contractual liability" section of a Commercial General Liability policy. It automatically comes as part of the CGL policy, so all you need is an ACORD Form 25 (a form of an insurance certificate) indicating CGL insurance with "occurrence" based coverage. Don't be fooled by Contractual Liability coverage: Contractual Liability coverage only insures the Indemnitor's obligation to indemnify and defend -- and only if "defend" is stated in the written agreement -- the Indemnitee against the "tort liability of third parties that the Indemnitor assumed in a written agreement." It does **NOT** provide insurance for claims that the Indemnitee has against the Indemnitor, like the Indemnitor's breach of contract, for example. Remember – the liability to the third party has to arise in tort (it can't be a contractual agreement to pay for the third party's medical care, for example) and the CGL policy only insures claims of death, bodily injury and property damage. So, if the owner of a construction site ("Owner") demands that the contractor ("Contractor") indemnify, defend, and hold harmless Owner against claims arising from performance of the construction work, the only thing that is insured is a claim by a third party against Owner for death, bodily injury or property damage. Owner's own damages are not insured. Additionally, almost all of these policies come with a host of conditions. There can be no obvious conflict in the defense between the interests of Owner and Contractor, Contractor's liability must arise out of a written agreement relating to a commercial endeavor, the Indemnitor must choose the lawyers, etc. If you are counting on the Indemnitor's CGL policy -- or if you are an Indemnitor and counting on your own CGL policy – to fund the indemnification obligation, then be sure and get a copy of the Indemnitor's CGL policy in advance of signing the agreement and read the conditions. The bottom line is that almost once a year, I run into another attorney who gives up a contractual right or remedy for my company's breach of contract because he or she believes that my firm's breach is covered by our contractual liability insurance. Don't be that lawyer.

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Indemnification Provisions and Insurance Clauses: Why Have Both In Contracts for Goods or Services?

Presented by: Ronald L. Hicks, Jr.

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Presented by Ronald L. Hicks, Jr.[1]

I. Introduction.[2]

Today, it is common for contracts involving the provision of goods and services to require one or both parties to agree to indemnify the other against certain losses and to require the parties maintain certain insurance and/or add one or both parties as an additional insured under the other's insurance policy. While some businesses (individuals and companies alike) execute these contracts without reading or understanding the significance of such indemnity and insurance provisions, many others have come to appreciate that such clauses constitute a risk-transfer tool that can help protect their business from potential risks that may arise in the future, including the other party's breach of contract. Indeed, more and more insurance companies are requiring their insureds to use such provisions in order to obtain insurance coverage at particular premiums.

Although the use of contractual indemnity provisions and insurance clauses has become commonplace, many businesses and their lawyers simply "copy and paste" such clauses from a prior contract or form and do not understand the interplay that exists between the two provisions. Nor do they consider whether one or both clauses are necessary given the particular circumstances, issues and needs that exist between the contracting parties. Additionally, many businesses and their lawyers do not think about whether the indemnification they have agreed to provide is actually covered under the terms of any Commercial General Liability (CGL) policy or other insurance that they have in place.

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[2] This handout contains general information concerning indemnification and insurance clauses in goods and services contracts and does not constitute a survey of the substantive law of indemnification and insurance in every state or jurisdiction. The information contained herein does not provide and should not be relied on as legal advice or opinion. Drafters of indemnification provisions and insurance clauses should use this article in conjunction with their own research on the applicable laws in their jurisdiction. The information contained herein should not be used or relied upon with regard to any particular facts or circumstances without first consulting with a lawyer. The information and opinions set forth herein may or may not reflect the views of the author's firm or any particular client or affiliate of the firm.

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This article provides an overview of what indemnification provisions and insurance clauses are in contracts involving the provision of goods and services and the risks that each clause seeks to protect. Also, this article explains the interplay that exists between the two provisions and certain issues that may arise depending on how the indemnification provisions and insurance clauses are written. Finally, this article provides some practical advice on how to draft effective indemnification provisions and insurance clauses in contracts involving the sale or purchase of goods and services.

II. Indemnity & Indemnification Provisions

Indemnity has been broadly defined as "the obligation or duty resting on one person to make good any loss or damage another has incurred by acting at his request or for his benefit."[3] Stated differently, indemnity is the right that a person suffering a loss or damage has to be made whole by another.[4]

Indemnity may be imposed by contract or by operation of law (*i.e.,* common law or statutorily). The most common example of legal indemnification is reflected by the doctrine of vicarious liability, which imposes liability on a party whose liability is considered to be "secondary" or "passive" in comparison to that of the party which owes indemnification (*e.g.*, employer-employee or principal-agent).[5] Also, legal indemnification exists where necessary to prevent an unjust result, such as when a person has a non-delegable duty of care (*i.e*., landowner's duty to protect against hazards or nuisances).[6] Further, legal indemnification exists to address personal injury or property damage caused by defective products (i.e., product liability).[7] Finally, with respect to contracts involving goods, the Uniform Commercial Code includes provisions for indemnification of third-party claims based on either breach of warranty or infringement of title.[8]

Generally, legal indemnification exists only where a person without fault has been held legally liable for damages caused by another. Consequently, legal indemnification is not available to a party who is partially at fault.[9]

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[3] *See* 42 C. J. S. 564, § 1.

[4] *See Pennsylvania Co. For Ins. v. Clark*, 340 Pa. 433, 18 A.2d 807 (1941).

[5] *See* 57B Am.Jur.2d *Negligence* §1106, at 363-64 (2004).

[6] *See* D. Dobbs, *The Law of Torts*, §337, at 920-923.

[7] *Id.* at §375, at 1039-1040.

[8] *See* Uniform Commercial Code §§ 2-312(3) & 2-607(3), (5) & (6).

[9] *See, e.g.*, *Orsini v. Kugel*, 9 F.3d 1042, 1049 (2d Cir. 1993); *Columbus v. McKinnon Corp. v. China Semiconductor Co.*, 867 F. Supp. 1173, 1178 (W.D.N.Y. 1994).

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In contrast, contractual indemnity is a covenant or agreement by one party (the "indemnitor") to indemnify or "save harmless" the other party (the "indemnitee") by way of compensation for a particular loss or damage suffered by the indemnitee.[10] Forms of contractual indemnity include cash payments, repairs, replacement and reinstatement.

Traditionally, contractual indemnity focused on claims or losses brought by third parties against the indemnitee. However, contractual indemnification provisions can vary widely and may include claims caused, in whole or in part, by the indemnitee's own fault or negligence or breach of contract.[11]

There are basically three kinds of indemnity or hold harmless clauses typically contained in contracts:

1. **Limited**: obligates the indemnitor to hold harmless the indemnitee only for the indemnitor's own negligence.

2. **Intermediate**: obligates the indemnitor to hold harmless the indemnitee for all liability except that which arises out of the indemnitee's sole negligence.

3. **Broad Form:** obligates the indemnitor to hold harmless for all liabilities, including the indemnitee's negligence or breach of contract.[12]

Contractual indemnification provisions are generally "not favored by the law" and are subject to a strict construction compelling an interpretation "against the party seeking their protection."[13] The interpretation of a contractual indemnity clause is a question of law for the courts to decide in accordance with the jurisdiction's rules governing contract interpretation and construction.[14]

Parties may lawfully contract to indemnify and save harmless others from the latter's own acts of negligence without violating public policy.[15] Because

[10] *See Reyburn Lawn & Landscape Designers, Inc. v. Plaster Dev. Co.,* 255 P.3d 268, 274 (Nev. 2011).

[11] *See, e.g.*, *BP Products N. Am. Inc. v. J.V. Ind. Cos., LTD.*, C.A. # H-07-2369 (S.D. Tex., Apr. 21, 2010).

[12] Coverage Insights, *The ABCs of Indemnity Agreements and Additional Insured Endorsements*, Bollinger Insurance (Undated), available at: http://www.bollingerinsurance.com/Products/RiskManagement/Documents/Coverage%20Insights%20ABCs%20of%20Indemnity%20Agreements.pdf.

[13] *See, e.g., Kiewit E. Co. v. L & R Constr. Co.,* 44 F.3d 1194, 1202 (3d Cir. 1995); *Lackie v. Niagara Mach. & Tool Works*, 559 F. Supp. 377, 378 (E.D. Pa. 1983).

[14] *Jacobs Constructors, Inc. v. NPS Energy Services*, *Inc.*, 264 F.3d 365, 371 (3d Cir. 2001).

[15] *See, e.g., J. V. McNicholas Transfer Co. v. Pennsylvania R. Co.*, 154 F.2d 265, 266 (6th Cir. 1946); *Aluminum Co. of America V. Hully*, 200 F.2d 257, 261 (8th Cir. 1952); *Govero v. Standard Oil Co.*, 192 F.2d 962, 964-965 (8th Cir. 1951); *Buckeye Cotton Oil Co. v. Louisville & N.R. Co.*, 24 F.2d 347, 348 (6th Cir. 1928); 42 C.J.S., *Indemnity*, § 12.

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indemnity provisions are strictly construed against an indemnitee, the tendency of courts has been not to sustain an indemnity agreement against the indemnitee's own negligence unless the agreement spells out the indemnitor's obligation in clear and unequivocal terms.[16]

Several courts have held that an indemnification clause in a contract need not make specific reference to indemnification against liability arising out of an indemnitee's negligence.[17] Other courts have required express contractual language to indemnify a party for its own negligent acts and have ruled that indemnification for negligent acts is not included in coverage for "any and all damages" or "any and all loss."[18] "But, where the scope of the particular indemnity agreement in question is broad enough to permit such result and it is plain from the language used that such was the intention, as stated, no public policy prevents it."[19]

No particular language, or "talismanic phrase," is necessary to create a contractual indemnity. Rather, so long as there is an express undertaking to indemnify, then contractual indemnity exists.[20]

To avoid any misinterpretation, courts have suggested that a contractual indemnification clause contain the classic "save, keep harmless, and indemnity" language.[21] Exculpatory language, such as "shall not be liable for" or "agrees to assume," generally is insufficient to create an enforceable contract for

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[16] *See, e.g., Turner Constr. Co. v. W. J. Halloran Steel Erection Co.,* 240 F.2d 441, 444 (1st Cir. 1957)*; Rice v. Pennsylvania R. Co.*, 202 F.2d 861, 862-863 (2nd Cir. 1953); *Willey v. Minnesota Mining & Mfg. Co.*, 755 F.2d 315, 323 (3d Cir.1985); *Standard Oil Co. of Texas v. Wampler,* 218 F.2d 768, 771 (5th Cir. 1955); *Halliburton Oil Well Cementing Co. v. Paulk*, 180 F.2d 79, 84 (5th 1950); 175 A.L.R. 30.

[17] *See, e.g., Berwind Corp. v. Litton Industries, Inc.*, 532 F.2d 1, 4 (7th Cir. 1976).

[18] *See, e.g., Schuch v. University of Chicago*, 87 Ill. App.3d 856, 410 N.E.2d 258, 261 (1st Dist. 1980); *Cotter v. Consolidated Construction*, 50 Ill. App.3d 332, 365 N.E. 636 (1st Dist. 1977); *Fidelity Bank v. Tiernan*, 249 Pa. Super. 216, 375 A.2d 1320, 1326 (Pa. Super. 1977)("Protection from the results of one's own negligence must not be found on the basis of general language; if found at all, it must be found in language so clear as to remove any doubt that the other party to the contract understood the extent of the immunity to which he was agreeing.").

[19] *Buffa v. General Motors Corp.*, 131 F. Supp. 478, 482 (E.D. Mich. 1955). *See also Office Furnishings, Ltd. v. National Guardian Sec. Services Corp.*, No. 88-C-7392, 1989 U.S. Dist. LEXIS 2927 (D. Ill., filed March 20, 1989) (an agreement to "indemnify, defend and hold harmless from any and all claims" filed "for any reason whatsoever" included indemnification for one's negligence).

[20] *See, e.g.*, *Sun Co. Inc. v. Brown & Root Braun, Inc.*, Nos. Civ. A. 98-6504 & 98-5817, 1999 U.S. Dist. LEXIS 13453, 1999 WL 681694 (E.D. Pa., filed Sept. 2, 1999)("*Sun I*")("Instead of finding certain language to be talismanic, the Pennsylvania Courts have consistently reviewed the entirety of the clause at issue in making an indemnity determination.").

[21] *See, e.g.*, *E. P. Wilbur Trust Company v. Eberts*, 337 Pa. 161, 167 (1940).

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indemnity.[22] Similarly, neither an agreement to maintain insurance nor a right of set-off constitute an express undertaking to provide contractual indemnification.[23]

Courts have held that where the parties have agreed to contractual indemnification, any indemnity provided by operation of common law is superseded by such contractual remedy.[24]

Contractual indemnification is not the same as a guaranty or surety contract. The latter represents a promise to answer for the debt, default or miscarriage of another person.[25] In contrast, contractual indemnification makes good on the loss which results to the indemnitee from the debt, default or miscarriage, but does not "answer for the debt, default or miscarriage."[26]

Contribution is not the same as indemnity. Generally arising by operation of law, contribution is a fault-sharing mechanism that requires those having joint liability to pay a proportionate share of the loss to a party who has discharged their joint liability.[27] By contrast, the party seeking indemnification generally has not done anything wrong, but nonetheless has become exposed to liability by virtue of a transaction or other relationship with the actual tortfeasor. Further, indemnification shifts to the indemnitor the entire loss, not just a portion of it. As a result, it is generally recognized that the right of indemnification supersedes the right of contribution, such that "[w]hen one tortfeasor has a right of indemnity against another, neither of them has a right of contribution against the other."[28]

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[22] *See, e.g., Babjack v. Mount Lebanon Parking Auth.*, 102 Pa. Commw. 499, 503, 518 A.2d 1311, 1313 (1986); *Reiff v. Brodsky*, 33 Pa. D. & C.2d 49, 53 (C.C.P. Montg. 1964).

[23] *See, e.g., Maryland Cas. Co. v. Regis Ins. Co.,* NO. 96-CV-1790, 1997 U.S. Dist. LEXIS 4359 at *20, 1997 WL 164268 at 7 (E.D. Pa., filed Apr. 1, 1997); *Eazor Express, Inc. v. Barkley*, 441 Pa. 429, 430, 272 A.2d 893, 894-95 (1971); *United States Fidelity & Guaranty Co. v. Aetna Casualty & Surety Co.*, 418 F. 2d 953 (8th Cir. 1969); *American Fidelity and Casualty Co. v. Simmons*, 253 F. 2d 634 (4th Cir. 1958).

[24] *See, e.g., Facility Constr. Mgmt. v. Ahrens Concrete Floors, Inc.,* No. 1:08-cv-01600-JOF, 2010 U.S. Dist. LEXIS 29242 (N.D. Ga., filed Mar. 24, 2010); *IU North America, Inc. v. Gage Co.*, No. 00-3361, 2002 U.S. Dist. LEXIS 10275, 2002 WL 1277327, *8 (E.D. Pa., filed Jun. 4, 2002); *Volkswagen of America, Inc. v. Bob Montgomery, Inc.*, No. 82-3598, 1985 U.S. Dist. LEXIS 15629, 1985 WL 2824, *3 (E.D. Pa., filed Sept. 25, 1985); *Wyoming Johnson, Inc. v. Stag Indus., Inc.*, 662 P.2d 96, 101 (Wyo. 1983); *Waller v. J. E. Brenneman Co.*, 307 A.2d 550, 553 (Del. Super. 1973); *County of Alameda v. Southern Pacific Company*, 55 Cal.2d 479, 11 Cal.Rptr. 751, 757, 360 P.2d 327 (1961).

[25] *See, e.g.,* 38 Am. Jur. 2d *Guaranty*, §2 (1998).

[26] *See, e.g.*, *Howell v. Commissioner of Internal Revenue*, 69 F.2d 447, 450 (8th Cir. 1934); *State ex rel. Copley v. Carey*, 141 W.Va. 540, 549, 91 S.E.2d 461, 465 (W.Va. 1956); 42 C.J.S., *Indemnity*, §3.

[27] *See, e.g.*, *Rosado v. Proctor & Scwartz, Inc.*, 484 N.E.2d 1354 (N.Y. 1985); Restatement (Second) of Torts §886A.

[28] Restatement (Second) of Torts §886A (4).

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The point at which a claim for indemnification accrues generally depends on whether the indemnity is against the occurrence of a loss rather than the existence of liability. If the indemnification is premised upon the occurrence of a loss, then a claim for indemnification does not accrue until actual payment is made to a third party in satisfaction of a judgment, settlement or other damages.[29] In contrast, a claim for indemnification against liability accrues as soon as the liability has become fixed and established, even though no actual payment for the loss is made.[30]

Some courts have held that certain phrases, such as to "save harmless" or "hold harmless" or the word "incur" create an indemnification against liability.[31] Other courts, however, have found similar phrases to create indemnification against loss only.[32]

While the language "indemnify and save harmless" does not create an affirmative duty to defend, the prevailing rule is that the language "'implies a duty to reimburse for costs of defense [of the third party's underlying litigation], whether successful or not."[33] Nevertheless, this implication only applies to "defense" litigation costs and does not create a duty to pay attorneys' fees and costs incurred in litigating the duty to indemnify, especially where the indemnification agreement is silent on such issue.[34]

A duty to defend can exist without a duty to indemnify. However, a duty to indemnify cannot exist without a duty to defend.[35]

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[29] *See, e.g.*, *Fleck v. KDI Sylvan Pools, Inc.*, 981 F.2d 107, 122 (3d Cir. 1992)("It is well settled that before any right of indemnification arises, the indemnitee must in fact pay damages to a third party.").

[30] *Crestar Mortg. Corp. v. Peoples Mortg. Co.*, 818 F.Supp. 816, 818 n.4 (E.D. Pa. 1993).

[31] *See, e.g., IFC Interconsult, AG v. Safeguard Int'l Partners, LLC*, 438 F.2d 298, 318-319 (3d Cir.)(construing "indemnify and *hold harmless* ...from ... *all damages and claims* which may be *incurred or asserted*" as an indemnity against liability)(emphasis original), *cert denied* 549 U.S. 821, 127 S. Ct. 136, 166 L. Ed. 2d 37 (2006); *Seitz v. A-Del. Constr. Co.*, 1987 Del. Super. LEXIS 1279, *7 (Del. Super. Ct., Aug. 13, 1987)("When the contract of indemnity binds the indemnitor to save harmless the indemnitee, it is a contract indemnity against liability.") *Sorensen v, Overland Corp.*, 142 F.Supp. 354, 361 (D. Del. 1956)(same as to the word "incurred").

[32] *See, e.g.*, *Coleman c. City of Bradford*, 415 Pa. 557, 558, 204 A.2d 260, 260-261 (1964)("*to indemnify, protect and save free ... from ... all claims, damages, demands and actions"* is for indemnification against loss)(emphasis original).

[33] *Schlosser Steel, Inc. v. Thomas Lindstrom Co.*, Civ. A. No. 87-6154, 1988 U.S. Dist. LEXIS 2349, 1988 WL 28250, at *1 (E.D. Pa. Mar. 23, 1988) (emphasis added) (*quoting Rogers & Babler v. Alaska*, 713 P.2d 795, 800 (Alaska 1986)).

[34] *See, e.g., TNT Logistics N. Am., Inc. v. Bailly Ridge TNT, LLC*, No. 05 C 7219, 2006 U.S. Dist. LEXIS 73316 (D. Ill., Sept. 21, 2006, Decided).

[35] *See The Frog, Switch & Manufacturing Co., Inc. v. The Travelers Insurance Company*, 193 F.3d 742 (3d Cir. 1999).

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III. Insurance Clauses & CGL Policies In General

It has been said that "[c]ontracts of indemnification often allocate between parties the burden of paying for and procuring insurance.[36] However, an indemnification provision is not the same as an insurance clause. Instead, to support the terms of a contractual indemnification provision, the contract will often include insurance clauses. These clauses spell out the type and amount of insurance and other insurance-related obligations required by the various parties entering into the contract. Nevertheless, because they are separate provisions and absent any terms of incorporation, the indemnity clause does not determine the scope of insurance coverage, and the CGL policy does not determine the scope of indemnity coverage.[37] Furthermore, notwithstanding insurance clauses that require one party to purchase contractual liability or additional insured endorsements as part of its CGL policy, insurance coverage may not be available when needed given the scope of the underlying coverage. As such, it is very important to understand what insurance clauses and general liability insurance policies are and how they interact with indemnification clauses when negotiating and drafting such provisions.

Generally, the purpose of CGL insurance is to protect a business against unforeseen third-party liability, such as personal injury and property damage caused by an insured's negligence.[38] Such insurance coverage protects the insured against "all sums that the insured becomes legally obligated to pay as damages" for "bodily injury" and "property damage" that is caused by an "occurrence" which is defined as an accident.[39] Courts have interpreted this language for the proposition that general liability policies do not provide coverage

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[36] *See Kiewit E. Co.*, 44 F.3d at 1199, n. 7 (*citing Jamison v. Ellwood Consol. Water Co.*, 420 F.2d 787, 789 (3d Cir. 1970); *Urban Redevelopment Auth. v. Noralco Corp.*, 281 Pa. Super. 466, 470 n.3, 422 A.2d 563, 565 n.3 (1980) ("[T]oday, in reality, the indemnity agreements do not shift the loss, but shift the burden of paying for and procuring insurance.").

[37] *See Transport Indem. Co. v. Home Indem. Co.*, 535 F.2d 232, 235 (3d Cir. 1976) ("The contractual obligations assumed by [truck lessee/indemnitor] to [lessor/indemnitee] cannot extend the obligations assumed by [insurer] to its named insured, [lessee], beyond the plain language of its contract."); *Meridian Mut. Ins. Co. v. Cont'l Bus. Ctr.*, No. Civ. A. 04-1693, 2005 U.S. Dist. LEXIS 6406 at *15, 2005 WL 856935 at 5 (E.D. Pa.. Apr. 14, 2005) ("The limits of the coverage are determined by the language of the policy, not the lease, because the policy did not incorporate paragraph 37 [insurance requirements] in its entirety."). *See also Carolina Cas. Ins. Co. v. Transport Indem. Co.*, 488 F.2d 790, 794 (10th Cir. 1973) (holding that "the primary insurer should be determined by looking to the insurance contracts and not by relying on terms and provisions found not in them but in a lease agreement between the named insureds.").

[38] *See* ISO Form, Paragraph 1(a) of Section I--Coverages--Coverage A--Bodily Injury and Property Damage Liability (emphasis added), *reprinted in* 15 E. Holmes, Holmes' Appleman On Insurance 2D, §111.2 at 81-106 (2002).

[39] ISO Form, Paragraph 13 of Section V--Definitions, *reprinted in* Appleman On Insurance, *supra* note 38, §111.2 at 104.

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for breach of contract and breach of warranty claims, but instead insure only against losses based on tort liability.[40] To hold otherwise would convert the CGL policy into a professional liability policy or performance bond.[41]

A corollary to the judicially recognized breach of contract restriction is the assumed liability exclusion. The assumed liability exclusion states that the CGL insurance does not apply to:

> b. *Contractual Liability*. 'Bodily injury' or 'property damage' for which the insured is obligated to pay damages by reason of the **assumption of liability in a contract or agreement**. This exclusion does not apply to liability for damages:
>
> (1) That the insured would have ***in the absence of the contract or agreement***; or
>
> (2) ***Assumed in*** a contract or agreement that is ***an 'insured contract***,' provided the 'bodily injury' or 'property damage' occurs subsequent to the execution of the contract or agreement.[42]

The assumed liability exclusion defines an "insured contract" to mean:

> f. That part of ***any other contract or agreement*** pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) ***under which you assume the tort liability of another party*** to pay for 'bodily injury' or 'property damage' to a third person or organization. ***Tort liability means a liability that would be imposed by law in the absence of any contract or agreement***.[43]

In light of this language, the assumed liability exclusion confines insurance coverage of any contractual indemnity "to liability that is imposed on the insured by operation of law, such as vicarious liability for the acts of an employee or agent under the doctrine of respondeat superior, or direct liability for the

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[40] *See, e.g., Nationwide Mut. Ins. Co. v. CPB Int'l, Inc.,* 562 F.3d 591, 598 (3d Cir. Pa. 2009); *Peerless Ins. Co. v. Brooks Sys. Corp.*, 617 F. Supp. 2d 348, 356 (E.D. Pa. 2008); *WDC Venture v. Hartford Accident and Indem. Co.*, 938 F. Supp. 671 (D. Haw. 1996); *Stanford Ranch, Inc. v. Maryland Cas. Co.*, 883 F. Supp. 493 (E.D. Cal. 1995) . *See also Hermitage Ins. Co. v. Champion*, NO. 2:09cv398-MHT (WO), 2010 U.S. Dist. LEXIS 41306 at *8 (M.D. Ala. 2010)(reaching the same result based on the CGL's exclusion for contractual claims).

[41] *Burlington Ins. Co. v. Oceanic Design & Constr., Inc.,* 383 F.3d 940, 949 (9th Cir. 2004).

[42] ISO Form, Paragraph 2(b) of Section I--Coverages--Coverage A--Bodily Injury and Property Damage Liability (emphasis added), *reprinted in* Appleman On Insurance, *supra* note 38, §111.2 at 82.

[43] ISO Form, Paragraphs 9(a) and (f) of Section V--Definitions (emphasis added), *reprinted in* Appleman On Insurance, *supra* note 38, §111.2 at 101-02.

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negligent selection of an independent contractor."[44] In other words, CGL insurance does not provide complete indemnity coverage for all risks, but instead only covers such secondary, or vicarious, liability that would be imposed by law in absence of a contract or agreement.[45] According to the courts, this exclusion "furthers the goal of protecting the insurer from exposure to risks whose scope and nature it cannot control or even reasonably foresee."[46]

Consequently, in light of the assumed liability exclusion, a CGL insurance policy will provide coverage for liability under an indemnity clause in a contract for the provision of goods or services only to the extent that such indemnity is covered by legal indemnification principles. An indemnity clause that seeks to transfer additional liability beyond that recognized under legal indemnification principles will not be covered by CGL insurance.[47]

One way to get around the effects of the assumed liability exclusion is through what is commonly referred to as the "contractual liability endorsement." In exchange for an additional premium, the contractual liability endorsement removes the assumed liability exclusion for "any contract relating to the conduct of the insured's business," thereby expanding CGL insurance coverage to include liability that is imposed by contractual indemnification as opposed to only legal indemnification. As a result, it is not uncommon for contracts involving the provision of goods and services to include as one of its insurance clauses a requirement that the indemnitor maintain a CGL policy with a contractual liability endorsement.

However, the contractual liability endorsement does not expand the scope of the underlying CGL insurance coverage. In other words, when a claim is based on breach of contract and not in tort, the contractual liability endorsement does not create coverage under the CGL policy because "the nature of the damages for which recovery is sought are not changed by this endorsement to include damages from a breach of contract, rather the damages to which this endorsement is directed is the same as in the original broad comprehensive policy, bodily injury and property damage caused by an occurrence."[48]

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[44] James E. Joseph, *Indemnification And Insurance: The Risk Shifting Tools (Part II): Degrees of Risk Shifting*, 80 Pa. Bar Assn. Quarterly 1, 12-13 (Jan. 2009).

[45] *Id.* at 13 ("The distinction between primary liability and secondary or vicarious liability, is the basis of the assumed liability exclusion. This parallels common law indemnity, which allows indemnification for secondary liability only.").

[46] *American Family Mut. Ins. Co. v. American Girl, Inc.*, 268 Wis.2d 16, 48, 673 N.W.2d 65, 81 (2004)). *See also* Annot., 63 A.L.R. 2D, 1122, 1123 (1959).

[47] James E. Joseph, *supra* note 44, 80 Pa. Bar Assn. Quarterly at 13.

[48] *Toombs NJ Inc. v. Aetna Casualty & Surety Co.*, 404 Pa. Super. 471, 479, 591 A.2d 304, 308 (1991).

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Generally, an indemnitee is considered to be neither an insured nor a third-party beneficiary of an indemnitor's CGL policy and, therefore, has no standing to sue or assert a bad faith claim against the indemnitor's insurance company.[49] As a result, many contracts include a clause that requires the indemnitor to add the indemnitee as an additional insured.

Traditionally, additional insured endorsements were narrowly construed, as the Eastern District of Pennsylvania explained years ago:

> In the insurance industry, additional insured provisions have a well-established meaning. They are intended to protect parties who are not named insureds from exposure to vicarious liability for acts of the named insured. These provisions are employed in countless situations in the industry, including such simple circumstances as those involving landlord and tenant relations, where the landlord asks or requires the tenant to procure insurance for the landlord for liability resulting from the tenant's activities.
>
> The insurance industry places this meaning on additional insured provisions because insurers will not increase and alter the kind of risks insured against without the charge of additional premiums. In this kind of provision, the risks have not been increased or altered, for the insurer is only insuring the additional insureds against vicarious liability for acts of the named insured.[50]

However, changes in its language have given additional insured endorsements greater importance.[51] As a result, courts have broadly construed such endorsements as providing coverage for more than just traditional legal indemnification coverage, but also contractual indemnification for the additional insured's own negligence.[52]

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[49] *See, e.g., Tremco, Inc. v. PMA Ins. Co.*, 832 A.2d 1120, 1121-1123 (Pa. Super. 2003).

[50] *Harbor Ins. Co. v. Lewis*, 562 F.Supp. 800, 803 (E.D. Pa. 1983).

[51] Coverage Insights, *supra* note 12 ("The Insurance Services Office (ISO) released new additional insured endorsements in 2004. The intent of the endorsements is to provide liability coverage for additional insureds (typically the general contractor or project owner) with respect to damages caused by the named insured (subcontractor). The endorsements do not provide coverage for the additional insured's sole negligence, but they can provide coverage for the additional insured's contributory negligence.").

[52] *See, e.g., Philadelphia Elec. Co. v. Nationwide Mut. Ins. Co.*, 721 F.Supp. 740, 742-743 (E.D. Pa. 1989) (an additional insured endorsement which read ""The Philadelphia Electric Company, its officers, agents and employees are added as Additional Insureds *for any work performed by the Davey Tree Expert Company on their behalf*" required Nationwide to indemnify PECO for all liability arising in connection with Davey Tree's work, including PECO's own negligence); *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251, 254 (10th Cir. 1993) (same conclusion based on an additional insured endorsement which read "The "Persons Insured" provision is amended to include as

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In light of the broad construction given to additional insured endorsements, some additional insured endorsements have been written to limit insured status to only injury or damage "caused in whole, or in part, by*"* or vicariously as a result of the acts or omissions of the named insured. Further, some versions of the endorsement exclude claims arising from the additional insured's sole negligence. According to the courts, the intended effect of such language in the additional insured endorsement is to not cover claims premised upon the additional insured's sole negligence but instead insure against only those claims involving an additional insured's own negligence so long as the named insured is partially negligent or at fault.[53]

Although an indemnification clause generally does not limit or expand the scope of coverage under a CGL policy with an additional insured provision,[54] that rule does not apply when the terms of the endorsement incorporates the indemnification clause. For example, when the additional insured endorsement states that a party shall be an additional insured "only with the coverages and the minimum amounts of insurances required to be carried by the Named Insured under the contract and only for the liabilities the Named Insured assumes under the contract," then the insurer "is only required to indemnify [the additional insured] to the extent of [subcontractor's] duty to indemnify," and the endorsement functions like a contractual liability endorsement.[55] In converse, a restrictive additional insured endorsement may be rendered ineffective by a broad indemnity provision which is incorporated into the endorsement.[56]

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an insured the person or organization named below but only with respect to liability arising out of operations performed for such insured by or on behalf of the named insured."). *See also Federal Home Loan Mortg. Corp. v. Scottsdale Ins. Co.,* 316 F.3d 431, 444 (3d Cir. 2003) (under New Jersey law, "courts have given a broad and liberal interpretation to common insurance policy language pertaining to coverage for additional insured parties for injuries arising out of work or operations performed by the main policyholder.").

[53] *See, e.g., Lafayette College v. Selective Ins. Co.,* 2007 U.S. Dist. LEXIS 88001, 2007 WL 4275678 (E.D. Pa. 2007); *Garcia v. Federal Ins. Co.,* 969 So.2d 288 (Fla. 2007)*; American Empire Surplus Lines Ins. Co. v. Crum Et Forster Specialty Ins. Co.*, 2006 U.S. Dist. LEXIS 33556 (S.D.Tex. 2006); *American Country Ins. Co. v. McHugh Construction Co.*, 801 N.E.2d 1031 (Ill. App. 2003); *The Clark Construction Group v. Modern Mosaic, Ltd*., 2000 U.S. Dist. LEXIS 22922 (D. Md. 2000); *National Union Fire Ins. Co. v. Nationwide Ins. Co.,* 82 Cal.Rptr.2d 16 (Cal. App. 1999)*; Liberty Mutual Ins. Co. v. Capeletti Bros., Inc.,* 699 So.2d 736 (Fla. App. 1997)*; Village of Hoffman Estates v. Cincinnati Ins. Co.,* 670 N.E.2d 874 (Ill. App. 1996).

[54] *See, e.g., Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 296 (9th Cir. 1997) (absent policy language confining the insurance coverage to those required under the contract's insurance clause, additional insured was entire to policy limits); *Forest Oil Corp. v. Strata Energy*, 929 F.2d 1039, 1044-1045 (5th Cir. 1991) (same); *Old Republic Ins. Co. v. Concast, Inc.*, 588 F.Supp. 616, 619-620 (S.D. N.Y. 1984) (same).

[55] *Sun I, supra* note 20, 1999 U.S. Dist. LEXIS 13453 at *19-22, 1999 WL 681694 at 9-10. *See also Forest Oil*, 929 F.2d at 1045.

[56] *CertainTeed Corp. v. Employers Insurance of Wasau*, 939 F.Supp. 826, 827-829 (D. Kan. 1996) (the court ruled that indemnification existed to an additional insured because the terms of the underlying contract required the insured

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NOTE: The additional insured endorsement is not the same as "additional named insured" coverage. An additional named insured usually is an affiliate of the primary insured.[57] Consequently, unless they are affiliated entities, parties to a contract for the provision of goods and services are not be able to be added as an additional named insured.[58] If the contract includes a requirement to add a party as an additional named insured, the clause should be removed or changed to be limited to an additional insured endorsement.[59]

IV. Drafting Indemnification Provisions & Insurance Clauses

As the law involving indemnification and insurance clauses suggest, there is a great deal of flexibility in crafting terms of indemnity provisions and insurance clauses in contracts for the provision of goods and services. Consequently, rather than using a standard indemnification or insurance provision or performing a "copy and paste" of such terms from a prior contract or form, the parties and their counsel should consider the particular circumstances, issues and needs that exist in the transaction and draft the indemnity provisions and insurance clauses accordingly.

As for drafting, the following techniques should be considered:

A. Use Definitions

Routinely, indemnification provisions and insurance clauses employ terms that are either undefined or insufficiently defined in the parties' contract. Terms such as "claims," "losses," "damages," and "defense" are just some of the terms that one should consider defining. If customized definitions are used, then the actual terms of the indemnification are relatively straight forward and easy to understand.[60]

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to obtain insurance coverage to indemnify the additional insured for its own acts of negligence and the underlying indemnification clause was incorporated into the additional insured endorsement).

[57] Coverage Insights, *supra* note 12.

[58] *Id.*

[59] *Id.*

[60] D. Hull Youngblood, Jr. and Peter N. Flocos, *Drafting and Enforcing Complex Indemnification Provisions*, The Practical Lawyer 21, 27 (Aug. 2010), available at: http://www.klgates.com/files/Publication/4fff23f1-3315-4425-b6ad-56e54bea55f0/Presentation/PublicationAttachment/fba1faaa-91de-4849-8a8f-6678e1cad2b2/Youngblood_Flocos_PracticalLawyer.pdf.

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For example, a standard short-form indemnification clause may read as follows:

> *The Seller agrees to defend, indemnify, and hold harmless the Buyer, from any and all damages, liability, and claims, arising out of Seller's conduct.*

This short-form clause gives no direction to the reader what damages, liability or claims will be defended or actually covered by indemnity. Instead, it leaves it up to the Courts to make that decision based on the facts of the matter and past judicial holdings.

In contrast, assume that the goods and services contract is written with the following customized definitions and indemnification clause:

> *"Buyer" shall mean the party identified in the caption of this contract.*
>
> *"Claims" shall mean all claims, requests, accusations, allegations, assertions, complaints, petitions, demands, suits, actions, proceedings, and causes of action of every kind and description.*
>
> *"Damages" shall mean each and every injury, wound, wrong, hurt, harm, fee, fine, penalty, damage, cost, expense, outlay, expenditure, or loss of any and every nature, including, but not limited to:*
> *(i) Injury or damage to any property or right;*
> *(ii) Injury, damage or death to any person or entity;*
> *(iii) Attorneys' fees, witness fees, expert witness fees and expenses; and*
> *(iv) All other costs and expenses litigation.*
>
> *"Defended Claim(s)" shall mean all Claims which allege that Damage was caused by, arises out of, or was contributed to, in whole or in part, Seller's Conduct.*
>
> *"Proven" shall mean that a court of competent jurisdiction or government or administrative agency has entered a final unappealable judgment on a Claim adjudging an entity or person liable for a monetary judgment.*
>
> *"Seller" shall mean the party identified in the caption of this contract.*
>
> *"Seller's Conduct" shall mean any act, failure to act, omission, professional error, fault, mistake, negligence, gross negligence or gross misconduct of any and every kind, of Seller, its employees, agents, representatives, or subcontractors, or employees, agents, or representatives of such subcontractors, arising out of:*

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> *(i) Performance of this Agreement (or failure to perform);*
> *(ii) Breach of this Agreement; or*
> *(iii) Violation of any laws.*
>
> *Seller shall provide a defense for Buyer from all Defended Claims and shall indemnify Buyer from any judgment arising from any Defended Claims which are Proven against Buyer.*[61]

Unlike the standard short-form, the above indemnification clause provides a clearer understanding to the reader of what the defense and indemnity obligations that have been agreed to by the parties because many of the terms are defined.

Using customized definitions is one of the best ways to provide clarity to indemnification provisions and insurance clauses that appear in any contract for the sale of good and services.

B. Identify the Parties

A corollary to using customized definitions is to make certain that you identify precisely who is going to be providing and who is going to be entitled to receive the indemnity and insurance protection provided by the contract. For example, if you are dealing with a newly formed company, perhaps you want to have the indemnity provided by the company's parent or affiliated entities. Similarly, you may want indemnity and insurance coverage provided for not only your company but also its affiliates, shareholders, directors, officers, managers, members, partners, agents, representatives, attorneys, employees and representatives. Including all these people, including any other third-party beneficiaries, in the language of the actual indemnification provisions or insurance clauses can make them become long run-on sentences. However, by using definitions for the terms "Seller" and Buyer," one can easily define who is going to be providing and who is going to be entitled to receive the indemnity and insurance protection provided by the contract.

C. Define the Losses and Damages Covered

In addition to identifying the parties, it is important to clearly state what losses and damages are intended to be recovered or not recovered by way of the indemnification provisions and insurance clauses. For example, are fees of attorneys, accountants, experts and other professionals recoverable as part of indemnity or are they limited to solely the duty to defend obligations? Does the indemnity obligation include consequential or indirect damages, including lost

[61] Youngblood and Flocos, *supra* note 60, The Practical Lawyer, at 27 (with modifications).

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profits, or is the indemnitor responsible for only actual, direct damages? Are fines, penalties and costs included within proffered indemnity or are these types of damages excluded from indemnity coverage? Again, these are questions that parties should consider and discuss when negotiating and drafting indemnification and insurance clauses.

Similarly, in those situations where insurance coverage may not exist for the indemnity being sought by the indemnitee, consider placing limits on the amount of indemnity being offered under the contract so as to minimize the amount of the self-insured risk. An example of this type of provision is as follows:

> Seller shall not be liable to indemnify and hold harmless Buyer for any Damages arising from the Claims, until the Buyer has first suffered, sustained or incurred aggregate losses relating to such matters in excess of $50,000, at which point the Seller will be liable to indemnify Buyer and hold it harmless from and against all such Damages in excess of the $50,000 deductible amount; provided, however, that Seller shall not be liable to indemnify Buyer for any Damages in excess of $2,000,000.[62]

D. **Understand The Meaning of the Terms Used**

So many times, counsel drafting contracts use terms without any appreciation of the legal significance that has been attributed to such terms. This is particularly true with respect to the use of the term "hold harmless" in indemnification provisions. Generally, a hold-harmless term requires one party to "assume [] the liability inherent in the undertaking, thereby relieving the other party of the responsibility."[63] Consequently, if a hold-harmless term exists in an indemnification provision (*i.e.,* "indemnify and hold-harmless"), the courts are more likely to reject the argument that the indemnification provision is a broad-form clause encompassing all liability suffered by the indemnitee and instead hold that the indemnification is a limited-form clause providing protection for only third-party claims or liability.[64] As such, if you want broad-form indemnity coverage, then do not use the "hold-harmless" term in your indemnification provision.

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[62] Youngblood and Flocos*, supra* note 60, The Practical Lawyer, at 31 (with modifications).

[63] *Valhal Corp v. Sullivan Assoc. Inc.,* 44 F.3d 195, 202 n. 6 (3d Cir. 1995).

[64] *See, e.g., Exelon Generation Co., Inc. v. Tugboat Doris Hamlin*, No. 06-0244, 2008 U.S. Dist. LEXIS 41340 (E.D. Pa., decided May 27, 2008). *But see BP Products N. Amer., Inc. v. J.V. Industrial Cos., LTD*, No. H-07-2369, 2010 WL 1610114 (S.D. Tex., decided Apr. 21, 2010), available at: http://www.tklaw.com/resources/documents/BPProductsvJVIndustrial.pdf.

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E. Integration of Indemnity and Insurance Coverages

When drafting indemnification and insurance clauses, it is important that the indemnification and insurance clauses are incorporated into the CGL policy's terms. Normally, the incorporation is accomplished by way of the additional insured endorsement or some other endorsement. No matter how it is accomplished, incorporating the contract's indemnification provisions and insurance clauses into the CGL policy insures that the indemnity and insurance coverages are consistent and will be subject to the same rules of construction.[65]

F. Exclusivity of Remedies

Parties to a goods and services contract can agree that a contract's indemnity and insurance coverage are the exclusive remedy available to the indemnitee for all claims that may arise, including those for breach of contract, tort or strict liability. Such a provision is particularly important to indemnitors who are seeking to limit their self-insured exposure. Failure to include such a provision may enable the indemnitee to pursue common law or other legal indemnification and thereby "sidestep" the contractual indemnity, including any financial limitations included therein.[66]

G. Notice & Selection of Counsel

When drafting indemnification and defense provisions, many counsel fail to address the mechanics of how indemnity and defense coverage is to be provided. More specifically, parties or their counsel rarely spend any time negotiating how notice is to be given and whether the failure to give notice by a certain time relieves the indemnitor of its obligations to defend and indemnify. However, such provisions can have serious consequences to indemnitees, especially when indemnification is being sought because of a third-party claim.

Indemnification provisions can be drafted to provide that late or untimely notice does not excuse one's defense or indemnification obligations except where substantial prejudice exists. An example of such a provision is as follows:

> Notice. Each Indemnitee must provide written notice to the Indemnitor within 10 days after obtaining knowledge of any claim that it may have pursuant to Section X (whether for its own Losses or in connection with a Third Party Claim); provided that the failure to provide such notice will not limit the rights of an Indemnitee to

[65] Joseph, *supra* note 44, 80 Pa. Bar Assn. Quarterly 1, at 20.

[66] Youngblood and Flocos, *supra* note 60, The Practical Lawyer, at 31.

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> indemnification hereunder except to the extent that such failure materially increases the dollar amount of any such claim for indemnification or materially prejudices the ability of the Indemnifying Party to defend such claim. Such notice will set forth in reasonable detail the claim and the basis for indemnification.[67]

Equally important is the term involving the selection of counsel for defense coverage. Normally, the standard term provides that the indemnitor has the right to select "qualified" counsel to provide the required defense, subject to the indemnitee's right of approval which "shall not be unreasonably withheld." However, the "shall not be unreasonably withheld" term may provide the indemnitor with a basis to excuse its obligation to provide indemnity if it can show that the indemnitee's approval was unreasonably withheld. A better approach to such language would be the following:

> Any party obligated to provide a defense hereunder shall do so with qualified counsel with demonstrable experience defending claims of the type to be defended, who is selected by the party providing the defense, and such counsel shall be deemed to have been approved by the party to be defended, without further action by said party, unless the party to be defended establishes: (i) a substantive conflict of interest with such counsel; or (ii) a substantial cause or reason to withhold such approval.[68]

V. Conclusion

Those who "copy and paste" indemnification provisions and insurance clauses into contracts for the provision of goods and services run the risk that they have exposed their business to a substantial self-insured risk. However, given their inherent flexibility, indemnification provisions and insurance clauses should be negotiated and drafted to fit the particular circumstances, issues and needs underlying the goods and services contract. When such an approach is taken, indemnification provisions and insurance clauses can provide an effective means of bringing one-self-insured risk to an acceptable level.

[67] Youngblood and Flocos, *supra* note 60, The Practical Lawyer, at 33-34.

[68] Youngblood and Flocos, *supra* note 60, The Practical Lawyer, at 35.

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A SELECTION OF SAMPLE INDEMNITY CLAUSES

VENDOR FRIENDLY INDEMNITY TYPICAL IN SOFTWARE CONTRACTS

1. Indemnification.

1.1. Each party (the "indemnifying party") shall indemnify the other party ("indemnified party") from and against any and all third-party suits and claims, as well as any resulting damages, attorneys' fees, and other expenses (collectively, the "Claims") for bodily injury and tangible personal property damage (excluding data, software, or documentation) arising directly out of indemnifying party's gross negligence or willful misconduct, but not to the extent that any Claim is based upon or arises from any fault or responsibility of the indemnified party or any third party not under the control of the indemnifying party.

1.2. Vendor shall indemnify Customer from and against all third-party claims for infringement of any patent or copyright, or misappropriation of any trade secret, applied against the Platform or the Deliverables. Vendor has the right to defend or, at its option, settle any such claim, and Vendor agrees at its own expense to defend, or at its option, settle any such claim, suit, or proceeding brought against Customer. This obligation to indemnify does not extend to any claims of infringement to the extent resulting from (i) Customer's modification of the Deliverable or use of the Platform or the Deliverable or any part thereof in combination with any equipment, software, or data not approved for use by Vendor, or use in any manner for which the Platform or Deliverable was not designed; (ii) any aspect of Customer's software, documentation, or Data which existed prior to Vendor's performance of Services; (iii) any claim arising from any instruction, information, design, or materials furnished by Customer to Vendor; or (iv) Customer's continuing the allegedly infringing activity after being notified thereof and after being informed and provided by Vendor with modifications that would have avoided the alleged infringement while not materially diminishing the performance or capabilities of the Platform or the Deliverable.

1.3. The obligations to indemnify and defend set forth in this section will not apply unless the indemnified party (i) promptly notifies the indemnifying party of any matters in respect to which the indemnity may apply and of which the indemnified party has knowledge; (ii) gives the indemnifying party full opportunity to control the response and the defense, including any settlement, but the indemnifying party shall not settle any such claim or action without the prior written consent of the indemnified party (which consent may not be unreasonably withheld or delayed); and (iii) reasonably cooperates with the indemnifying party, at the indemnifying party's expense, in the defense or settlement thereof. The indemnified party may participate, at its own expense, in the defense and in any settlement discussions directly or through counsel of its choice on a monitoring and non-controlling basis.

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1.4. This section sets forth the exclusive remedy and entire liability and obligation of each party with respect to third-party claims for intellectual property infringement or misappropriation, including patent or copyright infringement claims and trade secret misappropriation.

To strengthen the foregoing, the indemnification obligations should be carved out of the limitation of liability.

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BUYER FRIENDLY INDEMNITY FROM LARGE COMPANY BUYER OF SOFTWARE SERVICES:

1. **Indemnification.**

1.1 *Indemnification*. Vendor, at its own expense, shall defend, indemnify and hold Customer and its directors, officers and employees harmless from all claims, actions and demands ("Claims"), and shall pay any resulting liabilities, losses, damages, judgments, settlements, costs and expenses (including reasonable attorneys' fees) incurred (collectively, "Losses") insofar as such Claims are related to: (i) a Claim that the Subscription Service infringes any patent, copyright, trade secret, database right, or other intellectual property or proprietary right of any third party; (ii) a Claim that the Subscription Service breaches a third party license agreement; (iii) a breach by Vendor of any representation, warranty, covenant or agreement made by it hereunder; (iv) a Claim by any Vendor staff that they are an employee of Customer and any related costs; (v) a Claim by virtue of the operation of the Employment Regulations made by Vendor staff or by any trade union or other authority or body representing such individuals (including without limitation, where the Claim relates to dismissal or obligations to inform or consult); (vi) a Claim related to Vendor's breach of the Customer Data Processor Obligations; (vii) any act or omission by Vendor that constitutes fraud, bad faith, gross negligence or willful misconduct; (viii) any injury or damage caused by the Subscription Service or by Vendor to persons or property; or (ix) Vendor's breach of its confidentiality obligations.

Customer agrees to give Vendor the opportunity to defend or negotiate a settlement of any Claim, and to cooperate, to the extent reasonable with Vendor, at Vendor's sole expense, in defending or settling such Claim. Vendor does not have the right, without Customer' prior written consent, to settle any Claim if such settlement (a) contains a stipulation to or admission or acknowledgement of, any liability or wrongdoing (whether in contract, tort or otherwise) or the incurrence of any costs or expenses, on the part of Customer; (b) imposes any obligation upon Customer; or (c) would otherwise have a material adverse effect on Customer' business, as determined by Customer. Customer reserves the right, at its own expense, to participate in the defense of any matter otherwise subject to indemnification by Vendor.

1.2 *Enjoined Use*. If Customer' use of the Subscription Service is enjoined or is threatened to be enjoined as a consequence of any Claim of the kind described in the Section titled "Indemnification", then Vendor shall take the following actions at its own expense and shall, where commercially reasonable, honor

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Customer' express desire that they be attempted in the order of preference as follows:

(i) procure for Customer the right to continue using the infringing Subscription Service;

(ii) modify the infringing Subscription Service so that its use by Customer is lawful, except that the modification must not adversely affect Customer' use of the Subscription Service, as determined by Customer; or

(iii) replace the infringing Subscription Service, at no charge to Customer, with an equally suitable, compatible, functionally equivalent and conforming Subscription Service that lawfully may be used by Customer.

If none of the foregoing alternatives is reasonably available to Vendor, then Customer shall discontinue use of the Subscription Service and Vendor shall refund to Customer all fees relating to the infringing Subscription Service and any Subscription Service dependent upon such infringing Subscription Service, including implementation fees.

1.3 *Notice*. Vendor shall give Customer prompt written notice of any action against Vendor that could, if successful, have an adverse impact on Customer. Customer shall give Vendor prompt written notice of any action related to any Claim described in the Section titled "Indemnification", of which it becomes actually aware (provided, however, that any failure by Customer to so promptly give notice to Vendor will not relieve Vendor of its indemnification obligations hereunder, except to the extent that it has been materially damaged thereby).

1.4 *Indemnification Exception*. Vendor's indemnification obligation does not apply if the alleged violation, infringement, or misappropriation results solely from Customer' unauthorized (i) modification or enhancement of the Subscription Service; or (ii) use of the Subscription Service in combination with other products not provided or approved by Vendor where the violation, infringement, or misappropriation would not have occurred from use of the Subscription Service but for such combination.

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PURCHASER FRIENDLY INDEMNITY FOR CONTRACTING SERVICES, PROVISIONS RELATING TO SPECIFIC STATE LAW:

ARTICLE IX – INDEMNITY

A. Contractor's Indemnity. Contractor shall indemnify, defend, and hold harmless Purchaser, its parent, subsidiaries and affiliates, and each of their respective agents, officers, employees, successors, assigns, and indemnitees (the "Indemnified Parties"), from and against any and all losses, costs, damages, claims, liabilities, fines, penalties, and expenses (including, without limitation, attorneys' and other professional fees and expenses, and court costs, incurred in connection with the investigation, defense, and settlement of any claim asserted against any Indemnified Party or the enforcement f Contractor's obligations under this Article IX) (collectively, "Losses"), which any of the Indemnified Parties may suffer or incur in whole or in part arising out of or in any way related to the Work performed or to be performed, the presence of Contractor and/or its Subcontractors at Purchaser's Site, and/or the actions or omissions of Contractor and/or its Subcontractors, including, without limitation, Losses relating to: (1) actual or alleged bodily or mental injury to or death of any person, including, without limitation, any person employed by Purchaser, by Contractor, or by any Subcontractor; (2) damage to or loss of use of property of Purchaser, Contractor, any Subcontractor, or any third party; (3) any contractual liability owed by Purchaser to a third party; (4) any breach of or inaccuracy in the covenants, representations, and warranties made by Contractor under the Agreement; and/or (5) any violation by Contractor or any Subcontractor of any ordinance, regulation, rule, or law of the United States or any political subdivision or duly constituted public authority; subject, however, to the limitations provided in Section IX(B) (for Work performed in Pennsylvania), or Section IX(C) (for Work performed in states other than Pennsylvania). Purchaser shall be entitled to control the defense of any action indemnified hereunder, with legal counsel of its own choosing.

B. WITH RESPECT TO WORK PERFORMED OR TO BE PERFORMED WITHIN THE COMMONWEALTH OF PENNSYLVANIA, Contractor's indemnity obligations under Section IX(A) shall apply in each case whether or not caused or contributed to by the fault or negligence of any or all of the Indemnified Parties, and Contractor expressly agrees that Contractor will indemnify, defend, and hold harmless the Indemnified Parties in connection with Section IX(A) even if any such Losses are caused in whole or in part by the sole or concurrent negligence of one or more of the Indemnified Parties. Contractor agrees to waive and release any rights of contribution, indemnity, or subrogation it may have against any of th Indemnified Parties as a result of an

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indemnity claim asserted by another Indemnified Party under Section IX(A) . Section IX(A) is intended to be an express written contract to indemnify as contemplated under Section 303(b) of the Pennsylvania Workers' Compensation Act (or any successor to such provision).

C. WITH RESPECT TO WORK PERFORMED OR TO BE PERFORMED AT ANY LOCATION WHICH IS NOTWITHIN THE COMMONWEALTH OF PENNSYLVANIA, Contractor's indemnity obligations under Section IX(A) shall not apply to any Losses to the extent such Losses are found to have been initiated or proximately caused by or resulting from the negligence or willful misconduct of any of the Indemnified Parties.

D. Waiver of Immunities. If an employee of Contractor or its subcontractor, or such employee's heirs, assigns, or anyone otherwise entitled to receive damages by reason of injury or death to such employee, brings an action at law against any Indemnified Party, then Contractor, for itself, its successors, assigns, and subcontractors, hereby expressly waives any provision of any workers' or other similar law whereby Contractor could preclude its joinder by such

Indemnified Party as an additional defendant, or avoid liability for damages, contribution, defense, or indemnity in any action at law, or otherwise. Contractor's obligation to Purchaser herein shall not be limited by any limitation on the amount or type of damages, benefits or compensation payable by or for Contractor under any worker's compensation acts, disability benefit acts, or other employee benefit acts on account of claims against Purchaser by an employee of Contractor or anyone employed directly or indirectly by Contractor or anyone for whose acts Contractor may be liable.

E. No Impairments. Contractor's obligations under this Article IX shall not be limited to the extent of any insurance available to or provided by Contractor. Contractor's obligations to defend Purchaser shall survive any judicial determination invalidating, in whole or in part, the indemnity provision of the Agreement. Furthermore, the indemnification, defense and hold harmless of Purchaser by Contractor and any other right of Purchaser against Contractor shall not be impaired or affected in any way by the failure of Purchaser to provide Contractor with a copy of a notice to owner, notice of lien, mechanics lien, or other information.

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VENDOR FRIENDLY INTELLECTUAL PROPERTY INDEMNITY:

Vendor agrees to indemnify, defend, and hold harmless Customer, its parent, subsidiaries and affiliated companies, their successors and assigns from and against all claims of third parties and any damages, losses, costs, and expenses (including reasonable legal fees) arising from any actual or alleged infringement of any patent, copyright, trademark, trade name, or service mark in the performance of the Services, except that Vendor shall have no obligation under this Section 10.03 with regard to any infringement arising from: (i) Vendor's compliance with specifications issued by Customer, (ii) Customer's use or sale of goods and/or Services for other than their intended application, or (iii) Customer's modification of the goods and/or Services if such modification causes the goods and/or Services to be infringing. Vendor shall have the right to conduct, at its own expense, the entire defense of any such claim, suit, or action that alleges (a) the possession, use, or resale by Customer or any subsequent party possessing, purchasing, or using parts delivered hereunder, or (b) any process used to provide Services hereunder directly infringes any United States or foreign patent. Vendor shall, at its own expense, either: (i) settle such claim, suit or action and/or shall pay all damages, and costs awarded by the court, or (ii) procure for defendant the right to possess, use, or resell infringing parts, or (iii) replace infringing parts with equivalent, non-infringing parts, or (iv) modify infringing parts or processes so the infringing parts or processes become non-infringing, but equivalent. Any replacement or modification of infringing parts or processes in (iii) or (iv) above shall fulfill its original purpose. Vendor's fulfillment of its obligations under this Section 10.03 shall be Customer's sole and exclusive remedy for any actual or alleged infringement.

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MUTUAL INDEMNITY WITH NOTICE AND DEFENSE PROVISIONS, INDEMNIFICATION PAYMENT ADJUSTMENTS PROVISION AND LIMITATION ON LIABILITY—GENERALLY TOO BROAD FROM SELLER'S PERSPECTIVE

INDEMNIFICATION; LIMITATION OF LIABILITY

1.1 Indemnification.

(a) BUYER shall indemnify, defend and hold Seller (and its directors, officers, employees and Affiliates) harmless from and against any and all Damages in connection with suits, claims, investigations or demands of Third Parties (collectively, "Third Party Claims") incurred or suffered by Seller (and its directors, officers, employees and Affiliates) as a consequence of:

(i) any material breach of any representation or warranty made by BUYER in this Agreement or any agreement, instrument or document delivered by BUYER pursuant to the terms of this Agreement; or

(ii) any failure to perform duly and reasonably any covenant, agreement or undertaking on the part of BUYER contained in this Agreement; or

(iii) any actual or alleged infringement, misappropriate or violation of any Third Party's intellectual property resulting from Seller's performance of its obligations under this Agreement or BUYER's performance of the Activities, to the extent the same is attributable to the BUYER Intellectual Property;

except, in each case, to the extent such Damages are cause by Seller's breach of this Agreement or the willful misconduct or gross negligence of Seller or its Affiliates.

(b) Seller shall indemnify, defend and hold BUYER (and its directors, officers, employees and Affiliates) harmless from and against any and all Damages in connection with Third Party Claims incurred or suffered by BUYER (and its directors, officers, employees and Affiliates) as a consequence of:

(i) any material breach of any representation or warranty made by Seller in this Agreement; or

(ii) any failure to perform duly and reasonably any covenant, agreement or undertaking on the part of Seller contained in this Agreement; or

(iii) any actual or alleged infringement, misappropriate or violation of any Third Party's intellectual property resulting from Seller's

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performance of its obligations under this Agreement or BUYER's performance of the Activities, to the extent the same is attributable to the Seller Intellectual Property;

except, in each case, to the extent such Damages are cause by BUYER's breach of this Agreement or the willful misconduct or gross negligence of BUYER or its Affiliates.

"Damages" shall mean any and all actions, costs, losses, claims, liabilities, fines, penalties, demands, damages and expenses, court costs, and reasonable fees and disbursements of counsel incurred by a Party hereto (including interest which may be imposed in connection therewith).

1.2 Notice and Opportunity To Defend. Promptly after receipt by a Party hereto of notice of any Third Party Claim which could give rise to a right to indemnification pursuant to Section 9.1 such Party (the "Indemnified Party") shall give the other Party (the "Indemnifying Party") written notice describing the claim in reasonable detail. The failure of an Indemnified Party to give notice in the manner provided herein shall not relieve the Indemnifying Party of its obligations under this Section, except to the extent that such failure to give notice materially prejudices the Indemnifying Party's ability to defend such claim. The Indemnifying Party shall have the right, at its option, to compromise or defend, at its own expense and by its own counsel, any such matter involving the asserted liability of the Party seeking such indemnification. If the Indemnifying Party shall undertake to compromise or defend any such asserted liability, it shall promptly (and in any event not more than ten (10) days after receipt of the Indemnified Party's original notice) notify the Indemnified Party in writing of its intention to do so, and the Indemnified Party agrees to cooperate fully with the Indemnifying Party and its counsel in the compromise or defense against any such asserted liability. All reasonable costs and expenses incurred in connection with such cooperation shall be borne by the Indemnifying Party. If the Indemnifying Party elects not to compromise or defend the asserted liability, fails to notify the Indemnified Party of its election to compromise or defend as herein provided, or, if in the reasonable opinion of the Indemnified Party, the claim could result in the Indemnified Party becoming subject to injunctive relief or relief other than the payment of money damages that could materially adversely affect the ongoing business of the Indemnified Party in any manner, the Indemnified Party shall have the right, at its option, to pay, compromise or defend such asserted liability by its own counsel and its reasonable costs and expenses shall be included as part of the indemnification obligation of the Indemnifying Party hereunder. Notwithstanding the foregoing, neither the Indemnifying Party nor the Indemnified Party may settle or compromise any claim without the prior written consent of the other Party (not to be unreasonably withheld, delayed or conditioned), unless such settlement or compromise provides solely for a monetary payment for which the Indemnified Party is fully indemnified. In any event, the Indemnified Party and the

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Indemnifying Party may participate, at their own expense, in the defense of such asserted liability. If the Indemnifying Party chooses to defend any claim, the Indemnified Party shall make available to the Indemnifying Party any books, records or other documents within its control that are necessary or appropriate for such defense. Notwithstanding anything to the contrary in this Section 9.2, (i) the Party conducting the defense of a claim shall (A) keep the other Party informed on a reasonable and timely basis as to the status of the defense of such claim (but only to the extent such other Party is not participating jointly in the defense of such claim), and (B) conduct the defense of such claim in a prudent manner, and (ii) the Indemnifying Party shall not cease to defend, settle or otherwise dispose of any claim without the prior written consent of the Indemnified Party (which consent shall not be unreasonably withheld).

1.3 Indemnification Payment Adjustments. If any Indemnified Party shall have received any payment pursuant to this Section 9 with respect to any Damages and shall subsequently have received insurance proceeds or other amounts with respect to such Damages, then such Indemnified Party shall pay to the Indemnifying Party an amount equal to the difference (if any) between (i) the sum of the amount of those insurance proceeds or other amounts received and the amount of the payment by such Indemnifying Party pursuant to this Section 9 with respect to such Damages and (ii) the amount necessary to fully and completely indemnify and hold harmless such Indemnified Party from and against such Damages; provided, however, in no event will such Indemnified Party have any obligation pursuant to this sentence to pay to such Indemnifying Party an amount greater than the amount of the payment by such Indemnifying Party pursuant to this Section 9 with respect to such Damages.

1.4 Indemnification Payment. Upon the final determination of liability and the amount of the indemnification payment under this Section 9, the appropriate Party shall pay to the other, as the case may be, within ten (10) Business Days after such determination, the amount of any claim for indemnification made hereunder.

1.5 LIMITATION ON DAMAGES. IN NO EVENT SHALL BUYER OR Seller BE LIABLE FOR SPECIAL, INDIRECT, INCIDENTAL, PUNITIVE OR CONSEQUENTIAL DAMAGES, OR ANY DAMAGES CONSTITUTING LOST PROFITS, SUFFERED BY EITHER Seller OR BUYER UNDER THIS AGREEMENT, EXCEPT IN CIRCUMSTANCES OF (a) FRAUD, (b) BREACH OF SECTION 7 OR (c) TO THE EXTENT OF ANY SUCH DAMAGES PAID TO A THIRD PARTY AS PART OF A CLAIM SUBJECT TO INDEMNIFICATION HEREUNDER.

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BIBLIOGRAPHY
OF
USEFUL INTERNET RESOURCES

From the ACC website:

- *"Contractual and Insurance Related Risk Shifting Tools"* (4/3/12 ACC Presentation)
- *"Bulletproofing Your Deals 2010: Lessons from the Litigation Battlefield on Commercial Contract Clauses"* (6/10/10 Presentation at Conn. ACCA Seminar): Relevant slides are those numbered 1-18 and 37-47; Relevant pages from the Supplemental Materials are those numbered 1 (PDF p. 77) and 13-14 (PDF p. 89-90)
- *"Maximizing Insurance and Indemnification in Order to Protect Corporate and Personal Assets"* (6/10/10 ACC Webcast)
- *"Indemnification Clauses"* (8/10/11 Presentation to ACC Mid-America Chapter)
- *"Legal Risk Management: Minimizing the Risk of Litigation: Checklist"* (Updated as of January 2012 from the Practical Law Company)
- *"A Framework for Negotiating Limitation of Liability Clauses and Indemnity Obligations in Business Agreements"* (posted to ACC website in December 2007)

Other Internet Resources:

- *Indemnify* (by Bryan Garner): http://www.greenbag.org/v15n1/v15n1_articles_garner.pdf (recommend starting at the bottom of page 21).
- *Revisiting "Indemnify and Hold Harmless"* (Ken Adams' blog): http://www.adamsdrafting.com/2009/05/10/revisiting-indemnify-and-hold-harmless/
- *Agreements to Indemnify and General Liability Insurance: A Fifty State Survey* (by Weinberg Wheeler Hudgins Gunn & Dial): http://www.wwhgd.com/assets/attachments/50%20State%20Survey%2000810220.PDF
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- International Risk Management Institute, Inc. (IRMI) http://www.irmi.com/ Search site for articles about indemnification and other subjects.

- *Legacy Liability Management: The Role of Common Law Indemnification* http://www.butlerrubin.com/web/br.nsf/0/7068CE6904C33CE58525707F006C0212/$FILE/Feb+2003.pdf

- *Indemnification Agreements in Complex Business Transactions*, McGuire Woods http://www.acc.com/chapters/charlotte/upload/May-25-2011-Indemnification-Agreements.pdf

- *IP Issues in Contracts: Getting Beyond the Boilerplate*, Presentation to 2010 Midwest Intellectual Property Institute, Stacy A. Schultz, Gibson, Dunn & Crutcher LLP, September 23, 2010 http://www.minncle.org/attendeemats/79611/7%20Schultz.pdf

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- *IP Indemnities and Exclusions—Specifications, Modifications and Combinations*, Jeffrey Osterman, Weil, Gotshal & Mnages LLP 2010 http://www.aipla.org/learningcenter/library/papers/am/2010/Documents/Osterman_Paper.pdf

- *Intellectual Property Defense and Indemnification Provisions*, Rudnick and Grodin, iP Frontline, IP & Technology Magazine, July 13, 2010 http://www.ipfrontline.com/depts/article.aspx?id=24354&deptid=4

- Practical Law Company resources on indemnification (if you have a subscription)

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