

Drafting Indemnification and Hold Harmless Provisions in Commercial Contracts

Negotiating Scope and Exclusions, Allocating Costs, Overcoming Enforcement Hurdles, Interplay With Insurance

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Drafting Effective Warranties

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Overview

- Some Foundation: The Big Four
- Representations and Warranties
 - Initial considerations
 - Types of warranties
 - Real-world examples
- Questions/Discussion

Some Foundation (cont.)

- Trial v. Warranties v. Acceptance Testing v. Support Obligations
 - Overview of relationships
 - Understand how these concepts work together
 - Understand how they are different
 - **None is a substitute for any other**

Drafting Warranties

Initial Considerations

- What is the product and what does it do?
- Critical product?
- Magnitude of fees?
- Time to implement/productive use?
- Sensitive data at risk?
- Regulated industry?
- One size fits-all client form agreements

Warranties

- Avoid stock warranties of performance in accordance with the “published documentation”
 - “Published documentation” is a moving target over which the vendor has complete, unilateral control.
 - Control documentation/functionality creep.

Warranties (cont.)

- What does the warranty *really* cover?
 - Frequently overlooked issue
 - Make sure the warranties cover all of the following:
 - Licensed Software
 - Enhancements, releases, and new versions
 - Documentation
 - Hardware
 - Support and other professional services

Warranties (cont.)

- What is the warranty period? What triggers the start? How long does it run?
 - Thirty days from initial delivery
 - How long to implement?
 - Greater of one year from Acceptance or the period in which support is purchased
 - Cloud engagements
 - Getting around the revenue recognition argument – bolster support.

Warranties (cont.)

- Exclusive remedies should be avoided
 - Does the remedy even make sense (e.g., anti-virus, failure to comply with law)?
 - Time period for fix
 - Tolling of other remedies, but no waiver

Warranties (cont.)

Vendor Example: In the event of a breach of the foregoing warranties, Customer's sole and exclusive remedy and Vendor's sole and exclusive liability shall be for Vendor to use reasonable efforts to repair or replace the defective software.

Warranties (cont.)

Response: *In the event of a breach of [reference warranty of non-conformance only], Customer shall afford Vendor (thirty days) to remedy the breach before pursuing any other remedies hereunder.*

Warranties (cont.)

- Types of warranties
 - Performance (Specifications, Service Levels)
 - Intellectual Property Infringement
 - Why is this important if you have an indemnity?
 - What is reasonable?
 - Services (professional and support)
 - General standard: professional, workmanlike, timely
 - Industry standard
 - Contractual standard: Statements of work and other specifications

Warranties (cont.)

- Types of warranties
 - Legal compliance
 - Means to educate vendors
 - Privacy Laws and Regulations
 - Viruses and Disabling and Phone-Home Mechanisms
 - Understand these are three different protections.

Warranties (cont.)

- Types of warranties
 - Offshoring of data
 - Why do we care?
 - Intellectual property
 - Personal data
 - Pass through of third party warranties
 - Seldom applies

Warranties (cont.)

- Types of warranties
 - Open source/Third party software
 - Understanding open source
 - Know when it is relevant – Distribution?
 - Open source v. proprietary licenses
 - Beware proprietary licenses
 - Beware future product updates with new licenses

Warranties (cont.)

- Types of warranties
 - Known performance issues
 - Anticipate vendor pushback
 - Authority
 - Changes in functionality
 - Example of the Norther California Healthcare Provider
 - Documentation
 - Secure software development

Warranties (cont.)

- Types of warranties
 - Secure software development
 - Orphan code
 - Application development: Development environment represents best practices for assessing and testing security (e.g., Certified Secure Software Lifecycle Professional (CSSLP) or GIAC Secure Software Programmer certification)
 - Vulnerability testing: Check against most common security vulnerabilities (e.g., OWASP Top 10 Vulnerabilities; CWE/SANS Top 25 vulnerabilities)

Warranties (cont.)

Performance Warranty

Vendor Example: *For a period of thirty days from the Effective Date, the Software will materially conform to its then current Documentation.*

Warranties (cont.)

Performance Warranty

Response: *For the greater of six months or the period during which Customer purchases Support Services, the Software will materially conform to the requirements of this Agreement, including any statements of work, and, **to the extent not inconsistent with the foregoing**, the Documentation.*

Warranties (cont.)

Infringement Warranty

Vendor Example: None.

Response #1: *The Software will not infringe the intellectual property rights of any third party.*

Warranties (cont.)

Infringement Warranty

Response #2: To the best of Vendor's knowledge as of the Effective Date, Customer's licensed use of the Software will not infringe the intellectual property rights of any third party.

Warranties (cont.)

Service Warranty

Vendor Example: *The Services will be performed in material accordance with this Agreement.*

Response #1: *The Services will be performed in material accordance with this Agreement and in a timely, workmanlike manner.*

Warranties (cont.)

Service Warranty

Response #2: *The Services will be performed in (i) material accordance with this Agreement, (ii) a timely, workmanlike manner, and (iii) in accordance with industry best practices for services of this kind.*

Warranties (cont.)

Legal Compliance Warranty

Vendor Example: *Vendor will comply with all laws and regulations applicable to its business in the performance of the Agreement.*

Warranties (cont.)

Legal Compliance Warranty

Response: *Vendor will comply and will ensure its Software and Services comply with all applicable laws and regulations. Vendor shall, at no additional charge, promptly furnish all updates to the Software necessary for compliance with any change in laws or regulation during the term of this Agreement.*

Warranties (cont.)

Legal Compliance Warranty

Example general warranty: *Vendor further represents and warrants it shall, in connection with its performance hereunder, comply with all applicable laws, ordinances, rules, regulations, building codes, electrical codes, business licenses, visas, work permits, court orders, and governmental or regulatory agency orders (collectively, “Laws”), including, without limitation, laws relating to non-discrimination, human rights, child labor, and other employment and labor laws and applicable foreign export laws, and laws pertaining to health, safety, the environment, and hazardous materials.*

Warranties (cont.)

Privacy Laws and Regulations

Vendor represents and warrants that at all times during and after the term of the Agreement it will comply, at its sole expense, with all applicable local, state, federal, and international privacy, confidentiality, consumer protection, advertising, electronic mail, data security, data destruction, and other similar laws, rules, and regulations, whether in effect now or in the future, including, but not limited to the Gramm-Leach Bliley Act and its implementing regulations (all of the foregoing will be collectively referred to as the “Privacy and Security Requirements”). Vendor acknowledges that it alone is responsible for identifying, understanding, and complying with its obligations under the Privacy and Security Requirements as they apply to its performance of this Agreement and possession of the Personal Information.

Warranties (cont.)

Anti-Virus Warranty

Basic Version: *Vendor shall use industry practices to scan and remove from the Software all viruses, Trojan horses, worms, key loggers, and other similar code.*

Alternate: *Vendor has taken every commercially reasonable precaution to ensure and to the best of Vendor's knowledge, the Software does not contain any virus or similar code that may destroy, modify, alter, or cause the destruction, modification or alteration, in whole or in part, of any of Customers, data, equipment, devices, networks, or software.*

Warranties (cont.)

Anti-Virus/Disabling Mech. Warranty

Extended Version: *Vendor shall not insert into any Software any Destructive Mechanisms, as defined below, and shall use industry best practices to scan and remove any such mechanisms created by third parties from the Software. Vendor shall not invoke such mechanisms at any time, including upon expiration or termination of this Agreement for any reason.*

Warranties (cont.)

Anti-Virus/Disabling Mech. Warranty

“**Destructive Mechanisms**” means computer code that: (i) is designed to disrupt, disable, harm, or otherwise impede in any manner, including aesthetic disruptions or distortions, the operation of the Software or any other software, firmware, hardware, computer system or network (sometimes referred to as “viruses” or “worms”); (ii) would disable or impair the Software or any other software, firmware, hardware, computer systems or networks in any way where such disablement or impairment is caused by the passage of time, exceeding an authorized number of copies, advancement to a particular date or other numeral (sometimes referred to as “time bombs,” “time locks” or “drop dead” devices); (cont’d)

Warranties (cont.)

Anti-Virus Warranty

(iii) would permit Vendor to access the Software or any other software, firmware, hardware, computer systems or networks to cause such disablement or impairment (sometimes referred to as “traps,” “access codes” or “trap door” devices); or (iv) which contains any other similar harmful, malicious or hidden procedures, routines or mechanisms which would cause such programs to cease functioning or to damage or corrupt data, storage media, programs, equipment or communications or otherwise interfere with operations.

Warranties (cont.)

Phone Home Functionality

Example: The Software will not contain any “phone-home,” metering, or other feature designed to periodically transmit usage, statistical or other data to Licensor. Licensee may prevent access to the internet with regard to any such features or functionality and doing so will not adversely impact operation of the Software.

Warranties (cont.)

Offshoring of Data

Example: All Services shall be performed and rendered within the continental United States; and Vendor shall not transmit or make available any Customer Confidential Information, including Personal Data, to any entity or individual outside the continental United States.

Warranties (cont.)

Open Source and Third Party Software

Example: *Vendor represents and warrants that it shall not deliver to Customer any third party software, including open source software, **that would require Customer to accept and be bound by any third party terms and conditions**, except to the extent such terms and conditions are expressly identified in and attached to Exhibit A. Except as provided in Exhibit A, Customer hereby rejects all such third party terms and conditions.*

Warranties (cont.)

Pass-Through Warranties

Example: *Vendor shall assign and pass-through to Customer all representations, warranties, and indemnities provided to Vendor in its contracts with third party licensors and suppliers relating to the Software.*

Warranties (cont.)

Known Performance Issues

Example: There is no existing pattern or repetition of customer complaints regarding the Software, including functionality or performance issues, and that Vendor's engineers have not currently identified any repeating adverse impact on the Software, including functionality or performance, for which the root cause is believed to be a flaw or defect in the Software.

Warranties (cont.)

Authority

Example: *Vendor has the full power, capacity and authority to enter into and perform this Agreement and to make the grant of rights contained herein, including without limitation, the right to license any ancillary or third party programs licensed to Customer under this Agreement, and Vendor's performance of this Agreement does not violate or conflict with any agreement to which Vendor is a party; Vendor further represents that there is no pending or threatened litigation that would have a material adverse impact on its performance under this Agreement.*

Warranties (cont.)

Changes in Functionality

Example: *Vendor shall not modify or change the Software to reflect a material diminution in the form, features or functionality of the Software from that existing as of the Effective Date, and, accordingly, Vendor shall not change the form, features or functionality of the Software in any material adverse manner from that originally licensed under this Agreement.*

Warranties (cont.)

Documentation

Example: *The Documentation shall be complete and accurate so as to enable a reasonably skilled Customer user to effectively use all of its features and functions without assistance from Vendor and, on each date on which Vendor delivers it to Customer, the Documentation is Vendor's most current version thereof.*

Warranties (cont.)

Disclaimer

Example: THE PRODUCT IS PROVIDED ENTIRELY “AS-IS” AND “AS AVAILABLE,” WITHOUT WARRANTIES OF ANY KIND. WE DISCLAIM ALL WARRANTIES, EXPRESS AND IMPLIED, WITH RESPECT TO THE PRODUCT, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES OF NON-INFRINGEMENT, TITLE, MERCHANTABILITY, QUIET ENJOYMENT, QUALITY OF INFORMATION, AND FITNESS FOR A PARTICULAR PURPOSE.

Warranties (cont.)

Disclaimer - Revised

Example: EXCEPT AS PROVIDED IN SECTION __, THE PRODUCT IS PROVIDED ENTIRELY “AS-IS” AND “AS AVAILABLE,” WITHOUT WARRANTIES OF ANY KIND. WE DISCLAIM ALL OTHER WARRANTIES, EXPRESS AND IMPLIED, WITH RESPECT TO THE PRODUCT, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES OF NON-INFRINGEMENT, TITLE, MERCHANTABILITY, QUIET ENJOYMENT, QUALITY OF INFORMATION, AND FITNESS FOR A PARTICULAR PURPOSE.

Warranties (cont.)

- Be mindful of broad disclaimers that could override specific warranties (“as-is”; no liability for errors; not interrupted or error-free)
- Search for any other qualifications or limitations on warranty obligations.

Warranties (cont.)

- Beware of extensive customer warranties
- Use as leverage for greater vendor warranties
- Disclaim all other warranties of the customer
 - Where appropriate, disclaim representations, warranties, and **guarantees as to vendor revenue** (e.g., in processing or other transaction agreements)

Questions?

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Drafting Indemnification and Hold Harmless Provisions in Commercial Contracts

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Definition of Indemnification

Generally, indemnification (or indemnity) is an undertaking by one party to compensate another party for certain costs and expenses. Indemnity is imposed either by law or contract.

Definition of Indemnification

- Nearly every commercial contract has an indemnity provision. Parties include these provisions for a variety of reasons. For example, the parties to an equipment lease might include an indemnification provision to:
 - Allocate risk between the parties in the event a defect in the equipment causes injury to a third-party or lessee.
 - Address the possibility that the use of the equipment may infringe on a third-party's intellectual property rights.
 - Account for the failure of a lessor to timely deliver the equipment.
 - Provide for the possibility the equipment does not adhere to certain specifications.

Definition of Indemnification

- Allow an aggrieved party to pursue certain rights, like the right to attorneys' fees, which may otherwise not be available in a common law cause of action.
- Provide predictability and certainty of recourse.
- Show a court the parties' intent regarding risk allocation.

Definition of Indemnification

- If the contract does not contain a properly drafted indemnification provision the non-breaching party may:
 - have to rely on uncertain common law causes of action; and
 - not be able to obtain certain types of reimbursement, for example, attorneys' fees.
 - If the contract does not contain a properly drafted indemnification provision the breaching party may not adequately:
 - cap its liability;
 - reduce its liability by incorporating materiality qualifiers; or
 - reduce its liability by incorporating liability caps or deductibles like thresholds or baskets.

Definition of Indemnification

Indemnification clauses vary widely, but in a typical indemnification provision, the indemnifying party promises to reimburse the indemnified party from and against "losses, liabilities, claims, and causes of action" (**recoverable damages**) incurred by the indemnified party that "are caused by," "arise from," or are "related to" (**nexus phrase**) the specified events giving rise to the indemnity obligation (**covered events**).

Negotiating Indemnity Clauses

- In many cases, parties negotiating an indemnity clause also negotiate a defense clause. In a defense clause, the indemnifying party **promises to defend the indemnified party against third-party claims**, for example, litigation or arbitration, caused by or arising from:
 - The indemnifying party's breach of contract.
 - The indemnifying party's acts or omissions, even if the acts or omissions are not breaches.

Obligation to Indemnify Distinguished from Obligation to Defend

- The obligation to indemnify for damages and the obligation to defend against third-party suits generally are separate and distinct.
- Under an indemnity provision, the indemnifying party agrees to compensate the indemnified party for direct claims (by the indemnified party against the indemnifying party), third-party claims, or both.

Indemnity Requirements

Indemnity Requirements

- An indemnified party will almost always want the indemnification provision to expressly include the duty to defend because they otherwise risk having the indemnifying party assert that its obligation is limited to actual damages or judgments resulting from the claims made.
- The obligation to defend is generally held to exist only:
 - In the context of third-party claims.
 - If the defense provision covers allegations in the complaint and there is no applicable exclusion.

Indemnification Versus Hold Harmless Provisions

- Most indemnification provisions require the indemnifying party to "indemnify and hold harmless" the indemnified party for specified liabilities or losses. In practice, these terms are typically paired and interpreted as a unit to mean "indemnity." However, some commentators draw a distinction between the two. For example, they may construe "hold harmless" to protect another against the risk of loss as well as actual loss and define "indemnify" to mean "reimburse for any damage," a narrower meaning than that of "hold harmless."

Indemnification Versus Hold Harmless Provisions

- Therefore, a hold harmless clause can be a distinct commitment that requires that, in addition to reimbursing the indemnified party's costs, the indemnifying party will not hold the indemnified party liable for the underlying claim, even if it arises from the indemnified party's own negligence or fault. This view is only followed in a minority of states, including Florida, where courts have held:
 - Indemnify language covers third-party liabilities.
 - Hold harmless language covers releasing an indemnified party from any direct liability.

Indemnification Versus Hold Harmless Provisions

- Unlike the indemnity obligation, the hold harmless obligation may require the indemnifying party to advance payment for covered unpaid costs and expenses even when the defined recoverable damages are limited to losses and do not include liabilities, claims, and causes of action.

Indemnification Versus Hold Harmless Provisions

- In Florida, "hold harmless" may also release the indemnified party from any related claim or cause of action by the indemnifying party (see *Kitchens of the Oceans, Inc.*, 832 So. 2d at 272-73 and *Vermut v. Gen. Motors Corp., Inc., Cadillac Div.*, 773 So. 2d 126, 127 (Fla. 4th DCA 2000)).

Indemnification Versus Hold Harmless Provisions

- To avoid "hold harmless" being given the meaning specified above and beyond indemnification or otherwise causing confusion, the indemnifying party should:
 - Exclude "hold harmless" from the indemnification provision. However, if the contract includes the obligation to "defend," the indemnifying party will likely in any event have to compensate the indemnified party for paid and unpaid costs and expenses.
 - Clarify that payments will be made only for actual losses and in the form of reimbursement.

Statutory and Common Law Barriers to Enforcement

- Statutory or common law restrictions may limit the enforceability of an indemnity. Some regulated industries may have statutory limits on indemnification that limit the effectiveness or enforceability of contractual language. For example:
 - Florida has a statute that sets limits on indemnification in certain construction contracts (§ 725.06, Fla. Stat.). Counsel drafting indemnity provisions for construction related contracts should carefully review § 725.06, Fla. Stat. in its entirety and be aware of public policy prohibitions against indemnifying a party for their own negligence.

Statutory and Common Law Barriers to Enforcement

- An indemnity agreement in a motor carrier transportation contract is void against public policy where it protects the promisee (a defined term) from or against any liability for loss or damage resulting from negligence or intentional acts or omissions of the promisee (§ 316.302(13)(a), Fla. Stat.).

Statutory and Common Law Barriers to Enforcement

- Texas has a Construction Anti-Indemnity Act, which prohibits and makes void certain broad form indemnity agreements for construction projects that require the indemnifying party to indemnify a party for their sole or concurrent negligence. Texas Ins. Code §§151.001 – 151.51.

Identifying the Indemnified Parties

- Either or both parties to the agreement may be indemnified parties, depending on whether the indemnification clause is structured as a unilateral indemnification or a mutual indemnification. Some contracts include officers, directors, managers, members, employees, agents, subcontractors, and affiliates as indemnified parties.

Identifying the Indemnified Parties

- If parties include certain covered entities, such as affiliates, they may need to add temporal modifiers to expressly indicate if they intend the term to include both existing and future affiliates. In the absence of defining or modifying the term, Florida courts look to the language of the contract as a whole to determine who is an affiliate (see *Sanderson v. SPX Cooling Technologies, Inc.*, 2009 WL 426006, at *2 (M.D. Fla. 2009); see also *Cellco P'ship v. Kimbler*, 68 So. 3d 914, 917 (Fla. 2d DCA 2011) (use of the term "affiliates" in a contract includes only those affiliates in existence when the contract was executed, absent clear and unambiguous language indicating that the parties intended to extend the contract's application or the underlying obligations to future affiliates)).

Identifying the Indemnified Parties

- Parties can manage risk expectations and avoid interpretation, enforceability, and other disputes if the covered events and related damages under the indemnity are appropriate in nature and scope. To do this, a party should:
 - Carefully consider its needs and negotiating position within the given context.
 - Assess transaction-related risk in terms of events and consequences, and the likelihood that those events or consequences will occur.

Identifying the Indemnified Parties

- In defining the scope of the indemnity, the parties should consider how broadly or narrowly they will:
 - Define the recoverable damages
 - Define the nexus phrase.
 - Defined the covered events of the indemnity.
 - Limit the scope of the indemnity.

Defining the Recoverable Damages

- Although seemingly redundant, each word in the phrase "losses, liabilities, claims, and causes of action" has an individual meaning and serves a specific purpose. The terms are listed below in order of increasing breadth:
 - **Losses.** This includes any covered judgments, settlements, fees, costs, and expenses. The indemnifying party becomes responsible for a loss only after the indemnified party pays

Defining the Recoverable Damages

- **Liabilities.** This includes debts and other legal obligations. The amount of recovery includes the cost of defense (see *On Target, Inc. v. Allstate Floridian Ins. Co.*, 23 So. 3d 180, 185 (Fla. 2d DCA 2009)). The indemnifying party becomes responsible for a liability when the liability is legally imposed, but before the money is paid.

Defining the Recoverable Damages

- **Claims.** This includes damages resulting from a third-party lawsuit. The indemnifying party becomes responsible for a claim at the moment when a party, including any third party, files a lawsuit. In Florida:
 - courts have interpreted the word "suit" to mean a civil proceeding; and
 - the word "claim" may not necessarily have the same meaning as "suit" for the purposes of triggering an obligation to defend or indemnify. See *Altman Contractors, Inc. v. Crum & Forster Specialty Ins. Co.*, 832 F.3d 1318, 1323 (11th Cir. 2016).

Defining the Recoverable Damages

- Therefore, counsel should draft any indemnity agreement in such a way that it:
 - defines the specific events triggering the obligation to indemnify; and
 - broadly encompass third party claims. Under Florida law, where the main purpose of a contract is not for indemnification, indemnification provisions are strictly construed in favor of the indemnifying party. *See Barton Malow Co.*, 835 So. 2d at 1166-67 and *U.S.B. Acquisition Co., Inc. v. Stamm*, 660 So. 2d 1075, 1079 (Fla. 4th DCA 1995).

Defining the Recoverable Damages

- **Causes of action.** This includes damages resulting from a right to seek relief. The indemnifying party becomes responsible for a cause of action when the indemnified party's or a third party's right to seek relief, as the case may be, accrues.

Defining the Recoverable Damages

- The foregoing list of standard covered items is not exhaustive. Additionally, "losses, liabilities, claims, or causes of action" can be narrowly tailored, for example, to cover one or more of the following:
 - Personal injury and death.
 - Real and personal property damage. Parties may specify "tangible property damage" if they want to distinguish the term from indemnification for claims relating to intangible property (such as claims for intellectual property infringement).

- .

Defining the Recoverable Damages

- Infringement of intellectual property. However, intellectual property claims are often covered in a separate provision because intellectual property indemnification generally has different:
 - remedies: and
 - limitations of liability.
 - Breach of confidentiality.
 - Violation of law.

Direct Versus Third-Party Claims

- The obligation to compensate an indemnified party may apply to:
 - **Direct claims.** These are claims that the indemnified party has against the indemnifying party. In Florida, no presumption exists that indemnification provisions apply to both direct and third-party claims. To cover direct claims, the provision's language must clearly state that intent (*see S. Broad. Group, LLC v. Gem Broad. Inc.*, 145 F. Supp. 2d 1316, 1326 (M.D. Fla. 2001) and *MVW Mgmt., LLC*, 230 So. 3d at 112-13). Parties may be subject to increased risk of liability or dispute if they overlook or fail to address direct claims. An indemnification provision for direct claims typically covers damages relating to the indemnifying party's acts, omissions, or breach of the agreement.

Direct Versus Third-Party Claims

- The obligation to compensate an indemnified party may apply to:
 - **Third-party claims.** These are claims that a third party has against the indemnified party, which parties most commonly use indemnification to cover.

Direct Versus Third-Party Claims

- In many commercial transactions, parties limit indemnification to cover only third-party claims and address liability for direct damages elsewhere in the agreement, such as in the limitation of liability clause. If the indemnification clause covers direct claims and breach of the agreement, the parties should consider whether the indemnification obligation should be covered by the limitation of liability.

Attorneys' Fees

- The general rule under Florida law is that an indemnified party is entitled to recover reasonable attorneys' fees and legal costs incurred as a result of legal actions relating to indemnified matters (*Brown v. Fin. Indem. Co.*, 366 So. 2d 1273, 1274 (Fla. 4th DCA 1979); see also *Shannon v. Kaiser Aluminum & Chem. Corp.*, 749 F.2d 689, 690 (11th Cir. 1985)). However, attorneys' fees incurred in establishing the right to indemnification are not recoverable unless there is a clear and unambiguous contractual provision or a statutory right providing for such fees and costs (see *Fallstaff*, 143 So. 3d at 1143).

Attorneys' Fees

- To avoid potential interpretation issues, the indemnity provisions should reflect the intent of the parties and specifically address whether attorneys' fees are:
 - Excluded from or included in the indemnity obligation.
 - Limited to reasonable or out-of-pocket expenses, if relevant.

Choosing the Right Nexus Phrase

- The term nexus phrase is used to describe the series of words that link the list of recoverable damages (for example, losses or liabilities) to the covered events (for example, breach of the agreement or the indemnifying party's negligence). Nexus phrases dictate the degree to which the event giving rise to the indemnity and the indemnified party's damages need to be related for the event to qualify for recovery. The nexus phrase therefore helps shape the scope of indemnity and directly impacts the amount of recoverable damages.

Choosing the Right Nexus Phrase

- Usually, the indemnified party wants the indemnity to include a broad nexus phrase, for example, "related to." A broad nexus phrase helps to expand the indemnity's scope of coverage.

Choosing the Right Nexus Phrase

- Usually, the indemnifying party wants the indemnity to include a narrow nexus phrase. A narrow nexus phrase excludes damages unrelated to the indemnifying party's own acts or omissions. To narrow indemnity coverage, parties can use:
 - "Caused by."
 - "Resulting from."
 - "Solely resulting from."
 - "To the extent they arise out of."
 - "By reason of, or in connection with."

Choosing the Right Nexus Phrase

- While these examples are more narrow than "related to" language, courts may construe some of these more broadly than others. For example, the Eleventh Circuit subscribes to the general rule that indemnity agreements containing the phrase "**arising out of, or in any way contributed to**" should be read broadly (*See Natco Ltd. P'ship*, 267 F.3d at 1194).

Defining the Covered Events of the Indemnity

- Covered events generally arise from or relate to:
 - The indemnifying party's breach of the agreement.
 - The Indemnifying party's acts or omissions, even if the acts or omissions are not breaches.
- Covered events include two broad categories:
 - Direct claims.
 - Third-party claims.

Indemnities for Breach of the Agreement

- An indemnity for breach of some or all of the agreement may appear unnecessary because a breaching party can almost always be sued for the direct loss under contract theory. However, parties commonly include an indemnity for breach as a way to:
 - Change (in most cases, extend) the indemnified party's right to recover damages, particularly regarding legal costs and expenses.
 - Recover loss suffered as a result of third-party claims that result from the breach.

Limitations in the underlying contract language

- The scope, depth, and duration of the indemnifying party's representations, warranties, and covenants impact the indemnified party's indemnification rights for breach of the agreement. For example, the seller of a business often makes a series of representations about its business and the enforceability of the agreement to induce the buyer to enter into the transaction. If a statement is:

Limitations in the underlying contract language

- untrue when made, then the seller has breached the agreement, and the buyer may have an indemnification claim on this basis; or
- true when made, but becomes untrue later, then the seller has not breached the agreement, and the buyer does not have an indemnification claim (unless the seller breaches a corresponding covenant).
- To the extent that a representation is qualified, indemnification for breach of that representation will also be correspondingly limited.

Occurrence-Based Indemnities

- Indemnity clauses frequently cover liabilities based on specific occurrences. A broad occurrence-based indemnity obligation may, for example, cover **all negligent acts or omissions of the indemnifying party**. In some instances, parties may agree to forgo a non-infringement representation and warranty, but protect the indemnified party with an indemnity obligation covering third-party intellectual property infringement claims. In this case, the third-party claim does not arise from a breach, but is indemnified regardless.

Occurrence-Based Indemnities

- Occurrence-based indemnities can be narrowed, including by:
 - Limiting coverage to specific claims or liabilities. The claims may be known or unknown, contingent or non-contingent, or cover a specific subject matter, such as:
 - environmental harms;
 - claims arising in a specific jurisdiction; or
 - losses associated with specific pending litigation.
 - Limiting the scope of activities and qualifying the standard of care, for example, by replacing "negligent acts or omissions" with "negligent work" or limiting the indemnification obligation to apply only when the indemnifying party is solely negligent.

Limitation of Liability Approaches

- Parties should customize indemnity coverage to be reasonably consistent with the transaction-related risk and the parties' negotiating posture.

Limitation of Liability Approaches

- Parties can control the impact of the indemnity by:
 - Carefully tailoring the language, by negotiating, for example:
 - exceptions to the indemnifying party's obligation to indemnify;
 - the degree to which either party has the right or the obligation to control the defense of an indemnified claim.
 - the degree to which the indemnified party has the obligation to notify the indemnifying party of third-party claims;
 - indemnification deductibles;
 - an indemnification cap; and
 - materiality and other indemnification qualifiers.

Exceptions to Indemnification

- Indemnity coverage commonly excludes circumstances where the indemnified party's own actions cause or contribute to, in whole or in part, the harm triggering indemnification. For example, an indemnification provision may exclude the indemnified party's:
 - Negligent or grossly negligent acts or omissions or willful misconduct.
 - Use or alteration of the products that does not conform with the specifications.
 - Bad faith failure to comply with the agreement.

Waiver of Incidental and Consequential Damages

- This waiver, which often disclaims a host of non-direct damages including indirect, consequential, incidental, punitive, and special, limits the indemnifying party's liability to certain actual and direct damages and reduces the amount the party may otherwise be liable to pay.

Waiver of Incidental and Consequential Damages

- When drafting and negotiating an indemnification provision, parties should understand whether and how this type of waiver impacts the indemnification provision. For example, if the indemnity for third-party claims is not excluded from the waiver, the indemnifying party is not required to pay for indirect and consequential damages stemming from third-party claims even though these damages are caused by its own bad acts (See *Bartram, LLC v. C.B. Contractors, LLC*, 2011 WL 1299856, at *2 (N.D. Fla. Mar. 31, 2011)).

Waiver of Incidental and Consequential Damages

- If parties intended for the indemnity to cover all liabilities (including indirect and consequential damages) arising from third-party claims, then the parties should exclude indemnification for third-party claims from the waiver.

Control of Defense Provisions

- With an obligation to defend, the indemnifying party has the right to control the defense, unless the agreement states otherwise. As the paying party, the indemnifying party wants to control the defense to better regulate its expenses and liabilities. However, the indemnified party, as defendant, may want to control the defense to protect its own legal status, reputation, and liability.

Control of Defense Provisions

- To gain more protection and control over its liabilities in connection with any defense, an indemnified party can request contractual rights, such as the right to:
 - Assume the defense, either outright or based on certain contingencies (for example, conflict of interest or inaction of the indemnifying party).
 - Consent to settling the claim or entry of a judgment, either outright or based on certain contingencies (for example, if the judgment will have an adverse impact on the indemnified party's financial interest or reputation).
 - Consent to counsel selection.
 - Participate in the defense (possibly at its own expense).

Control of Defense Provisions

- To avoid any potential disputes regarding which party has the right to conduct the defense when a claim arises that triggers the duty to defend, the parties should include an express provision that clearly confers the right to one party or another.

Notice of Third-Party Claims

- The main point of contention regarding notice typically relates to whether the indemnified party's late or defective notice excuses or limits the indemnifying party's obligation to indemnify. To avoid this potential conflict, the parties should specify whether indemnification:
 - Is conditioned on notice.
 - Covers litigation expenses that were incurred before notice.

Liability Baskets

- Liability baskets are common in corporate transactions like asset and stock purchase transactions, but uncommon in commercial transactions like the sale of goods and services. However, sellers that engage in multiple transactions with individual buyers should consider including this provision, as the cost of indemnifying a relatively small third-party claim could greatly exceed the value of the commercial agreement.

Liability Baskets

- Generally, a basket shields the indemnifying party from having to indemnify an otherwise covered claim unless and until the amount of losses resulting from covered claims exceeds a defined amount. The parties can structure the basket as either:
 - A threshold, so that once the agreed amount is reached, the indemnifying party is liable for the total amount of losses (sometimes referred to as a "tipping," "dollar one," or "first dollar" basket).

Liability Baskets

- A deductible, so that once the agreed amount is reached, the indemnifying party is only liable for the amount of losses in excess of the agreed amount (sometimes referred to as an "excess liability" basket). For example, if an agreement provides for a deductible basket of \$1,000 and the party seeking indemnification claims \$1,500 in damages, then the indemnified party is entitled to receive \$500.

Maximum Liability (Limitation of Liability)

- An indemnifying party with negotiating leverage may insist on a monetary cap on indemnity. As with other types of liability caps, the indemnifying party should ensure that this provision:
 - Caps its potential liability to a fixed amount.
 - Limits the maximum aggregate liability for all potential claims that may arise under the agreement, not just for individual claims.

Maximum Liability (Limitation of Liability)

- The indemnification cap may appear in a general limitation of liability clause covering all contract liabilities (including indemnity) or as part of the indemnification provision. A limitation of liability covering all contract liabilities will affect the indemnity provision, unless indemnification is explicitly excluded from the cap.

Maximum Liability (Limitation of Liability)

- If the agreement includes a cap on the maximum liability for indemnification, the parties should ensure that the agreement does not contain any other provisions that potentially conflict with the stated limit.

Insurance and Escrow

- Like most other contractual obligations, indemnification is only valuable if the indemnifying party stands behind its promise. If an indemnifying party is a significant credit risk, then the indemnified party should consider requiring the indemnifying party to obtain a minimum level of insurance coverage. Parties commonly use insurance contracts to:
 - Supplement, or even substitute for, indemnity obligations.
 - Induce counterparties to enter into the transaction.

Insurance and Escrow

- The insurance policy can usually be tailored to correspond to the transaction at hand. Different kinds of coverage may apply to different aspects of the agreement, such as representation and warranty insurance; but the parties should carefully consider whether the types and amounts of insurance required are adequate to cover all indemnification obligations.

Insurance and Escrow

- Similarly, a party may seek a portion of the purchase price or service fees to be held in escrow to satisfy the other party's indemnification obligations. These funds are often held in escrow for the duration of the indemnity survival period.

Assignment Rights

- Assignment of the agreement could unexpectedly alter the risk allocation in the transaction. For example, a party may assign the contract to a third party that cannot honor the assigning party's indemnity obligations. Parties should therefore consider seeking assignment limitations such as consent requirements.

QUESTIONS?