

## **INDEMNIFICATION PROVISIONS –A/K/A, HANG IN THERE, YOU ARE ALMOST DONE READING!**

We understand completely: by the time one encounters a typical-looking indemnification provision at the end of an agreement—be it a 10-page master services agreement or 55-page asset purchase agreement—there can be the urge to skim it quickly and put it into the “standard boilerplate” column. Our advice—resist that urge, soldier on, and make sure this provision is evaluated with due care. The potential exposure as a result of an overly broad indemnification provision, particularly if it contains a duty to defend as well as an uncapped indemnity obligation, could cripple an unsuspecting company.

The purpose of indemnification provisions is for the indemnifying party (the “Indemnitor”) to hold the party being indemnified (the “Indemnitee”) harmless, and to secure that Indemnitee against losses or damages, usually from claims by third parties, as opposed to the other party to the contract. An Indemnitee seeks to include indemnification provisions in its legal agreements to maximize the protection it can receive from its business partners, and allocate some of the inherent risk in the deal to its business partner.

“Indemnitees” can be found in many kinds of commercial agreements. A buyer wants protection to ensure that the assets it is purchasing are what the buyer believes them to be. A commercial supplier wants to protect against products that were built poorly at a manufacturing plant. A subtenant to a laboratory space wants protection that all hazardous materials have been removed and that the space has been decommissioned properly. A business that pays for custom software development wants protection that the tech firm producing the custom software does not do so by stealing a third party’s source code. In business sale situations, the parties may agree to limit scope to all claims arising after closing or only to specified claims in existence at closing.

From the point of view of the Indemnitee, it usually seeks to *maximize* the scope of the indemnification provision. The Indemnitee often seeks to have an indemnification provision apply as broadly as possible, be triggered early in the process when a potential loss may occur, include a duty to defend, and be uncapped as to the potential indemnity obligation to be paid by the Indemnitor. While that Indemnitee otherwise may have been able to recover for the cost of legal fees for a defense against third party claims, having the right to require the Indemnitor to do so in advance is a far superior alternative.

The Indemnitor typically tries to *minimize* the scope of its potential indemnity obligations. It will try to do this by crafting the indemnification provision as narrowly as possible, limit it to actual, direct damages, avoid having the Indemnitor pay to defend the claims, and specify a cap on the indemnification obligations—preferably no more than the amount of compensation that the Indemnitor could receive as payment/fees from the Indemnitee pursuant to the underlying agreement. The Indemnitor may also wish to require that any indemnification claims be brought within a certain time period so that its potential liability is not perpetual.

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Some key points regarding indemnity provisions to always keep in mind include the following:

First, understand whether you are the party paying for the good or service or whether you are producing the good or service. Most often, if you are paying, you will seek to be an Indemnitee. Do not be lulled into complacency by “reciprocal indemnification provisions.”

Second, understand the magnitude of the deal and assess potential risks accordingly. Obviously, a multi-million dollar manufacturing agreement is on a different scale than a materials transfer agreement involving \$1,000 worth of materials. The assessment should factor in the potential exposure of the Indemnitee to third party claims. Claims for indemnity pertaining to computer ‘hacks’ resulting in loss of data can be especially costly.

Third, draft/edit provisions in a manner that makes the scope of the indemnification provision commensurate with the risks and economic impact to the parties.

Fourth, for both parties, liability insurance supporting the indemnity should be considered for all except the most credit-worthy indemnitors.

Our corporate partners are highly experienced in these matters and would be delighted to assist.

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