Indemnities in IT Contracts

In an indemnity clause, one party promises to protect the other against losses related to some incident, like an accident or a third-party lawsuit. If the incident happens, the "indemnitor" pays the costs, particularly liability to third parties.

Indemnities in IT contracts usually cover third-party claims and nothing else. The clause says that if a third party sues the "indemnified party," the indemnitor will pay any judgment. The indemnitor also generally agrees to pay settlements and to defend the case, hiring and paying lawyers. These promises apply, that is, if the third party's lawsuit involves one of the "indemnified claims" listed in the clause. Providers often indemnify customers against intellectual property (IP) claims involving provider products, for instance, and sometimes against data breach claims related to cloud services.

An indemnity could also cover incidents that don't involve a third-party claim. A technology provider, for instance, could indemnify its customer against the cost of responding to a data breach—notifying consumers, hiring security consultants, etc.—even if no one sues the customer. This book looks at a few examples of these *claim-independent* indemnities, but in most cases it examines indemnities against third-party claims.

Which contracting party should give an indemnity and for what? There is no standard answer, but, in general, indemnities make sense when one party faces a significant risk of getting sued by a third party thanks to its deal with the other contracting party—and that other party stands in a better position to address that risk. For example, IT providers often give intellectual property indemnities because the customer buys a risk of IP litigation—a risk that a third party will sue it for infringement—just by using the provider's technology. The parties consider that risk a feature of the provider's business, not the customer's, so they agree that the provider will bear the burden.

In IT contracts, the provider often serves as the indemnitor, while the customer is the indemnified party. But there's no reason the provider should not *get* an indemnity, particularly where *the customer's* business creates a risk of third-party claims.

Contrary to common belief, an indemnity against third-party claims is not a remedy for breach of contract or for other wrongdoing. Nor is it a punishment. The fact that a third party sues the indemnified party for some claim related to the indemnitor doesn't mean the indemnitor did anything wrong. The lawsuit might be bogus. Or it might result from events the indemnitor couldn't control, like patent infringement, which is notoriously hard to prevent. And even if the indemnitor did cause a third-party claim by doing something "wrong," the indemnity against third-party claims doesn't provide the other party's remedy for that wrongdoing. Those remedies appear elsewhere in the contract or in the underlying law about damages and the like. Rather, the indemnity focuses on defending against third-party claims and paying for them, and it generally requires that the parties *cooperate* in that defense.

I think IT customers and providers negotiate (and fight over) indemnities more than any other clause. I also think indemnities raise more complicated issues than any other typical clause in an IT contract. Thanks to that complexity, few lawyers or other contract drafters really understand their indemnities—and this book has a lot to explain. Chapter 1 explains the basics of indemnity. It provides the concepts used in the other chapters. Chapter 2 addresses the most common indemnities in IT contracts: about intellectual property claims. Chapter 3 addresses data indemnities: indemnities for data breach claims. And Chapter 4 addresses various other indemnities, including for personal injury claims. Finally, Chapter 5 explains a complex problem related to many indemnities, which I call "the cause problem."

1

Indemnity in General

This chapter explains how indemnities work, without getting into specifics about any particular *type* of indemnity. So it refers to "Indemnified Claims," but it doesn't address whether the claims in question relate to IP or data incidents or whatever. We'll address specific indemnified claims in chapters 2, 3, and 4.

In most indemnity clauses, the indemnitor promises to protect the indemnified party against third-party claims. Most indemnities also provide procedures for handling claims.

Generic Indemnity[3]

(a) *Defend & Indemnify*. Indemnitor shall defend and indemnify Indemnified Party and Indemnified Party's Indemnified Associates (as defined below) against any third-party claim, suit, or proceeding arising out of or related to _____ (an "Indemnified Claim"). Indemnified Claims include, without limitation, government enforcement actions. Indemnitor's obligations set forth above in this Subsection __(a) include, without limitation: (i) settlement at Indemnitor's expense and payment of judgments finally awarded by a court of competent jurisdiction, as well as payment of attorneys' fees, court costs, and other reasonable expenses; and (ii) reimbursement of reasonable attorneys' fees incurred before Indemnitor's assumption of the defense (but not attorneys' fees incurred thereafter). (The "Indemnified Associates" are

[3] In this clause box and the others in this book, I've tried to address typical IT providers' and customers' expectations for indemnities. So most of these indemnities use less "aggressive" terms than some you may have seen. Indemnities sometimes throw in scorched earth protection for the indemnified party. For instance, they protect against "all losses, court costs, other costs, expenses, liabilities, and damages directly or indirectly arising out of or related to an Indemnified Claim." That's common, though it's hard to say what the extra verbiage adds to terms like the clause box here—except that it leaves less risk for the indemnified party. Some indemnities go the other way, limiting the indemnitor's obligations by avoiding even the word "indemnify." "Indemnitor shall defend Indemnified Party against any Indemnified Claim and shall pay any judgment finally awarded against Indemnified Party by a court of competent jurisdiction." Again, it's not clear how that example differs from the indemnity terms suggested in this book, but it probably limits indemnitor obligations better. Obviously, you can beef up your indemnities in either direction if you want that sort of protection.