Contract Issues for Small Business Owners – Starting with Indemnification

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In the "Good Ol' Days" it used to be that a handshake was all that was needed to conduct business. Today's environment, however, makes that difficult – if not impossible. Contracts have become more and more complex. Even so-called basic terms and conditions contain provisions that are often counter intuitive and which create liability that you may not have anticipated.

In this multi-part series, we will be highlighting some of the key contract issues for today's business owners, including the following topics:

- ✓ Insurance Provision Pitfalls to Avoid
- ✓ Warranty Language – Does It Fit the Situation at Hand?
- ✓ Choice of Law and Choice of Venue – Why It DOES Matter
- ✓ The Real Implications of an Integration Clause

We begin the series with the indemnification clause.

As a business owner, the indemnification clause is one that you will encounter with increasing frequency. These clauses used to be relatively uncommon in contracts, but they have been forcing their way into contracts more and more often – and are now widely-considered to be a typical or normal provision.

But what exactly is indemnification? And how does it affect business owners?

In its most basic terms, when you agree to indemnify a person or entity, you agree to protect or restore that person or entity against a specified loss that they may suffer. You essentially step into their shoes. This protection or restoration comes through payment by you – perhaps from your applicable insurance policy – and may also include the repair or replacement of damaged goods or property. Most commonly, indemnification entails Party A agreeing to pay Party B for any losses or damages Party B may suffer (including perhaps the legal fees and costs) if Party B is sued for certain identified circumstances – or sometimes, for any reason. In this sense, indemnification can best be thought of as a risk-shifting device, where one party agrees to shift the risk of litigation or other loss to the indemnifying party.

One example is a commercial lease agreement in which the renter is asked to agree to indemnify the landlord if a third-party sues the landlord because of an incident that occurred on the property, such as a trip-and-fall accident by a visitor.

What are some key features of an indemnification clause? Typically, these clauses will contain phrases containing the words "to hold harmless" or "to secure against loss or damage." They are usually a standalone provision within larger contracts or terms and conditions, and are usually labeled conspicuously.

When reviewing indemnification clauses, look for any language imposing an obligation to "defend." This obligation – created with just this single word – expands the indemnification obligation by requiring that you begin paying the other party's legal fees from day one of any claim – most notably, *before* there has been any final determination of liability. In other words, you may end up footing high legal fees and costs for another party that was acting negligently,

even if you have done nothing wrong. This is just one example of the risk-shifting power of indemnification.

When it comes to reviewing indemnification clauses, *scope* – rather than mere *length* – is the most important thing to consider. A very short, yet broadly-worded indemnification clause may place you at a greater risk of loss than a long, narrowly-tailored clause that addresses very specific scenarios.

A specifically tailored indemnification clause, which fairly apportions liability for conduct that may occur in the business context at hand, may not be unreasonable. We recommend asking yourself a couple key questions: First, "does this indemnification clause instill an obligation upon me that is greater than what the law already provides?" That is, is this provision putting me "on the hook" for something I'm already on the hook – or does it create a new obligation. One example would be if you were asked to provide indemnification for another party, even if the other party was negligent. This goes beyond any duty generally imposed to you under governing law, and is something to watch out for.

The other critical consideration is, "have I created liability for myself that goes beyond the scope of my insurance coverage?" It is important for you to be familiar with the terms and scope of your own insurance coverages.

Before you sign any contract with an indemnification provision, get the assistance of a good business attorney to be sure you a fully informed about the risks and obligations you are being asked to take on. They may be more than you bargained for!

Delia Bouwers Bianchin is Senior Counsel at The Lynch Law Group and has almost two decades of high level experience, in both complex commercial litigation at two large prominent law firms in Pittsburgh and as in-house counsel for a diversified contract manufacturing company and for a dynamic start-up. During her tenure with Kirkpatrick & Lockhart and Eckert Seamans Cherin & Mellott, she gained experience in a wide range of litigation-related matters in various federal and

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She then joined Penn United Technologies, Inc. and for ten years, held the position of General Counsel for the diversified, international precision tool and die manufacturing company based in Cabot, Pennsylvania. As General Counsel, Delia assisted with commercial contract negotiations, human resource and employment related matters, retirement plan design and compliance issues, intellectual property development, and a wide range of corporate compliance and litigation matters germane to the manufacturing environment. She implemented several programs and systems, such as a comprehensive export control compliance program to support defense related work, and a contract review and management system. She worked closely with all operations teams, providing oversight, training and assistance for the review of all contracts and terms and conditions for both corporate customers and vendors.

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