

# **The Art of Holding Harmless: Indemnification Provisions in Supply Agreements and How They Differ from Warranty**

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According to Black's Law Dictionary (10<sup>th</sup> ed. 2014), indemnity is a "duty to make good any loss, damage, or liability incurred by another." At its core, an indemnification is a promise to reimburse a person for a loss incurred by that person. Often, the obligation to indemnify is limited to third party claims. Further, there is typically a "defend" component to the indemnity that requires the indemnifying party to take over the defense of the claim on behalf of the indemnified party.

## **I. Common Subjects of Indemnities in Supply Agreements**

The following are a few of the common subjects of indemnities found in supply agreements:

- Negligence and willful misconduct.
- IP infringement.
- Failure to comply with law.
- Personal injury and tangible property damage.

## **II. Consistency with Limitation of Liability Provisions.**

One must always be mindful of the interplay of the risk allocation provisions in a contract. For example, if the agreement contains a broad indemnity stating the indemnifying party will indemnify the indemnified party against all losses resulting from specified causes, and also includes a consequential damage disclaimer providing that neither party will be responsible to the other party for consequential damages, the agreement has an inherent inconsistency, which is not good for either side because neither can depend on an outcome (that is, the indemnified party does not know if its reputational or other consequential losses will be indemnified, for example, and the indemnifying party does not know if it is responsible to indemnify for reputational or other consequential losses). As another example, third party claims are typically classifiable as a consequential damage. If an agreement contains both an indemnity for third party claims and a consequential damage disclaimer, an internal conflict exists in the agreement, potentially leaving it to a judge or jury to determine what outcome was intended by the parties. As a result, it is important to ensure that contracts expressly address how indemnification clauses and damage disclaimers interact with one another.

## **III. Indemnification vs. Warranty.**

How is an indemnification different from a warranty? A warranty and an indemnity are two different tools serving two different purposes.

1. **Breadth.** First, an indemnity is usually broader than a warranty. A warranty typically only covers certain contractually prescribed (or implied by law) defects in a product, whereas an indemnity frequently covers a much more expansive array of concerns, like the negligence or willful misconduct of the indemnifying party that harms a third party who then brings a claim against the indemnified party (whether or not that negligence or willful misconduct relates to a product or a defect in a product).
2. **Defense.** Second, an indemnity typically includes an express requirement to defend the indemnified party against the claim incurred (such as, "Seller hereby agrees to indemnify, defend, and hold harmless Buyer from and against..."), and expressly provides for the indemnifying party to cover attorneys' fees. Neither of these protections are usually afforded by a warranty.
3. **Remedies.** Third, warranty remedies are commonly limited to repair or replacement of the affected product at issue, or reimbursement of the purchase price paid by the buyer for the affected product. In contrast, indemnification obligations are often unlimited and expressly carved out from any overall damage caps in the contract.

#### Indemnification VS. Warranty

Breadth	Typically broader than warranty	Often limited to product
Defense Cost	Typically expressly covered	Not typically covered
Remedy	Often carved out of liability caps and disclaimers	Typically limited to repair, replace, or refund
Third Party Claims	Typically expressly covered	Not typically covered

#### IV. Indemnification Procedures.

In addition to paying careful attention to the scope of the indemnification obligations themselves, it is also important to ensure that indemnification procedures are addressed:

1. **Notice of the Claim.** First, the indemnifying party will want to ensure that, when a claim is made against the indemnified party for which it will seek indemnification, the indemnified party provides prompt written notice to the indemnifying party of the claim.
2. **Control of the Defense.** Second, the indemnifying party should include a provision that gives it the right to have sole and exclusive control of the defense of the claim. The indemnifying party likely does not want to be in a position of having to reimburse the indemnified party for its defense costs and the cost of the settlement or judicial award; the indemnifying party typically would rather be in charge of the defense so that it can work to resolve the claim as quickly and cost-effectively as possible. The indemnified party may want to include a right to participate in the defense of the claim, at its own cost and subject to the right of the indemnifying party to control the defense.
3. **Requirement to Cooperate.** Often, the indemnified party will have access to key documents or witnesses that the indemnifying party needs for the defense of the claim. As such, it is important to include an express obligation on the indemnified party to cooperate fully with the indemnifying party's defense of the claim.
4. **Settlement Rights.** The indemnifying party wants the broadest possible settlement rights, while the indemnified party often pushes for the narrowest. A compromise is often reached with the indemnifying party having the right to settle without the indemnified party's consent if the settlement imposes only a monetary obligation to be paid by the indemnifying party (that

is, no fault is ascribed to the indemnified party and no rights of the indemnified party are infringed).

In conclusion, an indemnity is a powerful risk allocation tool that deserves careful attention and a critical eye, both in terms of subject matter and administration.

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