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ARTICLE

Reduce the risk of claims with indemnification clauses in contracts

A guide to risk management and liability protection of indemnification clauses

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Indemnification provisions or clauses appear in nearly all commercial agreements. They serve as an essential tool for allocating risk between parties and are, therefore, among the most commonly and heavily negotiated provisions in a contract.

Netlist EX2134
Samsung v. Netlist
IPR2025-01431

What is indemnification?

Indemnification refers to the broad concept of one party compensating another for losses, damages, or liabilities, usually due to third-party claims. It's an agreement that safeguards one party against the financial impacts of specific actions or events.

On the other hand, an indemnification provision is a distinct clause in a contract specifying how one party will execute indemnification. It outlines the responsibilities of the indemnifying party (the compensator) to cover the indemnified party (the compensated or indemnitee) for particular losses or damages. This clause also defines which claims are covered, the process for claiming compensation, and any liability limits.

It can also cover direct claims, which are claims or causes of action that one contracting party has against the other. There are one-sided indemnity agreements, where Party A receives indemnification, and there are mutual indemnification agreements, where both Party A and Party B receive some indemnity and are obligated to provide compensation to each other.

One-sided agreements are very common in commercial transactions. Mutual agreements are less common but are often used in construction contracts when both parties want protection against injury to employees, subcontractors, etc.

Indemnification clauses usually include the phrase "hold harmless." Although this phrase is often redundant, some states distinguish between indemnification provisions and hold-harmless clauses as two separate doctrines.

Why are indemnification provisions important?

Indemnification provisions allow a contracting party to:

- Customize the amount of risk it is willing to undertake in each transaction and with every counterparty
- Protect itself from damages and lawsuits that the counterparty can more efficiently bear

For example, in a sale of goods agreement, the risk that a product injures a third party is more efficiently borne by the seller than the buyer. The seller has more control over the goods than the buyer, whose principal obligation is payment. The seller is, therefore, in a better position to mitigate losses and liabilities related to the goods than the buyer. Indemnification comes into play in [service agreements](#), too. In that context, they can be used to guard against things like breaches of warranties or [breach of contract](#).

Drafting and negotiating an effective [indemnification provision](#) benefits both parties.

Such a clause may enable the indemnified party to:

- Recover certain types of losses, such as reasonable attorney's fees, which are not typically recoverable under a common law cause of action
- Reduce its liability by incorporating liability cap, materiality qualifiers, and liability basket



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What are the components of a typical indemnification clause?

Usually, an indemnity clause consists of two separate and distinct obligations: an obligation to indemnify and an obligation to defend.

Obligation to indemnify

This obligation requires the indemnifying party to:

- Reimburse the indemnified party for its paid costs and expenses, referred to as losses
- Provide advance payment to the indemnified party for its unpaid costs and expenses, such as liabilities, claims, and causes of action

Obligation to defend

For the indemnifying party, this obligation consists of two components:

- The duty to reimburse already-paid defense costs and expenses, as well as to make advance payment for outstanding defense costs and expenses
- A right to assume and control the defense of the third-party suit

The obligation to defend is broader than the obligation to indemnify because it applies regardless of the merits of the third-party suit. The allegations of the lawsuit trigger the obligation to defend, not the ultimate disposition of the case.

What are “hold harmless” provisions?

Most indemnification provisions require the indemnifying party to [indemnify and hold harmless](#) the indemnified party for specified liabilities. In practice, these terms are typically paired and interpreted as a unit to mean "indemnity." Colorado, Delaware, Ohio, and Louisiana are among the [states that treat these terms as synonyms](#).

However, in some states, the phrase hold harmless may require the indemnifying party to advance payment for covered unpaid costs and expenses, even when the defined recoverable damages are limited to losses. If the hold-harmless obligation is omitted, the indemnifying party does not become responsible for losses until the indemnified party makes payment. California, for example, is one state that sees indemnification and hold-harmless provisions as two separate rights.

In addition, the obligation to hold harmless may release the indemnified party from any related claims or causes of action by the indemnifying party.

What are the common limitations on the indemnifying party's obligation to indemnify?

The indemnifying party's obligation to indemnify is limited to recoverable damages caused by, related to, or resulting from covered events.

Covered events

Covered events are specific events or specific types of events listed in the indemnification clause. They can vary according to the particulars of the transaction and are subject to negotiation. The most common covered events are:

- Breach of contract
- Negligence
- Bodily injury or death
- Non-compliance with any laws

Recoverable damages

Recoverable damages are specific types of damages listed in the indemnification clause. These can vary, and the parties negotiate them. The principal categories of recoverable damages are:

- **Losses** include any covered judgments, settlements, fees, costs, and expenses. The indemnifying party becomes responsible for a loss only after the indemnified party pays.

- **Liabilities** are composed of debts and other legal obligations. The indemnifying party becomes responsible for a liability when the liability is legally imposed but before the money is paid.
- **Claims** consist of 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.
- **Causes of action** include 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.

What are the common exceptions to indemnification?

There are a number of common indemnification exceptions. They generally relate to circumstances where the indemnified party's actions either cause or contribute to the harm that triggers indemnification. For example, an indemnification provision may exclude indemnification for claims or losses that result from the indemnified party's:

- Negligence or gross negligence
- Improper use of the products
- Bad faith failure to comply with its obligations in the agreement

A typical formulation for the negligence exception states: "The indemnifying party is not obligated to indemnify the indemnified party for any claim arising from the indemnified party's negligence or a more culpable act or omission, including recklessness or willful misconduct."

Recently, the enforceability of certain indemnity provisions has come under scrutiny. Some courts have viewed no-fault indemnity clauses as violative of public policy because they arguably serve as a disincentive against responsible behavior. Additionally, courts may examine the indemnification agreement more critically if there is a significant power disparity between the parties.

Limitation of liability clause

A limitation of liability clause in a contract caps the amount of money or damages one party can recover from the other for breaches or performance failures. In other words, this clause restricts the damages Party A must pay to Party B under specific circumstances. It also defines the extent of risk allocated to each party in the contract, including the implications of indemnity provisions.

How you can use indemnification to reduce the risk for your organization

Indemnification is a crucial element in agreements between parties. When used properly, these provisions can help your organization calibrate the level of risk it is willing to accept, which can significantly influence the decision on whether to proceed with the agreement. While professional guidance is always a good idea, you don't necessarily need a law firm to help you understand and leverage indemnification to your advantage.

For a more comprehensive overview, review Practical Law's [Indemnification Toolkit](#) and [Drafting and Negotiating an Indemnification Clause Checklist](#) to help inform yourself

on the best way to use indemnification provisions. Or, try a [free trial of Practical Law](#) today.

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