Corporate Alert

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What Does "Defend, Indemnify and Hold Harmless" Mean?

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The phase "defend, indemnify, and hold harmless" is found in many, if not most, contracts with liability allocation provisions, across multiple industries. However, many parties do not have a complete understanding of what, exactly, these words mean. The meaning of all three terms varies on a state-by-state basis. Some states require an indemnitor to defend an indemnitee. For example, an Oklahoma statue regarding the interpretation of an indemnity contract states that unless a contrary intention is found in the contract, "[t]he person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity; but the person indemnified has the right to conduct such defense, if he chooses to do so." Some states, such as Ohio, view the duties to defend and indemnify as wholly separate. Moreover, states such as Colorado, use "indemnify" and "hold harmless" synonymously. Understanding the meaning of this common phrase in a given state goes a long way toward ensuring that the parties' risk allocation choices (and, ultimately, their economic deal) are respected, which is important in the best of times, and vital in the worst.

Indemnification

The concept of indemnification imposes an obligation on one party, the indemnitor, to pay or reimburse another party, the indemnitee, for losses covered in the indemnification provision. The obligation to reimburse or pay arises when an actual loss or liability has occurred. Generally, indemnification arises in two ways: implied-in-law or through an express contractual provision. Most states hold that, absent anything to the contrary in contract, a person is entitled to an implied indemnity when the person performing a duty owed by another party, the implied indemnitor, is not at fault and still incurs liability. For example, in *Alten v. Ellin & Tucker, Chartered*, the District Court for the District of Delaware noted that without an express contractual indemnification provision, a party may still rely on implied indemnity. The Appellate Division of the Supreme Court of New York, Third Department clarified in *Hanley v. Fox* that such indemnity exists to allow a party who was forced to pay for another's wrongdoing to recover. Importantly, the party seeking recovery cannot be at fault.

However, when there is an express indemnification provision in a contract, courts, including the Superior Court of Delaware, New Castle are reluctant to read in an

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implied indemnity. Instead, under these circumstances courts tend to look at the contract itself and honor the intent of the parties. Generally, if there happens to be any ambiguity surrounding an indemnity, it is typically construed by courts against whomever is seeking indemnification.

Defend

The duty to defend triggers an obligation to act when a claim, which is covered by the indemnification provision in the contract, is brought by a party against the indemnitee. The independent obligation to defend requires the indemnitor to actually defend, finance a defense or reimburse the indemnitee against any claim brought against it, regardless of the merits of the claim or the outcome. The differences between the duty to indemnify and to defend, while nuanced, are critically important. The obligation to indemnify arises once a judgment has been entered, whereas the obligation to defend is triggered as soon as a claim is filed against the indemnitee.

Most states consider the duty to indemnify and to defend to be distinct obligations. However, some states, including California and Oklahoma, consider the duty to defend and the duty to indemnify to be separate, yet statutorily require an indemnitor, if requested, to defend an indemnitee unless the contract states otherwise. A California statue regarding the interpretation of an indemnity contract states that unless a contrary intention is found in the contract, "[t]he person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity."

New York presents another variation on the duty to defend, applying separate analysis depending whether the case arises in an insurance context or non-insurance context. For instance, the Appellate Division of the Supreme Court of New York, Second Department in *Brasch v Yonkers Constr. Co.*, specified that since the defendant in that case was not an insurer, its duty to defend was not broader than its duty to indemnify.

Hold Harmless

The inherent meaning of "hold harmless" is subject to interpretation. The prevailing interpretation is that "hold harmless" and "indemnify" are synonymous. However, under the minority view, "hold harmless" requires payment of both actual losses and potential liabilities, while "indemnify" protects against incurred losses only. The main difference in this case is that "hold harmless" may require a party to protect against actual losses as well as potential losses while indemnification protects against actual losses only.

Certain states, including Ohio, Colorado, Louisiana and Delaware, hold that "indemnify" and "hold harmless" are synonymous. Alternatively, California sees the two concepts as distinct as shown in *Queen Villas Homeowners Assn v. TCB Prop. Mgmt.* There, the court categorized the obligations to indemnify and hold harmless as offensive and defensive rights. Indemnification, according to the court, is "an offensive right—a sword—allowing the indemnitee to seek indemnification." On the other hand, hold harmless is a defensive measure providing "[t]he right not be bothered by the other party itself seeking indemnification." Under this view, hold harmless shields one party from being sued for liability that the other party may incur. Courts in Alaska, New Mexico, Oklahoma and West Virginia have not addressed the issue.

Exclusive Remedy Provisions

Exclusive remedy provisions frequently accompany defend, indemnify and hold harmless provisions. An exclusive remedy provision provides that a given remedy (in this case indemnification, defense, and hold harmless) will be the only remedy for any claims arising out of the contract. In this context, much depends on the specific indemnity language chosen. In some states, for instance, failure to include "defend," together with an exclusive remedies provision, means that there will be no defense obligation. In this respect, certain rights, such as adjustments to a purchase price and payment of contingent consideration, do not lend themselves well to any of the remedies arising out of a defense, indemnification or hold harmless provision and should be excluded. In these cases, the obligee is likely to want the bargained-for consideration, not an indemnification right against their absence. However, without such an exclusion, it is not clear that the party entitled to such a right would be able to easily enforce it.

Concerns in the Current Market

Current market conditions have emphasized the importance of ensuring that risk allocations are understood and respected. Whether the obligations that arise under the contractual terms "defend, indemnify and hold harmless" hold up through bankruptcy and dissolution are growing concerns for market players. It is important to realize that the duty to indemnify may not survive bankruptcy as demonstrated recently in both Texas and Delaware. The U.S. Bankruptcy Court for the Northern District of Texas, in *In re Superior Air Parts, Inc.*, held that contractual indemnity provisions give rise to a dischargeable claim. While the contract survives bankruptcy, the indemnification provision within the contract was dischargeable in bankruptcy. The U.S. Bankruptcy Court for the District of Delaware looked at the issue of indemnification claims in *In re Touch America Holdings Inc.*, and found claims for indemnity were disallowed, consistent with section 502(e) of the Bankruptcy Code. How can parties in a contract protect their indemnification claims? One option is to insure against the claims. Representation and Warranty Insurance, Director and Officer Insurance and contingent liability policies have becoming increasingly common vehicles that can provide a financial backstop for risk allocation choices. Being knowledgeable about how different states view defend, indemnify and hold harmless provisions is crucial in today's market. A lack of clear understanding about how an indemnification clause will function, be that in bankruptcy or otherwise, can have long lasting, real impact. Remember that when drafting your next agreement.

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