

# Indemnification Clauses in Commercial Contracts (TN)

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*A Practice Note discussing indemnification and defense provisions in commercial contracts under Tennessee law. This Note defines indemnification and explains how parties often use indemnification to allocate risk. It discusses key issues including statutory and common law barriers to enforcement, defining the scope of the indemnity, limiting liability, and alternatives to indemnification. This resource includes drafting and negotiating tips.*

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## Contents

### **Definition of Indemnification**

[Indemnity Implied by Tennessee Law](#)

[Contractual Indemnity](#)

[Obligation to Indemnify Distinguished from Obligation to Defend](#)

[Indemnification Versus Hold Harmless Provisions](#)

### **Statutory and Common Law Barriers to Enforcement**

#### **Identifying the Indemnified Parties**

#### **Defining the Scope of the Indemnity**

[Defining the Recoverable Damages](#)

[Choosing the Right Nexus Phrase](#)

[Defining the Covered Events of the Indemnity](#)

#### **Limitation of Liability Approaches**

[Exceptions to Indemnification](#)

[Waiver of Incidental and Consequential Damages](#)

[Control of Defense Provisions](#)

[Notice of Third-Party Claims](#)

[Liability Baskets](#)

Maximum Liability (Limitation of Liability)

Sole Remedy Provisions

Mutual Indemnities

Materiality and Other Qualifiers

Representation and Warranty Insurance and Escrow

Assignment Rights

Duration of Indemnity

## Alternatives to Indemnification

Nearly every commercial contract has an indemnification provision. Parties include these provisions for a variety of reasons. For example, the parties to an equipment lease might include an indemnification provision to:

- Allocate risk between the parties that:
  - defects in the equipment injure the lessee or third parties like sublessees;
  - the lessee's use of the equipment infringes third-party **intellectual property** rights;
  - the lessor fails to timely deliver the equipment;
  - the equipment does not adhere to specifications; or
  - the lessor does not obtain all of the tax benefits associated with being the tax owner of the equipment.
- Allow an aggrieved party to pursue certain rights, like the right to attorneys' fees, which may otherwise not be available in a common law cause of action.
- Provide predictability and certainty of recourse.
- Show a court the parties' intent regarding risk allocation.
- Increase the odds of settlement based on the parties' intent.

If the contract does not contain a properly drafted indemnification provision:

- The **non-breaching party** may:

- have to rely on uncertain common law causes of action; and
  - not be able to obtain certain types of reimbursement, for example, attorneys' fees.
- The **breaching party** may not be able to adequately:
    - cap its liability;
    - reduce its liability by incorporating materiality qualifiers; or
    - reduce its liability by incorporating liability caps or deductibles like **thresholds** or **baskets**.

Although commonly used, **indemnity** provisions can be complex. If used improperly, an indemnification provision can subject a party to continuing liability for circumstances outside of its control. If used correctly, an indemnification provision can shield a party from lawsuits and damages (see, for example, *Developers Sur. & Indem. Co. v. Martin*, 2006 WL 1984425, at \*6-8 (E.D. Tenn. July 14, 2006)). This Note discusses the meaning and benefits of indemnity under Tennessee law, and helps parties to correctly draft and negotiate an indemnification provision that effectively manages risk.

## Definition of Indemnification

Generally, indemnification (or indemnity) is an undertaking by one party to compensate the other party for certain costs and expenses. Indemnity is imposed either by law or contract in Tennessee.

## Indemnity Implied by Tennessee Law

State law indemnity is a remedy implied under common law or statute and arises out of obligations imposed through a preexisting relationship (see, for example, [T.C.A. § 47-2-312\(3\)](#)). The extent to which this obligation is imposed depends on:

- Applicable state law.
- The nature of the transaction.

- The nature of the relationship.

Tennessee courts recognize a common law cause of action for indemnity based on the principle that a person should bear responsibility for his own wrongdoing. Tennessee courts will impose an implied obligation to indemnify when either:

- The obligation is a necessary element of the parties' relationship.
- Justice and fairness demand shifting the burden of paying for a loss to the party whose fault or responsibility is qualitatively different from the other parties' fault.

(*Memphis-Shelby Cnty. Airport Auth. v. Ill. Valley Paving Co.*, 2006 WL 3041586, \*3 (W.D. Tenn. Oct. 26, 2006).)

Generally, courts impose an implied indemnity on a contractual relationship only in the absence of an indemnification provision (but see *Colonial Refrigerated Transp., Inc. v. Worsham*, 705 F.2d 821, 824-25 (6th Cir. 1993) (affirming the trial court's conclusion that an indemnified party was liable on a theory of implied indemnity and not the express indemnity provision contained in a lease)). Parties relying on implied contractual indemnity generally face unpredictable outcomes and may not be able to obtain certain types of reimbursement. For example, when there is no express indemnity agreement between the parties, courts only impose an implied indemnification if the indemnifying party breached a contract or engaged in some other tortious conduct (*Colonial Refrigerated Transp.*, 705 F.2d at 825).

Similarly, attorneys' fees are only recoverable under an implied indemnity agreement where an indemnified party is required to defend itself due to some fault or wrongdoing by the indemnifying party (see *Pullman Standard, Inc. v. Abex Corp.*, 693 S.W.2d 336, 338-39 (Tenn. 1985); *Electric Controls v. Ponderosa Fibres of America*, 19 S.W.3d 222, 228-30; and *Dillard Const., Inc. v. Havron Contracting Corp.*, 2010 WL 4746244, at \*10 (Tenn. Ct. App. Nov. 23, 2010)). To avoid any uncertainty, the parties to an express indemnity provision may choose to include a disclaimer of the right to implied indemnity.

## Contractual Indemnity

Parties to a contract use a contractual indemnity provision to customize risk allocation. Tennessee courts interpret indemnification agreements in the same manner as other contracts by:

- Determining the parties' intention.
- Interpreting the language in a plain, ordinary, and popular sense.
- Construing the agreement as a whole.

(*Pitt v. Tyree Org. Ltd.*, 90 S.W.3d 244, 252-53 (Tenn. Ct. App. 2002).)

If the language of the indemnity agreement is unambiguous, courts must interpret it as written (*Pitt*, 90 S.W.3d at 252-53). In order for an indemnification agreement to indemnify the indemnified party against its own negligence, the agreement must express this intention in clear and unequivocal terms (*Kellogg Co. v. Sanitors*, 496 S.W.2d 472, 473 (Tenn. 1973); see also *Wells ex rel. Baker v. State*, 435 S.W.3d 734, 747-49 (Tenn. Ct. App. 2013), appeal denied (Apr. 9, 2014)).

Indemnification clauses vary widely, but in a typical indemnification provision, the obligor (indemnifying party) promises to reimburse the obligee (indemnified party) from and against any and all "losses, liabilities, claims, and causes of action" (recoverable damages) incurred by the indemnified party that "cause," "arise from," or are "related to" (nexus phrase) the specified events giving rise to the indemnity (covered events).

For more information on recoverable damages, nexus phrases, and covered events, see [Defining the Recoverable Damages](#), [Choosing the Right Nexus Phrase](#), and [Defining the Covered Events of the Indemnity](#), respectively.

The insurance policy is a classic example of a contractual indemnity. For another example of an indemnification provision, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\)](#).

In many cases, parties negotiating an indemnity clause also negotiate a defense clause (see [Obligation to Defend](#)). In a defense clause, the indemnifying party promises to defend the indemnified party against third-party claims, for example, litigation or arbitration, caused by or arising from:

- The indemnifying party's breach of contract.
- The indemnifying party's acts or omissions, even if the acts or omissions are not breaches.

## Obligation to Indemnify Distinguished from Obligation to Defend

The obligation to indemnify for damages and the obligation to defend against third-party suits are separate and distinct (see [Travelers Indem. Co. of Am. v. Moore & Assoc., Inc.](#), 216 S.W.3d 302, 305 (Tenn. 2007); see also [Policeman's Ben. Ass'n of Nashville v. Nautilus Ins. Co.](#), 2002 WL 126311, at \*6 (Tenn. Ct. App. Feb. 1, 2002)). For example:

- The duty to defend arises if the facts as alleged in the pleading bring the case within or potentially within the coverage of the indemnification provision.
- The duty to indemnify arises only if the true facts bring the case within the coverage of the indemnification provision.

([St. Paul Fire & Marine Ins. Co. v. Torpoco](#), 879 S.W.2d 831, 834 (Tenn. 1994)).

Therefore, it is possible that an indemnifying party may have a duty to defend but no subsequent duty to indemnify (see [St. Paul](#), 879 S.W.2d at 834; see also [Southland Mall, LLC v. Valor Servs., Inc.](#), 2005 WL 762616, at \*5 (Tenn. Ct. App. April 4, 2005)).

## Obligation to Indemnify

Under an indemnity provision, the indemnifying party agrees to compensate the indemnified party for direct claims (by the indemnified party against the indemnifying party), third-party claims, or both. For a more detailed discussion of indemnity for direct versus third-party claims, see [Direct Versus Third-Party Claims](#).

Indemnification requires the indemnifying party to:

- Reimburse for covered **paid costs and expenses** (losses). Indemnity against loss does not accrue until after the indemnified party actually pays the obligation for which it is liable. It limits the

indemnifying party's liability to the amount the indemnified party was actually required to pay. ([Long v. McAllister-Long](#), 221 S.W.3d 1, 11 (Tenn. Ct. App. 2006).)

- Advance payment for covered **unpaid costs and expenses** (like liabilities) as they are incurred but only if the recoverable damages under the indemnity include liabilities, claims, or causes of action. For more information on losses versus liabilities, see [Defining the Recoverable Damages](#).

Tennessee courts construe the language of the indemnity agreement and consider the posture of the parties and circumstances existing when the parties made the agreement to determine whether a particular agreement provides for indemnity against loss or indemnity against liability ([Long](#), 221 S.W.3d at 11).

### Obligation to Defend

The obligation to defend is usually broader than the obligation to indemnify because it may apply whether or not the third-party claim has merit (see [Travelers Indem. Co. of Am.](#), 216 S.W.3d at 305 and [Policeman's Ben. Ass'n of Nashville](#), 2002 WL 126311, at \*6).

For example, in *Nissan N. Am. v. Schrader Elec., Ltd.*, a third party's patent infringement claim failed, yet the indemnifying party was still potentially liable for more than \$3.7 million in attorneys' and other defense costs because it breached its duty to defend an allegation of patent infringement ([2014 WL 5410296](#), at \*3, \*11 (M.D. Tenn. Oct. 23, 2014)).

The obligation to defend is both:

- **An obligation.** The indemnifying party must:
  - reimburse for covered **paid costs and expenses** (losses) comprised of defense costs and expenses, which may include the cost and expense of appeals and counterclaims and losses on resolution of the dispute; and
  - advance payment for covered **unpaid costs and expenses** (like liabilities) comprised of defense costs and expenses.

- **A right.** The indemnifying party has the right to assume and control the defense, subject to applicable agreements (such as control of defense provisions (see [Control of Defense Provisions](#))) and the law (see *McCrary v. U.S.*, 235 F. Supp. 33, 37 (E.D. Tenn. 1964)).

An indemnified party always wants the indemnification provision to expressly include the duty to defend because they otherwise risk having the indemnifying party only offer to pay for actual damages or judgments resulting from the claims made.

The obligation to defend is generally held to exist only:

- In the context of third-party claims (see *Eatherly Const. Co. v. HTI Mem. Hosp.*, 2005 WL 2217078, at \*10 (Tenn. Ct. App. Sept. 12, 2005)).
- If the defense provision covers allegations in the complaint and there is no applicable exclusion (see *Marsh Furniture Com. v. Pennsylvania Mfrs. Assn. Ins.*, 1996 WL 328713, at \*3 (Tenn. Ct. App. Jun 17, 1996)). This test is based exclusively on the facts as alleged in the complaint, rather than the facts as they actually are (see *St. Paul*, 879 S.W.2d at 835; see also *Southland*, 2005 WL 762616, at \*4). Where at least one allegation of the underlying lawsuit is covered by the duty to defend, the lawsuit will trigger the indemnifying parties' duty to defend (see *Trinity Universal Ins. Co. v. Turner Funeral Home, Inc.*, 2003 WL 23218046, at \*24 (E.D. Tenn. Dec. 12, 2013)).

The allegations asserted in the suit, not the ultimate merits of the action, give rise to the obligation to defend (see *Nissan*, 2014 WL 5410296, at \*8 and *Jackson Hous. Auth. v. Auto-Owners Ins. Co.*, 686 S.W.2d 917, 922 (Tenn. Ct. App. 1984)). For an example, see [Defense is Often Broader than Indemnification: An Example](#). Therefore, a party may have to defend the other party even if the court ultimately finds the underlying claim to be without merit (see, for example, *Nissan*, 2014 WL 5410296, at \*11 and *Southland*, 2005 WL 762616, at \*5).

For a detailed discussion of the triggers to and scope of the obligation to defend, see [Practice Note, Commercial General Liability Insurance Policies: Property Damage and Bodily Injury Coverage \(Coverage A\)](#).

## Defense is Often Broader than Indemnification: An Example

Consider an indemnification provision that requires the indemnifying party to:

- Indemnify against third-party claims for damages and losses arising out of the indemnifying party's negligence.
- Defend against third-party suits raising claims covered by the indemnity.

The indemnified party sues the indemnifying party under the provision for losses and damages suffered. The court absolves the indemnifying party of negligence. In this case, the court:

- Also absolves the indemnifying party of any indemnity liability. Because the indemnifying party is absolved of negligence, the indemnifying party has no obligation to indemnify for its own negligence.
- May require the indemnifying party to defend the indemnified party. The indemnifying party's defense obligation is triggered by suits raising claims covered by the indemnity, not whether the conditions of indemnity were, or were not, later established. For example, some courts have upheld the defense obligation despite the claim being without merit (see [Southland](#), 2005 WL 762616, at \*5).

For information about the scope of defense obligations under insurance contracts, see [Practice Note, Commercial General Liability Insurance Policies: Property Damage and Bodily Injury Coverage \(Coverage A\): The Duty to Defend Is Broader than the Duty to Indemnify](#).

## Indemnification Versus Hold Harmless Provisions

Most indemnification provisions require the indemnifying party to "indemnify and hold harmless" the indemnified party for specified liabilities or losses. In practice, these terms are typically paired and interpreted as a unit to mean "indemnity." However, some commentators have drawn a distinction between the two. For example, they construe "hold harmless" to protect another against the risk of loss as well as actual loss and define "indemnify" to mean "reimburse for any damage," a narrower meaning than that of "hold harmless" (see Mellinkoff's Dictionary of American Legal Usage 286 (1992); see also discussion in [Bryan A. Garner, U, 15 Green Bag 2d 17, 22-24 \(2011\)](#)).

Tennessee courts generally interpret "hold harmless" to be synonymous with indemnification against liability. While some Tennessee courts have noted that a "hold harmless" provision is an indemnity

against losses, at least one Tennessee Court of Appeals decision has concluded that a "hold harmless" agreement is better classified as an indemnity against liability. See, for example:

- [\*Int'l Mkt. & Rest., Inc. v. Belmont Univ.\*, 2010 WL 4514980, at \\*4 \(Tenn. Ct. App. Nov. 9, 2010\)](#) (noting that "hold harmless" means to fully compensate the indemnitee for all loss or expense).
- [\*Phoenix Ins. Co. v. Estate of Gainer\*, 2008 WL 5330493, at \\*8 n.7 \(Tenn. Ct. App. Dec. 19 2008\)](#) (noting that "indemnify" and "hold harmless" are often considered the same concept).
- [\*Long\*, 221 S.W.3d at 10](#) (stating that the subject hold harmless agreement is generally classified as an indemnity against liability).
- [\*Pinney v. Tarpley\*, 686 S.W.2d 574, 579 \(Tenn. Ct. App. 1984\)](#) (stating that a hold harmless agreement is a contract of indemnity which requires the indemnifying party to prevent loss to the indemnified party or to reimburse them for all losses suffered from the "designated peril").

### Obligation to Hold Harmless

Similar to the obligation to indemnify against liability (see [Obligation to Indemnify](#)), under the obligation to hold harmless, the indemnifying party must:

- Reimburse for covered **paid costs and expenses** (losses).
- Advance payment for covered **unpaid costs and expenses** (like liabilities) as they are incurred.

However, unlike the indemnity obligation, the hold harmless obligation in states or courts that recognize a distinction may require the indemnifying party to advance payment for covered unpaid costs and expenses even when the defined recoverable damages are limited to losses and do not include liabilities, claims, and causes of action (see [Obligation to Indemnify](#) and [Defining the Recoverable Damages](#)).

Because Tennessee courts treat the terms "indemnify" and "hold harmless" as covering the same concepts, they are unlikely to draw this distinction between the terms (see [\*Phoenix\*, 2008 WL 5330493, at \\*8 n.7](#)). They have found indemnification provisions that include the term "hold harmless" may be too general and broad to construe them as indemnifying against indemnified party's own negligence ([\*Phoenix\*, 2008 WL 5330493, at \\*8](#) (quoting [\*HMC Technologies Corp. v. Siebe, Inc.-Robertshaw Tenn. Div.\*, 2000 WL 1738860, at \\*3 \(Tenn. Ct. App. Nov. 27, 2000\)](#))). Additionally, although unlikely in Tennessee, "hold

harmless" may release the indemnified party from any related claim or cause of action by the indemnifying party.

A hold harmless agreement will likely require an indemnifying party to pay the attorneys' fees that an indemnified party incurs in its efforts to avoid the losses that the indemnity agreement covers (see [Pinney, 686 S.W.2d at 581](#)). However, at least one Tennessee court has held that an indemnifying party is not required to pay an indemnified party's attorneys' fees that are incurred enforcing the hold harmless agreement when there is no express agreement to do so (see, for example, [Pinney, 686 S.W.2d at 581](#); see also [Wood v. Metro. Gov't of Nashville & Davidson Cnty.](#), 2009 WL 2971052, \*5 (Tenn. Ct. App. Sept. 16, 2009)).

To avoid "hold harmless" being given meaning above and beyond indemnification or otherwise causing confusion, the indemnifying party should consider:

- Excluding "hold harmless" from the indemnification provision. However, if the contract includes the obligation to defend, the indemnifying party will likely in any event have to compensate the indemnified party for both paid and unpaid costs and expenses (see [Obligation to Defend](#)).
- Clarifying that payments will be made only for actual losses and in the form of reimbursement.

For more information, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Drafting Note: Hold Harmless](#).

## Statutory and Common Law Barriers to Enforcement

Statutory or common law restrictions may limit the enforceability of an indemnity. While there is no specific statute that generally governs the enforceability of all indemnification provisions in Tennessee, parties should review any applicable Tennessee law specific to their circumstances that may restrict or establish rules regarding aspects of the indemnity provision. For example, certain types of indemnities are vulnerable to challenge under state law or public policy that:

- Require a party to indemnify another for all claims, regardless of who is at fault. In Tennessee, indemnification for a party's own negligence is not against public policy, but the parties must

expressly state that intent in clear and unequivocal terms (see *Kellogg*, 496 S.W.2d at 473 and *Wells*, 435 S.W.3d at 747-49). Tennessee courts, however:

- find indemnity clauses invalid as to damages caused by gross negligence or willful conduct on the part of an indemnified party (see *Planters Gin Co. v. Fed. Compress & Warehouse Co.*, 78 S.W.3d 885, 893 (Tenn. 2002)); and
  - regularly conclude that broad and seemingly all-inclusive language is not sufficient to impose liability for the indemnitee's own negligence (see, for example, *Summers Hardware & Supply Co. v. Steele*, 794 S.W.2d 358, 362 (Tenn. Ct. App. 1990)).
- Are used to avoid non-delegable duties (see *McCall v. Owens*, 820 S.W.2d 748, 751-52 (Tenn. Ct. App. 1991)).
  - Are not conspicuously set out in the contract (see *Jones Exp., Inc. v. Watson*, 2011 WL 1842853, at \*7 (M.D. Tenn. May 16, 2011) (rejecting the defendant's attempt to avoid indemnity and noting "the indemnification provision is not buried in the agreement, nor is it worded in such a way as to be confusing.")). While Tennessee does not require an indemnification provision to be conspicuous, courts may disfavor provisions buried in an agreement, especially where the provision might be viewed as disfavored or otherwise meriting greater conspicuousness (for example, protecting an indemnitee against its own negligence).
  - Contract away liability if the duty under which the indemnified party acts is a public one (see *Childress By & Through Childress v. Madison Cnty.*, 777 S.W.2d 1, 4 (Tenn. Ct. App. 1989)).
  - Are given by protected classes like:
    - construction-related contracts (T.C.A. § 62-6-123; see also *Caroum v. Dover Elevator Co.*, 806 S.W.2d 777, 779-80 (Tenn. Ct. App. 1990));
    - residential rental agreements (T.C.A. § 66-28-102(a) and T.C.A. § 66-28-203; see also *Crawford v. Buckner*, 839 S.W.2d 754, 760 (Tenn. 1992));
    - motor carrier transportation contracts (T.C.A. § 65-15-108);
    - patients (see *Olsen v. Molzen*, 558 S.W.2d 429, 431 (Tenn. 1977));
    - consumers; or
    - minors and incompetents (see, for example, *Childress.*, 777 S.W.2d at 7).

Absent one of the above exceptions, Tennessee courts generally respect the parties' rights to allocate liability for future damages through indemnity clauses ([Planters](#), 78 S.W.3d at 892).

The implied covenant of good faith and fair dealing may also impose requirements for performance under an indemnity agreement. Tennessee common law imposes an implied covenant of good faith and fair dealing in the performance of all contracts (see [Coleman v. Wells Fargo Banks, N.A.](#), 218 F. Supp. 3d 597, 606-07 (M.D. Tenn. 2016)). The covenant is particularly important where one party possesses a unilateral right to impose serious costs on or otherwise adversely affect the other party to the contract. Courts may examine whether the indemnified party breached the covenant by incurring excessive expenses that the indemnifying party would be liable to pay under the contract. The parties may, however, explicitly state their intention to avoid the imposition of the covenant in their agreement ([Coleman](#), 218 F. Supp. at 607).

## Identifying the Indemnified Parties

Either or both parties to the agreement may be indemnified parties, depending on whether the indemnification clause is structured as a unilateral indemnification or a mutual indemnification (for more on mutual indemnification, see [Mutual Indemnities](#)). Some contracts include officers, directors, managers, members, employees, agents, sub-contractors, and affiliates as indemnified parties.

If parties include certain terms, for example, affiliates, they should add temporal modifiers to expressly indicate whether they intend the term to include both existing and future affiliates. In the absence of defining or modifying the term, some courts, including the Sixth Circuit, have concluded that the term "affiliate" includes only existing affiliates (see [I.E.E. Intern. Elec. & Eng., S.A. v. TK Holdings Inc.](#), 2015 WL 4527809, at \*5 (E.D. Mich. Jun 27, 2015) ("The Court fails to see why an unadorned reference to 'affiliates' should be understood as referring to anything other than the parties' existing affiliates."); see also [Ellington v. EMI Music, Inc.](#), 997 N.Y.S.2d 339, 343-44 (2014) (use of the term "affiliates" in a contract includes only those affiliates in existence at the time the contract was executed, absent clear and unambiguous language indicating that the parties intended to bind other affiliated parties to the underlying contractual obligations)).

When identifying the indemnified parties, parties should consider the impact of other provisions in the agreement:

- **Third-party beneficiaries provisions.** The parties can use a third-party beneficiaries provision to give a third-party indemnified party the ability to enforce its rights under the agreement. For a sample third-party beneficiaries provision, see [Standard Clauses, General Contract Clauses: Third-Party Beneficiaries](#). Under Tennessee law:
  - courts generally presume parties executed a contract for the benefit of the parties to the contract, not third parties (*Burgett v. J.C. Penney Co.*, 2014 WL 1910881, at \*3 (W.D. Tenn. May 13, 2014); see also *Intern. Mkt. & Rest.*, 2010 WL 4514980 at \*4); and
  - an intended third-party beneficiary may enforce a contract only if the benefit flowing from the contract to the third-party beneficiary was intended, not merely incidental (*Burgett*, 2014 WL 1910881, at \*3).
- **Assignment provisions.** An assignment provision can change or expand the list of future indemnified parties (see [Assignment Rights](#)).

For more information, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Drafting Note: Who is the Indemnifying Party?](#).

## Defining the Scope of the Indemnity

Parties can manage risk expectations and avoid interpretation, enforceability, and other disputes if the covered events and related damages under the indemnity are appropriate in nature and scope. To do this, a party should:

- Carefully consider its needs and negotiating position within the given context.
- Assess transaction-related risk in terms of events and consequences, and the likelihood that those events or consequences will occur.

In defining the scope of the indemnity, the parties should consider how broadly or narrowly they will:

- Define the recoverable damages (see [Defining the Recoverable Damages](#)).
- Define the nexus phrase (see [Choosing the Right Nexus Phrase](#)).

- Define the covered events of the indemnity (see [Defining the Covered Events of the Indemnity](#)).
- Limit the scope of the indemnity (see [Limitation of Liability Approaches](#)).

When an indemnity clause is unambiguous, the plain language of the agreement will control the breadth of the indemnity clause (see [Planters, 78 S.W.3d at 892](#)).

## Defining the Recoverable Damages

Although seemingly redundant, each word in the phrase "losses, liabilities, claims, and causes of action" has an individual meaning and serves a specific purpose. The terms are listed below in order of increasing breadth:

- **Losses.** This includes any covered judgments, settlements, fees, costs, and expenses. The indemnifying party becomes responsible for a loss only after the indemnified party pays (see, for example, [Long, 221 S.W.3d at \\*11](#)).
- **Liabilities.** This includes 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 (see, for example, [Ford Motor Co. v. W.F. Holt & Sons, Inc., 453 F.2d 116, 118 \(6th Cir. 1971\) \(applying Tennessee law\)](#)).
- **Claims.** This includes 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.** This includes 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.

The above list of standard covered items is not exhaustive. Additionally, "losses, liabilities, claims, or causes of action" can be narrowly tailored, for example, to cover one or more of the following:

- Personal injury and death.
- Real and personal property damage.

- Infringement of intellectual property.
- Breach of confidentiality.
- Violation of law.

### Direct Versus Third-Party Claims

The obligation to compensate an indemnified party may apply to:

- **Direct claims.** These are claims that the indemnified party has against the indemnifying party. Commercial contract indemnification provisions typically do not cover direct claims. Tennessee courts have consistently held that standard indemnity provisions apply only to suits brought by third-parties, not to direct claims (see [Individual Healthcare Specialists, Inc. v. BlueCross BlueShield of Tenn., Inc.](#), 2017 WL 2105988, at \*23 (Tenn. Ct. App. May 15, 2017)). Parties seeking to include direct claims must adopt contractual language clearly and unequivocally doing so in their indemnity agreement ([Individual Healthcare](#), 2017 WL 2105988, at \*25). Parties may be subject to increased risk of liability or dispute if they overlook or fail to address direct claims (see [Indemnification: Avoiding Common Pitfalls: Overlooking or Failing to Adequately Address Direct Claims](#)). An indemnification provision for direct claims typically covers damages relating to the indemnifying party's acts, omissions, or breach of the agreement.
- **Third-party claims.** These are claims that a third party has against the indemnified party, which parties most commonly use indemnification to cover.

In many commercial transactions, parties limit indemnification to cover only third-party claims and address liability for direct damages elsewhere in the agreement, for example, in the limitation of liability clause. If the indemnification clause covers direct claims and breach of the agreement, the parties should consider whether the indemnification obligation should be included in the limitation of liability. For a sample limitation of liability clause, see [Standard Clauses, General Contract Clauses: Limitation of Liability \(TN\)](#).

### Attorneys' Fees

Under Tennessee law, costs and attorneys' fees are recoverable under an indemnity contract if the language of the agreement is broad enough to cover the expenditures (*N. Am. Specialty Ins. Co. v. Heritage Glass, LLC*, 2017 WL 440000, at \*2 (E.D. Tenn. Jan. 9, 2017)). However, an indemnified party cannot recover attorneys' fees incurred in a dispute with the indemnifying party unless the indemnity provision clearly and unequivocally applies to disputes (direct claims) between the parties (*Individual Healthcare*, 2017 WL 2105988, at \*23 (citing *Colonial Pipeline Co.*, 253 S.W.3d at 619)). At least one court applied this rule to deny the recovery of attorneys' fees incurred in a proceeding to enforce an indemnity agreement (see *Pinney*, 686 S.W.2d 574 at 581).

Even without an express indemnity agreement, attorneys' fees and other litigation costs incurred by the indemnified party in litigation with a third party may be recoverable under a theory of implied indemnity. Courts reason fees are recoverable where an indemnified party is required to defend itself due to some fault or wrongdoing by the indemnifying party (see *Pullman Standard*, 693 S.W.2d at 338; see also *Elec. Controls*, 19 S.W.3d at 229-30).

To avoid a potential construction issue, the indemnity provision should reflect the intent of the parties and specifically address whether attorneys' fees are:

- Excluded from or included in the indemnity obligation.
- Limited to reasonable or out-of-pocket expenses.

## Choosing the Right Nexus Phrase

This Note uses the term **nexus phrase** to describe the series of words that link the list of recoverable damages (for example, losses or liabilities) to the covered events (for example, breach of the agreement or the indemnifying party's negligence). Nexus phrases dictate the degree to which the event giving rise to the indemnity and the indemnified party's damages need to be related for the event to qualify for recovery. The nexus phrase therefore helps shape the scope of indemnity and directly impacts the amount of recoverable damages.

Usually, the **indemnified party** wants the indemnity to include a broad nexus phrase, for example, "related to." A broad nexus phrase helps to expand the indemnity's scope of coverage.

Usually, the **indemnifying party** wants the indemnity to include a narrow nexus phrase. A narrow nexus phrase excludes damages unrelated to the indemnifying party's own acts or omissions. To narrow indemnity coverage, parties can use:

- "Caused by" (see [Planters](#), 78 S.W.3d 885, 892 and [Hertz Equip. Rental Corp. v. Am. Equip. Co.](#), 1989 WL 100244 (Tenn. Ct. App. 1989)).
- "Result from" (see [Pitt](#), 90 S.W.3d at 253-54).
- "Solely result from" (see [Ford Motor](#), 335 F. Supp. at 778, rev'd on other grounds, 453 F.2d 116, 118 (6th Cir. 1971)).
- "To the extent they arise out of" (see [Canal Ins. Co. v. Axley](#), 680 F. Supp. 2d 923, 926-30 (W.D. Tenn. 2009) (applying Oklahoma law but looking to other states' laws); see also [Phoenix](#), 2008 WL 5330493, \*12-13).

While these examples are more narrow than "related to" language, courts may construe some of these more broadly than others. For example, Tennessee courts generally construe the term "arising out of" to be a broad and comprehensive term (see [Anderson v. Bennett](#), 834 S.W.2d 320, 322 (Tenn. Ct. App. 1992)). However, broad and inclusive language in an indemnity agreement alone is generally not sufficient to create liability for the indemnitee's own negligence or fault ([Estate of Spurling ex rel. Spurling](#), 2005 WL 1077730, at \*2 (E.D. Tenn. May 6, 2005)).

## Defining the Covered Events of the Indemnity

Covered events generally arise from or relate to:

- The indemnifying party's breach of the agreement (see [Indemnities for Breach of the Agreement](#)).
- The indemnifying party's acts or omissions, even if the acts or omissions are not breaches (see [Occurrence-Based Indemnities](#)).

Covered events include two broad categories, as follows:

- Direct claims.

- Third-party claims.

### Indemnities for Breach of the Agreement

An indemnity for breach of some or all of the agreement may appear unnecessary because a breaching party can almost always be sued for the direct loss under contract theory. However, parties commonly include an indemnity for breach as a way to:

- Change (usually extend) the indemnified party's right to recover damages, particularly regarding legal costs and expenses.
- Recover loss suffered resulting from third-party claims.

Indemnity based on breach of the agreement can be limited by:

- **Common law.** Common law rules relating to breach of the agreement, such as the foreseeability rule in *Hadley v. Baxendale*, may similarly modify indemnity coverage of breach ((1854) 156 Eng. Rep. 145). Under *Hadley*, a plaintiff may not recover damages that are improbable and unforeseeable unless the defendant had special knowledge of the circumstance. Tennessee courts follow the *Hadley* rule in breach of contract claims (see [Pankey v. S. Pioneer Prop.](#), 2014 WL 11514533, at \*2 n.2 (W.D. Tenn. Aug. 12, 2014)). *Hadley's* foreseeability rule would likely apply to an indemnity claim based on breach of the agreement. See, for example:
  - [Pankey](#), 2014 WL 11514533 at \*2 (the court applying the rule when awarding damages for breach of the indemnity agreement in excess of insurance policy limits); and
  - [Planters](#), 78 S.W.3d at 892 (the court stating "Though it may be possible that some negligent acts by a landlord could be so remote to the landlord/tenant relationship as to render the coverage of an otherwise applicable indemnity clause ambiguous.").

Therefore, if appropriate, parties should include reasonably foreseeable language in the indemnity provision to ensure that the common law rule of reasonableness applies (see [Nissan](#), 2014 WL 5410296, at \*2, \*7-8).

- **Limitations in the underlying contract language.** The scope, depth, and duration of the indemnifying party's representations, warranties, and covenants impact the indemnified party's

indemnification rights for breach of the agreement. For example, the seller of a business often makes a series of representations about its business and the enforceability of the agreement to induce the buyer to enter into the transaction. If a statement is untrue when made, then the seller has breached the agreement, and the buyer may have an indemnification claim on this basis. If the statement is true when made, but becomes untrue some time later, then the seller has not breached the agreement, and the buyer does not have an indemnification claim (unless the seller breaches a corresponding covenant). To the extent that a representation is qualified, the indemnification for breach of that representation will also be correspondingly limited. For sample representations and warranties, see [Standard Clauses, General Contract Clauses: Representations and Warranties](#).

For more information on indemnity for breach of the agreement, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\)](#).

### **Occurrence-Based Indemnities**

Indemnity clauses frequently cover liabilities based on specific occurrences. A broad occurrence-based indemnity obligation may, for example, cover all negligent acts or omissions of the indemnifying party. Occurrence-based indemnities can be narrowed, including by:

- Limiting coverage to specific claims or liabilities. The claims may be known or unknown, contingent or non-contingent, or cover a specific subject matter, such as:
  - environmental harms;
  - claims arising in a specific jurisdiction; or
  - losses associated with specific pending litigation.
- Limiting the scope of activities and qualifying the standard of care, for example, by replacing "negligent acts or omissions" with "negligent work" or limiting the indemnification obligation to apply only when the indemnifying party is solely negligent.

## Limitation of Liability Approaches

Parties should customize indemnity coverage to be reasonably consistent with the transaction-related risk and the parties' negotiating posture. Parties can control the impact of the indemnity by:

- Carefully tailoring the language, by negotiating, for example:
  - exceptions to the indemnifying party's obligation to indemnify (see [Exceptions to Indemnification](#));
  - the degree to which either party has the right or the obligation to control the defense of an indemnified claim (see [Control of Defense Provisions](#));
  - the degree to which the indemnified party has the obligation to notify the indemnifying party of third-party claims (see [Notice of Third-Party Claims](#));
  - indemnification deductibles (see [Liability Baskets](#));
  - an indemnification cap (see [Maximum Liability \(Limitation of Liability\)](#)); and
  - materiality and other indemnification qualifiers (see [Materiality and Other Qualifiers](#)).
- Integrating the language with the agreement's other risk allocation provisions, for example:
  - waiver of consequential damages (see [Waiver of Incidental and Consequential Damages](#));
  - sole remedy provisions (see [Sole Remedy Provisions](#)); and
  - assignment rights (see [Assignment Rights](#)).

## Exceptions to Indemnification

Indemnity coverage commonly excludes circumstances where the indemnified party's own actions cause or contribute to, in whole or in part, the harm triggering indemnification. For example, an indemnification provision may exclude the indemnified party's:

- Negligent or grossly negligent acts or omissions, or willful misconduct.
- Use or alteration of the products that does not conform with the specifications.

- Bad faith failure to comply with the agreement.

For a party to receive indemnity for its own negligence under Tennessee law:

- The parties must state that intent in expressly clear and unequivocal terms (for example, "including indemnitees' acts of negligence") (see [Kellogg, 496 S.W.2d at 473](#); see also [Wells, 435 S.W.3d at 747-49](#)).
- General, broad, and seemingly all-inclusive language in the indemnity agreement is not sufficient to impose liability for the indemnified party's own negligence (see [Summers Hardware, 794 S.W.2d at 362](#)).

Also, an indemnity agreement may not indemnify a party from damages caused by gross negligence or willful conduct on the part of the indemnified party ([Adams v. Roark, 686 S.W.2d 73, 75-76 \(Tenn. 1985\)](#); [Childress, 777 S.W.2d at 1](#); and [Planters, 78 S.W.3d at 893](#)). For other exceptions to indemnification, see [Statutory and Common Law Barriers to Enforcement](#).

For an example of an exceptions clause in an indemnity provision, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Section 2.1](#). For common indemnity exclusions found in the loan agreement context, see [Practice Note, Loan Agreement: Expenses and Indemnification: Exceptions to Expense Reimbursement Obligation](#).

## Waiver of Incidental and Consequential Damages

This waiver, which often disclaims a host of non-direct damages including indirect, consequential, incidental, punitive, and special, limits the indemnifying party's liability to certain actual and direct damages and reduces the amount the party may otherwise be liable to pay. For definitions of certain of these damages, see [Practice Note, Loan Agreement: Expenses and Indemnification: Waiver of Consequential Damages, Etc.](#) For a sample waiver of incidental and consequential damages, see [Standard Clauses, General Contract Clauses: Limitation of Liability \(TN\)](#).

When drafting and negotiating an indemnification provision, parties should understand whether and how this type of waiver impacts the indemnification provision. For example, if the indemnity for third-party claims is not excluded from the waiver, the indemnifying party is not required to pay for indirect and

consequential damages stemming from third-party claims even though these damages are caused by its own bad acts (see, for example, [Beaunit Corp. v. Volunteer Nat. Gas Co.](#), 402 F. Supp. 1222, 1224 (E.D. Tenn. 1975)).

In *Beaunit*, a court held that an express warranty provision (which excluded all special, indirect or consequential damages for breach of the express warranty) precluded a third-party plaintiff's indemnity claim based on an alleged breach of an implied warranty. If parties intend for the indemnity to cover **all** liabilities stemming from third-party claims (including consequential and so on), then the parties should exclude indemnification from the waiver, at least to the extent that it relates to third-party claims.

## Control of Defense Provisions

As the paying party, the indemnifying party wants to control the defense to better regulate its expenses and liabilities. However, the indemnified party, as defendant, may want to control the defense to protect its own legal status, reputation, and liability.

In some states, the obligation to defend also provides the indemnifying party the right to control the defense, unless the agreement states otherwise. Under Tennessee law, the indemnifying party does not have an absolute right to control the methods and means that a defense attorney chooses. The indemnifying party, however, frequently exercises its control over the defense. Indemnity agreements also frequently state that the indemnifying party will have control over the litigation. (See, for example, [Givens v. Mullikin ex rel. Estate of McElwaney](#), 75 S.W.3d 383, 395 n.5 (Tenn. 2002).)

The Tennessee Supreme Court has addressed the right to control litigation when analyzing the relationship between an insurance company, the insured, and an attorney retained by the insurance company to represent the insured (see [Givens](#), 75 S.W.3d at 395; see also [Petition of Youngblood](#), 895 S.W.2d 322, 328 (Tenn. 1995)). The court found that:

- An insured party is the sole client of an attorney hired by an insurer pursuant to a contractual duty to defend ([Givens](#), 75 S.W.3d at 396).
- The client maintains the right to control the objectives of the representation ([Givens](#), 75 S.W.3d at 396).

If the insurance company asserts control over the litigation, as is often the case, the insurance company may not impair the attorney's complete loyalty to the client with regard to the performance for the client of the legal services or with regard to any matter touching on the attorney-client relationship between the attorney and the insured ([Youngblood, 895 S.W.2d at 328](#)). The insurance company cannot:

- Control the details of the attorney's performance.
- Dictate the strategy or tactics employed.
- Limit the attorney's professional discretion with regard to the representation of the insured.

([Youngblood, 895 S.W.2d at 328](#).)

As the client, the insured may reject the insurer's directions to the attorney that affect the case's merits or the insured's rights. However the insured typically runs the risk of the insurer either issuing a reservation of rights or declining to participate in the defense or indemnification. ([Givens, 75 S.W.3d at 397 n.7](#).)

If representation by the same counsel presents a genuine conflict of interest between the parties, Tennessee law may grant the indemnified party the right to obtain independent counsel (*Board of Professional Responsibility of the Supreme Court of Tennessee, 2000 WL 1687507*; see also [Coleman, 218 F. Supp. 3d at 607](#) (citing *CHI of Alaska, Inc. v. Emp's Reinsurance Corp., 844 P.2d 1113, 1121 (Alaska 1993)* (holding that the unilateral right to select independent counsel is subject to the implied covenant of good faith and fair dealing))). However, for more certain protection and control over its liabilities, an indemnified party can seek contractual rights, such as the right to:

- Assume the defense, either outright or based on certain contingencies (for example, conflict of interest or inaction of the indemnifying party).
- Consent to settling the claim or entry of a judgment, either outright or based on certain contingencies (for example, if the judgment will negatively impact the indemnified party's financial interest or reputation).
- Consent to counsel selection.
- Participate in the defense (possibly at its own expense).

For an example of a Control of Defense Provision, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Section 3](#).

## Notice of Third-Party Claims

The indemnifying party is usually better able to limit its liability if:

- It has prompt notice of a covered third-party claim.
- The indemnified party agrees to cooperate throughout the disposition of the claim.

However, under common law, the indemnified party's failure to give the indemnifying party notice of covered claims does not relieve the indemnifying party from its indemnity obligations (see, for example, [Sears Roebuck and Co. v. Strey](#), 512 F. Supp. 540, 542 (E.D. Tenn. 1981)). Therefore, an indemnifying party may want to insist on prompt notice of a third-party claim.

The main point of contention regarding notice typically relates to whether the indemnified party's late or defective notice excuses or limits the indemnifying party's obligation to indemnify. To avoid this potential conflict, the parties should specify whether indemnification:

- Is conditioned on notice.
- Covers litigation expenses that were incurred before notice.

## Liability Baskets

Liability baskets are common in corporate transactions like asset and stock purchase transactions, but uncommon in commercial transactions like the sale of goods and services. However, sellers that engage in multiple transactions with individual buyers should consider including this provision, as the cost of indemnifying a relatively small third-party claim could greatly exceed the value of the commercial agreement.

Generally, a basket shields the indemnifying party from having to indemnify an otherwise covered claim unless and until the amount of losses resulting from covered claims exceeds a defined amount. The parties can structure the basket as either a:

- **Threshold**, so that once the agreed amount is reached, the indemnifying party is liable for the total amount of losses (sometimes referred to as a "tipping," "dollar one," or "first dollar" basket).
- **Deductible**, so that once the agreed amount is reached, the indemnifying party is only liable for the amount of losses in excess of the agreed amount (sometimes referred to as an "excess liability" basket).

For an example of a liability basket provision, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Section 2.2](#) and the accompanying Drafting Note, which also discusses the possibility of structuring the liability basket as hybrid threshold/deductible basket or a **mini-basket**. A party could even establish a "mini-basket," where an individual loss must exceed a certain dollar threshold to be applied to the basket itself.

### **The Implications of a Liability Basket on the Obligation to Defend**

Parties may choose to limit an obligation to defend using a liability basket. In this case, the obligation to defend may arise before the liability basket threshold has been reached. Parties should consider clarifying the parties' rights and responsibilities by obligating the indemnified party to reimburse the indemnifying party for all non-covered amounts in this event.

### **Maximum Liability (Limitation of Liability)**

An indemnifying party with negotiating leverage may insist on a monetary cap on indemnity. As with other types of liability caps, the indemnifying party should ensure that this provision:

- Caps its potential liability to a fixed amount.

- Limits the maximum aggregate liability for all potential claims that may arise under the agreement, not just for individual claims.

The indemnification cap may appear in a general limitation of liability clause covering all contract liabilities (including indemnity) or as part of the indemnification provision. A limitation of liability covering all contract liabilities will impact the indemnity provision, unless indemnification is explicitly excluded from the cap.

For an example of a maximum liability clause, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Section 2.3](#).

If the agreement includes a cap on the maximum liability for indemnification, parties should ensure that the agreement does not contain any other provisions that could potentially conflict with the stated limit (see, for example, *Harper v. Kelley*, 1991 WL 220611, at \*2 (Tenn. Ct. App. Oct. 31, 1991) (concluding that ambiguities regarding the applicability of an insurance policy's cap would be construed in favor of the insured and reversing the trial court's cap on insured's damages)).

### **Implications of Maximum Liability on the Obligation to Defend**

Parties may choose to limit an obligation to defend using a liability cap. In this case, the obligation to defend may continue after the liability cap has been reached. Parties should consider clarifying the parties' rights and responsibilities by obligating:

- The indemnifying party to continue the defense.
- The indemnified party to reimburse the indemnifying party for all non-covered amounts in this event.

### **Sole Remedy Provisions**

A sole remedy provision prohibits the indemnified party from recovering damages for covered claims beyond the terms set out in the indemnification provision. Without a sole remedy provision, the indemnified party may be able to use a non-indemnity related contractual remedy or remedy at law to recover more than what the indemnifying party thought the parties had originally bargained for.

With a sole remedy provision, the indemnified party can look only to the indemnification provision for recourse on covered claims. Similarly, an exclusive remedy provision in a contract may also preclude a party's claim for indemnity ([T.C.A. § 47-2-719](#) (allowing parties to a contract for the sale of goods to modify or limit available remedies); see also [Baptist Mem. Hosp. v. Argo Const. Corp.](#), 308 S.W.3d 337, 345 (Tenn. Ct. App. 2009) (holding that a contract provision providing that the exclusive remedies were repair, replacement, or refund precluded a cross-plaintiff's implied indemnity claim)).

In addition, the indemnifying party should ensure that the agreement does not contain a cumulative remedies clause that could conflict with this provision and, as a result, provide the aggrieved party an opportunity to seek damages or remedies beyond the scope of what is provided in the indemnification clause. Parties should, if appropriate, exclude the indemnification clause from the cumulative remedies provision.

For an example of a sole remedy provision, see [Standard Clauses, General Contract Clauses: Indemnification \(TN\): Section 2.6](#).

## Mutual Indemnities

Commercial contracts often include mutual indemnification provisions. Under a mutual indemnification provision, each party indemnifies the other (see, for example, [Cascade Ohio, Inc. v. Modern Machine Corp.](#), 2010 WL 4629467, at \*5 (Tenn. Ct. App. Nov. 15, 2010)). While mutual, each indemnity obligation is not necessarily identical or proportional to the other. The extent to which the provision is balanced depends on the allocation of risk and negotiating power between the parties. Each indemnifying party should strive to tailor the indemnity to cover only the risk it has agreed to shoulder.

The mutuality of an indemnity can serve to mitigate risk for either or both parties by:

- Reducing the likelihood of litigation between the parties.
- Strengthening the contractual relationship.
- Establishing certainty regarding future potential liability.

## Materiality and Other Qualifiers

Often, the representations and warranties in the agreement are subject to materiality or other qualifiers. For example, a warranty may state: "Seller represents and warrants that products are free from **material** defects in material and workmanship."

These qualifiers prohibit the non-breaching party from recovering damages for the breach unless it can prove that the nature or the subject matter of the breach, as the case may be, was material. Indemnity for breach of a contract provision does not negate the qualification placed on that provision, and so to this extent the unqualified indemnification is similarly diluted, unless the contract has an express statement to the contrary.

In Tennessee, to determine whether a breach is material, courts look to Section 241 of the Restatement (Second) of Contracts, which examines:

- The extent to which the injured party will be deprived of the benefit which he reasonably expected.
- The extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived.
- The extent to which the party failing to perform or to offer to perform will suffer forfeiture.
- The likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances.
- The extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

*(Forrest Const. Co., LLC v. Laughlin, 337 S.W.3d 211, 225–26 (Tenn. Ct. App. 2009).)*

Sometimes, the parties agree to qualify the indemnification provision with materiality. The parties should consider the consequences of qualifying the indemnification provision with materiality because:

- It introduces a second layer of materiality if the underlying representation is already qualified by materiality. In this case the indemnifying party indemnifies only if it materially breaches a provision that may already be qualified by materiality. This is sometimes called double materiality.
- It introduces a new layer of materiality to representations that the indemnifying party may have negotiated without qualification. This is sometimes called back-door materiality.
- The indemnifying party may already have negotiated protective qualifiers like indemnification baskets, which act as a kind of materiality qualifier (see [Liability Baskets](#)).

## **Representation and Warranty Insurance and Escrow**

Like most other contractual obligations, indemnification is only valuable if the indemnifying party stands behind its promise. If an indemnifying party is a significant credit risk, then the indemnified party should consider requiring the indemnifying party to obtain a minimum amount of representation and warranty insurance. Parties commonly use insurance contracts to:

- Supplement, or even substitute, indemnity obligations.
- Induce counterparties to enter into the transaction.

The insurance policy can usually be tailored to correspond to the transaction at hand.

Similarly, an indemnified party may seek a portion of the purchase price to be held in escrow to satisfy the seller's indemnification obligations. These funds are often held in escrow for the duration of the indemnity survival period.

Both insurance and escrows for indemnification obligations are more commonly used in M&A transactions but less frequently relied on in commercial contracts.

## **Assignment Rights**

Assignment of the agreement could unexpectedly alter the risk allocation in the transaction. For example, the indemnifying party may assign the contract to a third party that cannot honor the indemnity obligations. Absent language to the contrary, Tennessee common law applies and permits assignment in most cases (see [Price's Collision Ctr., LLC v. Progressive Hawaii Ins. Corp.](#), 2013 WL 5782926, at \*1 (M.D. Tenn. Oct. 28, 2013)). Under Tennessee law, a contractual right is generally assignable unless:

- The assignment would materially:
  - change the duty of the obligor;
  - increase the burden or risk imposed on him by his contract;
  - impair his chance of obtaining return performance; or
  - reduce its value to him.
- A statute or public policy prohibits the assignment or makes it inoperative.
- The assignment is validly precluded by contract.

(See [Petry v. Cosmopolitan Spa Int'l, Inc.](#), 641 S.W.2d 202, 203 (Tenn. Ct. App. 1982).)

Parties should therefore consider seeking assignment limitations, such as consent requirements, if appropriate. When a contract requires consent to the assignment of an agreement but is silent regarding when a party may withhold consent, the implied covenant of good faith and fair dealing requires the party to make its decision about consent in good faith and in a commercially reasonable manner (see [Dick Broad. Co. v. Oak Ridge FM, Inc.](#), 395 S.W.3d 653, 669 (Tenn. 2013)). Parties may expressly provide in a contract that a non-assigning party may, in its sole, absolute and unfettered discretion, withhold consent for any reason or for no reason ([Dick Broad](#), 395 S.W.3d at 669).

Tennessee law distinguishes between the right to assign performance and the right to receive proceeds arising from a loss or damages from a breach (see [Zaharias v. Vassis](#), 789 S.W.2d 906, 910 (Tenn. Ct. App. 1990); see also [Ford v. Robertson](#), 739 S.W.2d 3, 5 (Tenn. Ct. App. 1987)). For example, an insured may assign an insurance policy after a loss has occurred, despite an anti-assignment clause prohibiting assignments without the consent of the insurer. In this instance, the assignment is allowable because the assignee "stands in the shoes" of the assignor and only receives the rights that were held by the assignor. ([Price's, LLC](#), 2013 WL 5782926, at \*1 n.2.)

For more information on assignment limitations in Tennessee, see [Standard Clauses, General Contract Clauses: Assignment and Delegation \(TN\)](#). For information on assignability of commercial contracts, see [Practice Note, Assignability of Commercial Contracts](#).

## Duration of Indemnity

Indemnifying parties often impose time limitations on indemnity and related provisions to control liability. Absent an agreement to the contrary, Tennessee law statutes of limitations dictate the length of time that a party has to raise a claim, including an indemnity claim ([State Q&A, Statutes of Limitations: Tennessee](#)).

There is no statute that expressly provides a statute of limitation for indemnity claims. However, Tennessee courts have applied Tennessee's six-year statute of limitation period for contract claims to claims of indemnification based on an indemnification provision in a contract. ([Nissan N. Am., Inc., 2013 WL 3778729, at \\*4-5](#)). However, the parties can generally expressly contract for a shorter limitations period (see [Baptist Mem. Hosp., 308 S.W.3d at 349](#)).

Under Tennessee law, statutes of limitation for an action for indemnity do not commence until there has been a payment made or some loss suffered by a party seeking indemnification ([Sec. Fire Prot. Co. v. City of Ripley, 608 S.W.2d 874, 877 \(Tenn. Ct. App. 1980\)](#)). A federal court in Tennessee has explained that:

- The statute of limitation clock for a breach of a duty to indemnify starts when the underlying claim is resolved, including any appeals on the claim.
- A breach of the duty to defend may accrue at an earlier date, for example, when the party refuses to assume control of the underlying claim

(See [Nissan, 2013 WL 3778729, at \\*6](#).)

Nevertheless, a court may refuse to allow a party to untimely amend a pleading to assert an indemnity claim, even if the claim has not accrued at the court's deadline for amendments ([CBR Funding, LLC v. Jones, 2015 WL 12857355, at \\*2 \(W.D. Tenn. 2015\)](#)).

In some states, time limitations on indemnity claims vary depending on the type of claim (for example, a tort claim may have a different time limitation than a breach of contract claim), and whether the claim is a:

- **Direct claim.** In some states, the statute of limitations clock starts once the claim underlying the indemnity accrues and the length of time the indemnified party has to file the claim depends on the type of claim. This is not the case in Tennessee. In Tennessee, courts have applied the six year limitation period for actions in contract to express claims of indemnification (see, for example, [Nissan, 2013 WL 3778729, at \\*6](#) (the court rejected the indemnifying party's argument that the four-year statute of limitations for actions involving the sale of goods would apply to the purchaser's express indemnity claim)). Parties often limit the duration and survivability of contract terms, for example, to have the representations survive the deal closing but expire 30 days after the contract's effective date. For an example of a survival provision, see [Standard Clause, General Contract Clauses: Survival \(TN\)](#). For a direct claim such as this, the contractual time limitations supersede the statute of limitations.
- **Third-party claim.** Absent an agreement to the contrary, the statute of limitations limits:
  - the amount of time the third party has to bring a claim against the indemnified party (the statute of limitations clock starts from the time the claim accrues); and
  - the amount of time the indemnified party has to bring an indemnity claim against the indemnifying party. As noted above, the statute of limitation clock starts for a breach of a duty to indemnify when the underlying claim is resolved (see [Nissan, 2013 WL 3778729, at \\*6](#); see also [Sec. Fire Prot., 608 S.W.2d at 877](#)).

Ideally, the duration of the indemnity gives the indemnified party a reasonable amount of time to discover any covered breach or third-party claim. Parties should consider customizing indemnity duration in the agreement after:

- Analyzing each potential claim and its related statute of limitations.
- Coordinating the time limitations of each of the covered claims and the term and survival period of the contractual indemnity.

For a sample contractual statute of limitations clause, see [Standard Clauses, General Contract Clauses: Contractual Statute of Limitations \(TN\)](#). For a discussion of indemnity duration in the context of acquisition agreements, see [Practice Note, What's Market: Indemnification Provisions in Acquisition Agreements](#).

## Alternatives to Indemnification

Indemnification is often a highly negotiated provision, and sometimes the benefits are not worth the battle.

With this in mind, parties should consider alternatives to indemnity, including:

- Relying on Tennessee common law or statute for recourse (for example, bringing a lawsuit for breach of warranty, breach of contract, or fraud).
- Conditioning the purchase price on fulfillment of certain conditions.
- Using a right of offset by escrowing a part of the consideration with a third party.
- Deferring payment so that the indemnified party can deduct potential indemnity payments from future payments.
- If you are the buyer, using your own subsidiary to purchase the seller or the seller's assets to confine the transaction-related risk to that subsidiary.
- Providing contractual work-arounds for anticipated problems (for example, requiring the infringing party to provide a non-infringing replacement in the event of intellectual property infringement).
- Using other risk allocation provisions to limit overall risk (see [Practice Notes, Risk Allocation in Commercial Contracts](#) and [Remedies: Adequate Liability Coverage](#)).

Excluding an indemnification provision may increase the likelihood of dispute. Therefore, parties should consider including a strong dispute resolution provision, especially absent an indemnity clause. For a sample dispute resolution clause, see [Standard Clauses, General Contract Clauses, Alternative Dispute Resolution \(Multi-Tiered\)](#).