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Indemnities: The plain English guide for tech businesses

Any contract or contractual negotiation for our tech business clients will nearly always feature a discussion about indemnities. Ignore the indemnities in a contract and you could be literally committing commercial suicide. In fact, if you did ignore the wording of an indemnity it could reduce the value of your business at exit, and/or invalidate your professional indemnity ("PI") insurance cover and leave you with a very big legal bill if a PI infringement claim was brought against you.

As a result, when we are asked to give a 'once over' on a contract we will always look very carefully at any indemnities. The reason being that indemnities are:

- Closely looked at for any due diligence ahead of a funding round for a tech company, to make sure that any indemnities don't go further than they should
- A part of any contract, which could leave either the seller or buyer open to huge liabilities, regardless of the cap that, has been put on the contract liabilities.
- Commonplace for technology contracts, particularly regarding IP infringements
- A route to being sued for IP infringement, even if it isn't your fault. This will always be incredibly expensive, both in terms of time, money and reputation.

1. Common indemnity features

"oh, just one more thing, I don't think there will be a problem. Can you give this contract a quick once over please" – a fairly normal and regular request

from one of our clients. We, of course, agreed for our client. As always when we see a contract which has been provided by the customer, the indemnity tends to be pretty broad, and in this case, potentially bankrupting for our client. This is not an isolated example! After negotiating on behalf of our client, we reduced our client's liability with the indemnities to a point where both parties felt comfortable.

Probably the easiest way of thinking about an indemnity is it is an insurance policy for the customer. Most indemnities are worded such that is *pound-for-pound recovery for the customer*, without needing to go to court to get the right to recover costs.

An indemnity in a contract is normally agreeing the following:

- The product/service provider will pick up the tab for costs incurred by the customer as a result of an IP infringement

- What happens if it is only an alleged infringement? I.e. who will pick up the costs for the customer seeking legal advice in respect of any potential claim.

- What costs the provider is actually liable for. These are typically damages, reasonable legal fees, settlement agreement costs, court costs

- Who has control over any IP infringement claim (I will talk more about this later on in this article)

2. IP Infringements

Our client contacted us as they were getting towards the end of a significant piece of software development for a large customer. His professional indemnity insurance didn't cover patent infringements to the level he potentially needed. As always with these projects, money is very tight in the development phases. Like many software development houses, they only get fully paid when the software is delivered, integrated and fully tested. Therefore, he wanted to have an innovative solution where he could limit his patent searches and his potential exposure. Our client was understandably concerned about the extent to which they would need to do global patent searches, especially as his coding may infringe some of the mobile telephony patents. This is a fairly frequent dilemma faced by many of our tech businesses; how to balance risk with the cost of mitigating the risk. This is where we will often negotiate a suitable contractual arrangement, on behalf of our clients to help save them money, but take a pragmatic view of the commercial risks involved. As a result of our conversation, our client was able to get peace of mind by saving vital development funds by only focusing the patent searches in the major markets, backed up by an indemnity clause, which his customer agreed to.

Let's start with IP infringements, which are either patent infringements or copyright infringements. Because it is fairly easy to prove or disprove copyright infringements, the scope of indemnities against copyright infringement is not normally an issue in negotiations.

Patent infringement is another matter entirely! Very often, it is possible that a tech provider could unwittingly be infringing a patent. These have all happened to our clients at some point in time, for example:

- Their customer could modify their technology and in doing so infringe a patent
- Their customer could combine their technology, which could then infringe a patent
- The tech provider could take a commercial decision, to not go to the time and expense to do all the possible searches in all the possible territories where a patent could have been taken out.

3. How to reduce exposure on your indemnities

As I looked over the contract, giving it the 'once over', alarm bells started to ring. Our client's customer, a bank, was asking for uncapped liability for any intellectual property infringements. This was not a one-off. Many contracts, which are written in the customer's favour, tend to ask for uncapped liability. Agreeing to a contract with uncapped liability is commercial suicide and basically uninsurable. If such a claim arose, and pursued to the end, it could have meant our client going bust. We helped our client to negotiate a cap on the IP infringement cover which was aligned to our client's professional indemnity level of cover.

Part of our role on behalf of our tech clients is to help reduce their exposure on any indemnity that they need to provide. Typically this will include:

- Limiting where the indemnity for IP infringement actually applies. Is this a global indemnity or just selected territories?
- Is it all costs? Or just court awarded costs?
- Is it time limited? i.e. just for the life of the contract
- An option to rejig the technology so it no longer infringes
- Buying a licence to cover the infringing bits

- Supplying an alternative piece of technology so the customer is no longer infringing IP rights

- If the customer has modified or combined the technology, or not used it with the provider's instructions, then the indemnity is no longer valid.

- Putting a cap on the liability for an indemnity, which is normally agreed at the level of your professional indemnity insurance.

4. How to reclaim control over your indemnities

Our client had a problem. It was in the final stages of agreeing terms with a much larger customer. As so often happens with these situations there was a legal sticking point over the indemnity clauses in the contract. Any big company will always want to have control to defend any IP infringement claim that may arise. However, our client – quite sensibly – needed to keep control of any claim as their PI insurer stated that their policy would be invalidated if the insurer could not lead the claim. Typically, the way around this sort of contractual problem is for the provider of the service, i.e. our client in this case, to agree to consult with their customer in an event of a claim, but not do anything that would diminish their customer's position and reputation. As a result of our timely intervention, the contractual problem with the indemnities was solved quickly and the ink was soon dry on the contract!

One of things we will always push hard for, on behalf of our clients, is to control the claim. i.e. run the defence for the claim. After all, the last thing you want is your customer settling expensively, when there is actually no claim to be answered. Ideally, as the technology provider, you want to be in control of any claim, not just for monetary reasons. Often if there is one claim, there are likely to be more IP infringements which will produce claims. Ideally you want to fight one global claim, rather than occur higher costs by dealing with multiple IP infringement claims.

Getting control over any claim is not always easy as many big companies, whose 'reputation is paramount', do not want a small technology provider controlling any potential claim.

Here are some of the other ways, using *qualifications*, that tech providers can gain more control over any IP infringement claim:

- If you receive a claim you must tell us pronto, so we can potentially head off any claim

- You have to give us as much information as we need and cooperate with us

- You must cooperate with us before settling any claim

- If we get an IP infringement claim we can cancel the contract and walk away, and pay back any monies owing.

5. In summary

With indemnities the devil is very definitely in the detail. However, even if you are negotiating with a much bigger company, there are always creative ways of limiting your exposure with the indemnities that they are asking for.

Next time you have a contract to negotiate with a potential customer or supplier, why not let ***ClaydenLaw*** give it the once over? Our trained eyes may spot an indemnity, and assist you to avert the great risk therein for you and your business.

Please be aware that these notes have been compiled for general guidance only and should not be considered as specific legal advice.