

What You Need to Know About Indemnity Provisions

By Paul A. Rianda, Esq.

One of my recent articles for Transaction World concerned the various contractual provisions in an agent agreement. The response I received on this article was dramatically more than I have received from any of the other articles I have written for this publication. Consequently, I will be writing another series of articles focusing on the various contractual terms in a typical agent agreement between an ISO and sales agent. This month's article is an overview of indemnity provisions.

What is an Indemnity Provision:

The indemnity clause in most contracts is usually clearly labeled as such. There is generally a paragraph labeled "indemnity" or even an entire section of the typical agent contract devoted to the indemnity provision and various other related aspects, such as the way in which a lawsuit must be defended. Even without the heading, you can easily identify the indemnity provision generally by the words that are used in it such as "the agent agrees to hold the ISO harmless for all fees, costs and obligations arising from . . ." followed by a list of various circumstances under which an agent would owe an ISO an indemnity obligation.

An indemnity provision obligates one or both parties to a contract to provide a defense and indemnity to the other party in the contract. In plain English, this means that if one party to the contract is sued, the other party has to pay for defending the lawsuit and also potentially for any settlement or judgment rendered against the other party. As to the defense obligation, this could entail having to hire and pay a defense attorney for the party to whom you owe the indemnity obligation. In addition, items such as expert witness fees, copying costs, transportation, lodging letter fees and other costs associated with defense of the action can also be recoverable.

The indemnity portion of the obligation comes into play when the case is settled or there is a trial or arbitration. If there are settlement negotiations during the lawsuit, the party providing the indemnity to the other party must engage in the settlement negotiations and then fund any settlement that is mutually agreed upon. In addition, if indeed there is a judgment after a trial or arbitration against the party to whom you owe the indemnity obligation, conceivably you would have to pay that judgment or arbitration award.

Indemnity provisions can be either "mutual" or only favor one party, according to the terms of the agreement. In the past, a typical agent contract between an ISO and a sales agent had an indemnity provision that only favored the ISO. What this means is that if the agent engages in conduct that could trigger the indemnity provision, the agent would owe a defense and indemnity to the ISO. The reverse was not true, however, in these unilateral provisions, to the extent that there was no duty on the part of the ISO to defend and indemnify the sales agent if the ISO engages in conduct that causes the sales agent to be sued.

More and more contracts I see now have a "mutual" indemnity provision. This means that not only can the ISO potentially be entitled to defense and indemnity if the sales agent commits certain

acts, but also the sales agent can depend on the ISO to defend and indemnify it in any actions where the ISO potentially causes the sales agent to be sued.

Indemnity provisions can be triggered by a number of different types of conduct. One of the most typical types of indemnity provisions triggers upon a “breach of the agreement” by the agent or the ISO. What this means is that if the agent or the ISO breach any of the terms, which usually numbers in the tens if not hundreds set forth the agreement, then the other party can ask for a defense and indemnity of any lawsuit that is brought. This means that every single provision in the agreement, such as things like the sales agent’s pledge to comply with all Visa and MasterCard regulations, not violating state and federal laws regarding marketing and other sundry other provisions, could allow for the ISO to demand its indemnity rights under the agreement.

Invoking the Indemnity Provision:

In the context of an agent agreement between an ISO and a merchant-level salesperson, the indemnity obligation is usually invoked when a merchant sues either the ISO or the sales agent. The first typical scenario would be where the merchant alleges there was some kind of misrepresentation or other type of actionable conduct that occurred by the sales agent during the sales process. This could range for example from a misrepresentation regarding the monthly sales volume of the merchant to other items such as the compatibility of equipment with the merchant’s existing systems. The merchant would generally then sue the ISO and possibly also the sales agent. If the ISO in this case were sued, it would generally invoke its rights under the indemnity provision to make the sales agent pay for its defense and indemnity in such a case.

The other typical type of lawsuit in this industry is where an ISO engages in conduct, such as holding a merchant’s funds, which causes the merchant to sue both the sales agent and the ISO. In these circumstances, in a situation where there is a mutual indemnity provision since the sales agent was not responsible for holding the funds, the sales agent would generally be able to invoke the indemnity provision and ask the ISO to defend and indemnify the sales agent.

Given the expense of litigation, and the potential for large settlement or judgments, the indemnity provision is a critical provision to any agent. This is especially true for those sales agents who enter into contracts in their own name instead of the name of a corporation, limited liability company, or other corporate-type of entity. If you as a sales agent sign an agent agreement as an individual or personally guarantee such a contract, you could personally be liable for the defense and indemnity obligations under that agreement. This type of exposure is generally the greatest exposure sales agents face under an agent contract, other than the potential charge back liability in a shared risk arrangement.

It is imperative as a sales agent that you make sure that any indemnity provision that is in an agreement that you sign is at the very least mutual. In addition, it is very important to make sure that your liability is limited as much as possible. For instance, often times I suggest that the indemnity obligation as to the sales agent only be triggered if there is some type of fraud where the agent has been complicit in causing the harm to the ISO.

For the most part, I find that sales agents do not fully understand their indemnity obligations or their potential of personal liability for the indemnity obligations. For this reason, it is imperative that you closely analyze any indemnity provision and make sure that it is as limited as possible regarding your exposure to defend and indemnify the ISO and that the ISO provides you with reciprocal indemnity.

* Paul A. Rianda, Esq. is a partner in the Southern California law firm of Kring and Chung, LLP, and has worked in and with the bankcard industry for the past 8 years. For more information about this article or any other matters, please contact Mr. Rianda at (949) 261-7700 or via email at prianda@kringandchung.com.

** The information contained herein is for informational purposes only and should not be relied upon in reaching a conclusion in a particular area. The legal principles discussed herein were accurate at the time this article was authored but are subject to change. Please consult an attorney before making a decision using only the information provided in this article.