Dear General Counsel: Practical Insight for Business Owners

November 1, 2021

Porzio Business Law Update

With expectations rising, resources diminishing, and the complexity of life skyrocketing, today's business owners need practical solutions to their most common legal issues and questions. As experienced general counsel, we are thrilled to introduce our newest communication, Dear General Counsel: Practical Insight for Business Owners, where we will answer all of your questions and share practical insight to help lighten the load and shed light on some of the common and not-so-common legal issues faced during the course of growing and maintaining your business.

In today's edition, Porzio principal and experienced general counsel, David Carlson, answers questions and offers helpful tips on indemnity clauses, confidentiality agreements, and assignment clauses.

Have a question for a General Counsel? Click here to send us a question or topic for a future edition.

Q: Dear General Counsel,

My company wants to hire a vendor and the agreement contains an indemnity clause. I have no idea what it means, and my eyes glaze over when I try to read it. Help!

Glazed and Confused in Parsippany

A. Dear Glazed and Confused,

Let me see if I can help. Indemnity clauses are confusing, but if they're drafted well, they can play an important role. Of course, we all hope that you never have to worry about it because if you're looking at the indemnity clause, something has gone wrong with the vendor relationship. But, let's step back and take a look at what the indemnity clause is intended to do—perhaps, most importantly, an indemnity clause is supposed to protect you if you get sued by a third party because of something that a vendor did.

Let me give you an example: Imagine that a vendor has licensed a software product to your company, but someone else comes forward and says that the software product is really her creation and that your company should be paying her instead of the vendor. This third party—let's call her Ellen—sues the vendor and you. You're thinking, “wait a second, I didn't do anything wrong. I just signed a software agreement with the vendor and used the software.”

That's where the indemnity clause comes in. If drafted correctly, you can say to the vendor, “Based upon our software agreement, you agreed to protect me if my company gets sued because of something that you did.” In this context, protect means indemnify. Ideally, the indemnity clause requires the vendor to cover the costs and damages of your company so that you're not out of pocket for any money. Bottom line—don't throw up your hands and ignore the indemnity clause when you're negotiating an agreement for your company. It can either protect you or, depending on the circumstances, it can require you to protect the other party.

Tips for reviewing indemnity agreements:

- Look for indemnity agreements that are mutual so that both parties are protected.
- Make sure the indemnity provisions are not limited to specific causes of action, but rather all claims arising out of the breach of the agreement.
- Excepting out "gross negligence or willful misconduct" from the non-breaching party will make sure the non-breaching party is still on the hook for its actions.

Q: Dear General Counsel,

Frequently, my company is asked to sign confidentiality agreements when we talk to vendors. What's the big deal? Do we really need to sign a confidentiality agreement when we just talk to vendors?

Just Wondering in Whippany

A. Dear Just Wondering,

It depends on who you're talking to and whether one of the parties plans to share information that it typically doesn't share publicly. You might be better off asking yourself whether your company needs a confidentiality agreement when it talks to potential clients or vendors.

For example: if you are evaluating vendors to help your company with a project, and you need to share information about an aspect of your business in order to allow each vendor to submit a proposal to you, you probably should have a confidentiality agreement with each vendor.

What does a typical confidentiality agreement do? In addition to preventing a vendor from sharing information with someone else, it also stops a vendor from using your confidential information outside of a commercial relationship with your company. In other words, the vendor can't learn about your company's design process while preparing a bid and then turn around and copy your design process for its own commercial purposes. On the other hand, what it doesn't do is require either party to enter into a commercial agreement; it simply requires each party to keep quiet about the other party's confidential information.

Tips for dealing with confidentiality agreements:

- Make sure that you spell out what qualifies as confidential information. It can be more than confidential documents; it can also be verbal statements like something you say in a meeting.
- Make sure that the confidentiality agreement requires both parties to keep the other party's information confidential. Even if you don't think you will be sharing anything confidential when speaking with a potential vendor, it's better to be protected just in case.

Q. Dear General Counsel,

One of my vendors is asking me to include language that prevents my company from assigning the agreement. I don't think that I care, but should I?

Not Sure in Morristown

A. Dear Not Sure in Morristown,

The short answer is that you probably should care. Think about it this way—imagine that you want to sell your business. The potential buyer expects to continue to operate the business and needs to make sure that all of the existing agreements are in place post-sale. If you are prohibited from assigning contracts that are important to your business to the buyer, this may make the transaction more challenging to close. Sometimes you see language that says that you can't assign an agreement without the other party's permission. This type of clause makes it harder to close the sale because you will need to go get permission to be able to assign the agreement to the buyer. If you've ever sold a business before, you know that extra contingencies like obtaining a vendor's permission to assign an agreement are the last thing that you need when trying to get to the finish line.

Tips for assignment clauses:

- Try to avoid the assignment prohibition altogether.
- If eliminating the prohibition is not possible, then include language allowing you to assign the contract to a buyer succeeding to substantially all of your business (regardless of whether that buyer is purchasing assets, stock or merging with your company).
- Make sure you are still not on the hook for payments after assigning the agreements to the third party.

These provisions can be difficult to navigate, but our Business Law team is happy to help. For more answers to your business questions, please visit us at our Business Law page here, or contact David J. Carlson with specific questions.

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