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Avoiding an Ambiguous Hold Harmless Clause: What Every Lender Should Consider

Lenders rely on indemnification and hold harmless provisions in commitment and engagement letters to protect against claims that may be brought not only by third parties but by borrowers and their affiliates as well. Such provisions are often standard in lender letters without much room for negotiation or further review. However, a case out of the United States District Court for the Southern District of New York last summer highlights potential language ambiguities lenders should consider, especially in light of the current market uncertainty. And lenders may want to incorporate recommended revisions to form language in order to protect against such risks.

THE CASE: *Stephens Inc. v. Flexiti Financial Inc.*

In July of 2019, a United States District Court for the Southern District of New York (the “Court”) found hold harmless language, located within an indemnification provision of an engagement letter, to be ineffective as a general bar against liability.¹

The case, *Stephens Inc. v. Flexiti Financial Inc.*, involved a breach of contract claim in the context of a merger and acquisition transaction. The Defendant, Flexiti Financial Inc. (“Flexiti”), had engaged Plaintiff, Stephens Inc. (“Stephens”), to act as financial advisor with respect to an acquisition, and the parties executed an engagement letter. Flexiti ultimately refused to pay Stephens for its advising services, thus spurring Stephens to file suit. Flexiti brought two counterclaims against Stephens, which Stephens moved to dismiss. In particular, Stephens pointed to the three-page indemnification rider that was an exhibit to the engagement letter, which stated that “[N]o Indemnified Person shall have any liability to [Flexiti] for or in connection with the Agreement, except for liability for Damages which are finally, judicially

¹ See *Stephens Inc. v. Flexiti Financial Inc.*, No. 18-CV-8185 (JPO), 2019 WL 2725627 (S.D.N.Y. July 1, 2019).



determined to have resulted directly from the gross negligence or willful misconduct of the Indemnified Person.”² While the Court agreed that in isolation the language purports to bar the liability of “Indemnified Persons” in general, it further reasoned that the provision must be read within the context of its location within the engagement letter. The Court was “not persuaded that a general limitation of liability – significantly limiting Stephen’s liability to Flexiti in connection with its performance under the Contract – would be situated in the midst of the indemnification rider, as opposed to the agreement proper.”³ Accordingly, the Court construed the hold harmless language to limit Stephen’s liability to Flexiti only with respect to claims for which Flexiti had agreed to indemnify Stephens under the indemnification rider and not as a general limitation on liability.

CONCLUSION:

Several practical lessons can be gleaned from the Court’s ruling in *Stephens Inc. v. Flexiti Financial Inc.*

First, hold harmless language, limiting a lender’s liability to its borrower and related parties, should be placed separate and apart from any indemnification provision, preferably with each having its own section in a commitment or engagement letter. Second, the hold harmless language should clearly indicate which claims are barred. The barred claims should not be identified or cross referenced as “indemnification claims”. Instead, they should be defined broadly to include any and all types of claims. Finally, the hold harmless section should provide a clear statement describing who cannot bring a claim, meaning – against whom the lender does not have liability. This list of barred claimants, at a minimum, should include the borrower, the borrower’s affiliates, the borrower’s creditors and any other third-party beneficiary.

There has been some recent movement by lenders to re-examine the hold harmless language in their forms of commitment and engagement letters. The team at King & Spalding is here to assist with this type of analysis and provide practical recommendations for language revisions. We will continue to monitor practical applications and any case law surrounding this important lender issue.

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² *Id.*

³ *Id.*