

Negotiating and Enforcing Complex IP Indemnification Provisions

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Agenda

- General Considerations
 - Definitions
- Implied Warranty of Non-Infringement
 - UCC § 2-312
- Drafting
 - 15 Questions to Answer
- Unique Patent Considerations
 - Willful Patent Infringement
 - Joint Liability
 - Unintended Product Uses
 - NPEs
 - Privity Before the USPTO PTAB

Indemnification Provisions

- A promise to compensate someone from losses - a method of shifting risk
 - Breach of a covenant
 - Breach of a representation or warranty
 - Claims by third-parties (e.g., infringement)
 - Other claims
- A duty to indemnify can arise through common law or equitable principles or, more commonly, specific contract language
 - May offer very different remedies as compared to “regular” contract or tort law remedies
 - Rescission vs. damages

Sales of Goods and Services

- **The Uniform Commercial Code § 2-312**

Unless otherwise agreed, a seller that is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer that furnishes specifications to the seller must hold the seller harmless against any such claim that arises out of compliance with the specifications.

Sales of Goods and Services

- **The Uniform Commercial Code § 2-312**
 - Implied Warranty of Non-infringement
 - Merchant/Dealer
 - No specifications
 - No other agreement
 - Rightful claim of infringement
 - Disclaim the UCC Warranty
 - *Landis & Staefa v. Flair Int'l Corp.*, 60 F. Supp 2d 14 (E.D.N.Y. 1999) (rejecting buyer's indemnification claim against manufacturer based on standard disclaimers in sales forms)

Typical Boilerplate Indemnification Provision

Seller, at its own expense, will indemnify, defend, and hold harmless Buyer against any claim, suit, action, or other proceeding brought against Buyer based on a claim that the Product(s) as delivered to Buyer infringes in any manner any patent right of a third party.

Indemnify, Defend, Hold Harmless

- An **indemnity** is an assurance by which one person engages to secure another against an anticipated loss.
 - The loss must have happened before this duty arises
- The **duty to defend** arises at the earliest stages of a dispute and generally exists regardless of whether the party is ultimately found liable
- To **hold harmless** is generally considered the same as “to indemnify,” except it encompasses the broadest possible scope of loss

Strategy Considerations

- Importance of the customer to be indemnified
- Internal sales / revenue pressure
- The strength of the company's patent portfolio in the field
- The strength of competitors' patent portfolios in the field
- The industry's litigiousness
- History of IP claims asserted against the company
- Competitor approaches to indemnification for similar technology

Patent & Technology Licenses

- **Implied Obligations**

- No implied warranty under common law principles
- Typically unilateral, but subject to negotiation
- If you are the licensor, limit your obligations by:
 - Putting a cap on liability
 - Location
 - Avoid providing an express warranty against IP infringement!
 - No consequential, special, indirect damages
 - No modifications

Joint Ventures

- **Joint Venture Agreements**

- No standard common law principles
- Need clear unequivocal provisions to shift risk
 - Each party agrees to indemnify the other according to the technology in which they have expertise/component they provide
- Joint ventures cannot be implied
- Indemnification obligations not automatically terminated

Sample Provision

Scope. The Licensor (the “Indemnitor”) shall indemnify, hold harmless, and defend the Licensee and its directors, officers, employees, and agents and their respective successors, heirs and assigns (the “Indemnatee”) against any and all damages arising out of, resulting from or related to any claim of patent infringement brought by a Third Party accusing any product manufactured by Licensee pursuant to this Agreement of infringing a U.S. patent (a “Third Party Claim”), subject to the limitations set forth below.

Notice. Indemnatee shall give written notice to the Indemnitor promptly after the Indemnatee becomes aware of the facts giving rise to a claim (an “Indemnified Claim”), and in any event within 30 days, specifying in reasonable detail the factual basis of the Indemnified Claim and stating the amount of the damages (or if not known, a good faith estimate of the amount of damages).

Control. Indemnitor shall have the right to control and defend such Third Party Claim, in such manner as it may deem appropriate. Should the Indemnitor decline to or be unable control and defend the Third Party Claim, the Indemnatee shall have the right to control and defend the Third Party Claim in such manner as it may deem appropriate. The controlling party shall select counsel, contractors, experts and consultants of recognized standing and competence reasonably acceptable to the other party, shall take reasonable steps necessary in the investigation, defense or settlement thereof, and shall diligently and promptly pursue the resolution thereof. All parties shall cooperate fully with the party conducting the defense of any Third Party Claim.

Settlement. The party controlling the defense of any Third Party Claim shall be authorized to consent to a settlement of, or the entry of any judgment arising from, any Third Party Claims subject to the following provisions. If the Indemnitor is controlling the litigation, Indemnatee must consent to any such settlement, and such consent shall not to be unreasonably withheld. Indemnatee’s consent will be deemed unreasonably withheld unless the settlement would encumber any of its assets or contains any restriction or condition that would apply to the Indemnatee or to the conduct of its business. If the Indemnatee is controlling the litigation, it may not enter into a settlement or consent to an entry of judgment with respect to any Third Party Claim without the express written consent of the Indemnitor, not to be unreasonably withheld.

Limitations. The Indemnitor’s maximum liability to Indemnatee hereunder shall be \$10,000,000. In no case shall Indemnitor be liable for any consequential, incidental, indirect, special, punitive or exemplary damages (including, without limitation, lost profits, business or goodwill) suffered or incurred by Indemnatee. In no case shall Indemnitor be liable for any damages arising out of Indemnatee’s willful, negligent or reckless conduct.

Reimbursement. Indemnatee shall responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnatee within thirty (30) days of Indemnatee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnatee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Drafting: 15 Key Questions to Ask

1. Type of agreement?
2. Which parties are covered?
3. Who else is covered?
 - For example: “[t]he Licensor (the “Indemnitor”) hereby indemnifies the Licensee and its directors, officers, employees, and agents and their respective successors, heirs and assigns (the “Indemnitee”)...”
4. What types of activities are covered?
 - Combination products/modified products
5. Limitations on liability?
 - Caps, floors, time limits, insurance
 - For example: “[t]he Indemnitor’s maximum liability to Indemnitee hereunder shall be \$10,000,000.”

Drafting: 15 Key Questions to Ask (Continued)

6. What type of costs/claims are covered?
 - For example: *“[i]n no case shall Indemnitor be liable for any consequential, incidental, indirect, special, punitive or exemplary damages (including, without limitation, lost profits, business or goodwill) suffered or incurred by Indemnitee. In no case shall Indemnitor be liable for any damages arising out of Indemnitee’s negligent or reckless conduct.”*
7. Cooperation?
8. Who has the duty to defend or control?
 - For example: *“[i]n the event of receipt of notice of a Third Party Claim, the Indemnitor shall have the right to control and defend such Third Party Claim, in such manner as it may deem appropriate. Should the Indemnitor decline to control and defend the Third Party Claim, the Indemnitee shall have the right to control and defend the Third Party Claim in such manner as it may deem appropriate.”*

Drafting: 15 Key Questions to Ask (Continued)

9. Remedy available?

- Can the indemnitor merely replace with a non-infringing product and avoid money damages?

10. When is indemnity triggered?

- For example: *“[i]f the Indemnatee seeks indemnification, it shall give written notice to the Indemnitor promptly after the Indemnatee becomes aware of the facts giving rise to such claim for indemnification (an “Indemnified Claim”), and in any event within 30 days, specifying in reasonable detail the factual basis of the Indemnified Claim and stating the amount of the damages (or if not known, a good faith estimate of the amount of damages).”*

Drafting: 15 Key Questions to Ask (Continued)

11. When will the indemnitee be paid?

- For example: *“[i]ndemnatee shall responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnatee within thirty (30) days of Indemnatee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnatee receives or will receive from (a) an insurance carrier or (b) a joint infringer.”*

12. Choice of law?

13. Venue?

14. Location of infringement?

15. When does the obligation end?

Strategy: Scope, Notice, Control

Section	Indemnitor Strategy	Indemnatee Strategy
Scope	<ul style="list-style-type: none"> - Limit to claims brought by specific third-parties. - Limit the time that the provision will apply. - Limit to the product itself, and not to use of the product. 	<ul style="list-style-type: none"> - Do not accept limitations on the subject matter of the claims, or who can bring them. - Try to obtain indemnification for a claim that results from a misrepresentation or breach of a warranty.
Notice	<ul style="list-style-type: none"> - Promptly (but in any event within a specified time period). - In writing, including a statement of damages sought or a good faith estimate. - Failure to comply with the notification provision will render the indemnification provision void. - Indemnitor should be informed of possible claims. 	<ul style="list-style-type: none"> - No time limit. - Breach of the notification provision should not have any consequences unless indemnitor can show it was harmed by the failure to notify. - Indemnatee need not inform indemnitor of threatened (but not yet filed) suits.
Control	<ul style="list-style-type: none"> - Since the indemnitor will ultimately have to pay, indemnitor has a strong interest in controlling the litigation. - Indemnatee is required to cooperate with the defense efforts. 	<ul style="list-style-type: none"> - While indemnatee may like to control the litigation, not usually going to win this one. - Indemnatee will likely have control of the relevant documents and witnesses, and should be prepared to cooperate with the indemnitor.

Strategy: Settlement, Reimbursement

Section	Indemnitor Strategy	Indemnitee Strategy
Settlement	<ul style="list-style-type: none">- Indemnitee should only be able to withhold consent if it will affect any of indemnitee's rights.- Broader discretion to reject a settlement because it will ultimately have to reimburse indemnitee for any damages.	<ul style="list-style-type: none">- Indemnitee should have the right to consent to settlement if, e.g., such settlement would prevent indemnitee from practicing a patent under the agreement.
Reimbursement	<ul style="list-style-type: none">- Indemnitor should reimburse indemnitee within a reasonable amount of time after indemnitee has paid damages to the third party.- The reimbursement should exclude the limitations discussed previously, including monies paid to indemnitee by insurance or by joint defendants.- Should be limited to monies paid to the third party and expressly exclude consequential or incidental damages.	<ul style="list-style-type: none">- Indemnitor should pay the third party directly.- In the case of reimbursement, indemnitor should be required to reimburse indemnitee within a specified maximum period after indemnitee pays the third party.- Indemnitor should also be required to reimburse indemnitee for any consequential or incidental damages it suffers as a result of the suit.

Strategy: Limitations On Place, Amount, Time

Limit Indemnity To:	Objective	Considerations
A specified geographical area	<ul style="list-style-type: none"> - Avoid indemnifying outside of a known area, e.g., the United States 	<ul style="list-style-type: none"> - Customers may demand indemnification elsewhere if products are sold internationally - Does not limit amount of indemnification within the geographical area
Lawsuits demanding more than a certain amount (a specified floor amount)	<ul style="list-style-type: none"> - Avoid indemnifying for petty or nominal claims 	<ul style="list-style-type: none"> - Minimum amount may be either fixed or based on purchase price of equipment, for example - Does not affect indemnification for cases with greatest exposure - May be difficult to address demands for injunctive relief
A specified cap amount	<ul style="list-style-type: none"> - Limit monetary exposure for any given claim 	<ul style="list-style-type: none"> - Indemnification cap may be either fixed or based on purchase price of equipment - Cap could be total for the product, or in any individual lawsuit - Size of the cap may be contentious with customers
Within a specific period of time	<ul style="list-style-type: none"> - Minimize exposure to patent litigation based on older products - Shorten past damages window 	<ul style="list-style-type: none"> - Does not limit liability for infringement lawsuits brought within that window of time - May not effectively limit liability for products with a short operational life

Considerations Unique to Patent Law

- **Indemnifying for Willful Patent Infringement**

- Enhanced damages for willful patent infringement are considered to be punitive damages
- Some states have codified or common law public policy against indemnifying a party against punitive damages
- The UCC, however, does allow for indemnification of punitive damages (see UCC § 2-715)

- **Joint Liability**

- A party cannot ask for contribution from jointly and severally liable parties, so indemnification clauses need not take that into account.
- In a joint infringement situation, the court will apportion damages between the joint infringers. In such a case, the amount of damages should be limited to the damages actually incurred by the indemnitee.

Considerations Unique to Patent Law, Continued

- **Unintended Uses of a Product**

- It is possible that some uses of a product will infringe a third party patent while other uses will not
- An indemnitor can protect itself from unconsidered uses by limiting the indemnification to certain uses of the product (e.g., those uses described in documentation)

- **NPEs**

- Non-practicing entities may pose unique risks, particularly for software vendors
- An indemnitor concerned with exposure to NPE claims may wish to exclude coverage for suits brought by NPEs, or limit any indemnity to a reasonable royalty ***on the amounts paid by the indemnitee*** under the contract with the indemnitor
- Alternatively, the indemnitor may expressly exclude amounts spent beyond early settlements and arbitration

Considerations Unique to Patent Law, Continued

- **Privity/Real-Party-In-Interest Before the USPTO**
 - Under the new America Invents Act Post-Grant Proceeding statutes, does the existence of a contract/indemnification clause create privity between the contracting party or render an indemnitor a real-party-in-interest with respect to the indemnified party?
- **Damages**
 - What if a plaintiff measures damages by customers sales?
- **Litigation Strategies**
 - Staying litigation as to customers
 - Sequencing trials so supplier goes first
 - Bifurcating trial: liability and damages

Strategy: Limit By Type of Patent Claim Covered

Indemnify when:	Objective	Considerations
Your product, or a process performed with that product is accused	<ul style="list-style-type: none"> - Do not indemnify when your products are not the focus of the litigation 	<ul style="list-style-type: none"> - Does not limit exposure when your products are directly at issue - Could require indemnification even if you do not know how products are used
Your product, and not the use of that product, is accused	<ul style="list-style-type: none"> - Do not indemnify for customers' methods for using products because these may not be known 	<ul style="list-style-type: none"> - Limits exposure only to cases where the apparatus itself is accused - Could still be liable if both method and apparatus claims asserted - Customers may be concerned if they use products according to your instructions
Apparatus claims are asserted, but not method claims	<ul style="list-style-type: none"> - Do not indemnify for customers' methods for using products because these may not be known 	<ul style="list-style-type: none"> - Similar but possibly narrower in scope to indemnifying only when your product rather than use of the product is accused - Customers may be concerned if they use products according to your instructions
You are accused of indirect infringement	<ul style="list-style-type: none"> - Indemnify for claims based on your products and how you expect those products to be used 	<ul style="list-style-type: none"> - Avoids liability where customers do not use the product as instructed - Could still be liable if method claims are asserted - Less clear when you are obligated to indemnify

Questions?

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