PATENT INFRINGEMENT INDEMNIFICATION: WHAT YOU MUST KNOW

Indemnification provisions require close attention in contract negotiations, especially when it comes to patent infringement claims.

by C. Andrew Keisner, Esq, Davis & Gilbert LLP

Most robotics companies are aware of the serious increase in patent infringement lawsuits being asserted by competitors and non-practicing entities, which are frequently called “patent trolls.” In the past few months there has been significant activity involving patent trolls.

While Siemens AG resolved its lawsuit with patent troll Roy-G-Biv. Corp., several other companies, including ABB Robotics, are still fighting in court. Patent troll Hawk Tech. Systems filed suit against Fanuc Robotics Corp. - the day after Christmas - over technology so far from being “cutting-edge robotics” that the fellow defendants include mostly retailers, not other robotics companies. And patent troll Sonic Industry, LLC hit iRobot Corp.) with a patent infringement lawsuit.

While these patent infringement disputes are becoming increasingly known to the public, many robotics companies and suppliers are still unaware of the resulting indemnification disputes that often occur behind the scenes and outside of court. Indemnification is the act of compensation for actual loss or damage sustained.

When a robotics company is sued for patent infringement, it often turns to the companies who sold the allegedly infringing product. Patent infringement lawsuits by patent trolls are generally perceived as unpredictable and unfair, and companies seek to spread around the impact of such unpredictable claims by invoking their indemnification rights.

But for the company receiving the request to indemnify for a patent troll’s infringement claim, the request for indemnification appears equally unfair. After all, the underlying claim was unforeseeable and may even cover commonly used technology. Especially in comparison to other types of intellectual property claims that might be indemnified, such as copyright and trademark, for which the risk of an infringement claim can be reduced in advance, the inability to “clear” a product of any and all potential patent infringement claims makes indemnification of patent claims uniquely risky.

Such a risk is going to exist as long as patent trolls exist, and there is no current “silver bullet” to this problem. Accordingly, indemnification provisions require particularly close attention in contract negotiations, especially when it comes to the issue of indemnification for patent infringement claims. Both the indemnitor and indemnitee need to understand the unpredictability of patent infringement claims by third parties and, therefore, consider the scope of the indemnification provision when determining the price of the contract.

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QUALIFIERS LIMITING INDEMNIFICATION

For those providing indemnification of patent infringement claims for their products, certain qualifiers should be considered to limit the scope. These can include:

**Knowledge Qualifier**: Indemnification for only patent infringement lawsuits based on the patents that the indemnitor was already aware of.

**Cap on Liability**: Indemnification for patent infringement claims up to a certain amount. Fixed caps are always easy to determine, but when a contract contemplates the potential of future orders, a cap based on the percentage that the indemnitee paid over the prior X amount of months can be more palatable for both companies. However, companies purchasing goods where a cap on indemnification is tied to the sales for a preceding period of time should understand that their right to indemnification is useless after the relationship ends and the sales for that preceding period decreases to zero.

**Final Judgment Qualifier**: Indemnification obligation does not arise unless and until there is a final judgment against the indemnitee. While this qualifier is very limiting because the vast majority of cases never go to a final judgment, most attorneys and laypersons know this fact and reject such a qualifier outright.

**Filed Lawsuits Qualifier**: Indemnification obligation does not arise unless and until a lawsuit is filed. This qualifier is less limiting than the final judgment qualifier and typically more palatable to indemnitees. A large number of patent trolls do not file lawsuits, but instead send letters demanding a settlement based on the threat of a lawsuit. While some companies prefer to settle to avoid a lawsuit being filed, others are more discretionary and are willing to risk that some of the threats of a lawsuit are bluffs.

If you are the indemnitor and believe the letter threatening the indemnitee with a lawsuit is a bluff, but the indemnitee interprets it differently and wants to settle immediately, this type of qualifier can provide the indemnitor with significant leverage. That said, it is important to review indemnification provisions for this qualifier closely because it can be included in a myriad of different ways (some of which are not necessarily obvious).

**Control of Defense**: When negotiating an indemnification clause, it seems fair for the company paying the legal bills to have control of the defense. But when your company is hit with a hundred million dollar patent infringement claim and the indemnitor may not be capable of paying a worst case scenario, your company will no doubt be reluctant to hand over control of its defense. In reality, when a large company is the indemnitee and a small vendor is the indemnitor, the smaller company typically does not want to take over the control of an expensive litigation. But if there is a right by the indemnitee to take over control of the defense, be wary about failing to offer such control. Some cases suggest it could constitute a waiver of all your Company’s indemnification rights.

**Prompt Notice**: With few exceptions, prompt notice of a third-party claim should always be sent by a party seeking indemnification. That said, attorneys unfamiliar with indemnification law commonly rely on a failure to give notice promptly as the foundation for their rejection of an indemnification demand. But such a rejection based solely on an indemnitee’s failure to provide notice promptly is a mistake. With the exception of indemnification notices sent to insurance companies, a failure to give notice promptly will not waive a right to indemnification unless it also somehow prejudices the indemnitor.

See Smurfit Newsprint Corp. v. Southeast Paper Mfg., 368 F.3d 944, 952 (7th Cir. 2004). This is true even though agreements typically state that the notice must be prompt, and such agreements do not state that prejudice is a condition.

THE SCOPE OF A TRIGGERED OBLIGATION

Equally important as any of the above qualifiers is consideration of what types of costs and fees the indemnitor may be asked to pay in the event the indemnification clause is triggered. An indemnity clause requiring only “indemnification” and nothing more, typically comes with only an obligation to cover damages. That will be little comfort for the
indemnified company if it is faced with a patent litigation that may cost millions of dollars in attorney fees to resolve. As such, most agreements require the indemnitor to “indemnify, defend, and hold harmless” the indemnitee. Such indemnification provisions should also expressly state that the obligation extends to attorneys’ fees.

Most indemnification clauses do not, however, cover the indemnified company’s attorney fees that are incurred in recovering the amounts it is owed under the indemnification clause. For companies that want such fees reimbursed, they should include language expressly stating that such fees are recoverable, such as “... including any costs and fees incurred in enforcing this provision.”

THE CATCH 22 FOR MIDDLE STREAM COMPANIES

Many companies in the robotics industry are both buying from other companies and selling to other companies. As a company in the middle of the stream, it must negotiate for less indemnification obligations with its clients, and yet negotiate for greater indemnification rights with its vendors.

The goal for middle stream companies is to ensure that its indemnification rights to its vendors are equal to, or broader, than its indemnification obligations to its clients. One trick is for such companies to incorporate into its vendor agreement the indemnification obligation it took on for its client.

IMPLIED WARRANTY OF GOODS

In addition to a contractually created indemnification obligation, robotics companies selling “off-the-shelf” products need to know that the absence of an indemnifications clause in its agreements does not necessarily mean it has no indemnification obligation. This is especially true when it comes to third-party claims of patent, copyright, and trademark infringement. Under the Uniform Commercial Code, goods are sold with an “implied warranty against infringement” that can give rise to an indemnification obligation.

But to invoke an indemnification obligation under the U.C.C., the indemnitee must prove: (1) the seller was a merchant regularly dealing in goods of that kind; (2) the goods are subject to a “rightful claim” of infringement of a third party upon delivery; (3) the buyer did not furnish specifications to the seller; and (4) the parties did not form another agreement. Accordingly, this obligation will not arise for customized parts, but it can apply to non-customized parts regularly offered for purchase.

CONCLUSION

The bottom line is that no robotics company should blindly accept boiler plate indemnification clauses. Understand when and what type of claims can trigger the indemnification clause as well as what obligations arise when it is triggered. If your company is selling products to other companies, be wary about taking on endless indemnification obligations. If your company is purchasing another company’s products, make sure the agreement does not include qualifiers that significantly undermine your company’s ability to seek indemnification.

And more practically, consider the financial situation of any company willing to accept a broad indemnification obligation - if the indemnitor has no money, the obligation is meaningless.

ABOUT THE AUTHOR

C. Andrew Keisner is an associate in the Intellectual Property and Litigation Practice Groups of Davis & Gilbert. He has extensive experience advising clients with contract and intellectual property matters in the advertising, marketing, public relations, interactive entertainment, and technology industries. In addition, Mr. Keisner has an in-depth understanding of robotics technology and the unique issues that technology companies face. He may be reached at 212.468.4845 or akeisner@dglaw.com.