

Protecting Your Company from Patent Suits by Contracting for Indemnification

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In the world of patent litigation, the familiar phrase "buyer beware" serves as a particularly appropriate warning for the corporate consumer. Businesses that believe they are innocently purchasing products to incorporate into their own goods or distribute at a profit can unwittingly find themselves targets of patent litigation.

While most patent owners do not sue corporate consumers for fear of alienating potential customers, certain owners, such as "patent trolls" (companies which own patent rights without practicing the patented invention), do not hesitate to target manufacturers, resellers, and end users alike. Patent trolls use their IP to make money through licensing or litigation and will often sue multiple entities along the supply chain. Suits against manufacturers and their customers can serve as a means to maximize the chance of collecting damages while applying pressure on the parties to settle.

When faced with such a suit, the corporate buyer's initial thought often is to seek indemnification from the manufacturer. After all, the manufacturer presumably conducted a freedom to operate analysis and arguably should bear responsibility. However, in practice, obtaining indemnification is not always easy. Perhaps the manufacturer is a small company without adequate resources to stage a fight. Maybe the manufacturer made the product for the customer following the customer's own specifications. Perhaps the customer is not a big enough purchaser for the manufacturer to feel obligated to assist. Or the number of customers is so numerous that it is impossible for the manufacturer to police whether each customer simply resold the product or made material changes that could lead to a finding of infringement. All of these scenarios may hinder a manufacturer's willingness to assist. And, absent explicit language in the sales papers, the manufacturer's obligation to indemnify is often far from clear.

Who's Responsible

In general, an implied warranty of non-infringement accompanies every product sold. Yet, implied warranties may easily be disclaimed by sales forms incorporating standard disclaimer language. And, the risk that general disclaimer language could free a manufacturer from responsibility creates a significant impediment in business relationships where sales are consummated with just price quotes, purchase orders, and invoices.

Even when dealing with more complex business arrangements, the ability to rely on the implied warranty of non-infringement is questionable. If the buyer provides specifications for the product to the manufacturer, for instance, the law shifts responsibility to the buyer. The buyer is the one controlling the characteristics of the finished product. The burden is, therefore, on the buyer to do its own intellectual property due diligence. Yet, legal questions can arise as to whether compliance with the specifications led to the infringement, or whether infringement resulted from choices made by the manufacturer.

Even when the buyer does not furnish specifications, questions may arise if the buyer alters the product or incorporates it into a larger product. Fights can brew over whether the buyer's changes moved the product closer to the scope of what the patent covers. If the changes have nothing to do with the patent, responsibility arguably still lies with the manufacturer. However, a wide ranging gray area exists for parties to debate and litigate.

One other area that raises questions is the nature of the asserted patent itself. If the patented invention is directed to a method rather than a product, it is questionable whether the buyer can even assert the warranty of non-infringement. While logic suggests that such distinctions should not matter, the law is less certain.

Seek Indemnification Whenever Possible

Given the numerous factual and legal uncertainties in this area, corporate customers are well-advised to mitigate their risks by specifically contracting for indemnification. While this may be impractical in many instances, for large transactions or ongoing sales relationships, there may be sufficient incentive for parties to allocate the risk of infringement prior to sale. Drafting indemnification provisions into sales agreements also permits parties to tailor the language to the specific situation. For instance, if a reseller knows that it is going to make certain changes to a item, it can specifically negotiate language that accounts for those changes.

Failure to negotiate any form of indemnification clause leaves companies subject to murky and largely untested waters. Until there is more clarity in the law, contractual language may be the buyer's best friend.