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Patent Licensing Agreements

Crafting Effective Contracts to Avoid Litigation, Allocate Risk and Maximize Patent Value

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Today's faculty features:

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Patent Licensing

Peter J. Toren

Shulman Rogers Gandal Pordy & Ecker, P.A.

Agenda

- Common Mistakes
  - Technology vs. Intellectual Property
  - When is a grant not a grant?
  - Types of patent ownership
  - Change of Control
  - Royalty provisions
  - Settlement agreements
- Joint Ownership
- Negotiation

Technology vs. IP (patents)

- Fundamentally Different
  - Technology = Things, both tangible/intangible
    - Processes, techniques, know-how,, algorithms, software, content, data, databases, protocols, manufacturing processes, business or legal plans, etc.
  - IP = Legal Rights
    - Issued patents, trademarks, copyrights, trade secrets, etc.
    - Pending/applications, priority rights, etc.

Technology/IP Grants

- Pure Technology Grant – make use of a tangible item
  - May create an implied license to use IP necessary for technology grant
- Pure IP Grant – make and sell products manufactured by a process covered by U.S. Patent No. x,xxx,xxx.

Technology and IP Grant

- License
  - Transferability (license is personal or transferable)
  - Exclusivity
  - Type of IP (patent, trademark, copyright, trade secrets)
  - Grant
    - Patents – right to make use, sell, offer for sale, and/or import
  - Technology
  - Licensed field
  - Territory
  - Term of license (may or may not be coextensive with the license agreement itself)

A Promise To Grant Is Not A Grant

- Promissory language – “I will assign,” “X shall convey,” “X agrees to assign”
  - Ineffective to transfer title
  - Another document will be required (35 U.S.C. § 261)
  - Promise can be rendered impossible to fulfill if the grantor makes an intervening conveyance to a 3rd party after making the promise but before the conveyance (*see e.g., Film Tec Corp. v.. Allied-Signal, Inc.,* 939 F.2d 1568 (Fed Cir. 1991))
- “I hereby assign to you”
  - Conveys equitable title at the time of the grant
  - Converts to legal title when a patent (or patent application) comes into existence.

Types of Patent Grants

- Labels are not determinative
  - What was the actual intent of the parties
  - Court will correct inappropriate usage
- Assignment – Must be in writing (35 U.S.C. § 261)
- Exclusive License
- Nonexclusive license
- Covenant not to use

Assignment

- Conveyance of title
  - 1. Transfer of entire right title and interest (succession of ownership); or
  - 2. an undivided interest in the foregoing (joint ownership) (*See e.g., Rite-Hite Corp. v. Kelly Co, Inc.*, 56 F.3d 1538 (Fed. Cir. 1995)
- How?
  - Formal (transfer of title)

    Informal (transfer of all "substantial rights")
- Right to sue/license to practice the patent
  - Cannot assign patent on a claim-by-claim basis/field of use (must be of undivided interest)

When Is An Exclusive License Not an Exclusive License?

- Licensor retained right to obtain foreign patents +
- Licensor had reversionary interest (if Licensee went bankrupt or stopped product) +
- Licensor had right to receive infringement damages from third parties +
- Licensee was granted right to sue w/obligation to inform licensor +
- Licensee could sublicense only with licensor's consent =
- ASSIGNMENT

When Is An Assignment Not An Assignment?

- Grantor retained right to U.S. market +
- Grant was subject to prior licenses +
- Grantee given right to sue, but grantor could sue if grantee did not sue +
- Grantee was obligated not to prejudice or impair patent rights via suit/settlement +
- Grantor could participate in suit by patentee +
- Grantee couldn’t assign, except to successor in business =
- ASSIGNMENT

Exclusive License

- Lesser form of grant than assignment
- Grantor has expressly or impliedly promised that others shall be excluded from exploitation within the exclusive area (geographic, temporal, field of use) (*See Rite-Hite*, 56 F.3d 1538 (Fed. Cir. 1995)
- Right to prevent others from making/using/selling in the exclusive field => Standing to sue (whether or not agreement provides)

Avoid ambiguity
"... exclusive (even as to licensor) ...."

Nonexclusive License

- Freedom to operate (not the freedom to exclude)
- Personal to licensee (non-transferable)
- Promise that the patentee will not sue the nonexclusive licensee under the patent

Cannot give nonexclusive licensee standing to sue.

Covenant Not To Sue

- Promise that the patentee will not sue the grantee
- Does not run with the patent => Future assignees are not bound
- Useful to patentees who wish to sell their patents free of encumbrances

Standing To Sue

- Must be consistent with the grant type
- Plaintiff must hold legal title at time of suit
  - Patentees (35 U.S.C. § 281) /Successor in title (assignees) (35 U.S.C. § 100(d)) may sue
  - Exclusive licensees – Have right to sue with the patent owner.
    - Must file suit in the patentee's name => Must join the patentee in a litigation
  - Nonexclusive licensee – No standing to sue (and cannot be given any)

Watch for inconsistent enforcement grants: (1) retaining control (by the assignor; (2) inhibiting control (by the assignee or exclusive licensee); or (3) improperly granting control (to a nonexclusive licensee).

Joinder

- Required of all indispensable parties (parties having standing to sue, owners and exclusive licensees
- Rules for involuntary joinder may vary from jurisdiction to jurisdiction.

Licensee: Obtain owner's consent to join suit/jurisdiction

Licensor: Obtain exclusive licensee's agreement to join suit/jurisidiction

Change of Control

- Plan for change of control (licensee)
- Licensee may want license to pass to its successor in interest, but the licensor may not.
- IP licenses are exception to the general rule that favors the free alienability of assets.
  - IP licenses are by default non-transferable by the licensee
- When agreement is silent, patent/copyright rights are non-transferable by the licensee

Types of M&A Transactions

These transaction types **do** constitute a transfer:

– (1) acquiror survives merger, but not licensee; (2) Licensee merges into acquiror's subsidiary; (3) acquiror disappears into the targetwhich survives the merger).

These transaction types **do not** constitute a transfer:

(1) stock purchase (target gets new ownership); (2) aquiror's subsidiary disappears into the target, which survives the merger but in the process b/c a wholly owned subsidiary of the acquiror.

Structure transaction to avoid triggering anti-transfer clauses

Avoiding Benefit to the Acquiror

- *This Agreement may not be transferred (and no rights hereunder may be assigned, and no obligations hereunder may be delegated) without the express written consent of the licensor, and any such attempted assignment, delegation or transfer shall be void. <u>For the purpose of this provision, any for or change of control or the license shall be deemed an impermissible transfer, whether or not such change of control would otherwise be deemed a transfer under applicable law."</u>*

Bankruptcy

- Basic Concepts
  - BR Code recognizes the unique nature of IP licenses/imposes limitations on the ability of the BR estate to sell/cancel most IP agreements.
  - Trustee/debtor in possession has the discretion to "assume or reject" a debtor's executory contracts
  - Ability to terminate the license is vested in the bankruptcy trustee who has broad power to reject or assume any executory contract (contract with continuing obligations).
  - Trustee may not assume and then assign the agreement when non-bankruptcy law excuses accepting performance from an entity other than the original licensee. (11 U.S.C. sec. 365(c)),

Executory Contracts: Performance is still due from both parties to the contract.

IP licenses are almost always executory.

Bankruptcy

- Two basic scenarios:
  - (1) DIP is preparing to emerge from BR and seeks to assume the contracts to which it was a party before the BR filing as part of a reorganization;
  - (2) DIP seeks to assume, immediately sell and assign its rights to the contract.

    If approved by court, debtor can then freely assign its rights under contract so long as "adequate assurance of future performance of such contract is provided."

    Debtor rejects contract – Prepetition contract is considered breached, claim for breach of contract, making the counter party to the license an unsecured creditor of the estate

Bankruptcy

- Limitations:

    (1) Power to assume or reject a license is limited, by its terms to "executory contracts."

    (2) Section 365(c) establishes two conditions that must be satisfied before a DIP is prohibited from assigning a license to which it was a party before it filed for bankruptcy (i) "applicable law," must permit the non-debtor to refuse performance of the license from another party and (ii) the non-debtor does not consent, or has not already consented, to an assignment.

    (3) Debtor is a licensor of a patent, even if: (i) license is executory; (ii) applicable law does not bar its rejection; and (iii) debtor rejects the license

    The licensee can still retain its rights under the license

Bankruptcy Issues

- Problems - IP licensor/licensee enters bankruptcy, e.g., (i) the debtor-licensee may seek to assume the IP license and then to assign it to a competitor of licensor (which can use those rights to the detriment of the licensor) or (ii) a debtor-licensee who has acquired the exclusive rights to manufacture the licensor's product on a royalty basis may decide to reject the license and cease manufacturing the licensed product, which would deprive the licensor of the royalty payments.
  - Such problems cannot simply be avoided by including a clause in the agreement which provides for the right of the non-defaulting party to terminate or modify an executory agreement upon the insolvency or filing of a bankruptcy petition by the other party.

Bankruptcy

- Is the patent license exclusive or nonexcluisve?
  - Nonexclusive licenses are personal to the licensor and are not assignable unless expressly made so in the agreement.
  - Exclusive licenses - confers property rights and not merely personal rights.
  - Section 365(c) does not preclude the assumption or assignment of an exclusive patent license by the debtor.
  - Exception - one court applied the “hypothetical test” to bar a debtor licensee from assuming its interest under a patent license that the court characterized as “some version of an exclusive license.”

Rights Of A Non-Debtor Licensee Upon Rejection By Debtor Licensor

Intellectual Property Bankruptcy Protection Act of 1988

Creates 2 options: (1) Licensee can treat the debtor's rejection as a breach of contract – money damages; or (2) elect to retain the rights to the IP covered by the license

- continue to pay royalties
- does not allow the licensee to enforce the debtor-licensor's obligations to update/improve such IP contemplated by the license.

Licensee may want to acquire the technology outright from the a financially strapped licensor.

Unintended Grants

- Legal Estoppel – *No rights may arise by implication or estoppel, other than those expressly granted herein."*
- Sublicensing – Need to negotiate for survival of the existing end user sublicenses.

Practice Tip: Licensor should consider: requiring the licensee to notify the licensor of the name and address of each sublicensee; (b) requiring the licensee to recall and destroy all sublicensed technology post-term; (c) requiring that outstanding sublicenses to be automatically transferred to the licensor post-term; or (d) requiring the licensee to pass through to the licensor all post-term revenue.

Royalty Provisions

- Failure of the licensor to understand the licensee's revenue and reporting models/potential impact on the licensor.
  - Licensee does not have any direct sales to end users => use a fixed per-unit royalty.

Licensee should consider a royalty based on end user sales price to avoid disclosing confidential data.

Convoyed, bundled or package sales – Licensor should include a provision for (1) royalties as a percentage of the total price; (2) a pro rata allocation based on the respective list prices of the licensed/unlicensed technology when sold separately; (3) fixed per-unit royalty.

Joint Ownership

- Jointly owned U.S. patent – Joint owner can exploit the patent without permission of the other joint owner (35 U.S.C. § 262).
  - No duty to share royalties
- Jointly owned U.S. patent/copyright
  - Duty of accounting to the other joint owners.
- Joint owned foreign IP assets
  - Different countries have different rules

Refrain from creating joint ownership. Allocating IP rights to one of the participants or to the joint venture itself. IP owner can then grant specific field of use licenses to the participants to meet their individual needs.

Negotiations

- Need to include both commercial and IP counsel.
- Term Sheet should include all major provisions.
- Jurisdiction specific issues (left v. right coasts).

Reporting issues

- Need to understand how licensee keeps records
  - Preferable to specify exactly the type of records the licensee must keep
- What constitutes underpayment for a material breach?
  - Provision that permits a reasonable (but limited) number of accounting provisions before the licensee is penalized.

Speaker's Biography

Peter J. Toren is an intellectual property litigator, who has first-chaired patent and trademark trials and dozens of Markman, preliminary injunction and summary judgment motions. Peter has extensive experience in patent, copyright and trademark licensing and a frequent speaker on issues relating to licensing.

He is also recognized as a leading expert in the intersection of IP and computer crimes under the Computer Fraud and Abuse Act, the Economic Espionage Act, as well as other federal criminal laws. He is the author of the leading treatise on criminal violations of intellectual property rights and computer crime, *Intellectual Property & Computer Crime* (Law Journal Press).

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Risk Allocation Mechanisms in License Agreements

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Topics to Be Discussed

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- Risk Allocation Mechanisms
  - Breach of Contract
  - Remedies
- Reps & Warranties
- Indemnification
  - Exclusions

Risk Allocation and Balancing in Licensing Agreements

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- Breach of contract
  - Is the other party collectable post-close?
- Remedies
  - Repair
  - Replace
  - Modify
  - Get license to enable use as contemplated
  - Refund and terminate
  - Liquidated damages

Liquidated Damages Provisions

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- Common law rule of contracts is that unless a liquidated damages provision is reasonable, it is unenforceable as constituting a penalty rather than compensation
- Courts look at these factors:
  - Injury caused by breach that is difficult or impossible monetary analysis,
  - An intent to provide for damages rather than a penalty, and
  - A reflection that the liquidated amount is a reasonable pre-estimate or probably loss.
- Liquidated damages > of a calculable amount = penalty

Reps and Warranties

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- Representations are presentations of fact -- either by words or by conduct -- made to induce someone to act, especially to enter into a contract.
- Whereas, a representation is a statement of a present or past fact at the time the representation is made, a *warranty is a promise extending into the future*.
- Using the terms "representations" and "warranties" together blends the past, present and future within the agreement.

Standard Reps & Warranties

- Identification
  - "The term 'Intellectual Property Assets' means all intellectual property Owned or Licensed (as licensor or licensee) by Licensor, including . . ."
- Title (including assignments, transfers, and licenses)
  - "Licensor is the owner of all right, title, and interest in and to each of the owned Intellectual Property assets, free and clear of an Encumbrances, and has the right to use without payment to a Third Party all of the Intellectual Property assets."
- Adequacy
  - "Except as set forth in xxxx, [t]he Intellectual Property Assets are all those materially necessary for the operation of Seller's business as it is currently conducted."
- Infringement
  - "No Patent is infringed or has been challenged or threatened [in any way] and none of the products currently manufactured or sold, nor any process or know-how currently used by Licensor infringes, or to Licensor's knowledge is alleged to infringe any U.S. issued patent or other proprietary right of any other Person under the law of the United States."

Standard Reps & Warranties

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- **Validity**
  - “All of Licensor’s material Intellectual Property is currently in compliance with formal legal requirements (including payment of filing, examination, and maintenance fees and proofs of working or use), is valid and enforceable in those jurisdictions where Licensor has registrations for its intellectual property rights, and is not subject to any maintenance fees or taxes or actions falling due within ninety (90) days after the Closing Date.”
  - “No patent has been or is now involved in any interference, reissue, reexamination, or opposition Proceeding. To Licensor’s Knowledge, there is no potentially interfering patent or patent application of any Third Party.”
- **Specialized reps**
  - “No prior license or conflicting agreement”

General Problems

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- Licensee's Goals
  - Broadest, most iron-clad reps covering all contingencies
- Licensor's Goals
  - Narrow reps with wiggle room to avoid liability
- "Standard Reps" or a Licensee's wish list is/are almost always overbroad, especially as to IP rights
- You will succeed if you can help the parties find a rationally structured set of reps/warranties that give the Licensee comfort it is getting what it is paying for, while at the same time protecting the Licensor from undue potential risk or liability

Tools for Negotiating the Reps/Warranties

- Materiality
- Knowledge qualifiers
- Indemnifications
- Royalty rate/purchase price adjustments
- Territorial restrictions
- Temporal restrictions
- Other drafting techniques
- Remedies
  - Is a breach of contract action adequate?

Materiality

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- As Licensor counsel, you want to reduce the risk by making representations as "material" assets or aspects of the deal
- Consider a definition of "Material Adverse Effect":
  - "Material Adverse Effect" means any change, event, violation, inaccuracy, circumstance or effect that is [or could reasonably be expected to be] materially adverse to the business, assets, liabilities, financial condition, results, operations, or prospects of the Purchased Business other than as a result of: (i) changes generally adversely affecting the U.S. economy (so long as the Licensed Rights are not disproportionately affected thereby) . . ."
- Represent that (for example), disclosed potential IP liabilities or disputes will not have a "Material Adverse Effect" on the license

Knowledge Qualifiers

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- May also be a defined term in the document
- Recognize that there is a sliding scale of knowledge qualifiers:
  - No mention
  - Knowledge of the Licensor/Licensee
  - Knowledge of specific officers or executives
  - “Best” knowledge
  - Knowledge after “due” investigation

Knowledge Qualifiers

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- As Licensor, use knowledge qualifiers
- As Licensee, be wary of knowledge qualifiers and recognize what they really mean
  - Will they undermine the value of the rep in total?

Territorial and Temporal Tools

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- Restrict some representations by territory and/or time
  - Particularly adequacy/sufficiency, non-infringement, title
- Temporal restrictions can be useful for issued versus unpublished, pending patent applications

Reps Regarding Third Party IP

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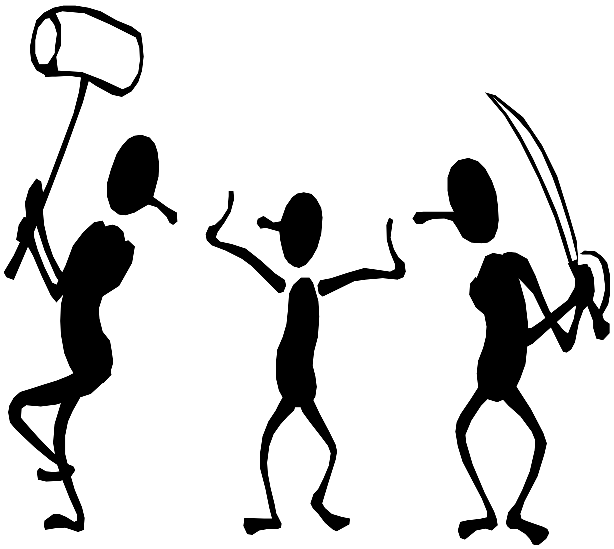

- For the Licensor, making representations regarding the existence or impact of third party IP is risky
  - Never know what patents are out there
  - Limit rep via knowledge like "as far as we know"
  - Get a cap
    - Beware seemingly innocuous "willful infringement" exclusions from the cap
      - May be an equivalent to negligence standard for patent infringement

IP Indemnification Generally

- An indemnity is a form of insurance by which one party agrees to shift risk that is in the first instance borne by another.
  - IP indemnification refers to A’s agreement to (usually) defend and reimburse B against claims that B has infringed the intellectual property rights of party C
- “Indemnitor” = the one giving the indemnity, also referred to as the “indemnifying party”
  - Licensor
- “Indemnitee” = the one receiving the indemnity, also referred to as the “indemnified party”
  - Licensee

IP Indemnity Questions

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- Five key questions that form the underlying basis for any indemnification provision:
  1. **Who** is indemnified?
  2. **What** actions are likely to trigger the indemnity and what limits apply?
  3. **How** will the indemnity work?
  4. **When** does the indemnity obligation apply?
  5. **Where** is the indemnity triggered?
- Each of these questions are explained below with considerations regarding proposed language.
  - Although sample language is provided, it is important to note that they key to any good indemnity clause is that it applies to the particular circumstances at play in a deal.
  - Relative strength of the parties, risks, technology area, etc.

The First Big Question - Who Is Indemnified?

Who?

Who Should Indemnify Whom?

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- Unilateral or Bilateral?
  - Most indemnification provisions are unilateral, *e.g.*, the seller of the product indemnifies the buyer, the licensor indemnifies the licensee, etc.
    - In such cases, the indemnity provision should leave no doubt as to which specific entity will be providing the indemnity.
  - Indemnification provisions can also be bilateral, meaning that the parties indemnify each other under certain circumstances.
    - An example of this may be in a joint development agreement where party A is bringing certain expertise in a first technology to the transaction and party B is bringing other expertise to the transaction.

Bilateral Indemnity Clause Example

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AlphaCo shall indemnify, defend, and hold BetaCo harmless from and against any and all damages or costs incurred or suffered by BetaCo as a result of a claim of patent infringement from the manufacture, use, or sale, by BetaCo of components provided by AlphaCo; and BetaCo shall indemnify, defend, and hold AlphaCo harmless from and against any and all damages or costs incurred or suffered by AlphaCo as a result of a claim of patent infringement from the manufacture, use, or sale, by AlphaCo of components provided by BetaCo.

Should Additional Parties Be Covered?

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- The indemnitee may want to consider whether additional people should be covered under the indemnity.
- Any party receiving the benefit of the indemnity should be listed specifically in the indemnity clause.
  - Such people include:
    - Board of directors,
    - Officers,
    - Employees,
    - Divisions,
    - Subsidiaries,
    - Affiliates,
    - Successors and assigns,
    - Subcontractors,
    - Contract manufacturers of the indemnitee, or
    - End users of the products.

Example Where Specific Parties Mentioned

Licensor shall indemnify, defend, and hold harmless <u>Licensee, its directors, officers, affiliates, contractors, subcontractors, agents, and employees</u> against all losses, damages, liabilities, costs, and expenses (including, but not limited to, reasonable attorneys' fees) suffered by the <u>Licensee, its directors, officers, affiliates, contractors, subcontractors, agents, and employees</u> due to a claim of patent infringement relating to the Licensed Technology.

Who Controls the Defense?

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- Indemnitor has no per se right to control or otherwise participate in the defense of the indemnitee absent an express agreement (*may depend on jurisdiction*)
- Traditional language is "defend, indemnify, and hold harmless"
  - While "indemnify" and "hold harmless" may be synonymous, the duty to "defend" is a separate and distinct responsibility.
  - **Duty to defend** = triggered by the factual allegations in the pleadings and the precise language in the contract
    - Could kick in at the initial allegation stage
  - **Indemnify** = triggered by judgment/jury's findings
    - At the conclusion – what if there is a settlement?
- Another important question is who selects counsel.
  - Should the indemnitee get to select counsel?
  - Should the indemnitee get to approve counsel?

Defense and Counsel Choice

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- If the indemnitor is going to be responsible for defending the indemnitee, then the indemnitor should want to have maximum control over the defense

  Licensor shall have the right to control the defense, including the selection of counsel, of any such claim involving the assertion of patent infringement against the Licensee, including the right to settle any such claim.

- A clause that would allow the indemnitee to participate, but give the indemnitor control, is below:

  The Licensor shall provide a defense with qualified counsel that is selected by Licensor, and such counsel shall be deemed to have been approved by Licensee, without further action by either party, unless Licensee establishes (i) a substantive and material conflict of interest with such counsel; or (ii) a fair and substantial cause or reason to withhold such approval, such as the incompetence or significant inexperience of such counsel.

The Second Question - <u>What</u> Triggers the Indemnity?

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What?

Causal Connection

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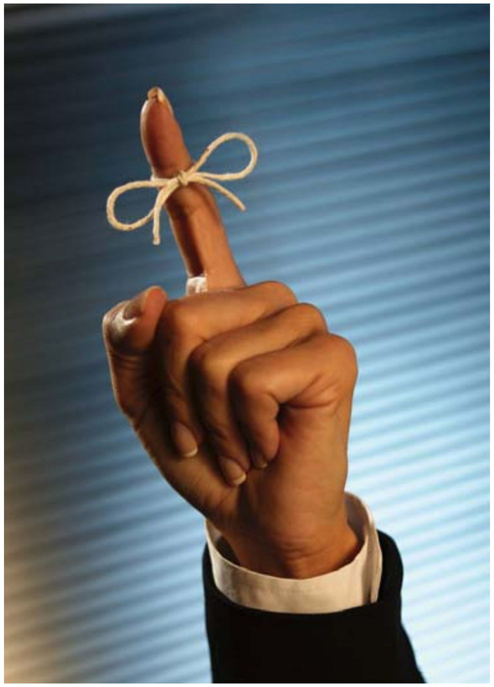

- Include a description of the causal connection between the claims that are protected and the subject matter from which they arise.
- An obligation to defend or indemnify claims "due to" and "caused by" ≠ "arising from" the agreement
  - "due to" requires "a more direct type of causation" than the phrase "arising from"
  - "arising from" is more expansive and will provide a broader scope of indemnity

Limitations on Liability – Limits? Caps?

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- An indemnitor may want its liability to be commensurate with the benefits received under the transaction.
  - Amount of royalties (or some percentage thereof) received under the license agreement.
- The indemnitor may want to place an upper limit (a cap) on the aggregate amount of the indemnity obligation
- The indemnitor may set a threshold amount of damage that the indemnitee must suffer before a claim of indemnification can be made.
- The indemnitee, however, may be unwilling to accept such a limitation

Exclusions – Specifications and Modifications

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- There are three common exclusions from indemnity obligations:
  - infringement arising from compliance with specifications,
  - modifications by the indemnitee, and
  - combinations by the indemnitee of intellectual property, components or products not supplied by the indemnitor.
- Note the UCC creates a default indemnity exclusion where the purchaser of goods has furnished specifications for the goods to the supplier of the goods.

What Costs or Damages Are Covered?

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- A provision explicitly setting forth what costs will be indemnified should be included, as seen in the following examples:

  Seller will pay any and <u>all costs, damages, and expenses, including, but not limited to, reasonable attorneys' fees and costs awarded against or incurred by</u> Buyer in connection with or arising from any such patent infringement claim, suit, action or proceeding.

- However, the indemnitor likely want to *exclude* consequential damages:

  Under <u>no circumstances shall indemnitor be liable to indemnitee for indirect, incidental, consequential, special or exemplary damages</u> arising from this Agreement, even if indemnitor has been advised of the possibility of such damages, <u>including, but not limited to, loss of revenue or anticipated profits or loss of business</u>.

What Types of IP Claims Are Covered?

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- IP indemnification is often framed more generally with respect to any type of intellectual property right, as seen in the following examples:

  Seller will defend, hold harmless, and indemnify Buyer and its customers, and their respective successors and assigns, against any claims of infringement (including <u>patent, trademark, copyright, moral, industrial design, or other proprietary rights, or misuse or misappropriation of trade secret</u>) and resulting damages and expenses relating to the goods and services covered by this Agreement.

- Or:

  Seller shall indemnify and defend Buyer and its customers against claims arising out of the actual or alleged infringement of <u>a third-party Intellectual Property Right</u> [where "Intellectual Property, Right" is a separately defined term that can be as broad as the parties would like.]

The Third Question - <u>How</u> Will the Indemnity Work?

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How?

Notification to the Indemnitor

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- Include a provision that sets forth the timing and procedure for notifying the indemnitor of potential claims.
  - The language should also expressly provide the extent to which a failure to notify will nullify the obligation to indemnify.
- Example of a strict, bright-line notification requirement (72 hours), that is also relatively forgiving of a failure to notify:

  If the Licensee receives notice of a claim of patent infringement to which indemnification is sought, the Licensee shall notify the Licensor in writing to the address given in the first paragraph of this Agreement, or another address as Licensor may subsequently specify. Notice of infringement must be received within 72 hours by overnight courier service. The failure of the Licensee to give notice in the manner detailed herein shall not exempt the Licensor of its indemnification obligation, except to the extent that such a failure has materially prejudiced the Licensor's ability to defend the claim.
- Conversely, below is an example of a more relaxed notification requirement

  The foregoing shall not apply unless Buyer has informed Seller as soon as practicable of the claim, suit or action alleging such infringement and tendered defense of the suit or action to Seller.

How Will the Defense Proceed?

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- The indemnitee will want to be kept abreast of the status of the defense since it remains a named party and will be liable for any judgment entered against it.

  The Licensor conducting the defense of a claim of patent infringement shall <u>at all times keep the Licensee informed on a reasonable basis</u> as to the status of the defense of such claim, and will conduct the defense of such claim in a <u>prudent manner</u>, and <u>will not cease defending</u> the claim of infringement (except pursuant to a permitted settlement or compromise thereof) <u>without the prior written consent of the Licensee</u>.

- Alternatively, the indemnitee may wish to retain the right to participate in the lawsuit at its own expense.
- In some cases, the parties may want to provide a joint defense against a patent infringement claim.

Settlement Negotiations

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- Although control over the settlement negotiations may reside with the indemnitor, the indemnitee will certainly not want a settlement that will limit its right to use the patented technology or otherwise impede the operation of its business.

  The Licensor will not enter into any settlement of any such claim without Licensee's prior written consent, which shall not be unreasonably withheld.

How Will the Parties Cooperate?

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- In order to defend against a claim of patent infringement, the indemnitor may need information and assistance from the indemnitee.

  The Buyer shall take <u>all reasonably appropriate and necessary action to assist Seller</u> in the defense of such infringement action.

- The indemnitor may also wish to make the indemnity obligation <u>explicitly contingent</u> upon the cooperation of the indemnitee:

  Seller will have no liability under this Section unless Buyer provides Seller with <u>full information, cooperation, and assistance</u> regarding, and authority to defend and settle a claim covered by this Section.

How Can the Indemnitor Remedy the Situation?

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- For the indemnitor, having the option to substitute non-infringing goods or obtain a license to the disputed patent may be another mechanism for mitigating the impact of a patent infringement claim.
- Of course, the indemnitee should ensure that the non-infringing goods are an acceptable substitute.

The Seller has the right to resolve a claim of patent infringement by: (i) <u>obtaining a suitable license</u> so that Buyer can continue using the patent-protected item; or (ii) <u>substituting a functionally equivalent</u>, but non-infringing item.

To resolve a claim of patent infringement, the Seller has the <u>right to elect to replace the (original) equipment with non-infringing (alternative) equipment</u> that meets the original performance specifications of the (original) equipment.

Protection Against a Failure to Defend

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- Promise to indemnify is only as strong as the promissor's ability to compensate the indemnitee for losses or damages
- Patent infringement insurance
- Escrow?
  - Funded by royalty payments or purchase price

The Fourth Question - **When** Does the Indemnity Obligation Apply?

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When?

When is the Indemnity Triggered?

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- A patent infringement allegation can arise by the filing of a complaint, the sending of a cease and desist letter, or even a simple offering of a patent license.
  - Consideration should be given to which of these events will trigger the indemnitor's duty to defend against the claim.
- Competing objectives
  - The indemnitee will want to be defended against any allegation of infringement from day one
  - The indemnitor will want the defense obligations to arise only when the allegations have crystallized or a judgment has been had
- Unless otherwise provided, in Texas, a claim for indemnification does not accrue until a judgment has been entered against the indemnitee.
  - Settlement is not a judicial determination of liability in Texas

Survivability

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- Another issue to consider is the expiration of the duty to defend and/or indemnify.
  - Should the expiration be commensurate with the term of the license (oftentimes the lives of the underlying patents), for instance?
  - Or should it expire with the Representations and Warranties of the underlying agreement?
  - Assignability?

When Will the Indemnitee Be Paid?

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- An indemnification provision should clearly state when the indemnitee will be paid for its losses or damages.
- Competing objectives
  - The indemnitee will want to avoid paying any out-of-pocket costs and have indemnity payments made as they become due
  - The indemnitor may wish to delay payments until after the claim is resolved.
- A provision favoring the indemnitor can be written as follows:

  <u>Upon final determination of liability</u> and the amount of indemnification under this Section, the indemnitor shall pay the indemnitee within ____ business days of such a determination of liability, the amount of the claim for indemnification made hereunder.

- Also, simply including the words, **"as incurred,"** can indicate that the indemnity payments will be made as they are accrued

The Fifth Question - Where is the Indemnity Triggered?

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Where?

Where Must the Alleged Infringement Occur?

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- The indemnitor may want the indemnification to be subject to geographical restrictions.
  - For example, countries where:
    - the indemnitor operates,
    - the product or technology is initially sold or licensed, or
    - the product or technology is expected or authorized to be used.

  Licensor shall indemnify, defend, and hold harmless Licensee against claims arising out of the actual or alleged patent infringement of the Products <u>in the Licensed Territory</u>.

- Similarly, indemnification may be limited to those jurisdictions in which the seller can readily or cost effectively undertake a search of third-party intellectual property rights.

  Seller shall indemnify, defend, and hold harmless Buyer against claims arising out of the actual or alleged patent infringement of the Products: (1) in the <u>United States, Japan, or the European Union</u>; and (2) in another jurisdiction if Seller is aware of the actual or alleged infringement in that other jurisdiction as of the Effective Date of this Agreement.

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