Patent Licensing Agreements:
Allocating Risk and Maximizing Patent Value
Structuring Enforceable Contracts in Light of Medtronic v. Mirowski Ruling

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PATENT LICENSING AGREEMENTS: Allocating Risk and Maximizing Patent Value

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Agenda

- Key Contract Terms and Common Mistakes in Licensing Agreements
  - Recent Supreme Court decision in *Medtronic v. Mirowski Family Ventures* and its effect on the key terms we will discuss if any
- Risk Management Mechanisms
Technology vs. IP in License Agreements

- A licensing agreement is a legal contract between two parties, the licensor and the licensee.
- Technology and IP are fundamentally different
- Technology = Things, both tangible/intangible
- IP = Legal Rights
Medtronic, Inc. v. Mirowski Family Ventures LLC (US 2014)

**Issue:** If a licensee in good standing files a declaratory judgment action, seeking a judicial declaration that its products do not infringe the licensed patents, which party bears the burden of proving infringement: the plaintiff licensee or the defendant patent owner?

**Answer:** Even though the licensee may commence the action, and even though the patent owner can’t file a patent infringement action (because the licensee remains in good standing, meaning there is no infringement), the patent owner retains the burden of proving infringement, “just as it would be had the patentee brought an infringement suit.” Op. at 6.

As discussed below, this decision will impact a number of areas of patent licensing practice, including drafting of license provisions, negotiations regarding whether later-introduced products are royalty bearing, and subsequent litigation (or arbitration) proceedings.
Key Considerations For Licenses

- Defining IPRs licensed
- Type of license grant
- Type of exclusivity
- Licensed field
- Term and termination
- Compensation (royalty rate and basis)
- Conflict resolution
Other Key Considerations to Avoid Chaos

- Definitions
- Milestones
- Transferability (license is personal or transferable)
- Audit rights
- Confidentiality
- Risk management
IPRs Granted

- Hard IP and soft IP
- Improvements by Licensor
- Improvements by Licensee
  - Modifications by Licensee
- Trademark vs. patent
- Later-developed IP rights?
Type of License Grant: 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)
- Exclusivity is as to the licensor unless provided otherwise
- Sublicensable?

Tip = 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
- Sublicensable?

Tip:
A nonexclusive licensee cannot be granted the right to sue for infringement.
When Is an Exclusive License Not an Exclusive License?

- Label used is not determinative.
- Grant of rights actually granted determine if the exclusive license is an exclusive license, an assignment or something else.

  Example:
  - 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
Licensed Field

- Field of use restrictions appropriate?
  - Geography
  - Product
  - Use
  - Purpose
  - Market segments (e.g., trademark for market segments)
  - Particular machine (e.g., software licenses)
- Other territorial restrictions?
Term and Termination

- Specify date commences and expires, unless perpetual
- Right of renewal?
- Right to terminate for convenience and for cause and ramifications for doing so
- Provide consequences of termination
Compensation

- Issues to consider:
  - Royalty rate
  - Royalty basis (e.g., gross revenue or net profit)
  - Paid up rights
  - Audit rights
  - Timing and frequency
  - Milestones
  - Tax liability
  - Minimums and maximums
  - “Most Favored Nations” clause

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.
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.
- Audit rights?
Conflict Resolution

- Escalation
  - e.g., Executives meeting
- Mediation
- Arbitration
  - Number of arbitrators and how chosen
- Choice of law
- Forum selection
- Costs
- Confidentiality
- Exclusions of certain matters?
Definitions

- Do not underestimate their importance.
- Definitions define the parameter of the license.
- Keep in mind that if there is a dispute on the interpretation of the license, a third party such as an arbitrator or judge will interpret terms.
Milestones

- Examples include:
  - Developmental milestones
  - Payment milestones
  - Term milestones
  - Beneficial to give definition
  - Especially useful in biotech licenses
Transferability and Change of Control Provisions

- IP Licenses are personal and cannot be transferred by the licensee without authorization of the licensor
  - IP licenses are exception to the general rule that favors the free alienability of assets.
- When agreement is silent, patent/copyright rights are non-transferable by the licensee
  - Due diligence point in acquisition of a licensee
Types of M&A Transactions Implicating Transfer Clauses

- These transaction types do constitute a transfer:
  - (1) acquirer survives merger, but not licensee;
  - (2) Licensee merges into acquiror’s subsidiary;
  - (3) acquirer disappears into the target which survives the merger.

- These transaction types do not constitute a transfer:
  - (1) stock purchase (target gets new ownership);
  - (2) acquirer’s subsidiary disappears into the target, which survives the merger but in the process b/c a wholly owned subsidiary of the acquirer.

Structure transaction to avoid triggering anti-transfer clauses
Avoiding Benefit to the Acquirer

- **Example Clause:**
- 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. 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.”
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.
Joint Development Agreements – Important Considerations

- Defining Foreground Technology (Improvements)
- Defining Background Technology
- Prosecution, maintenance, etc. responsibilities
- Litigation against an infringer
- Indemnities
- How to precede when the partners are not unanimous on the research program.
- Unwinding the Joint Agreement.
- Use of confidentiality clauses to maintain IP proprietary if no patent is going to pursued – but what if one joint partner wants to patent?
- Alternative dispute resolution – issues with AAA and other institutions – more expensive than going to court.
Risk Allocation in Licensing Agreements

- 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

- 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

- Representations are presentations of fact made to induce someone to enter into the contract
  - 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.
The Balance of Risks

- 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
Standard Reps & Warranties

- Capacity to enter the contract
- Denial of implied warranties and conditions
- 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 propriety right of any other Person under the law of the United States.”
Standard Reps & Warranties

- **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”
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

- 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.
- Beware as licensee counsel.
Knowledge Qualifiers

- 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
- As party making representation, use knowledge qualifiers
- As party receiving rep, be wary of knowledge qualifiers and recognize what they really mean
Territorial and Temporal Tools

- 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

- 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

- Five key questions that form the underlying basis for any indemnification provision:
  - **Who** is indemnified?
  - **What** actions are likely to trigger the indemnity and what limits apply?
  - **How** will the indemnity work?
  - **When** does the indemnity obligation apply?
  - **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.
Who Should Indemnify Whom?

- 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

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?

- 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 Licensee, its directors, officers, affiliates, contractors, subcontractors, agents, and employees against all losses, damages, liabilities, costs, and expenses (including, but not limited to, reasonable attorneys’ fees) suffered by the Licensee, its directors, officers, affiliates, contractors, subcontractors, agents, and employees due to a claim of patent infringement relating to the Licensed Technology.
Who Controls the Defense?

- 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

- 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.
What? . . . Causal Connection

- 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?

- 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

- 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?

- A provision explicitly setting forth what costs will be indemnified should be included, as seen in the following examples:
  - **Seller will pay any and all costs, damages, and expenses, including, but not limited to, reasonable attorneys’ fees and costs awarded against or incurred by 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 no circumstances shall indemnitor be liable to indemnitee for indirect, incidental, consequential, special or exemplary damages arising from this Agreement, even if indemnitor has been advised of the possibility of such damages, including, but not limited to, loss of revenue or anticipated profits or loss of business.**
What Types of IP Claims Are Covered?

- 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 patent, trademark, copyright, moral, industrial design, or other proprietary rights, or misuse or misappropriation of trade secret) 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 a third-party Intellectual Property Right [where “Intellectual Property, Right” is a separately defined term that can be as broad as the parties would like.]**
How? Notification to the Indemnitor

- 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?

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

- 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

- 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?

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

- **The Buyer shall take all reasonably appropriate and necessary action to assist Seller in the defense of such infringement action.**

- The indemnitor may also wish to make the indemnity obligation *explicitly contingent* upon the cooperation of the indemnitee:

- **Seller will have no liability under this Section unless Buyer provides Seller with full information, cooperation, and assistance regarding, and authority to defend and settle a claim covered by this Section.**
How Can the Indemnitor Remedy the Situation?

- 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) obtaining a suitable license so that Buyer can continue using the patent-protected item; or (ii) substituting a functionally equivalent, but non-infringing item.

- To resolve a claim of patent infringement, the Seller has the right to elect to replace the (original) equipment with non-infringing (alternative) equipment that meets the original performance specifications of the (original) equipment.
Protection Against a Failure to Defend

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

- 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
When Will the Indemnitee Be Paid?

- 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:
  - **Upon final determination of liability 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.
Where Must the Alleged Infringement Occur?

- 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 in the Licensed Territory.**

- 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 United States, Japan, or the European Union; 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.**
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?
THE END

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