PATENT INFRINGEMENT INDEMNIFICATION

VENDOR INDEMNIFICATION OF PATENT INFRINGEMENT CLAIMS
Maximizing the Indemnitee’s Right to Enforcement

By Chad A. Rutkowski*

Commercial buyers, with good reason, do not care to find themselves embroiled in expensive patent infringement suits for the mere act of purchasing goods or services. To protect against such claims, many supply contracts require the vendor to warrant against intellectual property infringement. This is fair because the vendor typically has the knowledge and expertise to discern what patents are implicated by the manufacture and sale of its product. Because the vendor wants to sell to as many buyers as possible, it has the incentive to either ensure non-infringement or purchase appropriate licenses. However, warranties may afford only cosmetic relief. To recover on a breach of warranty claim, it would first have to be proven that the vendor’s goods or services infringed the patent at issue. Then, in a subsequent suit between the buyer and vendor, the buyer would have to prove that the infringement fell within the scope of the warranty. The buyer incurs expense every step of the way, and often times does not recover legal fees and costs. Even if the buyer successfully defends against the underlying patent infringement claim itself, the victory achieved is often pyrrhic in light of the expense of patent litigation including out of pocket expenses and dedication of limited company resources. Thus, to be free from such claims buyers often supplement their warranty requirements in a supply contract with indemnification provisions. This common risk-shifting mechanism has engendered a rich body of case law in claims involving personal injuries, but little precedent concerning claims involving patent infringement.

It may be important for the buyer of goods and services seeking indemnity (known as the “indemnitee”) to follow certain procedural formalities in order to safeguard the indemnity right, including providing the vendor (or “indemnitor”) prompt notice of the claim and an opportunity to defend. If the indemnitee does not, and unilaterally tries the

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case to verdict or negotiates a settlement, then the indemnitee risks losing the indemnification or bearing the burden of proving that its actions were reasonable. In the case of a settlement, this may put the indemnitee in the uncomfortable position of proving its own liability, so as to rebut the assertion that it paid its settlement as a mere volunteer. The situation becomes more complicated where the goods and services of more than one vendor are implicated by the patent infringement claim, such as where the infringement claim is directed to a product that includes components from various vendors that are combined with other components to form the allegedly infringing product.

ANATOMY OF AN INDEMNIFICATION PROVISION—SPECIFICITY AND SCOPE

Indemnification provisions can be broken down into two basic parts—1) identification of the types of claims covered; and 2) the factual predicates that must occur to trigger indemnification for those claims. A simple indemnification clause, with the “kind of claim covered” bracketed first and the “factual trigger” bracketed second, might look like this—“Seller agrees to indemnify Buyer [for any and all claims of negligence] [arising out of Seller’s provision of goods and services].” Thus, if “Buyer” gets sued by a customer who is subsequently injured because of a Seller’s goods, it would appear reasonable for Buyer to expect Seller to indemnify it. It is rarely that easy.

Specificity in Kinds of Claims Covered

The majority of jurisdictions find that indemnification agreements are enforceable (i.e., not per se void against public policy) and should be interpreted consistent with the rules governing the interpretation of contracts generally. The majority of jurisdictions also find, despite this seemingly clear expression of standard interpretive principles, that provisions for indemnification of one’s own fault are to be strictly construed and must be spelled out clearly. However, because what is “clear” is inherently subjective, this reasoning can lead to absurd, casuistic results. Thus in order for the Buyer in our example above to obtain indemnity from Seller, the provision would have to use certain “magic words”—“Seller agrees to indemnify Buyer for any and all claims of negligence, including claims that Buyer was negligent, arising out of Seller’s provision of goods or services.” Courts impose these strict interpretative principles because of long standing reluctance against eroding the incentive to exercise reasonable care.

It appears that the strict construction doctrine has not yet been applied in the cases addressing indemnity for patent infringement claims. For example, in Tenneco Oil Co. v. Gulsby¹ the owner of a natural gas processing plant contracted with a design and build firm, Gulsby Engineering, for a new plant. Prior to hiring Gulsby, the owner, Tenneco, put

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the construction project out to bid and received a bid from a company that developed a patented gas separation process. Tenneco then passed certain confidential information received in that bid material on to Gulsby and awarded the project to it. Gulsby then employed the patented process at a lower price than the patent holder. The patent holder sued both Tenneco and Gulsby for patent infringement, unfair competition and misappropriation of confidential information. The case proceeded to bench trial against the two defendants, and the court found defendants jointly and severally liable on all counts and awarded the patent holder $835,000 in damages.

Gulsby specifically agreed to indemnify Tenneco for patent infringement claims “occurring or in any manner incident to, connected with or arising out of the work to be performed by Contractor,” unless “Tenneco specified in writing the particular product or process [claimed to be infringing].”2 The Texas Court of Appeals found that Gulsby was required to indemnify Tenneco despite the fact that Tenneco appeared to be actively involved in the infringing conduct, and despite the absence of any apparent express reference to coverage for Tenneco’s own infringement. The Court of Appeals did not apply, or even mention, strict construction principles despite adoption in Texas of the “express negligence doctrine.”

Other cases addressing patent infringement claims have also not imposed a strict construction doctrine.3 This is not to say that careful drafting is not necessary; the doctrine has also not been expressly rejected. Nonetheless courts to date appear willing to enforce patent indemnity provisions consistent with the interpretation of contracts generally.

Scope of Factual Trigger

Once it is determined what kinds of claims will be covered, the contract must also describe what facts must be present to trigger the indemnity. The trigger set forth in the contract can be broad, such as by reciting that indemnity will be provided for claims “arising out of” the work at issue. This kind of trigger is generally interpreted to require a causal nexus between the claim and the vendor’s work to trigger the indemnity. The scope can be further modified, depending on the complexities of the contractual relationship at issue and limited only by the imagination and foresight of the contract drafters.

For example, in *Carter-Wallace, Inc. v. Tambrands, Inc.*4 the buyer bought the subsidiary of a larger company which subsidiary owned certain technology used to produce pregnancy test kits. It was known at the

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2. Id. at 606.
time of sale that the buyer intended to modify and improve upon that technology. The indemnitor/seller agreed to indemnify the buyer for any patent infringement claims relating to any “products which were being distributed by [the subsidiary] at the time of the Closing [of the sale],” and excepted from the indemnity’s scope “any claim for infringement to the extent that such infringement is caused by any change made in such products after the Closing Date.” After the purchase the buyer was sued by a patent holder who claimed the pregnancy test kits infringed its patent. It was, however, “undisputed that the [buyer’s improvements] were not the basis for the . . . patent infringement claims.” The court found that the modified products constituted “products which were being distributed by [the subsidiary] at the time of Closing,” because the focus of the claim was on the purchased technology and not the improvements, and it was clear that “the parties intended that some changes could be made . . . without taking the resulting products outside the indemnity clause.” The court stated that to find otherwise would defeat the entire purpose of the indemnification clause:

The primary purpose of the clause was to protect plaintiff from claimed patent infringements relating to the [subsidiary’s] products being distributed by [the subsidiary]. A claim of such infringement would necessarily be based on the underlying technology, not the limited form in which it was being utilized at the time of the closing.

With careful drafting the indemnification clause can create whatever degree of risk-shifting the parties deem fair.

**Indemnification Is Contract-Based, Not Fault-Based**

It should be borne in mind when examining contractual indemnification clauses that the scope of the indemnity is determined by the liability the indemnitor undertook as defined by the contract. The indemnitor’s responsibility is in this respect similar to that of an insurer’s, which agrees to undertake a specific scope of risk even though it itself did nothing wrong. Issues of relative culpability should not be considered, unless culpability is made an issue by the terms of the contract:

[C]ommon law indemnity is an equitable remedy that arises out of obligations imposed through special relationships, but contractual indemnity is not concerned with ‘special relationships’ or vicarious, constructive, derivative or technical liability; it is concerned with the express terms of the agreement to indemnify. In cases involving contractual indemnity, the terms of the

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5. *Id* at 12.
6. *Id*.
7. *Id*. at 12-13. *See also* Symbol Technologies, Inc. v. Intersil Corp., 818 N.Y.S.2d 519 (broad indemnity language covered claims of patent infringement involving communications protocol in which indemnitor’s product was but one component of wireless device).
agreement will determine whether the indemnitor is obligated to reimburse the indemnitee for a particular claim.\footnote{Camp, Dresser & McKee, Inc. v. Paul N. Howard Co., 853 So. 2d 1072, 1077 (Fla. 5th DCA 2003). See also Brown v. Two Exchange Plaza Partners, 556 N.E.2d 430, 433 (N.Y. 1990) (indemnity attaches where claim arises out of subcontractor’s work, even if subcontractor not itself negligent); Correia v. Professional Data Mgmt., Inc., 693 N.Y.S.2d 597, 600 (N.Y. App. Div. 1999) (“Whether or not the proposed indemnitor was negligent is a non-issue and irrelevant.”).}

DUTY TO GIVE NOTICE AND RIGHT TO CONTROL LITIGATION

Once the scope of the indemnification is settled, it remains for the parties to determine how the indemnitee’s defense will be handled. Courts are split on whether an indemnitor has a \textit{per se} right to control or otherwise participate in the defense of an indemnitee. The only patent indemnity case to address the subject, the \textit{Gulsby Engineering, Inc.} case discussed above, found that no such right exists.\footnote{Gulsby Engineering, Inc., 846 S.W.2d at 606-07. See also Crystal River Enters. v. Nasi, 399 So. 2d 77, 78 (Fla. 5th DCA 1981) (“Generally, in the absence of a specific provision in the indemnity agreement, there is no requirement to notify the indemnitor to come in and defend as a condition precedent to recovery.”); Tillman v. Wheaton-Haven Recreation Ass’n, 580 F.2d 1222, 1229 (4th Cir. 1978), rev’d on other grounds 410 U.S. 431, 35 L. Ed. 2d 403, 93 S. Ct. 1090 (1973) (same); Boston and Maine Railroad v. Bethlehem Steel Co., 311 F.2d 847 (1st Cir. 1963) (same); Baker v. Northeastern Industrial Park, Inc., 73 A.D.2d 753, 754 (N.Y. App. Div. 1979) (same).} Indeed, absent an express contract provision granting “sole control” to the indemnitor, it would appear that such an obligation could not exist independently because the right to indemnity arguably does not accrue until after judgment has been rendered against the indemnitee.\footnote{See e.g. Tedesco v. A.P. Green Indus., Inc., 864 N.E.2d 65, 67 (N.Y. 2007) (cause of action for indemnity “accrues only when the person seeking indemnity or contribution has paid the underlying claim.”); Atchison, T. & S.F. Ry. v. Payne, 1996 Tex. App. LEXIS 2195 (Tex. App. 1996) (same); Parkridge Assocs. v. Leduc Indus., 113 Wn. App. 592 (Wash. Ct. App. 2002) (same); Caldwell Trucking PRP v. Rexon Tech. Corp., 421 F.3d 234, 244 (3d Cir. 2005) (“[I]n the usual indemnity situation, the indemnitor is liable to the indemnitee only after a judgment has been entered against it, and until that has occurred, no responsibility exists.”).} That is, if there is no actual right to indemnity until after the judgment has been paid, how could an indemnitee ever require the indemnitor to participate in the defense since no claim arguably exists at that time?

Some courts have also found that mere notice of the action is tantamount to a formal “tender” of defense, and an indemnitor that refuses to participate in the litigation can be bound by any judgment that follows:

Proper notice of the litigation must be given so that the indemnitor will have a reasonable time in which to prepare a defense. A tender of defense by the indemnitee, however, is not required since it can be inferred upon timely notice of the pending action. An indemnitor who refuses to appear and defend upon
proper notice is bound by the judgment and liable for indemnity.\textsuperscript{11}

Nonetheless, a number of courts have found that due process concerns require the indemnitee to offer the opportunity to either control or participate in the defense of the indemnitee before the indemnitor can be bound to indemnify, particularly in cases where the indemnitee has settled the underlying claim—“The indemnitee’s unilateral acts, albeit reasonable and undertaken in good faith, cannot bind the indemnitor; notice and an opportunity to defend are the indispensable due process satisfying elements.”\textsuperscript{12} Moreover, this duty has been inferred even in cases where the indemnification was implied, i.e., common law indemnification.\textsuperscript{13} Interestingly, though, these courts envision the indemnitee and indemnitor entering into yet another hold harmless agreement, this time with the indemnitor expressly agreeing to be responsible for the lawsuit at hand, and providing some proof of financial responsibility, relying on a procedure first articulated by the Sixth Circuit in \textit{Tankrederiet Gefion A/S v. Hyman-Michaels Company}:

A tender of the defense in exchange for a hold-harmless agreement is a feasible protection for the party desiring to settle, as well as for the proposed indemnitor. It certainly seems appropriate for B, the party desiring to settle and possessing the facts pertaining to the settlement, to be required to tender C the choice of approving the settlement or of going forward with the defense in exchange for a hold-harmless agreement. We assume that such a hold-harmless agreement would constitute C’s financially responsible guarantee that B would under no circumstances be forced to pay more than the sum for which it was prepared to settle. If such a tender were refused and B settled, then we think the proofs required in the subsequent suit against C would appropriately be potential liability and reasonableness of the settlement.\textsuperscript{14}

Even with recognizing the due process rights of the indemnitor, however, many of these same courts acknowledge the important public policy considerations served by fostering and encouraging settlement. Courts have therefore struggled with the proper way to treat an indemnitee who either failed to give notice to the indemnitor, or gave notice but did not tender control of its defense, and proceeded to reach a reasoned and fair settlement. In order to strike a balance between the competing concerns of ensuring due process for the indemnitor and encouraging the indem-

\textsuperscript{12} Jennings v. United States, 374 F.2d 983, 986 (4th Cir. 1967).
\textsuperscript{13} See Atlantic Richfield Co. v. Interstate Oil Transport Co., 784 F.2d 106, 111 (2d Cir. 1986) (indemnity contract with no control provision); Whisenant v. Brewster-Bartle Offshore Company, 446 F.2d 394, 402-05 (5th Cir. 1971) (no express indemnity agreement).
nitee to settle, many courts have adopted a doctrine in which the indemnitee does not lose his right to indemnity, but must demonstrate his own fault in order to prove that the settlement was fair and reasonable. Thus the indemnitee must prove its actual liability.

There are situations, however, where the indemnitee would only need to prove its potential liability, a much lower standard:

A practical device by which an indemnitee can protect himself against the awkward possibility of having to prove the original plaintiff’s case against himself, the original defendant, is to offer the indemnitor before any settlement is concluded the choice of (1) approving the settlement or (2) taking over the defense of the case and agreeing to hold the indemnitee harmless in any event for damages which may be assessed against him in excess of the amount of the proposed settlement. If the indemnitor approves the settlement or defends unsuccessfully against the original claim, he cannot later question the indemnitee’s liability to the original claimant. If the indemnitor declines to take either course, then the indemnitee will only be required to show potential liability to the original plaintiff in order to support his claim over against the indemnitor. 15

Unfortunately the cases are imprecise on what exactly must be offered to the indemnitor by the indemnitee, with some courts describing it as a tender of control of the litigation, and other courts saying merely that the indemnitor has to have an opportunity to participate. In some cases, the notions of controlling the defense and participating in the defense are used interchangeably. 16 Some courts have found that mere notice that settlement discussions were taking place, without tendering defense in exchange for a hold harmless agreement or offering an opportunity to approve the settlement, did not sufficiently protect the indemnitor, and required the indemnitee to prove actual liability in order to recover on a settlement agreement. 17 In contrast, other courts have found that an indemnitee need only show potential liability, even when defense was not tendered, where the indemnitee gave notice of the claim, the indemnitor was kept apprised of settlement negotiations, and the indemnitor did not articulate approval, disapproval, or any desire to participate in the settlement discussions. 18

What emerges then is a doctrine that is highly fact specific and will turn on what a court perceives to be the equities in play. The indemnitee’s best chance at ensuring recovery is to actually tender its defense, and cede control, in return for another express agreement to indemnify it (i.e., hold it harmless) against the precise litigation at issue, and to keep the indemnitor involved in settlement discussions and invite it to approve

17. Tankredseriet, 406 F.2d 1039. See also Whisenant, 446 F.2d 392.
18. Burke v. Ripp, 619 F.2d 354 (5th Cir. 1980). See also Parfait, 484 F.2d 296.
or disprove a settlement. If such a paradigm is not followed, recovery will depend on what the court deems equitable. It should be noted, however that courts do not enforce the paradigm slavishly and the settlement will be upheld where the indemnitor has been “afforded substantially the same protection” as that afforded by the Tankredereit procedure. And of course much of the guesswork can be eliminated if the parties engage in clear, precise contract-drafting setting out the parties’ relative rights and obligations regarding notice, defense obligations, and the right to negotiate and approve settlements.

**Allocation of Indemnity Amongst Multiple Vendors**

This opaque analysis is further muddied when an indemnitee is potentially owed indemnity from more than one vendor. In that case, the indemnitee’s desire to maintain control of its own defense can be all the greater, especially if there is a concern that any one indemnitor would “steer” the litigation in a fashion so as to maximize the liability of a co-indemnitor and thereby minimize its own. It appears that the obligation of co-indemnitors in such situations is joint and several, such that the indemnitee could require any one indemnitor to fully indemnify it. The indemnitee should therefore have significant latitude in crafting an allocation scheme, for any co-indemnitor that refuses to accept allocation is at risk for full indemnification.

**Conclusion**

Indemnification of patent infringement claims is an important risk-shifting mechanism that ought to be carefully considered at the time vendor contracts are drafted. Courts appear willing to enforce such provisions without imposing any special contract-interpretation rules. The parties should therefore consider what rights and responsibilities they expect to have during the course of the underlying litigation, including whether the indemnitor must be promptly notified of the claim against the indemnitee; the degree of control the indemnitor will have over the defense of the indemnitee; and the rights either party will have to approve or disapprove settlements. Consideration of these relative rights and responsibilities should extend to allocation of indemnification amongst multiple indemnitors, especially where the finished product at issue incorporates multiple component parts. Failure to do so may subject both parties to the uncertainty of judicial determination of what is fair and equitable under the precise circumstances at issue.

19. *Parfait*, 484 F.2d at 305.