Intellectual Property Indemnity Clauses

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Abstract:

In this article, Mr. Hemnes examines the history of intellectual property warranty and indemnity contractual provisions. He then describes events that have destabilized provisions that had become standardized, particularly in the computer software field, and critiques the positions currently taken by both vendors and customers. He concludes with proposals for a better allocation of risk between technology providers and consumers.

I. Background

The practices associated with intellectual property indemnity can be traced in part to Article 2 of the Uniform Commercial Code. At the dawn of the computer age practitioners searched for legal models that could be used for transactions in intangible rights and products such as computer software. Although computer software did not fit easily into the “sale of goods” paradigm, analogies to the familiar rules governing sales of goods were inevitable.
Buried in the lower reaches of Article 2 of the UCC one finds an implied warranty of noninfringement in Section 2-312(2):^\textsuperscript{5}

Unless otherwise agreed, a **seller** that is a **merchant** regularly dealing in **goods** of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a **buyer** that furnishes specifications to the seller must hold the seller harmless against any such claim that arises out of compliance with the specifications.

In the context of a sale of goods at the time Article 2 was drafted^\textsuperscript{6} a noninfringement warranty made good economic sense. The only form of intellectual property likely to be of concern to the purchaser of goods was patent protection.\textsuperscript{7} In the early to mid-20\textsuperscript{th} century, when Article 2 of the UCC was adopted, patents were the disfavored stepchildren of the federal courts. A high percentage of patents were held to be invalid,^\textsuperscript{8} and the damages accorded to those found to be valid were often limited to a modest royalty.\textsuperscript{9} Furthermore, patent rights are as a rule exhausted

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^\textsuperscript{4} Indeed, there was a decade-long effort to adapt a revised UCC article perched between Article II and the non-UCC concept of an intellectual property license. See Maureen A. O’Rourke, *An Essay on the Challenges of Drafting a Uniform Law of Software Contracting*, 10 LEWIS & CLARK L. REV. 925, 926 (2006).

^\textsuperscript{5} Uniform Commercial Code §2-312(2). For a discussion of the application of this provision to IP licensing transactions, see G. Ross Allen, *The Basics of Indemnification*, 21 INTELL. PROP. LITIG., Spring 2010, at 7, 8.

^\textsuperscript{6} The Uniform Commercial Code’s drafting commenced in 1942; the UCC was first published in 1952. See http://en.wikipedia.org/wiki/Uniform_Commercial_Code.

^\textsuperscript{7} Books could be considered an exception to this generalization. However, copyright covers only the right to reproduce and distribute a copyrighted work in copies; therefore, the purchaser of a copyrighted work may use it – i.e., read it – even if the work were distributed without permission of the copyright owner. See 17 U.S.C. §106. Therefore, the UCC’s implied noninfringement warranty is quite unnecessary to the typical ultimate purchaser of a copyrighted work; it would only be important to persons higher in the distribution chain who need the right to redistribute the work.

^\textsuperscript{8} In a study, the PTO found that 70% of patents were held invalid in the courts of appeals during the period 1968-1977. See http://ipmall.info/hosted_resources/notices_reports/PTOinvaliditystudy.pdf.

^\textsuperscript{9} Section 284 of the Patent Act provides:

> Upon a finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer . . . .

upon the first sale of a product. For all these reasons, the risk that the ultimate purchaser of a product would be sued for patent infringement was very remote, and even if the purchaser were sued the damages would be only a tiny fraction of the purchase price – typically 2 to 4% for a manufactured product.

In this context, a product manufacturer could provide an implied warranty of noninfringement with very little risk beyond whatever modest risk of infringement the manufacturer already incurred by manufacturing the product itself. Product purchasers did not typically insist on an indemnity beyond the implied warranty perhaps because the risk was perceived as too remote to be worth worrying about. They would assume, probably quite rightly, that the manufacturer would “stand behind its product” and obtain the required license if an infringement claim were actually made, since the claim would almost certainly be made against the manufacturer, not against the user.

With this background, and without giving the matter too much additional thought, it did not seem unreasonable for the lawyers representing software and other technology providers to provide a warranty of noninfringement governing their clients’ products as well. Such a warranty was certainly consistent with established practice, as embodied in UCC Article 2, and therefore would have met the expectations of the marketplace. Furthermore, the risk of infringement liability seemed manageable. At the time we are discussing virtually no one believed that computer software would be patentable, and absolutely no one imagined that business methods would be patentable. The risks of trade secret or copyright infringement liability are more uniquely within the control of the software provider,

10 Adams v. Burke, 84 U.S. 453, 456 (1873) (“when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use.”); Bloomer v. McQuewan, 55 U.S. 539 (1852).

11 It is instructive that standard practice at the time disclaimed the implied warranties of merchantability and fitness in favor of more closely drafted express warranties, but almost always neglected to disclaim the implied warranty of noninfringement. It was simply not a point of concern.

12 Indemnities generally provide fuller remedies than mere warranties. Warranties provide recovery for the difference in value between the product as sold and the product as delivered. U.C.C. § 2-714. In the context of an infringement claim, one assumes that this would be measured by the price of the royalty required to obtain a license to use the infringing item. An indemnity, by contrast, would cover all losses occasioned by the infringement, usually including attorneys’ fees and potentially including lost profits if there is an interruption in use. See Allen, supra note 5.

13 The General Talking Pictures case was an unusual exception in which the user was sued on the ground that the patentee’s rights had not been exhausted by the first sale. General Talking Pictures Corp. v. Western Electric Co., 304 U.S. 175 (1938), aff’d, 305 U.S. 124 (1938).
since each of them requires an element of *mens rea*, or a near equivalent.\(^{14}\) By adopting appropriate internal controls and standards, sometimes even including a “clean room,” a software provider ought to be able to minimize its infringement risk.

There was an additional consideration, namely, the desire to control litigation concerning rights in the product. At the time we are discussing, protection for computer software was in a state of flux.\(^{15}\) Copyright in computer software was only expressly recognized in the years following the Copyright Act of 1976, and even there one found great doubt as to the extent of protection – did it protect operating systems that communicate only with machines?\(^{16}\) Did it protect the “look and feel” of the user interface generated by the software?\(^{17}\) These were considered weighty issues going to the heart of the value represented by computer software, and the software providers did not want to risk having them decided in litigation against their licensees, whose interest in broad protection would likely be less than the interest of the software providers themselves.

The effect of this concern was to migrate the infringement issue from the warranty clauses of software license agreements to an indemnity provision. The *quid pro quo* in indemnity clauses was to tell the licensee that the licensor would provide indemnity against infringement claims, but only if the licensee gave the licensor prompt notice of the claim and full authority to defend or settle the case on behalf of the licensee. To mitigate their risk, most software licensors further provided that their obligation, and the licensee’s sole remedy, was either to (a) obtain for the licensee the right to use the licensed product, (b) modify the product to make it non-infringing or, failing (a) or (b), (c) to terminate the license and refund a pro-rated portion of the purchase price, depending on how much of the license term had been exhausted at the date of termination.\(^{18}\)

Clauses along these lines became a de facto standard in the software industry and persisted for many years. They were hardly perfect from the standpoint of licensees. Option (c) could be very painful in the case of software that was critical to a business, and even option (b) could be problematic if the required modifications degraded functionality or compatibility. As a result, licensees with sufficient

\(^{14}\) To infringe copyright one must copy; independent creation of the same work never infringes. 17 U.S.C. § 501. To misappropriate a trade secret one must be on notice of the existence of the secret and have entered into an express or implied agreement to protect it. U.T.S.A. § 1.2.

\(^{15}\) For an example of how many issues were in the air at this time, see the author’s effort to evaluate whether copyright would attach to video games. Hemnes, “The Adaptation of Copyright Law to Video Games,” 131 U. Pa. L. Rev. 171 (1982).

\(^{16}\) Apple Computer, Inc. v. Franklin Computer Corp., 714 F.2d 1240 (3d Cir. 1983).

\(^{17}\) This issue was never completely resolved. Lotus Dev. Corp. v. Borland Int’l, Inc., 49 F.3d 807 (1st Cir. 1995), *aff’d per curiam by an equally divided court*, 516 U.S. 233 (1996).

\(^{18}\) For an example of one such clause, see Appendix B, Example 7.
bargaining power would nibble at the edges of such indemnity clauses, sometimes providing for full refunds and often providing that (b) could only be exercised if functionality were not compromised. But the basic pattern - limited indemnity in exchange for control over litigation - became well-fixed in many persons' minds.

Indeed, as so often happens in the law, the basic practices that emerged from the software industry infected practice in other industries as well, and intellectual property indemnification clauses were inserted into virtually any agreement that included a license of intellectual property - most notably, licenses of patented technology.

II. Destabilizing Developments

The balance of power between licensor and licensees represented by the "standard" IP indemnity clause was gradually but profoundly destabilized by the reforms in the patent system that followed the establishment of the Court of Appeals for the Federal Circuit ("CAFC") in 1982. Prior to the CAFC, the circuit courts of appeals had jurisdiction over patent appeals. To varying degrees, these courts were hostile to patents, resulting in a surprisingly small percentage of litigated patents being held valid on appeal. The author of this paper clerked on the Third Circuit Court of Appeals from 1974 to 1975. One of the first cases assigned was a patent infringement matter inherited from the out-going clerk. The out-going clerk handed the file over with the statement, "Remember as you review this, no patents are valid in the Third Circuit." Not too surprisingly, the patent in question - covering an articulated boom for a crane - was found invalid for obviousness.

This was typical of the attitude to validity throughout the federal system. Patents were considered suspiciously anti-competitive, and courts considered it their duty to limit their impact. In the comparatively rare instance when a patent was found to be valid, the damages for infringement were generally measured in terms of a reasonable royalty, which for manufactured articles would typically be in the low single digits.

The exclusive jurisdiction over patent appeals accorded to the CAFC changed this in fundamental ways. Populated as it was by patent practitioners, the CAFC cast a kindly eye on patents, confirming the validity of patents more than 50% of the time. The CAFC also dramatically expanded the scope for damages, permitting

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19 See PTO study, supra note 8.
21 This rule of thumb still applies in licensing transactions, where royalties on manufactured products rarely exceed 5%. Royalties on products with lower production and distribution costs such as software can be higher, reflecting their much higher gross profit margin.
claims based not only on the profit that would have been made by the patented product but also profits from lost sales of ancillary products and enforcing the statutory provisions permitting treble damages in cases of willful infringement.23 Finally, the CAFC, certainly aided and abetted by the Supreme Court,24 dramatically expanded the range of things that could be patented from the traditional subjects of mechanical devices, chemical compounds and industrial processes to include computer software,25 business methods26 and even forms of life.27

Running in parallel with these legal developments was the inexorable invasion of digital technology into all realms of human endeavor. What had begun as something buried in the bowels of mainframe computers, and having no intrinsic value other than to help operate the computers, had morphed into something that is now known vaguely as “The Web,” “The Internet” and “The Cloud” through which every form of transaction and communication passes and without which modern life hardly seems possible. Thanks to the CAFC, large patches of this Cloud have been staked out with patent claims, permitting the patentees to charge tariffs for anyone passing over or through them.

In this context, the goods and services provided by giant corporations using digital technology became the targets of an increasing number of patent infringement claims whose value would be calculated in millions of dollars by reason of the huge volume of business dependent on the technology. Worse yet, a large corporation could face the possibility of an injunction against its use of mission-critical technology if it did not settle. To their absolute shock and horror, entities like banks found themselves enmeshed in patent infringement actions,

(Donald Dunner, Michael Jakes and Jeffery Karceski (1995) report that during 1982-94, the CAFC found patents valid in 67% of adjudications).


26 State Street Bank & Trust Co. v. Signature Financial Group, 149 F.3d 1368 (Fed. Cir. 1998). Protection for business methods engendered such a fury of controversy that the CAFC was subsequently required to retrench. In re Bilski, 545 F.3d 943 (Fed. Cir. 2008) (en banc).

almost always based on technology that they had licensed from third parties. Patentees realized that really big dollars could be had from suing the oftentimes large and well-heeled users of licensed technology, rather than the oftentimes smaller and poorer technology providers. Furthermore, from the standpoint of the patentee, it made much more sense to sue the users, since their incentive to defend vigorously would be far weaker than that of the licensors. Even better, obtaining negotiated license agreements in settlement of their claims was evidence strengthening the patents’ claim to validity.\textsuperscript{28} Patentees therefore developed “roll-up” strategies in which they brought actions against the users, not the producers, of technology, offering settlements that were lower than the likely cost of litigation and that were therefore very attractive to the defendants in such cases.\textsuperscript{29}

As a result, the limited indemnity/defense of litigation solution that had emerged from early software licensing practice came under intense pressure. Scarred by patent infringement claims, licensees began to demand “full” indemnity from all of their technology licensors, without the formerly standard outs of (a) obtain a license; (b) modify or (c) give a refund.

Licensors, on the other hand, began to look for new ways to protect themselves against potentially ruinous infringement liability. In one well-known case in the District of Massachusetts, Boston Communications Group (BCG), a modest-sized public company with a market capitalization of about $120 million at the time, provided software to major players in the telecommunications industry and indemnified them against infringement claims. Freedom Wireless sued BCG for patent infringement. BCG lost and suffered an adverse jury verdict of $128 million, based largely on the scope of use of its technology by its licensees. BCG eventually settled the case for $55 million (plus another $32 million from the indemnitees) after BCG spent $27 million defending it.\textsuperscript{30}

III. Current Situation\textsuperscript{31}

\textsuperscript{29} It has been observed that patent litigation is the “sport of kings.” A fully litigated patent infringement case is unlikely to cost less than several million dollars.
\textsuperscript{31} Appendix B provides examples of the highly variable clauses found in license agreements.
The net effect of these developments is a highly unstable environment in which an inordinate amount of time and energy is spent negotiating IP indemnity clauses, the outcome of negotiation often reflects bargaining power rather than economic reality and the interests of neither licensors nor licensees are appropriately balanced.

It is very common for large enterprises having substantial leverage to insist on a blanket IP indemnity, with no restriction on liability, in all transactions. In many cases, one suspects that this primarily serves the internal purpose of derriere protection. If the company is sued for infringement, as it inevitably will be one day, the first question likely to be put to the company lawyers is, “Are we indemnified?” Nobody wants to be in the position of saying “No” or “Yes, but …”. So the easiest solution is to establish a blanket policy that all IP licenses must carry indemnification, and that the indemnification must not be subject to the limitations on liability that otherwise limit the licensor’s obligations.

In many cases this solution is completely ridiculous from an economic perspective. As an example, the author was representing a very small, privately owned design shop for consumer devices in attempting to negotiate a license of one of their designs to a nationwide “big box” houseware chain. The “big box,” whose annual revenues are in the billions and which would have been capable of selling millions of dollars worth of the particular design, insisted on an uncapped indemnity from the design shop, including the usual provision that the licensor would not only indemnify but also defend Big Box and hold it harmless in the event of a claim. It mattered not that the design shop’s resources would have been exhausted after the first couple of months of litigation, nor that any measure of damages based on Big Boxes’ sales would have immediately bankrupted the design shop and left Big Box with no indemnity at all. The policy was the policy and it had to be implemented. When challenged, the attorneys for Big Box respond with the rhetorical question, “Isn’t your client willing to stand behind his product?”

It is worth observing that these are situations in which the licensor/technology provider is unlikely to be in a position to mitigate its risk. Whereas a computer software company could in the old days mitigate risk through “clean rooms” and company policies, the cost of conducting a “freedom to operate” study on many technologies is so prohibitively high that none but the largest manufacturers ever attempt one. Furthermore, even the most thorough study will not uncover patent applications that are pending but not yet issued. For these reasons, the risk of infringement liability is not really something in the nature of a defect in a product that the licensor will not “stand behind”; it is more in the nature of a business risk, akin to natural disasters, that cannot be effectively avoided through any exercise of diligence.

The net effect of this extreme is to create window dressing for transactions that have no economic reality whatsoever. The large organization will still bear the risk of infringement liability, no matter what the indemnity clause says; at most it will
have the satisfaction of bankrupting its vendor if a claim is made. This may or may not be in its interest, depending on how important the technology may be and whether it could realistically be replaced without the help of the vendor.

At the opposite extreme one finds vendors with great market power simply refusing to offer any IP warranty or indemnity, and getting away with it because their licensees have no alternative to the technology. 32 Others imagine new ways to create the illusion that they have provided indemnity for their products when in fact they are providing none. One recent example reviewed by the author had a clause entitled “Indemnification” that began with the usual IP indemnity/defense provisions, but then added a list of exceptions, including, among other things, technology that is already in use at the time the patent is issued and patents known to the licensee. This says in effect that if there are already infringers of the patent, the indemnity will not apply. It is certainly possible to imagine another customer “checking the box” that there was an indemnity clause without realizing that the clause provided little or no protection.

Another gambit is to provide indemnity only for final judgments of infringement. As everyone knows, this almost never happens: the vast majority of cases are settled on terms that do not admit infringement, even if they might require payment of substantial sums to settle the claim. In such cases, the customer who paid to make a claim go away – which will usually be the case if the patentee is smart and sets its settlement figure below the realistic present value of risk to the customer – will be unable to recover the settlement amount from the vendor because there was no final judgment of infringement. There would of course be a negotiation over the question whether the vendor would pay the cost of settlement, but the customer may well reach the conclusion that it is better to pay than to continue to sustain the risks and burden of on-going litigation. This will particularly be the case if the potential risks are great enough to require disclosure to investors.

We have also seen the development of gamesmanship regarding the interpretation of indemnity clauses when a claim is actually made. In a recent case, the customer/licensee received a letter claiming that the licensed technology infringed a series of patents.33 The customer duly provided prompt written notice of the claim to the vendor. The vendor responded that its indemnification clause required there to be a “claim,” which the vendor interpreted as requiring a lawsuit

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32 Microsoft is an exception, but it has dramatically beefed up its patent portfolio to back up its indemnity obligations. See Ina Fried, Microsoft to back customers in infringement cases, CNET News, Nov. 10, 2004, http://news.cnet.com/Microsoft-to-back-customers-in-infringement-cases/2100-1014_3-5445868.html.
33 This itself was somewhat unusual – it is more common to receive a letter putting one on notice of a patent and offering a license, without actually claiming infringement.
The customer was then in the position of deciding whether to provoke a lawsuit in hopes of receiving indemnification or to settle short of a lawsuit, typically for less than the matter could be settled after a lawsuit was filed.35

A final problem frequently encountered, but seldom resolved, concerns what one might call “mixed” technology. The typical indemnification clause will include an exclusion for the combination of the licensed technology with other technology not supplied by the vendor.36 On the other hand, the typical patent, if artfully drafted, will include claims not only on a core invention, but also on the combination of the core invention with all the applications and combinations that the patent drafter can think of. Furthermore, many of the most important licenses concern “platform” technologies that by their nature are intended both to interoperate with technologies from other vendors and to provide a basis on which the licensee can build its own applications and solutions. In this context, the exclusion of indemnity liability for all but the bare thing licensed becomes an exception that consumes the rule: virtually every infringement claim will involve such combinations, and will therefore be excluded from the scope of the indemnification.

Interestingly, the “check the box” mentality applied by many technology consumers – while draconian in its approach to total liability – often completely fails to realize that in practice its blanket indemnity will be washed out by reason of its use of the licensed technology in combination with both its own additions and technology from other vendors.

In short, the current practice typically fails to strike a reasonable and appropriate balance between the interests of licensors and licensees. Something better needs to be developed.

IV. Proposals37

35 The recent cases of Southern California Gas Co. v. Syntellect, Inc., No. 08cv941 BEN (NLS), 2011 U.S. Dist. LEXIS 33373 (S.D. Cal. March 28, 2011) and Olaes Enters., Inc. v. A.D. Sutton & Sons, Inc., No. 09 Civ. 8680 (CM)(PED), 2011 U.S. Dist. LEXIS 67737 (S.D.N.Y. June 20, 2011) suggest that narrow readings of indemnity provisions may not be favored by courts if the indemnitee chooses to bring a claim against the sophisticated indemnitor. See the summary of these cases in Appendix A.
36 See Appendix B, Example 7.
37 Robert E. Rudnick and Andrew M. Grodin review most of the clauses that can be considered from the standpoint of a technology vendor to mitigate its indemnification liability in Drafting and Negotiating Defense and Indemnification Provisions, INTELL. PROP. LITIG., Spring 2010, at 9-12.
A solution to these dilemmas ought to begin with a consideration of what is actually at stake. Rather than thinking of intellectual property as an undifferentiated lump—“IP”—it is helpful to remind ourselves that “IP” comes in a variety of flavors, and each of them has unique characteristics that suggest different approaches to warranties and indemnification.

Consider first trade secrets. Trade secrets can attach to any form of technology, from industrial methods to chemical formulas and computer software. As we all know, to be protected as a trade secret something must be actually maintained in secrecy and confidence and disclosed only to persons who have agreed to hold it in secrecy and confidence.\(^{38}\) To misappropriate a trade secret one must have either accessed it through improper means or violated an express or implied agreement to hold it in confidence. For these reasons, violation of trade secret rights is not something that can happen by accident, and it is not unreasonable to expect a technology vendor to have adopted policies and procedures that will keep track of its trade secret obligations and guard against misappropriation. Furthermore, to the extent that trade secret misappropriation is a form of tort, it is possible to obtain insurance against liability arising from employees’ commission of such torts. The insurance would of course include limits on liability, but would serve to mitigate at least in part the risk of indemnity liability to one’s customers.\(^{39}\) Finally, a licensee of technology that was misappropriated from a third party would have no liability to the third party unless the licensee continued to use it, without justification, after being put on notice of the misappropriation, and even in that case damages would be limited to the period of use following notice. For all these reasons, there is a strong case that imposing blanket liability on technology vendors for liability arising from misappropriation of trade secrets will not impose risks that the vendors cannot mitigate, will not expose them to liability that would be measured by their customers’ size rather than their own, and is therefore reasonable.\(^{40}\)

Copyright has some but not all of the characteristics of trade secret liability. Like trade secrets, copyright infringement requires the infringer to do something that the


\(^{40}\) Owens-Illinois, Inc. v. BTR plc, No. 05 Civ. 2873 (LLS), 2010 U.S. Dist. LEXIS 64813 (S.D.N.Y. June 28, 2010) is an example of a case in which the court interpreted the scope of an indemnification provision in part in reliance on the economics of the situation, reasoning that the indemnity should not attach to a class of products sold after an acquisition when the acquirer was in a position to reap all the benefits of the sale. See Appendix A.
infringer can ordinarily identify as wrong, or at least suspect – copying, distributing, displaying or performing somebody else’s work. We can of course get in to greyer areas here than in the case of trade secret misappropriation: what about unconscious copying,\textsuperscript{41} or the creation of works that are not “substantially similar” to the original,\textsuperscript{42} or the line between idea and expression?\textsuperscript{43} Nevertheless, the creative process will usually raise sufficient red flags in the minds of knowledgeable creators that they should know when to seek competent advice about what they may or may not do, consistently with their copyright obligations. In addition, as already noted above, copyright provides no remedy for mere use of a copyrighted work. For this reason, the risk that a person who believes that a product has infringed copyright is unlikely to attempt to bring an action against ultimate users of the infringing work. Copyright law does provide much more draconian remedies than trade secret law, including statutory damages and attorneys’ fees liability, but these are reserved for cases of willful infringement and, again, should for this reason be mitigable by the technology vendor. One concludes that a case for broad indemnity protection in the case of copyright claims can be justified.

We now come to patents and find a completely different liability terrain. To begin with, patents can be infringed unwittingly by a person who developed and sold a product in complete ignorance of the patentee’s claims. Furthermore, there is no effective means of avoiding infringement. Patent filings are secret for about eighteen months from the date of application; for this reason, even the most thorough and expensive “freedom to operate” search provides no guard against claims issued after the search is performed. The America Invents Act\textsuperscript{44} arguably makes this problem even worse because the technology vendor can no longer take comfort in the possibility of proving prior invention – his date of invention is no longer determinative; instead the fact that the patentee filed first will usually govern.\textsuperscript{45} In addition, patents provide the exclusive right to “use” the patented invention, and patentees are often motivated to bring infringement actions against end users, particularly when they are larger than the technology vendor and more likely to want a quick settlement than to challenge the patent’s validity. Finally, the measure of damages in actions brought against end users will typically be based on

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\item \textsuperscript{41} Bright Tunes Music Corp. v. Harrisongs Music, Ltd., 420 F. Supp. 177 (S.D.N.Y. 1976) (finding copyright infringement even though copying may have been subconscious).
\item \textsuperscript{42} Selle v. Gibb, 741 F.2d 896, 900 (7th Cir. 1984) (proving copyright infringement includes proof of substantial degree of similarity between the two works).
\item \textsuperscript{43} Nichols v. Universal Pictures Corp., 45 F.2d 119 (2d Cir. 1930) (determining protectable and non-protectable portions of a play).
\item \textsuperscript{45} There is a twelve-month grace period from filing where the inventor’s own disclosures are not used as prior art; an inventor can publicize the invention without waiving patent rights. However, this does not include disclosures by third parties who independently arrive at the invention information. \textit{Ibid.} at § 3.
\end{itemize}
their size, revenues and scope of use, and will bear no relationship to the size and resources of the technology vendors.

For all these reasons, blanket indemnification for patent infringement claims presents a much harder question than indemnification for trade secret or copyright claims. Because the vendor is not necessarily in a position to mitigate the risk, an indemnification clause makes the vendor effectively an insurer against what must be considered a substantial and ubiquitous risk of doing business in the post-CAFC era. Real insurance policies are in fact available that provide limited coverage against infringement risk, and such policies can be written to include indemnification liability.\(^{46}\) The policies can, however, be costly, and will always include a retained or co-insurance amount and a liability cap.\(^ {47}\) No insurer would write the policy that technology vendors are asked to write in the form of uncapped indemnity liability for patent infringement claims.

For these reasons, it seems both inherently unreasonable and economically unjustifiable to expect technology vendors to provide uncapped indemnification protection against patent infringement claims to their customers. If one reverts to the question Professor Calabresi asked years ago in connection with tort reform,\(^ {48}\) who is best able to bear the cost of the risk (or pass it along to its customers), the answer will depend on the relative sizes of the technology vendor and its customers, but will often lean in the direction of the customers, not the vendor. Coupled with a concern that infringement liability can easily chill new product development, not to mention support for existing technologies, it is not difficult to make the argument that blanket patent indemnity is a bad idea in the technology sector.

Some consideration must also be given to differences in technologies. If a technology is a stand-alone device that is sourced exclusively from one vendor, that vendor will both be in a better position to pass the risk to customers via pricing and also will not have the excuse that the customer combined its technology with something else, resulting in the infringement.\(^ {49}\) But where it is a platform technology or a technology that by its nature is combined with other technologies – think here of applications operating on an iPhone – one is immediately confronted with the question of who should be holding the indemnity bag when a claim is made that is based on the combination, or on something built on the platform.


\(^{47}\) *Id.* Premiums can range from one to ten percent of the insured amount per year. *Id.*


\(^{49}\) It is interesting to note that in two recent cases in which the author was involved, the vendor for a stand-alone technology willingly agreed to indemnify the client (who was a reseller), whereas in the second case the vendor for a platform technology found multiple excuses not to indemnify its end-user customer.
In addition, a distinction can reasonably be drawn between patent claims of which the vendor is aware and those of which the vendor is ignorant. For the former, the vendor certainly should bear responsibility to find a solution, whether through licensing, litigation or acquisition of patents. For the latter, though, asking a vendor to write an uncapped pure insurance policy on terms that no real insurance company would ever consider must be considered unreasonable at best; silly at worst.

The only sensible solution to these dilemmas must be some combination of commercial insurance solutions and cooperation among technology vendors and their licensees in addressing patent infringement claims, particularly in the context of platform technologies and components of interoperating systems. Insurance can be used to mitigate the risk to both vendor and customer; intellectual property vendors can even consider solutions in which they price their products differentially, depending on whether intellectual property claims respecting the product are covered by insurance or not.

For liability beyond what an insurer would be willing to underwrite, or beyond which the customer would be unwilling to pay a premium, one must fall back on the contractual allocation of risk between vendor and customer. For the reasons set forth in this paper, it is unreasonable to expect either to bear the entire risk, but at the same time it is reasonable to expect both parties to cooperate in mitigating their mutual risk. Consider therefore a clause along the following lines:

The Parties acknowledge and agree that the Licensed Materials are intended for use as platforms on which Customer can build applications programs, and that claims of infringement may be based on the combination of the Licensed Materials with applications programs that are created by Customer ("Combination Claims"). In the event that a Combination Claim is made, or that another Claim is made that covers both materials provided by the Vendor and by the Customer, the Parties will cooperate in good faith, subject to a mutually agreeable Community of Interest Agreement, to respond to the Claim. The Party against whom a Combination Claim is made shall have primary responsibility for the defense and/or settlement of the Combination Claim, using counsel of its choosing. If a Combination Claim is made against both Parties, then the Parties shall jointly defend or settle the Combination Claim, using counsel acceptable to both Parties. The Parties shall bear their own expenses and Losses arising as a result of a Combination Claim and shall divide equitably any settlement or judgment, depending on the relative contribution of each to the infringement.

Admittedly, there remains room for disagreement over relative contribution to the infringement, but at least the clause addresses the problem directly and points to an equitable solution. The parties clearly have a commonality of interest in resisting the infringement claims, and at the outset it will almost never be clear whether there is infringement or what the cause of it might be. Indeed, even after a
case is litigated these questions may not be answered, since the case will be settled with a general denial of liability all around. Why not face up to these facts from the beginning and reach an agreement that pools resources rather than squandering them on finger-pointing?

One might even imagine creating systems in which a vendor and its customers pay into a patent defense pool – rather like a joint marketing pool in franchise arrangements – that would be available to be tapped if a claim is made respecting the relevant technology. This would in effect create a mutual insurance company for the technology in circumstances in which ordinary insurance policies are either unavailable or prohibitively expensive. The existence of such a policy could even act as a deterrent against infringement claims, particularly if its funds were dedicated to defense and not to settlement.

Sadly, cooperation of this type is seldom achieved. There is a strong urge to seek black-and-white solutions, seeking to place the burden of defense and indemnification on one party or the other but more often than not placing the burden on both, with substantial duplication of effort and multiplication of risks.
Appendix A

Summary of Recent Caselaw Respecting Indemnification Clauses


Southern California Gas (SCG) entered into a contract with Syntellect to purchase an automated interactive telephone system, which SCG could use for handling incoming customer phone calls. Two indemnity provisions were included in the contract, including an obligation that Syntellect defend and indemnify SCG in the event SCG was sued for IP infringement in connection with the automated interactive telephone system. SCG was later sued for patent infringement. SCG sued Syntellect to enforce the indemnity provision when Syntellect failed to provide a defense and indemnify SCG in its settlement with the third party. The contract specifically provided:

Supplier shall indemnify, defend and hold Company, and its present and future direct or indirect parent company(ies), subsidiaries and affiliates . . . harmless from and against any and all claims, actions, suits, proceedings, losses, liabilities, penalties, damages, costs or expenses (including attorneys’ fees and disbursements) of any kind whatsoever arising from (1) actual or alleged infringement or misappropriation by Supplier or any subcontractor of any patent, copyright, trade secret, trademark, service mark, trade name, or other intellectual property right in connection with the System, including without limitation, any deliverable, (2) Supplier’s violation of any third party license to use intellectual property in connection with the System, including, without limitation, any deliverable.

The court rejected a number of Syntellect’s arguments as to why it should escape liability:

1) Syntellect argued that because the third party did not specifically name Syntellect or its software as the infringer in its complaint against SCG, the indemnity provision is not triggered. The court held that the indemnity provision does not require a third party specifically to name Syntellect or its product to trigger the indemnitor’s duties.

2) Syntellect argued that SCG’s own negligence extinguished its right to indemnity. The court held that the broad indemnity provision does not extinguish Syntellect’s liability even in cases where SCG is actively negligent. Nor does it extinguish Syntellect’s liability even in cases where SCG is accused of patent infringement for its own acts.

3) Syntellect argued that California’s UCC § 2312(3) extinguishes SCG’s right to indemnity because its software product merely complied with the specifications SCG furnished. The court held that § 2312(3) does not apply because of the specific written indemnity provision in the agreement.

Owens-Illinois (Owens) purchased from BTR a group of food and beverage packaging companies under a Share Disposition Agreement, including Continental PET Technologies, Inc. (CPET). CPET manufactured plastic food and beverage containers, and was developing a plastic beer bottle using material (CPTX-312) that could trigger patent infringement claims. BTR brought a summary judgment motion on the issue of whether the agreement required it to indemnify Owens for losses Owens sustained in connection with a patent infringement action which was brought against CPET by a third party. The agreement contained a non-infringement warranty and indemnification provision stating that BTR will indemnify Owens for “any actual Losses . . . relating to or arising out of (i) any breach of any representation or warranty made by Seller contained in this Agreement . . . .” Indemnifiable Losses include “any actual damages, claims, losses, charges, actions, suits, proceedings, deficiencies, interest, penalties, and reasonable costs and expenses (including without limitation reasonable attorneys’ and consultants’ fees) . . . .” BTR’s indemnification obligation was only triggered if Owen’s losses exceeded $35 million. After the deal between Owens and BTR closed, CPET was sued for patent infringement. CPET then sublicensed rights to use the relevant patent with Chevron, an exclusive licensee.

Owens sent BTR notice of the patent infringement suit against CPET, but BTR did not participate in the suit. In a separate suit, a court held that Chevron did not have the rights to grant a sublicense to CPET. CPET and the third party then settled the matter in which CPET agreed to pay $25.1 million and execute a license agreement. Owens sought to enforce the indemnification provision in its agreement with BTR.

The court addressed the issue of whether BTR’s IP representations and warranties covered CPET’s sales of CPTX-312 containers, since those sales did not start until after closing. The court found that the CPTX-312 sales were not included because the warranty was limited to “all Intellectual Property necessary to operate the Packaging Business as currently conducted” and “the conduct of the business of the Packaging Companies as currently conducted.” The court also reasoned that placing the risk of loss from the future sales on Owens was consistent because Owens would control the extent of those sales and reap all the profits. Furthermore, the court did not find that an obligation to indemnify for losses from manufacturing automatically created a promise to indemnify for losses from sales. Thus, the sale of CPTX-312 containers was not covered by the agreement’s representations and warranties, relieving BTR from its indemnification obligation for losses arising out of the third party’s claim for CPET’s infringing sales.


OCC (counterclaim defendants) was sued by Olaes for copyright infringement predicated on the use in OCC-licensed products of certain artistic enhancements to OCC logos allegedly copyrighted by Olaes. In license agreements between OCC and its licensees, OCC warranted and represented that it owned certain “Property” it was authorizing the licensees to imprint on various consumer goods. The agreements also included indemnification provisions, which required OCC to indemnify the
licensees for damages and reasonable legal expenses incurred in defending against a claim of the sort Olaes brought against the licensees. The licensees sought to enforce the indemnification provision against OCC. Although OCC said it would indemnify the licensees, hired attorneys and paid the licensees’ legal bills, OCC reneged on the arrangement once a judge denied OCC’s motion to dismiss Olaes’ copyright claims. OCC argued that it had no obligation to indemnify as to what the licensees were imprinting on their merchandise because OCC had warranted and represented to the licensees only that no else could claim an interest in OCC’s Property, which did not include the licensees’ imprints. All of the licensees settled with Olaes and brought a renewed motion for indemnification.

The court found that OCC could not deny its contractual obligation to indemnify the licensees in connection with this lawsuit because of the following:

1) OCC represented to the licenses that they were free to incorporate the entire design provided by OCC into their licensed products.
2) OCC delivered the designs used by the licenses to those licensees in tangible or electronic format without copyright notice or other notice that would have identified Olaes as having any proprietary right in the designs.

Thus, the licensor led each licensee to believe the licensor owned the material that was provided for the licensees’ use, making the representations and warranties applicable and triggering the licensor’s indemnification obligation.


Gyro Advertising (Gyro) contacted Shannon Associates because it needed an illustration of a pig flying in front of the Philadelphia skyline for a PMH advertising campaign. Shannon Associates provided such an illustration to Philadelphia Media Holdings (PMH), a Gyro client. In a professional services agreement between Gyro and Shannon Associates, Shannon Associates agreed to provide and perform services and deliver deliverables for Gyro’s benefit. The agreement contained a non-infringement warranty and an indemnification clause, which stated:

Contractor shall defend, indemnify, and hold harmless Gyro and its officers, directors, shareholders, employees, representatives, agents, successors, and assigns from and against any and all losses, obligations, risks, damages, Injuries, costs, settlements, liabilities, and expenses (including reasonable attorneys’ fees), and against any and all claims, actions, suits, and proceedings, arising out of or relating to (a) any breach of Contractor’s representations or warranties in this Agreement; (b) any breach of this Agreement by Contractor; (c) any fraud, negligence, willful misconduct, or violation of law by Contractor; and (d) any damage to property or injuries to persons, or other acts or omissions caused or contributed to by the Contractor or any of its Representatives, or anyone acting under the Contractor’s direction or control or on the Contractor’s behalf, in the course of performance under this Agreement.

R. Bradley Maule sued Gyro and PMH on the basis that the illustration infringed upon his copyrighted photograph. Gyro notified Shannon Associates of the
suit, and Shannon Associates responded two months later that it did not have an obligation to indemnify based on the agreement (e.g., there had not yet been a breach), but that it would defend and indemnify Gyro. Gyro rejected the offer for defense in the future because it believed the case was close to a settlement.

The court found that the language of the agreement was clear and unambiguous, and that Shannon Associates was required to indemnify Gyro for the costs, attorneys’ fees and amount paid to settle the litigation. Shannon Associates warranted, represented and covenanted that the illustration did not “infringe any intellectual property rights of any person,” and that neither the illustration nor “any use or exploitation by Gyro of the [illustration would] infringe any patent, copyright, trademark, trade secret, privacy, publicity, or other intellectual property or proprietary right of any person or entity.” The court rejected Shannon Associates’ argument that it was not obligated to defend and indemnify Gyro because a term such as “alleged” or “claimed” did not appear after “against any and all claims.” The court held that such wording was not necessary before the term “breach” to trigger indemnification obligations because “claim” is defined as “to assert” or “a cause of action.” Analyzing the two separately, the court found that Shannon Associates had a duty to indemnify and a duty to defend Gyro under the agreement.
Appendix B

IP Indemnification Clause Examples

Example 1:
Vendor, at its own expense, will indemnify Buyer against any claim, suit, action, or other proceeding brought against Buyer based on a claim that the Product(s) as delivered to Buyer infringes in any manner any patent right of a third party.

Example 2:
Seller will defend, indemnify and hold Buyer harmless against a third-party action, suit or proceeding ("Claim") against Buyer to the extent such Claim is based upon an allegation that a Product, as of its delivery date under this Agreement, infringes a valid United States patent or copyright or misappropriates a third party's trade secret.

Example 3:
INDEMNIFICATION. The term "Claim" means any claim, suit or action by any third party, and the term "Losses" means any damages awarded and fines assessed in any Claim by a court of competent jurisdiction or pursuant to an arbitration proceeding, any amounts due under Claim settlement, and any other costs or expenses incurred in complying with any injunctive or equitable relief or any settlement requirements.

(a) Party Indemnification.

(i) Indemnification by Party-1. Upon receipt of notice from Party-2 requesting Party-1 to do so, Party-1 agrees to indemnify, defend, and hold harmless Party-2 and its affiliates, subsidiaries, shareholders, members, directors, officers, employees, agents, and parents, from and against any Claim, and any associated Losses to the extent caused by violation of any patent, copyright, trademark, trade secret, or other intellectual property or proprietary right due to Party-1 providing the Deliverables (except to the extent a Claim is caused by Party-2’s internally created specifications).

(ii) Indemnification by Party-2. Upon receipt of notice from Party-1 requesting Party-2 to do so, Party-2 agrees to indemnify, defend, and hold harmless Party-1 and its affiliates, subsidiaries, shareholders, members, directors, officers, employees, agents, and parents, from and against any Claim, and any associated Losses to the extent caused by violation of any patent, copyright, trademark, trade secret, or other intellectual property or proprietary right to the extent caused by Party-2's internally created specifications or Party-2’s use of the Deliverables.

(b) Indemnification Procedures. The term "indemnifying party" means the party assuming indemnification obligations under this Agreement, and the term "indemnified party" means all parties, including any third parties, which the indemnifying party agrees to indemnify under this Agreement.
(i) **Notice.** The indemnified party must give the indemnifying party prompt written notice of a Claim, provided, however, that failure of an indemnified party to give prompt written notice does not relieve the indemnifying party from its indemnification obligations under this Agreement except to the extent the defense is materially prejudiced by the failure. When the indemnifying party receives notice of a Claim from an indemnified party, the indemnifying party agrees, at its sole cost and expense, to assume the defense of the Claim by representatives chosen by the indemnifying party. The indemnified party may participate in the defense of the Claim and employ counsel at its own expense to assist in the defense of the Claim, subject to the indemnifying party retaining final authority and control over the conduct of the defense.

(ii) **Conduct of Defense.** The indemnifying party’s defense attorneys must be reasonably experienced and qualified in the areas of litigation applicable to the defense. The indemnifying party has the right to assert any defenses, causes of action or counterclaims arising from the subject of the Claim available to the indemnified party and also has the right to settle the Claim, subject to the indemnified party’s prior written consent to the extent the settlement affects the rights or obligations of the indemnified party. The indemnified party agrees to provide the indemnifying party with reasonable assistance, at the indemnifying party’s expense, as may be reasonably requested by the indemnifying party in connection with any defense, including, without limitation, providing the indemnifying party with information, documents, records and reasonable access to the indemnified party as the indemnifying party reasonably deems necessary.

**Example 4:**
Vendor shall indemnify, defend, and hold harmless Buyer, its officers, agents, and employees against all losses, damages, liabilities, costs, and expenses (including but not limited to reasonable attorneys’ fees) resulting from any judgment or proceeding in which it is determined, or any settlement agreement arising out of the allegation, that (i) Vendor’s furnishing or supplying Buyer with parts, goods, components, programs, practices, or methods under this order constitutes an infringement of any patent, copyrights, trademark, trade name, trade secret, or other proprietary or contractual right of any third party, or (ii) Buyer’s use of such parts, goods, components, programs, practices, or methods supplied by Vendor under this order for research use in the manner and for the purposes specified in the accompanying product literature constitutes and infringement of any patent, copyrights, trademark, trade name, trade secret, or other proprietary or contractual right of any third party, provided that the foregoing indemnity shall not apply to any new product made by Buyer with use of the products supplied by Vendor hereunder. The foregoing shall not apply unless Buyer has informed Vendor as soon as practicable of the suit or action alleging such infringement and tendered defense of the suit or action to Vendor. Vendor shall not settle such suit or action without the consent of Buyer (such consent not to be unreasonably withheld) unless such settlement does not require any payment of money or other consideration by Buyer.
Buyer shall not settle such suit or action without the consent of Vendor unless Vendor has declined to defend Buyer in such suit or action. In any suit or action for which Vendor has accepted the defense of Buyer, Buyer retains the right to participate in the defense at its own expense, but shall permit Vendor to control the defense (subject to good-faith consultations with Buyer) and shall not confess judgment, admit liability, or take any other actions prejudicial to the defense of such suit or action.

**Example 5 (Licensee friendly):**

1.1 In the event a third party makes a claim against Licensee that the Products provided by Seller under this Agreement infringe such third party’s IPR, Seller shall:
   (a) Procure an irrevocable release for the Licensee, free of cost to Licensee, from such alleged infringement claim(s) for past use; and
   (b) For continued use of the Products that are the subject of the infringement claim(s), do one of the following: (i) First, using commercially reasonable efforts, procure for Licensee a worldwide royalty free license to continue to use the Products that are the subject of the infringement claim(s); and if unable to procure such right, (ii) modify or replace the Products so as to make such Products (while retaining the form, fit and functionality of such Products) non-infringing, to the satisfaction of such third party; and
   (b) Indemnify Licensee for all reasonable costs (including attorneys’ fees) and damages (including redesign costs) if any, incurred by Licensee.

1.2 Where a third party has initiated a lawsuit or other similar proceeding (including the seeking of preliminary injunction) against Licensee based on an allegation that the Products infringe IPR of such third party, Licensee shall notify Seller of such occurrence as soon as commercially reasonable and Seller shall assume and diligently conduct the defense of such lawsuit or other proceeding and pay all costs relating thereto, including attorneys’ fees. If Seller fails to assume the defense within a period of thirty (30) days, Licensee may conduct the defense and Seller shall reimburse Licensee for the costs incurred (including reasonable attorneys’ fees).

1.3 Any settlement of the lawsuit or other proceeding referred to in section 1.2 shall be subject to Seller taking, at its own expense and costs, the measures set out in section 1.1.

1.4 In the event Seller is not successful in its defense, in whole or in part, in the lawsuit or other proceeding referred to in section 1.2, Seller shall:
   (a) Reimburse Licensee for any damages or costs awarded against Licensee related to the past use that is found to be infringing; and
   (b) Take, at its own expense and costs, one of the actions as defined in sections 1.1(a) and 1.1(b) to avoid future infringements, and
   (c) Indemnify Licensee for damages incurred, as defined in section 1.1(c).

1.5 Licensee shall, upon Seller’s written request and at the expense of Seller, provide reasonable assistance to Seller to support Seller in the defense of the lawsuit or other proceeding referred to in section 1.2. In addition, Seller agrees to provide such reasonable assistance to Licensee where Licensee undertakes to conduct the defense as provided in section 1.2.
1.6 Seller shall not be liable under sections 1.1 to 1.5 where the allegation or claim of infringement is based solely on one of the following:

(a) The unauthorized or unforeseeable use by Licensee of the Products where the Products would not be infringing but for such unauthorized or unforeseeable use; or

(b) The unauthorized alteration or modification of the Products by Licensee where the Products would not be infringing but for such unauthorized modification or alteration.

**Example 6 (Licensee friendly):**

1.1 “Claim” and “Losses” Defined. “Claim” means any demand, or any civil, criminal, administrative, or investigative claim, action, or proceeding (including arbitration) asserted, commenced or threatened against a Licensee entity or person employed or engaged by a Licensee entity. “Losses” means all judgments, awards, settlements, liabilities to third party plaintiffs, damages awarded to third party plaintiffs, liens and claims together with all related costs and expenses incurred by reason of a Claim, including reasonable attorneys’ fees and disbursements, costs of investigation, litigation, settlement and judgment, and any taxes, interest, penalties and fines with respect to any of the foregoing to the extent Licensor breaches any of its obligations to defend Licensee under Section 1.2. “Losses” shall not include a claim by Licensee Indemnitees for consequential damages suffered by them directly (in contrast with amounts awarded to third party claimants), whether in the nature of lost profits or punitive damages against Licensor.

1.2 Indemnification. Licensor will, at its sole cost and expense, indemnify, defend and hold harmless Licensee and its affiliates and subsidiaries, and their respective officers, directors, employees, contractors, agents, representatives, successors and assigns (collectively, “Licensee Indemnitees”) from and against any and all Losses resulting from a Claim that any Product(s), Deliverable(s), works, information, material(s) and/or Services furnished by or on behalf of Licensor, or the use thereof by Licensee, constitutes an infringement, misappropriation or unlawful use or disclosure of any Intellectual Property Rights of a third party.

1.3 Procedures. Licensee agrees to give Licensor prompt written notice of any Claim for which a Licensee Indemnitee seeks indemnification, provided that any failure by Licensee to provide such notice will not relieve Licensor of its indemnification obligations except to the extent Licensor can demonstrate actual prejudice as a result of such failure. Within 30 days after receiving Licensee’s notice of a Claim, but no later than 10 days before the date on which any formal response to a Claim is due, Licensor will notify Licensee in writing as to whether Licensor acknowledges its indemnification obligation and elects to assume control of the defense and settlement of the Claim (a “Notice of Election”). Licensor will have the right to conduct the defense of the Claim and, consistent with the rights of Licensee Indemnitees hereunder, all negotiations for its settlement, provided, however, that Licensee may participate in such defense or negotiations to protect its (or their) interests and that any settlement will be for the payment of money by Licensor and will not, without the prior written approval of Licensee, obligate or impose any liability on any Licensee Indemnitee in any way, including without limitation, to any
licensor with licensor’s defense of any claim, and shall render an accounting of all amounts for which indemnification is sought. if licensor does not deliver a timely notice of election, the affected licensee indemnitee(s) may defend and/or settle the claim in such a manner as it (or they) may deem appropriate, at the cost and expense of licensor, including payment of any settlement, judgment or award and the cost of defending or settling the claim. licensor will promptly reimburse the licensee indemnitee upon demand for all losses suffered or incurred as a result of or in connection with the claim.

1.4 corrective actions. Licensor will give licensee prompt notice of any threat, warning or notice of any claim asserted against licensor that any products, deliverables, information, materials and/or services furnished by or on behalf of licensor, or the use thereof by licensee, constitutes an infringement, misappropriation or unlawful use or disclosure of any intellectual property rights of a third party. In addition to licensee’s other rights and licensor’s other obligations hereunder, if all or any part of a product or deliverable is, or in the opinion of licensor’s intellectual property counsel may become, the subject of any claim or suit for infringement of any intellectual property right, licensor may, and in the event of any adjudication that the product or deliverable, or any part thereof, does infringe or if the use of the product or deliverable, or any part thereof, is enjoined, licensor will promptly (a) procure for licensee, at no additional cost or expense to licensee, the right to use the product or deliverable, or the affected part thereof, or (b) to the extent such option is not available to licensor on commercially reasonable terms following commercially reasonable efforts to procure such right, replace, at no additional cost or expense to licensee, the product or deliverable, or affected part thereof, with a modified or substituted product or deliverable or part, that does not violate any third party’s intellectual property rights and that is qualitatively and functionally at least the equivalent of the affected product or deliverable, or part thereof.

1.5 return. if neither (a) nor (b) of section 1.4 is available to licensor on commercially reasonable terms following commercially reasonable efforts by licensor, and licensor has so advised licensee, then licensee may at its option surrender the products and/or deliverables, in whole or in part, and receive a full refund of the aggregate payments made by licensee for or in respect of the returned products and/or deliverables, including amounts paid in respect of services performed in relation to the returned products and/or deliverables.

example 7 (licensor friendly):

1.1 indemnification. Subject to section 1.2, licensor shall, at its own expense, indemnify and defend licensee against any claim by a third party that the licensor software as used in compliance with this agreement infringes a valid U.S. patent issued prior to the effective date, berne convention copyright or U.S. trade secret (a “claim”), provided that licensee: (i) provides licensor with prompt written notice of the claim; and (ii) permits licensor to exclusively defend, compromise, settle or appeal such claim. licensee shall provide licensor with full information, assistance and cooperation, at licensor’ expense, to enable licensor to defend, compromise,
settle and/or appeal such Claim and shall not settle or compromise any Claim without Licensor' prior written consent. The provisions set forth in this Section 1.1 shall not prohibit the participation of Licensee with Licensor in the defense or appeal of any Claim should Licensee choose to participate, at its own expense (such expense not being indemnified by Licensor) and with attorneys of its own choice, provided that Licensor shall have sole control and authority with respect to any such defense, compromise, settlement, appeal or similar action related to the Claim. Licensor shall pay any final award of damages assessed against Licensee resulting from a Claim defended by Licensor pursuant to this Section 1.1, including any awarded costs or attorneys’ fees, or any settlement amount agreed to by Licensor.

1.2 Exclusions. Licensor shall have no obligation to Licensee under Section 1.1 if the alleged infringement or violation is based upon:

(i) Use of the Licensor Software other than as set forth herein and in the then-current version of the Documentation;

(ii) Any modification or alteration to or of the Licensor Software performed by anyone (including Licensee) other than Licensor or its subcontractors, agents or assignees;

(iii) Licensor’ compliance with Licensee’s designs, specifications or instructions if Licensor is unable to follow such designs, specifications or instructions without infringement or violation;

(iv) Combination, operation or use with software, hardware, information, data, or other materials, not approved or supplied by Licensor, if infringement (including, without limitation, contributory infringement) would have been avoided by use without such software, hardware, information, data, or other materials;

(v) Use of a superseded or altered release of the Licensor Software if the infringement would have been avoided by use of the current unaltered release of the Licensor Software; or

(vi) Use of the Licensor Software after Licensor’ notice to cease use of the Licensor Software due to a claim of infringement.

1.3 Remedies. Notwithstanding anything to the contrary in the foregoing, should Licensee’s right to continue to use the Licensor Software pursuant hereto be subject to a claim that it infringes or misappropriates a valid patent or copyright or other intellectual property right, or if Licensor reasonably believes such a claim may arise, Licensor may fulfill its obligations under this Article 1 by, in Licensor’ sole discretion and at no cost to Licensee:

(i) Procuring for Licensee the right or license to continue to use the Licensor Software;

(ii) Modifying the Licensor Software to render it non-infringing but substantially functionally equivalent to the Licensor Software prior to such modification; or

(iii) If the alternatives described in clauses (i) and (ii) of this Section 1.3 are not commercially practicable, Licensor may terminate the License(s) to the Licensor Software, in which case Licensor shall refund to Licensee any fees paid under this Agreement by Licensee to Licensor for unused use of or support for the allegedly infringing Licensor Software. For the purposes of this Section 1.3(iii), the fees with respect to unused use of allegedly infringing Licensor Software that is
licensed for a one-time or up-front License fee shall be the unamortized value of such one-time or up-front License fee actually paid by Licensee to Licensor under this Agreement for such allegedly infringing Licensor Software, as depreciated on a five-year straight line schedule beginning on delivery of such allegedly infringing Licensor Software to Licensee. Upon such refund, Licensee shall return such allegedly infringing Licensor Software and Licensee’s right to use such Licensor Software shall cease.

1.4 Effect. THIS ARTICLE 1 STATES LICENSOR’S AND ITS SUPPLIERS’ ENTIRE LIABILITY AND CUSTOMER’S EXCLUSIVE REMEDY FOR INFRINGEMENT AND/OR MISAPPROPRIATION, WHETHER SUCH ACTION, CLAIM OR PROCEEDING IS BASED ON BREACH OF WARRANTY OR ANY OTHER CAUSE OF ACTION. EXCEPT AS STATED ABOVE, LICENSOR AND ITS SUPPLIERS DISCLAIM ALL INDEMNITIES, EXPRESS, IMPLIED OR STATUTORY FOR INTELLECTUAL PROPERTY INFRINGEMENT AND/OR MISAPPROPRIATION.

1.5 Licensee Indemnity. Licensee shall indemnify, defend and hold Licensor harmless from any claims and liability and any and all damages and costs (including reasonable attorneys’ fees) arising out of: (i) Licensee’s breach of any of its obligations under this Agreement; (ii) any breach by Licensee of any third party agreements relating to the Licensor Software; (iii) any claim related to Licensee’s or Authorized Users’ or any third party’s use of the Licensor Software, except to the extent such claims are subject to Licensor’ indemnity obligations under Section 1.1; and/or (iv) any claim that any materials, software, or other items provided to Licensor by Licensee infringes a third party’s intellectual property rights.

Example 8 (Licensor friendly):

1.1 Licensor Indemnification. Licensor will defend at its own expense any action against Licensee brought by a third party to the extent that the action is based upon a claim that the Licensed Software infringes any US copyrights, US patents issued as of the Effective Date or that Licensor misappropriated any trade secrets recognized as such under the Uniform Trade Secret law in the development thereof, and Licensor will pay those costs and damages finally awarded (without right of appeal) against Licensee in any such action that are specifically attributable to such claim or those costs and damages agreed to in a monetary settlement of such action. If the Licensed Software becomes, or in Licensor’s opinion is likely to become, the subject of an infringement claim, Licensor may, at its sole discretion and expense, either (a) procure for Licensee the right to continue using the Licensed Software; (b) replace or modify the Licensed Software so that it becomes non-infringing; or (c) accept return of the Licensed Software and give Licensee a refund for the License Fees paid by Licensee as further described below, less a reasonable allowance for the period of time Licensee has used the Licensed Software. If Licensee obtains a perpetual license to the Licensed Software, the refund shall be equal to the License Fees prorated over sixty (60) months. If, however, Licensee obtains a subscription-based license, the refund shall be equal to the balance of any License Fees pre-paid for the duration of the then-current subscription term. Notwithstanding the foregoing, Licensor will have no obligation under this Section 1 or otherwise with respect to any infringement claim based upon (i) any use of the Licensed Software not in
accordance with this Agreement; (ii) any use of the Licensed Software in combination with other products, equipment, software, or data not supplied by Licensor; (iii) any use of any release of the Licensed Software other than the most current release made available to Licensee; or (iv) any modification of the Licensed Software where the modification is the basis of the claim. THIS SECTION 1.1 STATES LICENSOR’S ENTIRE LIABILITY AND LICENSEE’S SOLE AND EXCLUSIVE REMEDY FOR CLAIMS OF INFRINGEMENT OR MISAPPROPRIATION OF ANY INTELLECTUAL PROPERTY RIGHT.

1.2 Licensee Indemnification. Licensee will indemnify, defend and hold harmless, at its own expense, Licensor, its agents, employees and representatives from or against any and all damages, losses, claims, expense, costs (including attorney’s fees and litigation costs) and other liability incurred by Licensor relating to any action against Licensor by a third party for the infringement of a copyright, patent, trademark or misappropriation of a trade secret relating to Licensee’s use of the Licensed Software in an unauthorized manner. Licensee will pay those costs and damages finally awarded against Licensor in any such action that are specifically attributable to such claim or those costs and damages agreed to in a monetary settlement of such action. THIS SECTION 1.2 STATES LICENSEE’S ENTIRE LIABILITY AND LICENSOR’S SOLE AND EXCLUSIVE REMEDY FOR CLAIMS AND ACTIONS DESCRIBED IN THIS SECTION 1.2.

1.3 Procedural Requirements. Each party’s indemnification obligations are conditioned on the other party (a) promptly notifying such party in writing of such action; (b) giving such party sole control of the defense thereof and any related settlement negotiations; and (c) cooperating and, at such party’s request and expense, assisting in such defense. Notwithstanding the foregoing, Licensee shall not have any right, without Licensor’s written consent, to settle any action if such settlement arises from or is part of any criminal action, suit or proceeding or contains a stipulation to or admission or acknowledgement of, any liability or wrongdoing (whether in contract, tort or otherwise) on the part of Licensor.

Example 9 (Negotiated variation of Example 8):

1.1 Licensor Indemnification. At its own expense, Licensor will defend at its own expense, indemnify and hold harmless Licensee and Affiliates (including the employees, officers, directors, agents and contractors of each) from any action brought against Licensee brought or Affiliates (including the employees, officers, directors, agents or contractors of each) by a third party to the extent that the action is based upon a claim that the Licensed Software infringes any US copyrights, US patents issued as of the Effective Date trademarks or that Licensor misappropriates any trade secrets recognized as such under the Uniform Trade Secret law in the development thereof, and Licensor will pay those costs and damages finally awarded (without right of appeal) against Licensee in any such action that are specifically attributable to such claim or those costs and damages agreed to in a monetary settlement of such action. If the Licensed Software becomes, or in Licensor’s opinion is likely to become, the subject of an infringement claim, Licensor may, at its sole discretion and expense, either (a) procure for Licensee and Affiliates the right to continue using the Licensed Software as provided in this Agreement; (b)
replace or modify the Licensed Software so that it becomes non-infringing but retaining similar functionality in all material respects; or, if neither of the foregoing options are commercially feasible, (c) accept return of the Licensed Software and give Licensee a refund for the License Fees paid by Licensee as further described below, less a reasonable allowance for the period of time Licensee has used the Licensed Software. If Licensee obtains a perpetual license to the Licensed Software, the refund shall be equal to the License Fees prorated over sixty (60) months. If, however, Licensee obtains a subscription-based license, the refund shall be equal to the balance of any License Fees pre-paid for the duration of the then-current subscription term, which will be a full refund during the first year and thereafter prorated over forty-eight (48) months. Notwithstanding the foregoing, Licensor will have no obligation under this Section 1 or otherwise with respect to any infringement claim to the extent it is based upon (i) any use of the Licensed Software not in accordance with the terms of this Agreement; (ii) any use of the Licensed Software in combination with other products, equipment, software, or data not supplied by Licensor or referenced in the Documentation as necessary or authorized for the operation of the Software; (iii) any use of any release of the Licensed Software other than the most current release made available to Licensee at no additional charge with notice that use of such release is necessary to avoid such a claim and after a reasonable period of time to promptly install such release; or (iv) any modification of the Licensed Software by or on behalf of Licensee, except when done pursuant to instructions from or on behalf of Licensor, where the modification is the basis of the claim. THIS SECTION 1.1 STATES LICENSOR’S ENTIRE LIABILITY AND LICENSEE’S SOLE AND EXCLUSIVE REMEDY FOR CLAIMS OF INFRINGEMENT OR MISAPPROPRIATION OF ANY INTELLECTUAL PROPERTY RIGHT.

1.2 Licensee Indemnification. Licensee will indemnify, defend and hold harmless, at its own expense, Licensor, its agents, employees and representatives from or against any and all damages, losses, claims, expense, costs (including attorney’s fees and litigation costs) and other liability incurred by Licensor relating to any action against Licensor by a third party for the infringement of a copyright, patent, trademark or misappropriation of a trade secret to the extent relating to Licensee’s use of the Licensed Software in an unauthorized manner Licensee Data. Licensee will pay those costs and damages finally awarded against Licensor in any such action that are specifically attributable to such claim or those costs and damages agreed to in a monetary settlement of such action. THIS SECTION 1.2 STATES LICENSEE’S ENTIRE LIABILITY AND LICENSOR’S SOLE AND EXCLUSIVE REMEDY FOR CLAIMS AND ACTIONS DESCRIBED IN THIS SECTION 1.2.

1.3 Procedural Requirements. Each party’s indemnification obligations are conditioned on the other party (a) promptly notifying such party in writing of such action; (b) giving such party sole control of the defense thereof and any related settlement negotiations; and (c) reasonably cooperating and assisting, at such party’s request and expense, assisting in such defense. Notwithstanding the foregoing, each party shall not have any right, without the indemnified party’s written consent, to settle any action if such settlement arises from or is part of any criminal action, suit or proceeding or contains a stipulation to or admission or
acknowledgement of, any liability or wrongdoing (whether in contract, tort or otherwise) on the part of Licensor, the indemnified party or Affiliates (including the employees, officers, directors, agents or contractors of each).