

Negotiating and Drafting Patent Indemnification Provisions

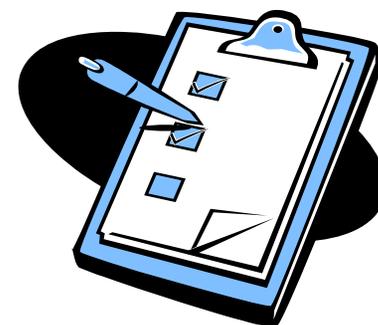
October 6, 2011

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Agenda

- General Considerations
- Implied Warranty for Sales of Goods and Services
- General Drafting Considerations
- Considerations Unique to Patent Law
- IP Liability Insurance



General Considerations

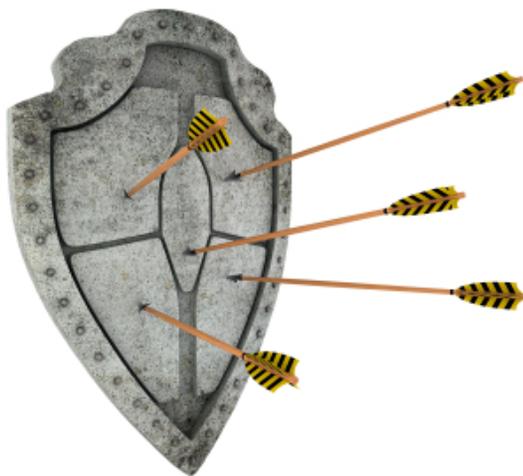
Definitions: Indemnity

- An ***indemnity*** is “[a] collateral contract or assurance, by which one person engages to secure another against an anticipated loss.”
 - Resolution of patent validity is not required for resolution of indemnity



Definitions: Duty to Defend

- The **duty to defend** arises at the earliest stages of litigation and generally exists regardless of whether the party is ultimately found liable
 - In contrast, indemnification only requires the indemnitor reimburse the indemnitee



Purpose of an Indemnification Clause

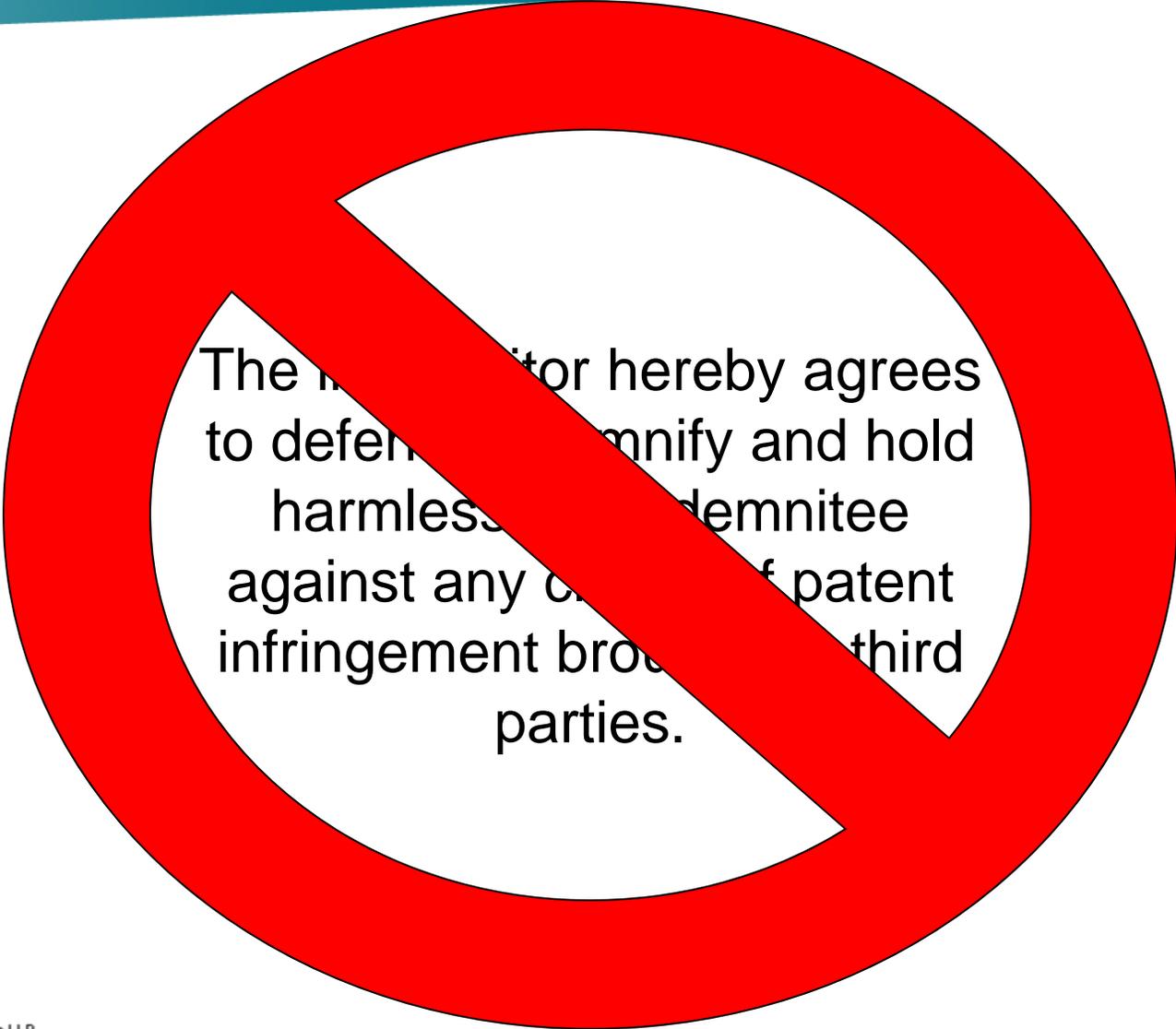
- The purpose of an indemnification clause is to allocate risk between the indemnifying party (the indemnitor) and the indemnified party (the indemnitee).
- The first and most important step is to determine what your client desires to achieve under an indemnification clause. This will be your starting point for both drafting and negotiating.

A Word of Caution...

Indemnification clauses are frequently negotiated at the end of the drafting process. This is the point where many people do not want to be bothered to spend the time negotiating what is perceived to be a “boiler-plate” provision. However, due to the far-reaching impact of indemnification clauses it is important to spend time thinking about how to best protect your client (whether the indemnitee or indemnitor). Indemnification clauses should not be rushed.



Defend, Indemnify and Hold Harmless



The licensor hereby agrees to defend, indemnify and hold harmless the licensee against any claims of patent infringement brought by third parties.

A Sample Indemnification Provision

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Scope. The Licensor (the “Indemnitor”) hereby indemnifies the Licensee and its directors, officers, employees, and agents and their respective successors, heirs and assigns (the “Indemnitee”) against any and all damages arising out of, resulting from or related to any claim of patent infringement brought by a Third Party accusing any product manufactured by Licensee pursuant to this Agreement of infringing a U.S. patent (a “Third Party Claim”), subject to the limitations set forth below.

Notice. If the Indemnitee seeks indemnification, it shall give written notice to the Indemnitor promptly after the Indemnitee becomes aware of the facts giving rise to such claim for indemnification (an “Indemnified Claim”), and in any event within 30 days, specifying in reasonable detail the factual basis of the Indemnified Claim and stating the amount of the damages (or if not known, a good faith estimate of the amount of damages).

Control. In the event of receipt of notice of a Third Party Claim, the Indemnitor shall have the right to control and defend such Third Party Claim, in such manner as it may deem appropriate. Should the Indemnitor decline to control and defend the Third Party Claim, the Indemnitee shall have the right to control and defend the Third Party Claim in such manner as it may deem appropriate. The controlling party shall select counsel, contractors, experts and consultants of recognized standing and competence reasonably acceptable to the other party, shall take reasonable steps necessary in the investigation, defense or settlement thereof, and shall diligently and promptly pursue the resolution thereof. All parties shall cooperate fully with the party conducting the defense of any Third Party Claim.

Settlement. The party controlling the defense of any Third Party Claim shall be authorized to consent to a settlement of, or the entry of any judgment arising from, any Third Party Claims subject to the following provisions. If the Indemnitor is controlling the litigation, Indemnitee must consent to any such settlement, such consent not to be unreasonably withheld. Indemnitee’s consent will be deemed unreasonably withheld unless the settlement would encumber any of its assets or contains any restriction or condition that would apply to the Indemnitee or to the conduct of its business. If the Indemnitee is controlling the litigation, it may not enter into a settlement or consent to an entry of judgment with respect to any Third Party Claim without the express written consent of the Indemnitor, not to be unreasonably withheld.

Limitations. The Indemnitor’s minimum liability to Indemnitee hereunder shall be \$750,000. The Indemnitor’s maximum liability to Indemnitee hereunder shall be \$10,000,000. In no case shall Indemnitor be liable for any consequential, incidental, indirect, special, punitive or exemplary damages (including, without limitation, lost profits, business or goodwill) suffered or incurred by Indemnitee. In no case shall Indemnitor be liable for any damages arising out of Indemnitee’s negligent or reckless conduct.

Reimbursement. Indemnitee shall be responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Implied Warranty for Sales of Goods and Services

UCC Philosophy Generally

When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

Sale of Goods Under UCC §2-312

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.



Sale of Goods Under UCC §2-312

- The seller must be a merchant regularly dealing in the goods.
- The indemnity is limited to the goods themselves as delivered—it does not cover the buyer’s use of the goods.
- The implied warranty only covers “rightful” claims, which has been defined by courts to be more than frivolous or of a substantial nature.
- The implied warranty does not apply if the buyer gives the specifications for the product to the seller. Any patent infringement that arises here will trigger buyer’s good faith duty to indemnify the seller for losses suffered.

And Remember...

Two parties can always agree to not be covered by the implied warranty provided in UCC § 2-312.

General Drafting Considerations

Drafting an Indemnification Clause

Drafting an indemnification clause is necessary when:

- The parties involved in a sale of goods do not wish to be bound by the implied warranty provided in UCC § 2-312.
- The parties are involved in a transaction not covered by UCC 2-312, including:
 - A licensing agreement
 - A joint research and development agreement



Indemnification Provision

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Scope. The Licensor (the “Indemnitor”) hereby indemnifies the Licensee and its directors, officers, employees, and agents arising out of, product manufacturing subject to the

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Reimbursement. Indemnitee shall responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Scope. The Licensor (the “Indemnitor”) hereby indemnifies the Licensee and its directors, officers, employees, and agents and their respective successors, heirs and assigns (the “Indemnitee”) against any and all damages arising out of, resulting from or related to any claim of patent infringement brought by a Third Party accusing any product manufactured by Licensee pursuant to this Agreement of infringing a U.S. patent (a “Third Party Claim”) subject to the limitations set forth below.

What Types of Claims will be Covered?

Indemnitor

- Goal – to have as few claims covered as possible.
- Strategies:
 - Limit to claims brought by specific third parties.
 - Limit the time that the indemnification provision will apply.
 - Limit the indemnification to the product itself, and not to use of the product.

Indemnitee

- Goal – cover as many claims as possible.
- Strategies:
 - Do not accept limitations on the subject matter of the claims or who can bring them.
 - Try to obtain indemnification for a claim that results from a misrepresentation or breach of a warranty.

Who Will be Covered?

- Strategies
 - Indemnitor – include fewer people and entities
 - Indemnitee – include as many people and entities as possible
- Generally the indemnification should include the indemnitee's directors, officers, employees, and agents.
- Consider whether the indemnification should include Indemnitee's affiliates.
- If the transaction allows for sublicensing, will the indemnitee's sublicensee be indemnified?
- Will the indemnitee's successors, heirs and assigns be covered?
- Will indemnitee's customers be covered?

Indemnification Provision

Scope. The Licensor (the "Indemnitor") hereby indemnifies the Licensee and its directors, officers, employees, and agents arising out of, product manufacturing, and distribution, subject to the terms and conditions of this Indemnification Provision.

Notice. If the Indemnitee becomes aware in any event with respect to the amount of damages or the amount of any claim, the Indemnitee shall promptly give written notice to the Indemnitor.

Control. In the event of a Third Party Claim, the Indemnitor shall have the right to control and defend such Third Party Claim in such a manner as the Indemnitor, in its reasonable sole discretion, may deem appropriate to pursue the resolution of such Third Party Claim.

Settlement. The Indemnitor shall have the right to settle or compromise any Third Party Claim, and the Indemnitee shall not be unreasonably or unconscionably required to incur the cost of the defense or the conduct of the defense of such Third Party Claim, or to consent to any settlement or compromise of such Third Party Claim, not to be unreasonably withheld.

Limitations. The Indemnitor's minimum liability to Indemnitee hereunder shall be \$750,000. The Indemnitor's maximum liability to Indemnitee hereunder shall be \$10,000,000. In no case shall Indemnitor be liable for any consequential, incidental, indirect, special, punitive or exemplary damages (including, without limitation, lost profits, business or goodwill) suffered or incurred by Indemnitee. In no case shall Indemnitor be liable for any damages arising out of Indemnitee's negligent or reckless conduct.

Reimbursement. Indemnitee shall be responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Notice. If the Indemnitee seeks indemnification, it shall give written notice to the Indemnitor promptly after the Indemnitee becomes aware of the facts giving rise to such claim for indemnification (an "Indemnified Claim"), and in any event within 30 days, specifying in reasonable detail the factual basis of the Indemnified Claim and stating the amount of the damages (or if not known, a good faith estimate of the amount of damages).

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Notice

Indemnitor

- The indemnitee should be required to notify the indemnitor promptly (but in any event within a specified time period).
- The notice must be in writing.
- The notice should include a statement of damages sought or a good faith estimate.
- The indemnitor should be informed of possible claims.
- Failure to comply with the notification provision will render the indemnification provision invalid.

Indemnitee

- There should not be a time limit on informing the indemnitor of claims.
- Breach of the notification provision should not have any consequences unless the indemnitor can show it was harmed by the failure to notify.
- The indemnitee need not inform the indemnitor of threatened suits, only of filed suits.

Indemnification Provision

Scope. Effective as of the Closing, the Licensor (the "Indemnitor") hereby indemnifies the Licensee and its

directors, officers, employees, agents, representatives, independent contractors, consultants, subcontractors, and any other persons acting on behalf of the Licensee against any and all claims, damages, losses, costs, and expenses, including reasonable attorneys' fees, incurred by the Licensee or any of the foregoing persons in connection with a Third Party Claim, including a Third Party Claim for patent (a "Third Party Claim").

Notice. If the Indemnitor declines to control and defend the Third Party Claim, the Indemnitor shall provide written notice to the Indemnitee in any event within 30 days of the date the Indemnitor receives notice of the Third Party Claim, and the amount of the Third Party Claim.

Control. In the event of receipt of notice of a Third Party Claim, the Indemnitor shall have the right to control and defend such Third Party Claim in such manner as it may deem appropriate. Should the Indemnitor decline to control and defend the Third Party Claim, the Indemnitee shall have the right to control and defend the Third Party Claim in such manner as it may deem appropriate. The controlling party shall select counsel, contractors, experts and consultants of recognized standing and competence, and shall take reasonable steps necessary in the investigation, defense or settlement thereof, and shall diligently and promptly pursue the resolution thereof. All parties shall cooperate fully with the party conducting the defense of any Third Party Claim.

Settlement. The Indemnitor shall be responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Limitations. The maximum liability of the Indemnitor shall be limited to the amount of the Indemnitor's net worth, and shall not exceed the amount of the Indemnitor's net worth. The Indemnitor shall not be liable for consequential, special, or punitive damages, or for any damages arising out of the Indemnitor's negligence or willful or wanton conduct.

Control. In the event of receipt of notice of a Third Party Claim, the Indemnitor shall have the right to control and defend such Third Party Claim, in such manner as it may deem appropriate. Should the Indemnitor decline to control and defend the Third Party Claim, the Indemnitee shall have the right to control and defend the Third Party Claim in such manner as it may deem appropriate. The controlling party shall select counsel, contractors, experts and consultants of recognized standing and competence, and shall take reasonable steps necessary in the investigation, defense or settlement thereof, and shall diligently and promptly pursue the resolution thereof. All parties shall cooperate fully with the party conducting the defense of any Third Party Claim.

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Who Will Control the Defense?

Indemnitor

- Since the indemnitor will ultimately have to pay the damages, the indemnitor has a strong interest in controlling the litigation.
- The indemnitor should also ensure that the indemnitee is required to cooperate with the defense efforts.

Indemnitee

- While the indemnitee may like to control the litigation, its interest probably isn't as strong as the indemnitor.
- The indemnitee will likely have control of the relevant documents and witness, and should be prepared to cooperate with the indemnitor.

Indemnification Provision

V&E

Scope. The Licensor (the "Indemnitor") hereby indemnifies the Licensee and its directors, officers, employees,

and agents arising out of, product manufactured or sold by the Licensee, subject to the following provisions:

Notice. If the Indemnitee be in any event with the amount of

Control. In the defend such T control and de Claim in such and consultant reasonable ste

pursue the res Party Claim.

Settlement. T settlement of, If the Indemnitor be unreasonable would encumb the conduct of consent to an Indemnitor, no

Limitations maximum liability consequential, business or general arising out of

Reimbursement Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Settlement. The party controlling the defense of any Third Party Claim shall be authorized to consent to a settlement of, or the entry of any judgment arising from, any Third Party Claims subject to the following provisions. If the Indemnitor is controlling the litigation, Indemnitee must consent to any such settlement, such consent not to be unreasonably withheld.

Indemnitee's consent will be deemed unreasonably withheld unless the settlement would encumber any of its assets or contains any restriction or condition that would apply to the Indemnitee or to the conduct of its business. If the Indemnitee is controlling the litigation, it may not enter into a settlement or consent to an entry of judgment with respect to any Third Party Claim without the express written consent of the Indemnitor, not to be unreasonably withheld.

Reimbursement

Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Settlement

- Generally, the controlling party will have settlement authority, subject to the other's party consent.
- The indemnitee should only be able to withhold consent if it will affect any of indemnitee's rights.
- The indemnitor should have broader discretion to reject a settlement because it will ultimately have to reimburse indemnitee for any damages.
- By way of example, indemnitee should have the right to consent to settlement if such settlement would prevent indemnitee from practicing a patent licensed under the agreement.

Indemnification Provision

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Reimbursement. Indemnitee shall responsible for paying any damages arising out of a Third Party Claim to the Third Party. Indemnitor shall reimburse Indemnitee within thirty (30) days of Indemnitee making such a payment. The amount of the reimbursement shall be reduced by any amount Indemnitee receives or will receive from (a) an insurance carrier or (b) a joint infringer.

Floors and Caps

- Floors are also known as “nickel dime provisions.”
- Floors and caps can be useful to the indemnitor.
 - Floors can be used to ensure that the indemnitee cannot seek indemnification for small claims.
 - Caps allow the indemnitor to know its maximum exposure (in a license transaction, caps are often tied to royalties).
- The indemnitee does not benefit from floors and caps.

Limitations

Indemnitor

- Specifically exclude all claims arising out of indemnitee's acts or omissions, including willful patent infringement.
- The reimbursement should be reduced by:
 - Insurance proceeds paid to indemnitee
 - Third party payments to indemnitee (such as from a joint infringer)
 - Tax benefits enjoyed by indemnitee due to the damage award

Indemnitee

- All claims should be covered, regardless of how they accrue (if there is a carve-out for indemnitee's acts or omissions, then limit to negligence and recklessness).
- Specifically include claims related to willful patent infringement.
- If there is a reimbursement, it should only be reduced by:
 - Insurance proceeds paid to indemnitee
 - Third party payments to indemnitee (such as from a joint infringer)

Indemnification Provision

Scope. The Licensor (the "Indemnitor") hereby indemnifies the Licensee and its directors, officers, employees, and agents arising out of, product manufacturing, and distribution of the Licensee's products, services, or information, subject to the terms and conditions of this Indemnification Provision.

Notice. If the Indemnitee becomes aware of any event which may give rise to a Third Party Claim, the amount of the Indemnity shall be reduced by any amount that the Indemnitor shall reimburse the Indemnitee within thirty (30) days of the Indemnitee making such a payment.

Control. In the event of a Third Party Claim, the Indemnitor shall have the right to control and defend such Third Party Claim in such a manner as the Indemnitor, in its reasonable discretion, may deem appropriate, and the Indemnitee shall cooperate with the Indemnitor in the defense of such Third Party Claim.

Settlement. The Indemnitor shall have the right to settle or to defend such Third Party Claim in such a manner as the Indemnitor, in its reasonable discretion, may deem appropriate, and the Indemnitee shall cooperate with the Indemnitor in the defense of such Third Party Claim. If the Indemnitor's settlement of such Third Party Claim is not to the satisfaction of the Indemnitee, the Indemnitor shall not be liable for any damages arising out of such Third Party Claim.

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Reimbursement

Indemnitor

- The indemnitor should reimburse the indemnitee within a reasonable amount of time after indemnitee has paid damages to the third party.
- The reimbursement should exclude the limitations discussed previously, including monies paid to indemnitee by insurance or by joint defendants.
- Should be limited to monies paid to the third party and expressly exclude consequential or incidental damages.

Indemnitee

- The indemnitor should pay the third party directly.
- In the case of reimbursement, indemnitor should be required to reimburse indemnitee within a specified maximum period after indemnitee pays the third party.
- Indemnitor should also be required to reimburse indemnitee for any consequential or incidental damages it suffers as a result of the suit.

Considerations Unique to Patent Law

Indemnifying Willful Patent Infringement

- Enhanced damages for willful patent infringement are considered to be punitive damages.
- Some states have codified or common law public policy against indemnifying a party against punitive damages.
- The UCC, however, does allow for indemnification of punitive damages (see UCC § 2-715).

Joint Liability

- Under patent law, a party cannot ask for contribution from jointly and severally liable parties, so indemnification clauses need not take that into account.
- In a joint infringement situation, the court will apportion damages between the joint infringers. In such a case, the amount of damages should be limited to the damages actually incurred by the indemnitee.

Unconsidered Uses of Products

- It is possible that some uses of a product will infringe a third party patent while other uses will not.
- An indemnitor can protect itself from unconsidered uses by limiting the indemnification to certain uses of the product.

IP Liability Insurance

Indemnification Shortfalls

- **Customer loss of revenue**
- **Damage to downstream customer relationships**
- **Customer modifications to components**
- **Overseas Suppliers**
 - Enforcing indemnity
 - Identifying and locating original suppliers
- **Multiple indemnitees or suppliers**
 - Performing financial due diligence
 - Performing due diligence on IP
- **As a result, customers often contractually require suppliers to carry insurance**



Patent Infringement Liability Insurance Policies

- **Comprehensive General Liability policies exclude intellectual property**
 - Advertising injury rarely covers patent infringement
- **“Specialty policies” for intellectual property**
 - Offensive Enforcement Liability (also “Pursuit Coverage” and “Infringement Abatement”)
 - Defensive Infringement Liability
 - “Multi-Peril” Liability (also “First-party IP Coverage”)



Defensive Infringement Policies

- **Costs**
 - Defense
 - Damages
 - Settlement
- **Parties**
 - Indemnified customers
- **Products**
 - Component part or material products; finished products
- **Claims**
 - Injunctive relief
 - Damages
 - Counterclaims
 - Mix of covered and uncovered claims

Offensive Enforcement Policies

- **Costs - Reimbursement to insurers**
- **Patents**
- **Claims**
 - Invalidity counterclaims
 - Reexamination proceedings
 - Declaratory judgment actions



Multi-Peril Policies

- **Loss of intellectual property value**
 - Business income
 - Profits
 - Royalties
 - Declared Value

Important Terms for Any Policy

- **Temporal limitations**
- **Geographic limitations**
- **Prior knowledge of potential infringement or threat of infringement**
- **Self-insured retention or deductible**
- **“Coinsurance”**
- **Endorsements**
- **Appeals**



Patent Insurance: Vulnerabilities

- **Limited policy availability**
- **Cost**
- **Scope of coverage**
 - Exclusions
 - Endorsements
- **Uncertainty in valuation of claims**
 - Calculation of infringement damages
 - Direct vs. contributory infringement

How to Use Patent Insurance to Address Risks

- **Share the cost of insurance policies**
- **Add coverage to vendor insurance programs**
- **Broaden insurance policy**
 - Include indemnitees
 - Include customers not indemnified by supplier
 - Cover situations where supplier cannot honor its indemnification obligation
 - Cover situations where indemnification does not apply or only partially applies
 - Cover situations where indemnification is capped or there is a limitation of liability

Questions?