Advanced Licensing Workshop: Negotiating and Drafting Indemnification and Limitation of Liability Provisions

Sections 8:42-8:50—Non-Warranty Risk Allocation: Indemnities

from

Modern Licensing Law

a Treatise by Raymond T. Nimmer and Jeff C. Dodd

Submitted by

Jeff C. Dodd
Andrews Kurth LLP
jeffdodd@andrewskurth.com

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patible with Apple computers **and software** used **in** those computers. A retail dealer that acquired the systems for resale alleged that the systems were returned by many customers **because** they **could** not **use a number** of programs sold by Apple. **This partial proof of incompatibility was not sufficient to establish a** breach, **however, because many other Apple-related programs in the market had not been tested for compatibility. Significantly, there was no proof regarding whether compatibility with one or certain types of software was more important than with others. The warranty did not require that the system accommodate all existing Apple software.**

A claim of compatibility does not assert that a system is entirely compatible with all traits of the other system or software unless the warranty language is very explicit on this point. Incompatibility thus cannot be established merely by proving that some features are incompatible. On the other hand, a compatibility warranty requires more than simply that some minor aspects of two systems can interrelate. Breach of the warranty does not require proof that the warranted system is entirely incompatible with the other products. The proper measure lies somewhere between these extremes. Compatibility requires regularity and reliability of interchange and the presence of at least those elements of compatibility that are clearly important in the commercial context (e.g., specific programs, specific functions).

IV, NONWARRANTY RISK-ALLOCATING MECHANISMS

§ 8:42 Nonwarranty risk allocation

Contracts allocate risks in many ways. One common method of allocating risks relates to warranties. In this part, we address other contract mechanisms that allocate risks. Absent some contravening public policy, such contractual allocations are, as they should be, enforceable.

§ 8:43 Nonwarranty risk allocation: indemnities

Indemnities and hold-harmless provisions are more common than express warranties as risk allocation mechanisms for the title, validity, and infringement risks in commercial transactions.[1] The reason for this is simple: validity and infringement risks are

[Section 8:43}

1See, e.g., Victory Bottle Capping Mach. Co. v. 0. & J. Mach. Co., **280 F. 753, 755 (CCA. 1st Cir. 1922) (Suit by licensor against licensee for royalties; licensor granted to licensee " 'the sole and exclusive right to make, use, and vend the said invention" throughout the United States . . ."; licensee also agreed to a grant back clause. The licensor also agreed that it would "at its own cost**

so uncertain that many licensors' hesitate to offer robust representations. However, while a licensor may decline to aver unequivocally that title is unclouded, it may agree- to shoulder some or all of the title risks, at least to a point, by indemnifying the licensee against losses, from claims asserted by third parties.

Unless there is- specific public policy against particular types of indemnity, there are no fundamental barriers to enforcing the agreement the parties reach.[2]

In the next several sections, we discuss some issues that arise with respect to indemnities.

§ 8:44 Nonwarranty risk allocation: indemnities—What they are

An indemnification is a contractual obligation to pay for specified losses or costs of the other party.[1] Like insurance, indemnity

and expense, defend and protect the [licensee] in the exclusive making, using, and vending of the machines included in this agreement against all infringers, licensees, or others in countries where applications for patents are now pending, and where patents have been or may be issued for such machines . . . and save the [licensee] harmless from all results of such acts. . . ." The licensee was in the midst of manufacturing 40 machines when it received a letter from Crown, Cork & Seal alleging that the machines infringed two of its patents; it completed the manufacture and sale of those machines, but none others. In fact, the machines covered by the licensor's patent could not be manufactured without infringing the Crown Cork & Seal patents. In light of the exclusivity and the broad indemnity and defense language, the court found "something corresponding to eviction must be proved if a licensee would defend against an action for royalties" based on patent invalidity, but that something corresponding to eviction had occurred based on the existence of the prior patents, the demand by Crown Cork to cease manufacture, and the letter from the licensor's lawyer advising the licensor that "no other infringing machines be produced showed. However, since the licensee did manufacture and sell 40 machines and no claim was going to be made based on those sales, it owed royalties for those machines on the principle that a licensee cannot escape payment of royalties while it continues in the enjoyment of its license . . ."; the court also enforced the grant-back clause.).

***2International Minerals & Chemical Corp. v. Avon Products, Inc.*, 889 S.W.2d 111 (Mo. Ct. App. E.D. 1994) (Contractual indemnity relating to patent infringement claims did not apply to claims arising after the sale of a company actually engaged in the infringing conduct. The claims had been settled. The court held that under general New York law, when an indemnitor has notice of the underlying action against the indemnitee and declines to defend that action, the indemnitor is conclusively bound by any reasonable settlement that the indemnitee made in good faith.).**

[Section 8:44]

1The concept of indemnity is often thought of in the context of insurance agreements, but "not all contracts of indemnity are insurance contracts; rather, an insurance contract is one type of indemnity contract." Russ and Segalla, Couch on Insurance 3d, p.1-13 (2005); Kelly, Scope of Advertising Injury Under

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