Patent Infringement Risk – A Rising Challenge for Digital Agencies

Best Practices for Digital Agencies in Writing Indemnification Agreements and Mitigating Risk

by Aaron R. Johnson, PhD and Bradley Gross, Attorney at Law
The mission of the Society of Digital Agencies (SoDA) is very clear. The organization serves as the preeminent voice for digital marketing professionals worldwide, aiming to advance the industry through Best Practices, Education and Advocacy. As such, SoDA would be remiss not to tackle an issue head on that has quickly risen to the top of the docket for many digital marketing leaders – allegations of patent infringement by Non-Practicing Entities (“NPEs”, also known, less affectionately, as “Trolls”).

Patent Trolls are an increasingly frequent topic of conversation for SoDA members (a highly select group of the world’s leading digital agencies), for our thousands of followers and for our industry as a whole. There are, however, concrete steps agency leaders can take to mitigate risk and to protect the livelihood of their businesses. This White Paper outlines some of those steps and serves as a precursor to the launch of SoDA’s Business Insurance Suite initiative which will include an innovative IP Insurance Option for SoDA member agencies (to be deployed by the end of Q3 2011).

**The Issue**

Patents are infringed by making, using, selling or offering for sale a product or service comprised of a claimed invention. As the technologies and techniques used by digital advertising agencies become more sophisticated and prevalent, allegations of patent infringement from NPEs rise in frequency and, unfortunately, cost.

In an industry replete with widely-used, standard application and development platforms as well as reusable code, there is plenty of liability for patent holders to seize upon from deep-pocketed clients, small, scrappy agencies, and firms of every size in between. To mitigate the risk posed by NPEs, clients often turn to patent infringement indemnification agreements, shifting the burden of risk management to the agency.

**The Challenge of Non-Practicing Entities**

Most often, NPEs acquire individual patents or patent portfolios, but do not make, use, sell or offer to sell any of the technologies covered by the patents they obtain. In short, they do not “practice” the inventions they own. Instead, they often lie dormant, waiting for unsuspecting companies to utilize one of the technologies covered by the patents they own. At that point, NPEs assert their patent rights through a barrage of cease and desist letters, court complaints and public relations campaigns that can often bring all but the strongest defendants to their knees. When faced with the daunting prospect of lengthy litigation, skyrocketing attorneys’ fees, and the potential for catastrophic monetary damages, many agencies simply elect to pay the trolls rather than take their chances in court.

When NPEs go to court, defendants often find the legal proceedings to be particularly challenging, as the typical characteristics of patents owned by NPEs have a) broad scope over b) well-known and widely used technologies, and utilize c) vague terms which seem to apply to many technologies.
Broad

NPEs make use of broadly-worded patents to snare agencies and their clients, and then leverage their superior legal positions to force agencies into paying for expensive license agreements to cover both the agencies' and their clients' activities. The broadness of the asserted patents often presents a frustrating dilemma for agencies: either challenge the patent as being overbroad (and risk significant monetary damages if the challenge is unsuccessful), or pay the ransom requested by the trolls, despite the fact that the scope of the patent was overly broad and, in many cases, indefensible.

Known

Many patents filed in the early to mid-1990s are still enforceable today. Back then, many patent examiners in the United States Patent and Trademark Office were not as “technologically aware” or savvy as they are today. The Internet was still referred to as the “information superhighway” and patent examiners did not have the vast body of invalidating prior art that they have at their disposal today. Consequently, the technologies (or “claims”) covered by these older patents often seem obvious, even trivial, to present-day developers, but at the time they were filed they appeared to be cutting-edge ideas worthy of patent protection. Often, it is these older patents that are favored by NPEs who assert patent rights long after the technologies covered by the patents have become widely adopted.

Vague

Patent claims often describe technologies in a manner that is both ambiguous and vague, in order to cover many variations and uses of the relevant technology. As a result, the world is left to decipher the meaning and scope of patent claims that are overly broad and, often, impossible to avoid. For example, the phrase “moving data from one computing node to another computing node” may have seemed novel and sufficiently specific at the time of the patent filing, but today a developer would have great difficulty identifying an application which did not utilize this type of activity.

Litigation, Not Infringement - A Pervasive Risk

Agencies and clients commonly misperceive the risk posed by NPEs as a risk of actual patent infringement, rather than a risk which is limited to the litigation costs required to prove their innocence. As a result, many potential defendants operate under the mistaken belief that proper IP due diligence will suffice to protect their operations. This is misguided for two reasons:

1. Actual non-infringement does not always prevent litigation.
   - Reasonable minds may disagree about the scope of a patent; unreasonable litigants may assert their patents without regard to reasonable protest.
   - NPEs may seek a quick “inexpensive” license as part of their business model – justice and IP rights notwithstanding.
   - Even armed with iron-clad arguments of non-infringement, agencies and clients must still spend millions of dollars in litigation expenses for the chance to make those arguments in court.
2. The nature of the technology involved means that typical (and reasonably priced) patent searches can easily miss pertinent documents.

- Inscrutable acronyms, polysemy (one word, many meanings), synonymy (one meaning, many words) and the general ability of inventors to be their own lexicographers create a significant challenge to patent searchers since a well-planned and executed patent search can still miss the most relevant and dangerous documents.

While NPEs are largely a U.S. phenomenon, non-U.S. agencies bear the same liability as their American counterparts whenever they conduct business with American companies or consumers. U.S. courts tend to be more plaintiff-friendly and tend to award damages and reasonable royalties far in excess of their non-U.S. judicial counterparts. With the advent of indemnification agreements and the ubiquity of network connectivity, liability for patent infringement has begun to spread to geographic areas normally unconcerned with such issues. Thus, nationality and/or geographic location no longer provides a significant buffer from patent troll litigation.

Agencies, both in and outside the U.S., are often unaware of the significant infringement liability which results from meeting their clients' needs. For example, a commonly requested feature for websites and mobile applications is one which presents a user with a list of nearby retail locations based on the user's geographical location (as determined by IP address or GPS coordinates). While this may seem commonplace and standard, advertising based on geographical proximity is currently the subject of a number of patent infringement lawsuits brought by GeoTag, Inc. (the now-infamous US Patent 5,930,474). Over 400 defendants have been named in the pending litigation, and the list continues to grow.

The most pernicious consequence of the NPE business model is not the effect it has on the cutting edge development of emerging technologies, but rather the uncertainty and risk the NPE model creates for agencies in their day-to-day operations. For instance, Lodsys, LLC has taken a controversial yet, unfortunately, unsurprising position by suing many iPhone app developers for patent infringement under Lodsys' U.S. Patents 7,620,565 and 7,222,078, which purport to cover basic in-app purchase functionalities on iOS-based mobile devices. This is true despite the fact that (i) Lodsys is a party to a comprehensive license agreement with Apple for the very same patents, and (ii) based on that license, Apple freely distributed its API (containing the patented technology) to its iOS programmers, thus potentially exposing those programmers to significant legal liability.

It will be years before agencies know the final outcome of these cases, but in the meantime, clients will no doubt continue to request seemingly uncontroversial, yet ultimately risky, features for web and mobile platforms. More importantly, clients will continue to request that agencies take on more and more infringement liability through indemnification agreements. Without informed consideration of this serious transfer of risk, agencies may end up taking on liabilities far in excess of their risk appetite or even ability to pay.
Construct the Proper Indemnification Agreement

While the particulars of any negotiation and the realities of the market require an open mind and an appetite for risk, here are some important indemnification provisions to consider:

1. **Include Deductibles in Indemnification Agreements** - Large clients may be subjected to patent infringement litigation in low-dollar, or “shake down”-type cases. In these cases, most companies feel that cost of defense is far outweighed by the license fee being requested by the troll, and the companies simply pay the fee instead of spending excessive amounts on lawyers’ fees and costs. To some extent, this is a risk of being in the business of creating innovative and cutting-edge products. Consider spreading the risk of this type of scenario by excluding claims where a fully-paid up license is less than an agreed-upon deductible. A $100,000 deductible for a large client is not, in our opinion, unreasonable.

2. **Include Co-Payments for Claims** – “Skin in the game” ensures that clients have an interest in the proceedings as well as the outcome of a claim. For example, a co-payment split could be 10% / 90% of claim costs for client / agency.

3. **Consider if Defense Costs Should be Included** – If defense costs are not included, indemnification should be limited to judgments rendered, and exclude amounts spent on early settlements and arbitration. Otherwise, a poor or non-existent defense could leave the agency paying claim costs which could have been mitigated or avoided.

4. **Limit the Time of Indemnification** – Instead of an open-ended, perpetual indemnification obligation, consider setting a cut-off period for indemnification. For example, by limiting indemnification activities to 18 months, an agency would obtain a degree of predictability with regard to expenses and indemnification-related outlays, and the parties would be encouraged to either settle or bring the matter to trial in an expedited fashion.

5. **Describe Functionalities and/or Methods that Pose Risk, and Have Your Client Specifically Waive Those Risks** - By identifying specific pieces of client-requested functionality as a risk from the outset, such as the above geo-tagging example cited above, clients could be given the choice to assume the risk of patent infringement litigation. [Note: SoDA is adopting this approach within its SoDA Doc.s Program of best practice agreements which includes the SoDA Master Service Agreement]

6. **Set Maximum Total Indemnification** – Open-ended indemnification clauses expose the agency to unknown and potentially limitless liability. Such clauses should be avoided if at all possible.

7. **Limit the Scope of Indemnification to Only That Which Has Been Produced** - Exclude indemnification obligations arising from the combination of third party materials with the agency’s work product. Agencies are advised to agree to indemnify the client only when the agency’s work product would be accused of infringing the plaintiff’s patent in isolation, and not in combination with other party’s materials.

8. **Exclude indemnification for essential patents in standard/generic work** – The use of standard protocols requires that certain methods be included in the agency’s work product, offering little opportunity to design around problem patents. Since these problems cannot be avoided, the risk of these problems should not fall entirely on the agency.

9. **Exclude client modifications to the work product** – This is a reasonable, but often overlooked, exclusion.
10. **Require patent infringement liability insurance** – The premium, or a portion of the premium, can be shared between the agency and client.

**How to Leverage Patent Insurance to Strengthen Indemnification**

Whatever form the final indemnification agreement takes, insuring the use of the agency's work product and adding the client as an additional named insured benefits both the client and the agency. Remember, the agency is not in the business of taking on patent risk, has received no payment for taking on that type of risk and, likely, has not conducted the actuarial or patent analysis necessary to fully appreciate the substantial financial risk involved. On the client side, indemnification works only when the client has confidence that the supplier has the financial means to pay claims. A capable and experienced insurer offers the best mechanism to satisfy both concerns.

Patent infringement indemnification covers litigation expenses and damages including settlements and awards, invalidity counter-claims, and re-examination proceedings at the USPTO arising from covered litigation. Some key elements are:

- **Worldwide Territory**
- **Terms up to 3 years**
- **Limits up to $10 million/ Higher limits may be available**
- **10% Co-Pay**
- **2% Self-Insured Retention (minimum)**
- **Claims Made & Reported policy**
- **Pre-existing threats of infringement are excluded from coverage**
- **Coverage does not begin until 90 days after the policy is bound, 90 days of coverage are added to the last year after non-renewal**

Patent indemnification policies don’t offer blanket coverage; they are scheduled policies. This means that the applications or functionality included in the agency’s work product must be listed or described, and the policy will not cover infringement activities based on functionality that is not included on the schedule.

The good news is that as the agency adds features to the work product or includes functionalities that were not included at the beginning of the project, the insurance schedule can be amended. Additionally, the schedule can be worded broadly so that minor changes and updates do not require additional amendments. As such, the insurer’s due diligence can be concurrent with the development of the work product, allowing the agency to avoid patent issues before they arise.

Policies can be tailored to the specific need of the agency. A policy can be written to cover a single project and client, or can be written to cover many clients who have contracted with the agency to produce similar applications.

Remember that neither indemnification nor insurance makes infringement (or the possibility of patent troll litigation) go away. However, the terms of an IP insurance policy can be written to be commensurate with the agency’s indemnification obligations, thereby reducing the risks that digital agency leaders on the front lines of the NPE issue face each day. This is exactly the approach that the Society of Digital Agencies is pursuing on behalf of its member
agencies via its forthcoming Business Insurance Suite initiative (including an IP Insurance alternative) and its SoDA Doc.s Program of best practice agreements.

###

**ABOUT THE AUTHORS**

**Dr. Aaron Johnson, PhD**

Aaron is an Intellectual Property Underwriter and registered Patent Agent with whom SoDA is working to develop its Business Insurance Suite, including an IP Insurance alternative for SoDA member agencies. He specializes in electronic and communications technologies, software and emerging technologies. Additionally, Aaron has developed and implemented statistical and heuristic techniques for the analysis of IPISC’s historical claims data and the rapid identification of IP risk.

**Bradley Gross, Attorney at Law and SoDA General Counsel**

A technology law attorney with thirty years of experience in the computer and technology fields, Brad is SoDA’s General Counsel and Legal Advisor. He educates SoDA’s members about the laws, cases and legal trends that impact the business of digital marketing, focusing in particular on intellectual property and contract issues that are crucial to the viability and stability of digital marketing agencies and their clients.

**ABOUT SoDA**

The Society of Digital Agencies (SoDA) serves as a voice for digital marketing professionals worldwide with a mission to advance the industry through Best Practices, Education, and Advocacy. SoDA is the largest network of digital agencies in the world, with over $370 million in combined annual revenues, offices in 22 countries on 5 continents and in excess of 2,600 staff members. SoDA is a non-profit industry organization with Adobe Systems as its founding sponsor. For more information, visit [www.SoDAspeaks.com](http://www.SoDAspeaks.com).