4A's Agency Patent Risk Guidance

Indemnification and Limitations on Liability

A Guidance Directive from the American Association of Advertising Agencies

1. Objective

Many clients and agencies in the marketing industry have been surprised and alarmed to find that they are the targets of patent infringement litigation relating to online and mobile applications and functions. The surprise stems in part from the fact that these firms have not thought of themselves as technology providers or software companies. However, as the world of advertising turns increasingly digital, the fact is that many of these firms are now technology providers and software companies, and they face the same patent risks that other players in that space have come to expect.

There is an acute risk for advertising agencies that operate under outdated services agreements, i.e., agreements that do not account for patent infringement exposure. Patent infringement is a "strict liability" tort, meaning that liability does not turn on intent to copy or knowledge of the infringed patent; this, coupled with the high cost of defending patent infringement claims, can add up to devastating exposure for unprepared agencies. What is more, patent plaintiffs are much more likely to sue marketers — who actually use and get ongoing benefits from these technologies — than agencies who performed a discrete project for a set fee. This, of course, can be quite disruptive or damaging to an agency's relationship with its client.

The purpose of this directive is to alert 4A's members to the risks presented by patent infringement claims and to recommend changes to agency-client agreements to manage these risks.

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The 4A's recommends that agencies make clear in their client agreements that clients assume all risks associated with patent infringement. Clients decide what software functions and features will be used on their Web sites and in their other digital offerings. Clients receive the commercial benefits that catchy and engaging software features bring to those Web sites and other digital offerings. Agencies — as agents — implement the instructions of their client-principals. As such, agencies must look to their clients to take responsibility for addressing patent infringement issues; agencies should, whenever possible, obtain indemnity from their clients against patent claims.

2. Background

The dramatic increase in the volume and sophistication of electronic commerce and advertising over the past 15 years has required a dramatic increase in technical innovation. These technical innovations — most often implemented through software running on new consumer and network devices — have been costly to develop, and many of the companies that make those investments seek to protect their innovations by obtaining patents.

Agencies now routinely produce digital work product that includes software to perform functions to hold viewers' attention or to enable advertising to be presented. The software that is integrated into client work product presents very different issues for agencies than does the use of words and images and video alone. The mechanisms for securing copyright or taking a license to photographs and other artwork is well-understood. Agencies know how and when to get model releases to avoid publicity rights claims. However, functions that are implemented through software may be protected by patents, and it is extremely difficult — even for specialized patent counsel — to determine whether a particular function is freely available or requires a patent license. There are a host of recent patent infringement cases that provide examples of the types of marketing functions that have been involved in patent disputes.

According to a recent PricewaterhouseCoopers study: (1) the number of patent applications filed each year in the United States has increased nearly 70% over the past 15 years (resulting now in approximately 200,000 new patents each year); (2) the number of patent infringement lawsuits filed each year in the U.S. has increased more than 100% over the past 15 years; (3) the median damages award in these cases is an inflation-adjusted $5.2 million; and (4) the ten largest awards in the past 15 years, before appeal or other adjustment, ranged from $250 million to $1.85 billion.

The cost of defense of patent cases is a prominent feature in companies' analysis of whether and when to settle. According to a recent survey by the American Intellectual Property Law Association, the nationwide median cost to fight a patent infringement case involving a single patent, where between $1 million and $25 million was at stake, was $1.5 million up until trial and $2.5 million through trial. The costs were significantly higher on the coasts and in plaintiff-friendly Texas. These costs, obviously, create a strong incentive to settle even a weak case, and some companies have made a business of exploiting this economic reality. In fact, more than 95% of patent infringement cases settle before trial.

How serious a problem is this "strong incentive" to settle weak patent cases? The Federal Trade Commission in its March 2011 report *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* notes that "Invalid or overbroad patents disrupt that balance [between exclusivity and competition] by discouraging follow-on innovation, preventing competition and raising prices through unnecessary licensing and litigation."

There are a range of challenges associated with investigating whether new software or digital commerce functions may infringe issued patents. One challenge is that it can be very difficult to perform a search that will "clear" a new product or a function as non-infringing. This is because there is no universally accepted nomenclature for many of these functions. Another challenge is system complexity. A robust commerce website may include hundreds of potentially patentable functions, from the manner in which shopping carts work to the way images are pulled into html to the algorithms used by the site's search engine and on and on. It may be literally impossible to search and identify every patent that a complex site or a piece of software may infringe. Still another challenge is timing. Generally, patent applications are published by the U.S. Patent & Trademark Office eighteen months after they are filed. This is the first time they become publicly available, unless the inventor wishes to publicize its application earlier. So, there is always a "dark period" of eighteen months that is unsearchable.

The result of these features of the patent landscape is that a business must, as a practical matter, assume some possibility of infringement and work to manage the degree of infringement risk and expense.

3. Best Practice Guidance

Agency clients that choose to include software-implemented features and functions in their advertising and marketing programs need to prepare for the possibility of patent infringement suits, and agencies may do well to discuss these issues candidly with their clients.

The 4A's recommends that agencies make clear in their client agreements that clients assume all risks associated with patent infringement.

The agency-client services agreement should either include an affirmative statement about client indemnification for patent risk or alternatively provide an express exclusion of any agency duty to indemnify the client in connection with alleged patent infringement.

An example of an affirmative statement about client indemnification for patent risk might read:

> Client agrees to indemnify, defend and hold harmless Agency, its officers, directors, and employees, from and against any and all liability, claims, causes of action, suits, damages and expenses, including reasonable attorneys' fees (collectively, "Losses"), to the extent based upon a third party claim, investigation or dispute that: (i) arises out of the gross negligence or willful misconduct of Client, (ii) is based upon any of the Content or Client's products or services, (iii) arises out of risks brought to the attention of Client where Client has nonetheless elected in writing to proceed or (iv) is based upon Client's ultimate use of the Services and Deliverables, or a patent infringement claim, except to the extent caused by a breach of this Agreement by Agency.

An example of an exclusion of any agency duty to indemnify the client might read:

> Agency will defend, indemnify and hold Client harmless against any and all damages, fees, penalties, deficiencies, losses and expenses (including court costs, and reasonable attorneys' fees) ("Losses") suffered, incurred or sustained by Client or to which Client becomes subject, resulting from, arising out of or relating to, any claim, suit or proceeding instituted by a third party for the unauthorized use of name or likeness of any person; libel; slander; defamation; disparagement; piracy; plagiarism; infringement of copyright, title, slogan or other property rights (excluding trademarks and service marks as provided in the Section entitled TRADEMARK OBLIGATIONS, below, and excluding any claim of patent infringement), in connection with the advertising or other material prepared pursuant to this Agreement. The foregoing indemnity shall not apply where: (i) such Losses arise from the use of materials provided by Client; (ii) such Losses arise from the use by Client of Agency-supplied materials in a manner inconsistent with agreements with third parties, (iii) Client has directed the Agency to take or to refrain from taking certain actions, or (iv) Client has elected to assume the risk of a claim in the nature of the foregoing. If and to the extent Agency's obligation to indemnify Client arises from a breach of a third party's warranties or representations, Agency's liability to Client shall be limited to the amount recoverable from such third party.

The 4A's booklet *Provisions in Agency Client Agreements* notes that "One area where caution must be exercised is the agency's responsibilities with respect to intellectual property claims, specifically with respect to claims of patent infringement". The publication references that many so-called junk patents are used by patent assertion entities to file baseless infringement claims and that because patent litigation tends to be very costly, many companies settle these claims and pay a license fee for even these so-called junk patents simply to avoid litigation. Furthermore, because insurance companies recognize the high cost of defending these claims and the difficulty of preventing these claims, if an insurance company is willing to issue patent infringement insurance at all, it may be prohibitively expensive.

If an agency agrees in its contract with a client that it will take on responsibility for patent infringement claims — either through an indemnification or an affirmative representation, warranty or agreement — the agency's role is tantamount to that of an insurance company taking on risk over which it has little or no control. Agencies generally are not being paid to cover the cost of these additional risks.

The 4A's recommends that agencies give serious consideration to adjusting price in situations where they take on risks that have not historically been factored into their pricing models.

If an agency concludes that it will provide some level of indemnity, the 4A's recommends that the indemnity include a monetary cap and other reasonable limitations.

Agencies have to reevaluate their agreements and review the scope of their representations and indemnification to make sure that they are not taking on responsibility for claims beyond those factored into the agencies' original consideration of pricing for services, i.e., beyond those that an agency believes are fair or cost effective to cover. If, based on the facts in a particular situation, an agency agrees with its client to somehow share the risk with respect to patents, then, at a minimum, fairness would dictate that the agreement should include some combination of deductibles (payable by the client), client co-pays, a cap on the agency's total liability for any patent claims or other reasonable limitations on the agency's patent indemnity.

An example of some of the limitations on liability that might be included in an agency-client agreement is:

> Agency's and its affiliates' total aggregate liability for any claim of any kind arising as a result of or related to the services performed hereunder, whether based in contract, warranty, or any other legal or equitable grounds, shall be limited to the amounts received by Agency from Client for the particular project(s) which form(s) the basis of such claim. [OPTIONALLY: Furthermore, Agency indemnification liability in relation to any patent infringement claim will be mitigated by Client's obligation to pay directly or reimburse Agency for (1) the initial ($T/B/D) of defense costs, settlement costs and/or damages awards and thereafter (2) fifty percent (50%?) of any further defense costs, settlement costs and/or damages awards in excess of $T/B/D.]

4. Agency Patent Risk Guidance Summary

The marketing industry has seen patents asserted in connection with seemingly basic functionality including one-click online shopping, online shopping carts, the hyperlink, video streaming, pop-up windows, targeted banner ads and even paying with a credit card on line. The complexities associated with patent issues are a challenge for technology-based industries. There is discussion among government regulators, and there will likely be patent reform legislation aimed at addressing some of the challenges in the patent system. However, for the foreseeable future, patent infringement risk management will continue to require vigilance on the part of marketers and their agents.

Even though clients ultimately decide what to bring to market, some clients will call upon their agencies to provide indemnity against patent infringement claims. Each agency will need to reach its own conclusions with respect to how much risk it is willing to take for the benefit of a particular client engagement.

Agencies are confronted with patent infringement issues to a greater degree than at any time in their history; however, the risks presented by those issues can be reduced through appropriate contractual relationships with clients. Your agency should review with its counsel the extent of exposure presented by engagements where the agency develops web and/or mobile functionality for a client's marketing programs, as these could, directly or indirectly, expose the agency to patent risk.

For additional discussion on patent risk management 4A's members should:

- Visit the 4A's website www.aaaa.org
- Register to join the 4A's Patent Discussion Micro site: http://patents.aaaa.org