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# Patent Claims Against Retailers

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In recent years, the frequency of patent infringement claims against some retailers has been steadily rising. This is certainly not an industrywide trend, as the total number of patent cases filed against the country's 50 largest retailers actually declined slightly from 2006 (162 cases) to 2009 (only 150). On an individual basis, however, some of the increases have been significant—especially among on-line retailers. Amazon.com saw only six patent cases in 2006 versus 20 in 2009, while over the same period the number of cases for eBay jumped from four to nine. This data is perhaps not surprising, given the steady increase in on-line shopping over the same period of time.

On the other hand, some traditional "brick and mortar" retail chains saw patent claims decline sharply over the past few years. Wal-Mart had 15 patent cases filed against it 2006 versus only nine in 2009; Target saw a similar drop, from 34 cases in 2006 to 16 in 2009. Even in this part of the retail sector, however, there is a strong possibility of increased activity going forward, given the recent wave of so-called "false patent marking" cases that are being filed around the country.

While the high-tech and "big pharma" industries face patent claims regularly, and thus are generally familiar with how to defend this type of case, patent litigation is often an unfamiliar environment for a retailer that does not design or make its own products, but instead resells merchandise provided to it by its suppliers. However, as the rising incidence of patent litigation in the retail sector demonstrates, all retailers need to be familiar with the steps they should take if faced with a patent-related lawsuit. This paper will summarize some of the key issues that should be kept in mind.

## Indemnity 101

Most patent cases against retailers involve products supplied to the retailer defendant by a third-party distributor or manufacturer. The first reaction in such a case is often "this is not my problem"—especially for companies that do not frequently face such claims.

Although this reaction is understandable, such a *laissez-faire* response can get a retailer defendant in serious trouble. The reason for this—and the single most important issue to keep in mind—is that U.S. laws impose liability for infringing a patent by making, using, *or selling* (or even offering to sell) the patented invention. Furthermore, patent infringement is a strict liability cause of action. In other words, it does not matter to the courts whether the retailer should have—or even could have—known of the asserted patent. As a result, a retailer must pay careful attention to any patent claim asserted against it, even if its only role was to stock on its shelves a product designed, tested, manufactured, and supplied by a third party.

## Assessing the Landscape

In any case involving a product supplied by a third party, the crucial threshold issue for the retailer defendant is to assess and pursue its contractual rights of indemnity. Of course, most supply contracts include indemnity provisions, many with clauses specifically related to intellectual property claims. Any such provision in an applicable agreement must be carefully scrutinized to determine the extent of the parties' respective rights and obligations.

For example, does the supplier have a duty to defend the case, a duty to indemnify for any damages that might be assessed in the case, or both? Does the supplier have the right to settle the case without consent from—or possibly without even notice to—the retailer defendant? On the retailer's side, is there an express obligation to cooperate in the defense of the case? What rights, if any, does the retailer have to actively participate in the case, in the event indemnity is accepted?

If there is no supply agreement, or an agreement that does not specifically address indemnity, all is not necessarily lost for the retailer. Many state statutes provide that a seller of goods provides an implied warranty that the goods do not infringe the intellectual property rights of any third party.

## The Need for Speed

Although it is important to analyze the parties' various rights and obligations, it is critical to do this quickly. Many supply agreements include provisions requiring the retailer/customer to provide prompt notice of any claim as to which indemnity might exist. Some agreements even specify a deadline by which notice to the supplier is required, e.g., 10 days from service of the summons and complaint. If prompt notice is not given, a supplier may qualify, or even flat-out deny, a request for indemnity, especially if it feels that it suffered some prejudice as a result of the delay.

At the risk of stating the obvious, if a pleading deadline passes before notice is given—or, even worse, if a default judgment was entered—indemnity will often be denied. Even in less extreme cases, however, delay may lead to loss of the retailer's rights. For example, many plaintiffs seek to settle claims quickly by offering a license that gets more expensive as time goes on—e.g., a royalty rate of 3% for the first 30 days, 4% for the next 30 days, and 5% thereafter. If a retailer receives such an offer, but does not provide notice to its would-be indemnitor until the terms of the offer have changed (or even too close in time to the deadline), the supplier may deny indemnity, depending on the terms of the parties' agreement.

# When Is Indemnity Not Enough?

If there is a right of indemnity, notice is given, the case is timely tendered to the indemnitor, and the supplier accepts its obligations, the retailer defendant should hopefully be able to relax and let the supplier/indemnitor handle the defense of the case—but not always. There are several important issues that a retailer defendant must consider in deciding whether it should play an active role in a patent case, even when a supplier has agreed to defend and indemnify.

## Potential Injunction

First, is there a possibility of an injunction that would prohibit future sales of the accused product? Such an injunction is almost always requested in patent cases, and is often awarded to a successful patentee, especially if it competes with the supplier/manufacturer for sales of the patented item. If an injunction is possible, the retailer defendant should consider whether it would present a problem for its own business. For smaller or specialty retailers, the loss of a single important product could seriously impact sales or customer relations. Even for larger retailers with many diverse products, an injunction could pose a problem if it related to a broad class of products or one particularly popular item.

If a potential injunction would be problematic for your business, there are several possibilities to consider. If the supplier/manufacturer is large, sophisticated, and committed to defending itself, then it might be sufficient for a retailer defendant to simply monitor the case without playing an active role. However, if the indemnitor seems “in over its head,” the retailer might need to step in and take over the defense, or at least provide material support to the supplier, to ensure that everything possible is done to keep the important accused product available even after the litigation has concluded.

Another issue to keep in mind is the possibility that the supplier could seek to provide a substitute for the accused product, in the event of an injunction. Some supply agreements give suppliers this option, while others affirmatively require it. By the same token, retailers sometimes have the right to approve such a substitute product, often with some sort of “reasonableness” restriction on the retailer’s ability to withhold consent.

## Indemnitor’s Ability/Willingness to Pay

Another obvious issue is whether the supplier/indemnitor would be able to pay the potential liability that could be imposed if the plaintiff’s claims are successful. If the supplier is a small company, but one that has supplied a tremendously successful product for a number of years, the potential liability could very well bankrupt the indemnitor.

For example, consider a modest, family-owned business that has supplied 1,000,000 infringing products over a six-year period, with an average retail price of $100. With a royalty base of $100 million, even a fairly low royalty rate of 2% to 3% could lead to a damages award that the supplier simply could not satisfy. In that situation, the retailer would be on the hook for whatever portion of the judgment could not be covered by the indemnitor.

One corollary issue involves suppliers that, while able to satisfy a potential judgment, are not willing to do so. Keep in mind that, if judgment is entered in the patent case, it will likely be a judgment against the retailer that the retailer itself will be bound by law to satisfy. Even if a supplier has an iron-clad obligation to indemnify the retailer for the damages awarded to the patentee, that fact does not (of course) guarantee that the supplier will gladly reimburse the retailer for that full amount. It will not surprise anyone to learn that, once the fight is over and the battle has been lost, a previously cooperative supplier can sometimes become recalcitrant when asked to open its checkbook.

When that happens, the retailer may have little choice but to swallow the judgment itself or to pursue its own separate breach of contract action against the supplier—neither of which are appealing options. As a result, if a retailer defendant suspects—for whatever reason—that it might be put in such a position, it should carefully consider either playing an active role in the defense of the case (to hopefully help ensure that an adverse verdict does not result) or, in an extreme case, filing a third-party complaint to officially make the supplier a party in the underlying patent case.

### Possibility of Treble Damages for Willful Infringement

Under U.S. patent law, if a defendant is found to have willfully infringed a patent, the court may find the case to be "exceptional," which can lead to enhanced damages of up to three times the compensatory damages awarded to the patentee. This can be a tricky issue in cases where there is indemnity, because state law might limit the indemnitor's obligations to cover such enhanced damages. Enhanced damages are often characterized as "punitive" in nature, and many states prohibit agreements that indemnify against punitive damages. In addition, willful infringement is in the nature of an intentional tort, which is also not a proper subject for indemnity under the laws of some states.

Willful infringement generally occurs in one of two basic situations—either the defendant had pre-suit notice of the plaintiff's infringement allegations and blindly continued to sell the infringing conduct, or the defendant continued selling the infringing products after the suit was filed with no objective basis for believing it was justified in doing so. If a retailer defendant believes it might be subject to a claim of willful infringement, there are several potential options to consider:

1. Ask the supplier/indemnitor whether it has a written opinion of counsel that it can share, which would provide the objective good-faith belief necessary to avoid a finding of willfulness.

2. Push the indemnitor as hard as possible to settle the case, to take the possibility of enhanced damages out of play.

3. If all else fails, consider playing an active role in the case, or at least closely monitoring it to ensure that the supplier is putting up an effective defense.

## Potential Indemnity-Related Complications

In some cases, indemnity is simple—one defendant, one supplier, a clearly worded contract, and a straight yes-or-no answer from the supplier when the defendant tenders the case. Unfortunately, many cases are not quite so straightforward. Below are some suggestions for how to deal with such situations.

### What If Indemnity Is Unclear or Disputed?

Even with a contract containing a well-drafted indemnity provision, rights and obligations are not always clear-cut. For example, the product sold by the supplier might be part of a larger product that also incorporates components from other sources. In such a case, indemnity will often turn on such questions as: What exactly does the patent cover? What are the allegedly "novel" features of the patented invention and how do those features relate to the supplier's product? Would the supplied product infringe the patent by itself if not combined with the other components? Questions like these often cannot be easily answered at the beginning of the case (and, indeed, may not be answered until after trial). As a result, an indemnitor may feel compelled to accept defense of only a portion of a case, or agree to defend the case but without waiving its rights to later dispute its indemnity obligations. When this happens, what is the retailer defendant to do?

The easy answer—take what you can get. If a supplier is willing to pay the legal bills to defend the case, the retailer would usually be well advised to accept that assistance. At the same time, however, a retailer must be very careful when there is a partial or qualified agreement to indemnify. The case must be closely monitored to ensure that the indemnitor is not (consciously or otherwise) steering things in a direction that would make it easier to dispute or avoid indemnity once the case is over. Similarly, if indemnity is provided only as to certain claims, then the retailer will likely have to take responsibility itself for analyzing and defending the other claims. This is certainly not an uncommon situation, but one that requires a retailer defendant to tread lightly and carefully to protect its own interests.

## What If There Are Multiple Indemnitors?

At the other end of the spectrum, retailers often face suits where they obtain the accused products from more than one supplier, in which case there might be multiple indemnitors obligated to defend the case, or at least portions of the case. Even with such an embarrassment of riches, there are issues that the retailer must keep in mind.

The primary thing to be concerned about in this situation is consistency. If there are even subtle differences between one supplier's accused products and another's, such differences might be material to the question of patent infringement. For example, if there is a particularly important claim term in the patent, one supplier's products might avoid infringement if the term is defined narrowly, while another supplier's invalidity defenses might benefit from a broader construction.

As a result, it is imperative that a retailer with more than one indemnitor monitor the litigation to ensure that one supplier does not take a position that would be disastrous for the products of the other supplier(s). Although it is not always possible to reconcile the conflicting positions and priorities of multiple entities, the retailer is generally the only one in a position to watch over the different interested parties and try (if possible) to keep everyone on the same page.

## What About False Patent Marking Cases?

As mentioned briefly above, the latest trend in patent litigation involves claims under 35 U.S.C. § 292 based on the allegation that the seller of goods has falsely marked them as being covered by a patent that does not really apply, often because the patent in question expired before the product was sold. Obviously, retailers are particularly vulnerable to claims like this, given the nature of their business model. If faced with such a false marking claim, there are a couple of important issues retailers should keep in mind with respect to indemnification from the manufacturer of the goods.

First, a claim for false marking is probably not covered by the same contract provisions that apply to most patent-related disputes. Many supply agreements between manufacturers and retailers include sections on IP-specific indemnity obligations, but those are generally phrased in terms of claims that the product being supplied infringes the patent or other intellectual property rights of third parties, not the converse situation where the product claims to be covered by an inapplicable patent. Thus, these claims must be treated differently from other patent-related claims.

Nevertheless, most supply agreements will still provide indemnity for a false marking claim, even if the retailer defendant must look a little harder to find it. Many agreements provide indemnity for claims that are based on the negligence or other culpable conduct of the supplier, which would seem to apply where the supplier has made and sold products marked with an inapplicable patent number.

In addition, many agreements include provisions requiring both parties to comply with all relevant state and federal laws, and provide indemnity for a claim based on the other party's breach of such a provision. In such cases, a supplier who has allegedly violated section 292 by falsely marking its products often should be required to provide indemnity for a retailer defending against such a claim.

## Conclusion

Retailers faced with patent-related lawsuits face a set of issues that is, in many ways, very different from that facing most defendants in patent cases. The primary difference is the prospect of obtaining indemnification from a third-party manufacturer or supplier, an issue on which a retailer defendant must focus as soon as possible after receiving the complaint. In addition, simply obtaining or confirming a commitment to provide indemnity is often not enough. There are numerous other issues and potential complications, some of them quite subtle and case-specific, that a retailer defendant must analyze before turning over control of the case to its supplier or manufacturer.

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