Downstream Liability: How New Patent Venture Laws Could Impact Intellectual Property Suits and Ways to Protect Your Business

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Is your company a middleman in a supply chain? If so, you may already be aware of the risks of downstream intellectual property (IP) liability and have taken steps to protect yourself. If not, in view of recent changes in the patent venue statute, companies should take a fresh look at their supply and e-commerce agreements.

For the most part, infringement of another's IP, whether it is a patent, copyright or trademark, is strict liability, meaning the accused's "intent" is irrelevant. Liability for IP infringement does not depend on whether you meant to infringe or didn't know you were infringing. If you are infringing someone's IP, regardless of your knowledge or role, you can still be held liable. Plain and simple.

What makes it more problematic in the business-to-business supply chain is that IP infringement claims are allowed to move up and down the supply chain. By selling a product in the United States, manufacturers, designers, distributors and sellers of that product (and/or component parts of that product) all are at risk. Hence, the term "downstream liability."

Of course, it frequently happens that IP owners would rather go after the source of the infringing product for efficiency sake, but recent changes in the patent venue laws could change this strategy and impact your risk of being sued as a downstream company.

"Patent Venue" laws- Why Should You Care?

Until recently, a patentee had its choice of where to sue the manufacturer/supplier of an infringing product, as courts applied the general federal venue statute. This statute allows a plaintiff to sue a party in any jurisdiction where it had committed an infringing act and resulted in (1) defendants being sued in far-away districts strategically chosen by plaintiffs; and (2) "patent trolls" suing multiple defendants in patent-friendly jurisdictions (i.e. the Eastern District of Texas), even if the defendants had little to no true contacts there. This is called "forum shopping."

The Supreme Court's 2017 decision in TC Heartland confronted this "forum-shopping" strategy by holding that patent cases were governed by a more specific venue statute, 28 U.S.C. § 1400(b). Under this statute, a court only has proper venue over a defendant if it (1) "resides" in the district, or (2) has committed acts of infringement there and has a regular and established place of business there. Under TC Heartland, a corporation resides only where it is incorporated. Regarding the latter requirement, (1) there must be a physical place in the district; (2) it must be a regular and established place of business; and (3) it must be the place of the defendant.

So far, this all sounds like good news, i.e. the more restrictive venue statute will prevent companies from being sued in faraway places. However, there has been an unexpected consequence which could impact your business and/or your customers. Following TC Heartland, patentees have been filing lawsuits against different parties within the supply chain in order to pursue lawsuits in more favorable jurisdictions. Thus, patentees are forum shopping by suing distributors, retailers, customers, or other entities within the supply chain.

The financial consequences and business interruption caused by downstream liability can be devastating to any company. One way to potentially decrease exposure is with indemnification clauses, which require suppliers or manufacturers to cover costs in the event of infringement. Given the increase in downstream liability suits, it is important to confirm your company has express, written agreements with suppliers, which clearly state they will provide IP indemnification for any and all costs and damages associated with their products. Assuming you do have written indemnification agreements, confirm the following:

- Suppliers are required to provide indemnification if a product they supply is accused of infringement, including any costs of a defense (legal fees can be greater than the monetary damages/exposure).
- You have the ability to stop buying products/parts accused of infringement.
- No upper limits or restrictions on the upstream supplier's liability.
- Indemnification will cover modifications or combinations of parts into a larger product.
- You have the right to settle with the IP holder without the supplier's consent.
- Consider your downstream customers; will the indemnification cover them?
- Are there any prerequisites or notice requirements? You could inadvertently waive an indemnification by not complying.

Relatedly, many companies are turning to large, on-line marketplaces to sell their products, i.e. Amazon, eBay, as well and online retailers like Sears and Walmart are allowing third party vendors to sell (or "drop-ship") products through their high-volume websites. However, doing business with these sites does come with a price; i.e. among other things, an exceedingly one-sided contract with virtually unassailable indemnification clauses. These indemnification obligations typically require the vendor to pay all attorney fees and monetary damages, for both parties, even though the retailer will want to be in charge of the lawsuit. What this means is that the large retailer has no liability, while the small vendor is responsible for all damages and attorney fees for both parties. As you can imagine, this could devastate a small company. So, before you sign up, read the indemnification terms and sufficiently protect yourself.

Downstream liability is a business risk that everyone in the supply chain must accept and endure. However, whether you choose to minimize your risk or simply bear it, the best defense is to educate yourself by reading your agreements before you find yourself on either end of the indemnification issue. These can be located in many different places (e.g. invoices, purchase orders, receipts, formal agreements, etc). You may also consider IP insurance coverage. Most general liability insurance claims (although not all) expressly exclude coverage for IP claims outside the realm of "advertising injury." However, some form of IP defense coverage, could make sense for your company or as a requirement for those with whom you do business.