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Chapter 12. Warranty and Indemnification Against Infringement

12.1.0 Sales, Infringement, and the Warranty Against Infringement – If you buy something, you might figure you should be able to use it in a normal way without getting sued. But intellectual property laws could frustrate your expectations.

Suppose Phoebe has a U.S. patent claiming a tractor implement with rotating titanium blades arranged in a 7-pointed star shape. You might guess that manufacturing such a tractor implement in the United States would be an infringement of Phoebe’s patent. And that is correct. But it is also true that anyone importing, selling, or even using such a tractor implement is infringing Phoebe’s patent.

Federal patent law at 35 U.S.C § 271(a) provides:

[W]hoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefor, infringes the patent.

This applies whether the infringer has any knowledge of the patent. Willfulness can increase the amount of damages, but patent infringement itself is a strict-liability affair.

And it’s not just patent law. Copyright and trademark laws also provide for strict-liability infringement and can interfere with an innocent buyer’s ability to use goods they paid for.

So let's go back to considering Phoebe's patent. Suppose Selena, a tractor merchant, sold to Brent, a farmer, a tractor implement with rotating titanium blades arranged in a 7-pointed star shape – that is, a tractor implement covered by the claims of Phoebe's patent. Let's further suppose that neither Brent nor Selena knows anything about Phoebe's patent, and that Brent paid good money for the implement. Brent proceeds to use the implement on his farm. What result? Phoebe can successfully sue Brent for damages and might well be able to get an injunction to prevent Brent's further use of the implement. That is notwithstanding the fact that Brent paid for the implement and owns it.

So what is a buyer like Brent to do? It's no defense against patent infringement for Brent to prove he paid for the implement or that he didn't know about Phoebe's patent. Moreover – and this is a very important point – the UCC will do nothing to help him in this regard. After all, patent law is federal law, and the UCC is state law. It is entirely outside of the authority of the UCC to do anything to interfere with Phoebe's federal patent rights.

What the UCC can do is give Brent a cause of action against Selena, providing him with a way to make Selena make it up to him that the tractor implement she sold is hobbled by third-party intellectual-property rights. This is where UCC §2-312(3) comes in. It provides:

Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like ...

This section makes it a default provision of sales-of-goods contracts that the covered merchant sellers will have to reimburse buyers for their losses on account of infringement of a third-party's intellectual property rights.

12.1.1 Applicability Only to Merchants – It is important to note that the warranty covers “a merchant regularly dealing in goods of the kind.” It's not an obligation of the casual, non-merchant seller, and even for merchants, it doesn't apply to their goods that aren't part of their regular merchandise. Comment 3 notes:

When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty.

12.1.2 The Extent of the Warranty Against Infringement – Like anything else in law, infringement issues are often less than clear. Infringement itself is an abstract concept. And in any given case, whether patent, trademark, or copyright

infringement has occurred might require a lot of legal analysis or even a full trial to determine.

So what do we do when we don't know for sure if there is infringement, but we can say that there is at least something like a cloud of possibility of infringement? Certainly, even a cloud can be a problem for a buyer. Here's what a leading treatise has to say:

[I]t is not every claim but, in the words of the statute, only a rightful claim of infringement that constitutes a breach of this warranty. ... A rightful claim of infringement falls somewhere between a purely frivolous claim and a claim that has been proven to show liability. A "rightful claim" is a nonfrivolous claim of infringement that has any significant and adverse effect on the buyer's ability to make use of the purchased goods. The infringement claim must be of a substantial nature that is reasonably likely to subject the buyer to litigation.

18 *Williston on Contracts* § 52:63 (4th ed.).

The result is that the protection offered to buyers by the warranty against infringement is inevitably incomplete – that's even assuming a solvent seller who can make good on the obligation imposed by the warranty.

12.1.3 Case: ***EZ Tag v. Casio America***

This case explores another way in which the warranty against infringement may provide incomplete protection to the buyer – by not covering attorneys fees incurred in the defense against an infringement claim.

EZ Tag Corp. v. Casio America, Inc.

U.S. District Court for the Southern District of New York

March 8, 2012

861 F.Supp.2d 181. EZ TAG CORPORATION, Plaintiff, v. CASIO AMERICA, INC., and Casio Computer Co., Ltd., Defendants. No. 11 Civ. 4685 (DAB). Norman H. Zivin, Tonia A. Sayour, Cooper & Dunham LLP, New York, NY, for Plaintiff. Scott David Stimpson, SNR Denton US LLP, Katherine Marguerite Lieb, Sills Cummis & Gross, P.C., New York, NY, for Defendants..

DEBORAH A. BATTS, District Judge:

Plaintiff EZ Tag Corporation ("EZ Tag") brings this action against Defendants Casio America, Inc. and Casio Computer Co., Ltd. (collectively, "Casio") under Section 2-312 of the New York Uniform

Commercial Code (“NY–UCC”) for attorney’s fees and costs incurred in defense of a patent infringement action brought by Raylon LLC (“Raylon”) in the Eastern District of Texas (the “Raylon Action”). Now before the Court is Defendants’ Motion to Dismiss under Federal Rule of Civil Procedure 12(b)(6).¹ For the reasons set forth herein, the Motion to Dismiss is GRANTED.

I. BACKGROUND

The following facts, set forth in the Complaint, are assumed to be true for purposes of this Motion to Dismiss.

In or about August 2009, Raylon LLC brought an action against EZ Tag and Casio in the United States District Court for the Eastern District of Texas for alleged infringement of United States Patent No. 6,655,589 (“the 589 patent”). The 589 patent is directed to a hand-held computing device that could be used for printing traffic citations.

EZ Tag had purchased indirectly from Casio hand-held computing devices that Raylon charged infringed the 589 patent. EZ Tag “resold those devices to police departments and enforcement agencies in the State of New York.” After the commencement of the Raylon action, EZ Tag requested that Casio indemnify and hold EZ Tag harmless against Raylon’s patent infringement claim. Casio did not agree to indemnify EZ Tag. As a result, EZ Tag was required to expend \$152,579.00 for attorney’s fees and expenses for defending against Raylon’s patent infringement action.

On March 23, 2011, the court granted summary judgment for the defendants in the Raylon Action, including EZ Tag and Casio, on the ground that the hand-held computing devices did not contain all of the elements of the 589 patent, and therefore did not infringe those claims. EZ Tag then again requested that Casio indemnify EZ Tag for its attorney’s fees and expenses, but Casio refused.

II. DISCUSSION

A. Legal Standard for a Motion to Dismiss

For a complaint to survive dismissal under Rule 12(b)(6), the plaintiff must plead “enough facts to state a claim to relief that is plausible on its face.” *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).~

B. Breach of Warranty and Indemnification under NY-UCC 2-312(3)

EZ Tag claims that Casio had a duty and obligation to indemnify EZ Tag for defending against Raylon's patent infringement action under Section 2-312 of the New York Uniform Commercial Code. That section provides that "[u]nless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like ..." NY-UCC § 2-312(3). NY-UCC Sections 2-714 and 2-715 govern a buyer's remedies for a seller's breach of warranty, such as the warranty of non-infringement in Section 2-312(3). Section 2-714 provides that generally, "[t]he measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." NY-UCC ¶ 2-714(2). Section 2-714 continues, "[i]n a proper case any incidental and consequential damages ... may also be recovered." NY-UCC § 2-714(3). Section 2-715 states that consequential damages include "injury to person or property proximately resulting from any breach of warranty." NY-UCC § 2-715(2)(b).

Although these sections of the NY-UCC are litigated fairly infrequently, the weight of authority in this Circuit counsels against the inclusion of attorney's fees and litigation expenses as damages for breach of warranty under Sections 2-714 and 2-715 in the absence of bad faith or contractual authorization. See, e.g., *CGS Industries, Inc. v. Charter Oak Fire Ins. Co.*, 777 F.Supp.2d 454, 462-64 (E.D.N.Y.2011) (finding that NY-UCC Section 2-715 did not obligate the seller as a matter of law to reimburse the buyer's defense costs incurred in an infringement suit where the contract of sale did not provide specifically for indemnification for attorney's fees); *In re O.P.M. Leasing Svcs.*, 61 B.R. 596, 603-04 (Bankr.S.D.N.Y.1986) (finding that attorney's fees and expenses are not recoverable as incidental or consequential damages under the NY-UCC); *Larsen v. A.C. Carpenter, Inc.*, 620 F.Supp. 1084, 1126, 1136-40 (E.D.N.Y.1985) (finding that attorney's fees and litigation costs were not recoverable as consequential damages under the NY-UCC in the absence of bad faith or contractual authorization); accord *Chere Amie, Inc. v. Windstar Apparel Corp.*, No. 01 Civ. 40(WHP), 2003 WL 22056935, at *2 (S.D.N.Y. Sept. 4, 2003) (permitting recovery of attorney's fees and costs where the vendor agreement specifically provided for them).

In any event, even were this Court to find that attorney's fees and litigation expenses were remedies for a breach of the warranty of non-infringement, they would not be appropriate here, as the claims in the Raylon Action were not "rightful" within the meaning of NY-UCC Section 2-312(3). Although the precise definition of term "rightful" is a question of first impression in this Circuit, in no case in this jurisdiction has a court determined that a claim was "rightful" following an affirmative adjudication of non-infringement. See, *CGS Industries, Inc.*, 777 F.Supp.2d at 458 (noting underlying infringement suit resolved by settlement); *Dolori Fabrics, Inc. v. Limited Inc.*, 662 F.Supp. 1347, 1349 (S.D.N.Y.1987) (awarding judgment for plaintiff on infringement before discussing indemnification cross-claim). Furthermore, it is evident from the Order granting summary judgment in the Raylon Action, referenced in paragraph fourteen of the Complaint, and the Order denying Rule 11 sanctions, referenced in paragraph 13 of the Complaint, that the claim asserted in the Raylon Action cannot be considered "rightful" under any of the definitions of the term put forth by courts around the country.

In *84 Lumber Co. v. MRK Technologies, Ltd.*, 145 F.Supp.2d 675 (W.D.Pa.2001), the court determined that the question of whether or not a claim was "rightful" would involve a comparison of the patent with the goods at issue to determine "that there was an adequate basis for [claimant]'s assertion that defendants' products infringed his patents." The court stated that "[i]f claims of patent infringement are seen as marks on a continuum, whatever a 'rightful claim' is would fall somewhere between purely frivolous claims, at one end, and claims where liability has been proven, at the other."

The court in *Sun Coast Merchandise Corp. v. Myron Corp.*, 393 N.J.Super. 55, 922 A.2d 782, 796-97 (2007) agreed with the court in *84 Lumber* that the patent and claim of infringement must be examined to determine whether or not a claim was "rightful." The court stated, "[a] third party's claim of infringement-to be 'rightful' ... must cast a 'substantial shadow' on the buyer's ability to make use of the goods in question, in order to constitute a breach of the warranty against infringement." The "buyer must establish that the infringement claim is of a substantial nature that is reasonably likely to subject the buyer to litigation, and has a significant and adverse effect on the buyer's ability to make use of the goods in question."

Relying on *84 Lumber*, EZ Tag argues that a patent infringement claim is "rightful" as long as it is non-frivolous, and that the denial of Rule 11

sanctions in the Raylon Action resolves this question. This Court disagrees. It is clear from *84 Lumber* and *Sun Coast* that a claim of infringement must have some merit beyond being “nonfrivolous” for Rule 11 purposes to support a breach of warranty claim. The Raylon Action, which the Texas court described as “stretch[ing] the bounds of reasonableness,” does not rise to that level.

All of the claims of the 589 patent that was the subject of the Raylon Action require a “display being pivotally mounted” on the device housing. To sustain Raylon’s patent infringement claim, the court would have had to define “pivotally mounted” broadly enough to encompass moving one’s arm or wrist so that the entire device is moved and the viewer’s perspective is altered. As the court in Texas found, this interpretation is “contrary to the specification and the plain meaning of the claim,” which required that the display be pivotally mounted relative to the housing, rather than to the viewer. Raylon’s claims, therefore, while not so frivolous as to be sanctionable, surely were not so substantial as to impose a significant and adverse effect on EZ Tag’s ability to make use of the goods. As Raylon’s claim of infringement against EZ Tag was not “rightful” within the meaning of NY–UCC 2–312(3), Casio had no duty to indemnify EZ Tag for the expenses incurred in the Raylon Action.

C. Common Law Indemnification

EZ Tag makes no attempt to defend its common law indemnification claims. Those claims cannot survive the Motion to Dismiss in any event, as to state a claim for common law indemnification under New York law, the party seeking indemnification must have been “held liable to the injured party.” See *Mathis v. United Homes, LLC*, 607 F.Supp.2d 411, 434 (E.D.N.Y.2009). EZ Tag’s success in the Raylon Action therefore precludes any common law indemnification claim.

D. Leave to Replead

When a complaint has been dismissed, permission to amend it “shall be freely given when justice so requires.” Fed.R.Civ.P. 15(a). However, a court may dismiss without leave to amend when amendment would be “futile”, or would not survive a motion to dismiss. *Oneida Indian Nation of New York v. City of Sherrill*, 337 F.3d 139, 168 (2d Cir.2003). Leave to amend would be futile in this case, as it is abundantly clear from the Complaint and the documents referenced therein that the claims asserted in the Raylon Action were not “rightful.” Leave to replead is denied.

III. CONCLUSION

Defendants' Motion to Dismiss is GRANTED, and the Complaint is dismissed WITH PREJUDICE and without leave to replead. The Clerk of Court is directed to CLOSE the docket in this case.

SO ORDERED.



12.2.0 The Buyer's Indemnification Obligation – UCC § 2-312(3) doesn't just provide for the warranty against infringement. It also provides for an obligation flowing the other way, from buyer to seller, at least when it is the buyer's specifications – adhered to by the seller in fulfilling the order – that result in infringement.

The buyer's indemnification obligation under § 2-312(3) is a kind of reverse warranty. Below is the whole UCC § 2-312(3). It's a little unwieldy and could benefit from a comma or two, but it's worth scrutinizing to see how the buyer's obligation is worked in – starting “but a ...”:

Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

Official Comment 3 expands on this a little, noting that there's no implication of an warranty obligation “when the buyer orders goods to be assembled, prepared or manufactured on his own specifications.” It continues:

If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

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