

Risk Management and Intellectual Property Insurance Coverage

Don Glazier

As intellectual property (IP) assets continue to increase in value and importance to more companies, the need to protect those IP assets increases. Many look to insurance as part of the solution to help manage the risks associated with claims of IP infringement. The marketplace offers various risk transfer solutions that warrant consideration as part of any entity's risk management strategy.

INTRODUCTION

Basic risk management analysis involves assessing the probability of an event and multiplying it by its impact.

Applied at a personal level, the chance of a fire burning my house to the ground or a repairman being seriously injured are small. However, the impact of those events are potentially huge—nowhere to live, my largest investment gone, and a catastrophic financial judgment against me.

In business, risk assessment is part of management's responsibilities and many companies have a dedicated risk manager or an entire department focused on this area. Insurance represents perhaps the most important element for an enterprise's risk management strategy.

Stripped to its core, insurance simply involves shifting a particular risk to another entity, which agrees to accept it for an agreed upon price. Risks of fire, wind, and other insurance "perils" have well-established avenues of coverage through property insurance.

Companies address their liability exposures through various lines of insurance—including directors and officers liability insurance for claims against management and all types of variations of professional liability errors and omissions coverage.

Among the risks facing companies, those associated with intellectual property (IP) present less obvious insurance solutions.

It goes without saying that IP assets are certainly worthy of protection and risk management consideration. For many organizations, IP represents the largest and most valuable asset, providing its biggest competitive advantage. And, the importance of IP continues to increase.

As an indicator, the number of patents granted by the United States Patent and Trademark Office continues to increase steadily, increasing by 14 percent over last year.

While robust risk management can decrease both the likelihood and severity of infringement claims, resolving these matters many times involves an expensive legal battle.

Consequently, infringement has the potential to diminish the value of IP assets and potentially an entity's financial survival.

Despite the risks presented in the IP area, the insurance marketplace does not as of yet offer a single, all-inclusive insurance product addressing all facets of the exposure.

As described below, the insurance industry does, however, present solutions for certain aspects of IP risk, either through more widely held insurance products or more specialized offerings.

MULTICOVERAGE POLICIES

Comprehensive General Liability Insurance

Most business entities purchase some form of comprehensive general liability insurance (CGL) coverage. Those policies are a logical first place to look upon receipt of an IP-related lawsuit.

Depending upon what is alleged in the suit, CGL policies may respond with defense and indemnity, but are limited in scope and do not provide blanket coverage for all types of IP infringement claims ranging from copyright infringement to patent infringement.

Under the insuring provisions in CGL policies, there is often coverage for what is known as “advertising injury.” Depending upon the wording of the particular policy, coverage for advertising injury often exists with respect to claims made against the insured for copyright infringement as well as trademark and trade dress (product design and packaging) infringement.

The alleged infringing activity must be a direct result of the actual advertising itself. Patent infringement is often excluded from coverage.

Since alleged infringement can occur in many situations not involving advertising, it is apparent that a CGL policy, even with advertising injury liability coverage, may only offer limited value in IP risk management.

Another problem with the CGL policy coverage is that an infringement can be construed as an intentional act, implicating a policy exclusion, and providing a basis for the carrier to deny coverage for the claim submitted.

In light of the fact that the CGL policy is not normally considered a primary source of protection for third-party claims based on allegations of IP infringement, there are a number of other potential sources of insurance coverage for IP related risks.

Media Liability Insurance

Media liability policies may extend coverage to claims that many times would otherwise be excluded under other liability policies. Media liability insurance is a specialized type of errors and omissions insurance that offers protection against claims brought by third parties.



These policies are most commonly purchased by media and entertainment insureds including traditional and online publishers, broadcasters, and companies with significant marketing activities. Any company with a market-facing presence may benefit from looking at media liability insurance.

These policies cover liability resulting from a wide range of claims, which depending on the insured’s particular policy terms, may include allegations of defamation, disparagement (including product disparagement), copyright infringement, plagiarism, and other unauthorized use of material, names, or trademarks.

Media liability policies can be coupled with an errors and omissions insuring section, which protects companies from claims involving professional negligence in their work for customers.

Media liability coverage is generally not written on standard form policies. Instead, most media liability insurers manuscript policy forms to meet their insured’s specific needs. In that regard, the policy normally extends only to claims arising out of the insured’s “business,” which is defined in the policy.

The breadth of this definition can have a significant impact on the scope of coverage provided. As such, careful consideration should be given to make sure this term accurately reflects all the entity’s media activities prior to purchasing coverage.

Cyber Liability Insurance

Another line of insurance coverage designed mainly to focus on a non-IP-type of risk, but which may also offer some protection from IP-related litigation is a cyber liability policy.

While most attention related to cyber insurance focuses on data breaches and privacy issues, policies often provide multimedia liability coverage similar to stand-alone media policies that provide protections for IP-related exposures. The policies may provide protection for liability stemming from claims alleging copyright, trademark, or other IP infringement claims.

IP ONLY POLICIES

Patent Only Policies

The insurance marketplace has not embraced insurance coverage for exposures associated with patents to the same extent as other intellectual property risks such as copyright or trademark. Patent exposures are different—difficult to underwrite, adjust claims, and expensive to resolve.

Some insurers who had ventured into insuring patent-related exposures suffered significant losses and eventually exited that market segment. As a consequence, most policies that cover other IP exposure such as copyright or trademark will specifically exclude patent claims from coverage.

There have been a few exceptions to those carriers not willing to consider patent-related risk. Certain specialized insurers offer insurance products of different varieties that can help serve as risk management tools for those who either own patents or are worried about claims from other patent owners.

Besides patent coverage, these policies will also cover alleged infringement for other types of IP rights addressed in other policies. The underwriting process involved in obtaining insurance for patent-related claims is more involved than that for other lines of coverage, but the insurance is available in various forms.

Defense and Indemnity Policy

To protect insureds from claims asserting patent infringement, insurers offer policies that cover claims that stem from the insured's use, distribution, advertising, and/or sale of its products. The policies typically cover defense costs associated with the claim, damage awards, and settlement payments.

However, the policies will typically not cover willful infringements or potential infringements that the insured knew about at the time policy was put into place.

Defense Only Policy

Due to the specialized and many times uniquely technical nature of patent litigation, defense costs are many times significant. Because of this exposure, carriers may offer a policy only covering the defense cost portion of the total loss associated with a patent infringement claim.

The policies would not cover the amounts needed to resolve the claim by way of paying for a settlement or judgment. Nonetheless, defense only policies can offer a valuable risk transfer option.

IP Withdrawal Expense

As not all patent litigation turns out in favor of the insured, insurers can offer a component of coverage to reimburse the insured for costs associated with removing a product from the marketplace as directed by a court.

The insurer will cover the costs and expenses such as transportation to withdraw the product from the distribution chain as well as relabeling, destruction and disposal of the product, packaging or labeling materials.

IP Abatement Policy

Enforcement or abatement insurance is a unique plaintiff's policy, which reimburses the litigation expenses to enforce IP rights against infringers. The insurance is available, however, only for insureds who are likely to prevail in such claims. To obtain this coverage, outside independent patent counsel must provide an opinion that the patent in question is valid.

The value in abatement coverage is that it protects companies who possess a valid patent but cannot protect their asset because of the significant expense that will be incurred in pursuing an infringing party, especially when the infringer is well funded and can wear down the patent owner through a war of attrition in the courts.

Representations and Warranties Insurance

Another insurance product that offers protection in connection with IP is representations and warranties (R&W) insurance. This insurance product is designed to protect parties entering into a transaction such as merger, acquisition, or joint venture from losses which may arise as a result of events or circumstances that are not disclosed prior to such transaction.

As such R&W insurance protects against the loss of anticipated benefits, that is, valuable IP assets from the transaction that were represented to exist, or against, potential liabilities that were represented not to exist.

INSURANCE COVERAGE ISSUES

Regardless of the type of insurance under consideration to protect against IP-related risks, a fundamental question always involves how much insurance is appropriate and conversely, how much risk to retain.

The patent only insurance marketplace offers various limits of liability ranging from \$1 million to significantly larger limits including multiple layered programs in the tens of millions of dollars.

The decision as to how much insurance to purchase depends first and foremost on the entity's underlying risk management philosophy. Is the insurance designed to protect against a catastrophic, potentially business-ending claim, typically by a business competitor?

If so, the insured should purchase large limits of liability with a commensurately large self-insured retention. Such a program would keep relatively small claims as part of the company's retained cost of business.

On the other hand, if the concern is small claims, such as those brought by nonpracticing entities (NPE), a small limits policy, with a relatively small self-insured retention may provide the best answer.

Along with considering how much risk to retain through a self-insured retention, insurers will many times require a co-insurance percentage applicable to all loss payments. Those provisions require the insured to pay a percentage, in the range of 20 to 25 percent, of all costs incurred in the claim to provide that the insured keep some "skin in the game."

As found in every insurance policy, there are certain types of claims that insurers do not wish to cover. Therefore, they add exclusions to the policies to carve those out.

Common exclusions in liability policies which cover IP claims can include the following:

1. Fines or penalties, including punitive, exemplary, treble, or multiple damages
2. Infringement actually known by the insured prior policy inception
3. Losses or expenses arising from willful infringement, although this exclusion often

requires final adjudication by a court or other body before it becomes effective

Policies may also exclude coverage for any counterclaims, retaliatory lawsuits, or certain administrative proceedings and require authorization for an appeal should the insured not prevail in the initial lawsuit.

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NONINSURANCE RISK MANAGEMENT OPTION OF DEFENSIVE ACQUISITION

Defensive acquisition represents a unique risk management option used by some entities exclusively in connection with patents. Designed mainly to address NPE claims, defensive acquisition involves using capital contributed from similarly situated entities facing such claims to preemptively acquire patent assets and rights prelitigation.

Each entity that contributes capital to the pool to purchase patents receives a license to every patent owned. Possessing a license precludes the NPE from being able to bring suit in connection with those patents.

SUMMARY

The options available to address IP risk management continues to develop. The insurance marketplace assesses the opportunities presented by developments in IP exposure and considers its risk-taking appetite depending on perceived opportunities.

Any entity facing IP risk of some sort would benefit from a risk management assessment. Companies should seek the assistance of a knowledgeable insurance broker in looking at the insurance products available that might provide valuable risk transfer options.

Don Glazier is a vice president and claims counsel at Lockton Companies Chicago office. Don can be reached at (312) 669-6754 or at donald.glazier@lockton.com.

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