Addressing an Insurance Gap– Intellectual Property Liability Insurance

Authored by

Nancy Adams, Member, Mintz Levin

Dan A. Bailey, Member, Bailey Cavalieri

Ankit Patel, Intellectual Property Underwriting Counsel, Ambridge Partners LLC

Insurance coverage for intellectual property ("IP") claims has long been a source of interest, debate and confusion among companies, insurance advisors and underwriters. The potential liability and financial exposure from these claims can be enormous and can jeopardize the very existence of some companies. However, historically, insurers have often been reluctant to offer commercially viable insurance protection for this exposure, both because of the volatile nature of the exposure and because companies often choose to embrace if not increase their IP exposures as part of their strategic plan or operational model. In addition, many companies mistakenly believe that they have coverage for these claims under their standard insurance program.

For many companies the biggest and therefore most important asset on the balance sheet is their intangible assets, including their intellectual property. Innovation and R&D have long been key to success for companies in most industries. As the economy becomes increasingly global, companies are placing even more emphasis on safeguarding their intellectual property (patents, trademarks, copyrights and trade secrets). At the same time there has been a significant rise in the number of IP-related court filings by companies doing business in the United States and internationally.

Consider the following

- A 2015 annual study of intangible asset market value by Ocean Tomo[1] reported that the value of the S&P 500's intangible assets grew to 87% of total valued assets – equates to $19 trillion (mostly IP assets).
- The WIPO 2017 Annual Report notes that in 2016 "global patent filings grew by 8.3% and global trademark filing activity by 13.5% – making for seven years of straight increase."
- The report further notes that US filings for patents and trademarks increased by 2.7% and 5.5%, respectively. [2]
- The USPTO FY 2017 Performance and Accountability Reported stated that since 2000 the number of utility patent applications has more than doubled from 291,653 to 602,354 in 2017. This has also resulted in a dramatic increase in the number of utility patents being issued from 164,486 to 315,367.
- In June 2018 the USPTO awarded the 10 millionth US patent.

1 Ocean Tomo 2015 Annual Study of Intangible Asset Market Value
2 World Intellectual Property Indicators 2017, WIPO (2017), available at: Annual Report

Recognizing the significance of the value of their IP in relation to their core operations, many IP owners, whether operating companies or non-practicing entities (sometimes referred to as 'patent trolls'), are utilizing licensing and enforcement tactics to monetize their IP assets. Accordingly, companies are faced with increased exposure to IP litigation. This exposure is further heightened when IP disputes are cross-jurisdictional, and litigants are faced with the challenge and uncertainty driven by varying application and interpretation of IP laws in courts of different countries. [3]

Insurance Policies that Potentially Provide IP Coverage

There appears to often be a disconnect between a company's management of its IP risks and its other risks. It is rare for risk managers to become involved in evaluating and managing risks related to a company's IP portfolio, so questions as to whether those risks should be retained, transferred or insured (in whole or in part) are rarely considered.

Standard risk management opportunities for IP risks are limited but available. As a practical matter, it is difficult, if not impossible, to transfer the risks associated with a company's ownership and use of IP to a third party other than through an insurance arrangement. Until recently, however, IP insurance was rarely considered as a viable option because the premium was too expensive, the underwriting process was too time-consuming, or the scope of coverage was inadequate.

Another reason that companies have not purchased IP insurance is the mistaken belief that general liability insurance affords coverage for the company's IP risks and exposures. This confusion appears to stem from the fact that, in addition to bodily injury and property coverage, general liability policies provide coverage for "personal and advertising injury," which may expressly include infringement of copyright, trade dress or slogan. To be afforded coverage, however, the infringement must be in the company's advertisement. Moreover, courts have repeatedly held that personal and advertising injury does not include either direct or induced patent infringement. See Heritage Mut. Ins. Co. v. Advanced Polymer Tech., Inc., 97 F. Supp. 2d 913, 924 (S.D. Ind. 2000). As recognized by one court, it is "absurd to suggest" that a general liability policy "encompasses patent infringement or inducement to infringe" even where the policy covers personal and advertising injury. See Gencor Indus. v. Wausau Underwriters Ins. Co., 857 F. Supp. 1560, 1564 (M.D. Fla. 1994). After all, "[s]ince the gravamen of patent infringement is the unauthorized production, use or sale of a patented product and not its advertisement, it could not arise out of or occur in the course of advertising activities." Atlantic Mut. Ins. Co. v. Brotech Corp., 857 F. Supp. 423, 429 (E.D. Pa. 1994).

As a result, companies which rely on their general liability policy or other standard insurance policies to manage their IP risks potentially have a significant "gap" in coverage. The following briefly summarizes the primary types of non-IP insurance policies which may afford some limited coverage for IP-related exposures and the "gaps" in coverage for IP exposures under those policies.

3 For instance, in the United States, litigation strategies may vary based on a judge's prior management of IP cases, the typical time to trial or legal arguments. In the United States, clients may further be concerned with perceived threats of frivolous lawsuits brought by non-practicing entities and high costs of litigation. In jurisdictions such as Germany and South Korea, clients may be more concerned with the bifurcated nature of proceedings which may prolong the dispute and add costs. In a jurisdiction such as China, where IP laws are undergoing revisions, clients may be concerned with the potential for uncertainty in the interpretation of an IP law by relatively uninitiated courts and judges.

A. Commercial General Liability Insurance

As noted above, typically commercial general liability ("CGL") insurance policies include coverage for "personal and advertising injury," which includes: (i) "[o]ral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, product or services"; (ii) "[t]he use of another's advertising idea in your 'advertisement'"; and (iii) "[i]nfringing upon another's copyright, trade dress or slogan in your 'advertisement'".[4] However, consistent with the insuring provisions in CGL policies, the alleged infringing activity must be a result of the actual advertising itself. Further, given that most patent infringement claims relate to an insured's unauthorized use or sale of a patented product (and the advertising thereof), it is unlikely that such claims would ever arise out of the insured's advertisement. Accordingly, coverage for patent infringement is limited, if provided at all.

Another potential gap in coverage relates to the scope of covered "damages" under CGL policies. In a typical insuring agreement, the insurer agrees to pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury". Although the term "damages" is not defined, in certain jurisdictions, attorneys' fees, punitive damages and disgorgement may not constitute damages. Moreover, it is highly unlikely that amounts that a company incurs as "work around costs", for example, would be considered "damages" under a CGL policy. And yet, a third potential gap relates to an insured's strategic decision; for example, to affirmatively prosecute its right to IP. Most general liability policies do not afford coverage to an insured for counterclaims or the insured's affirmative prosecution of claims against a third party.

B. Media Liability Insurance

Media liability insurance is a specialized type of errors and omissions liability coverage that is typically purchased by companies involved in media and entertainment activities, such as publishers, broadcasters and companies with significant marketing activities. These policies typically cover liability resulting from alleged defamation, disparagement, copyright infringement, plagiarism and other unauthorized use of material, names or trademarks.

Most of these policies utilize manuscript policy forms, and therefore the coverage can to some extent be tailored to the needs of the specific Insured. But, like CGL policies, a media liability policy will only cover certain specific types of intellectual property claims arising out of the Insured's "business," which is defined in the policy.

C. Directors and Officers Liability Policy

Most Directors and Officers ("D&O") insurance policies cover not only claims against directors and officers, but also certain claims against the company. D&O policies issued to publicly-held companies typically cover Securities Claims against the company, but do not cover any other type of claim against the company. In contrast, D&O policies issued to privately-held companies usually afford coverage for any type of claim against the company unless specifically excluded. But, these policies usually include a broad exclusion for any type of intellectual property claim against the company, including claims related to alleged infringement of copyright, patent, trademark, trade name, trade dress or service mark, or alleged misappropriation of ideas or trade secrets.

4 Commercial General Liability Coverage Form, Insurance Services Office, Inc. (CG 00 01 04 13).

D. Representations and Warranties Insurance

Representations and warranties ("R&W") insurance policies often include coverage for breaches of representations in transaction agreements relating to intellectual property matters. However, this coverage is backward (and not forward) looking and is also limited by the scope of a seller's representation in the transaction agreement and by the survival period of that representation. Moreover, R&W insurance is only applicable in the M&A deal context and thus has a narrow applicability. In other words, R&W insurance would not be available to a company unless, at a minimum, it involved the breach of a seller's representation in an M&A deal. Even then, the liability limits apply to all breaches of representations and thus a R&W policy would not afford separate limits that were only applicable to breaches of IP representations.

E. Cyber Insurance

Broadly, cyber insurance affords coverage for the risks associated with a company's storing of data or information or conducting business through the internet. Cyber insurance policies may afford limited coverage for certain types of IP-related claims if the alleged wrongdoing arises out of cyber-related incidents. For example, a cyber insurance policy may afford coverage for claims that a policyholder failed to properly safeguard a third-party's IP that was in its possession. Thus, costs or expenses that the policyholder incurs to determine the source or extent of a theft of a third-party's IP, as well as any damages arising from the theft of the third-party's IP, could potentially be covered. Cyber insurance policies would not, however, afford coverage for allegations that the policyholder's patents infringe upon those of a third-party. Moreover, this coverage most often applies in the multimedia context and is similar in scope to some of the coverage afforded under a media liability policy.

Intellectual Property Liability Insurance

The insurance market is now responding to these typical "gaps" in coverage for IP exposures—like it did for gaps in coverage for other unique exposures such as environmental and cyber insurance —by offering commercially viable IP policies tailored to the unique aspects of an insured's IP risks. Not surprisingly, there are many types of IP policies with a wide variety of coverage terms.

These IP policies are customized to provide worldwide protection for a company's unique products and services as well as its valuable intellectual property portfolio. Recognizing the requirements and concerns of each potential insured, experienced insurers can manuscript policies to respond to third party lawsuits and proceedings alleging IP infringement, third-party indemnification claims under licenses or other agreements relating to IP, as well as invalidation proceedings brought before a court or administrative agency. IP Insurance policies are further designed to reimburse the policyholder for any incurred defense costs as well as payment of a damage award or settlement amount on a "claims-made" basis. The coverage is renewable annually allowing the policyholder to modify coverage to incorporate any new IP or products or services offered by the company.

The following summarizes some of the different types of IP policies which may be available in today's market.

1. **Defense and Indemnity Policy:** The most common type of IP policy covers defense costs, settlements and judgments incurred by the Insured in IP claims against the Insured. These policies frequently include coverage for a broad range of intellectual property infringements, although policies may exclude patent infringement. Other important exclusions apply to willful infringements or potential infringements that the Insured had reason to expect at the time the policy incepts.

2. **Patent Infringement Policy:** Coverage for settlements and judgments in claims alleging patent infringement are offered by only a small group of specialized insurers with unique expertise in this area. The underwriting process for such a policy is time consuming and expensive, and the coverage frequently applies only with respect to certain listed patents. Further, policies can be designed to limit coverage to claims brought by non-practicing entities.

3. **Enforcement (aka Abatement, Offensive, Pursuit) Policy:** Some IP policies include coverage for the Insured's costs as a plaintiff to enforce the Insured's intellectual property rights against alleged infringers. The types of intellectual property infringements covered under this type of policy can be relatively broad, including patent infringement. However, like a patent policy, the underwriting process is typically time consuming and the premium can be relatively large.

Conclusion

With the rise in global IP enforcement and costs associated therewith, an IP dispute can curtail or impede a company's growth or necessitate a redesign of its products. This is particularly true for technology companies facing threats of litigation from non-practicing entities. However, when utilized appropriately, IP Insurance can provide the policyholder an ease of mind and a distinct advantage in cost-efficiently managing risks from unforeseeable third-party threats and lawsuits.

When evaluating and purchasing an IP policy, it is critical that the company work with a knowledgeable broker who is familiar with the IP insurance products on the market. It is also important that the risk managers themselves understand the scope of insurance that can be purchased under an IP insurance policy. In years past, it was not unusual for an IP policy to only afford coverage when the insured prevailed in IP litigation. Today, however, there is a variety of coverages available from defending against a notice of infringement to affirmatively challenging a third party's IP application or registration process. Thus, when considering proposals for IP insurance, it is vital that a company consider the scope of coverage and whether, for example, it includes coverage for any requests from a licensee for indemnification in connection with an infringement claim. As insurers have gained expertise in this area they are now better positioned to provide a specific product, in a timely manner, that meets a company's IP risk transfer needs.

Ambridge Partners LLC
520 Eighth Avenue, 25th Floor
New York, NY 10018
t.212.871.5400
f.212.947.1838
www.ambridgepartners.com

Ambridge Insurance Solutions West, LLC
One Market Street, Spear Tower
36th Floor, Suite 3639
San Francisco, CA 94105
t.415.249.0270

Ambridge Europe Limited
77 Cornhill, 5th Floor
London EC3V 3QQ
t.+44 (0)20 3874 0050
f.+44 (0)20 3727 0824
www.ambridgeeurope.com