



***The 411 on What, Why, Who, Where, When,
How, How Much, and How to Use
Intellectual Property Insurance***

***Dallas Bar Association
IP Section Meeting***

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Setting Expectations



- *The focus of this presentation*
 - We will not focus on trademark, copyright, or trade secret coverage
 - *Trademark infringement coverage is usually easier to obtain and is generally less expensive*
 - *Copyright infringement coverage is sometimes easier to obtain, but is more difficult to obtain for software copyright infringement*
 - *It is very unusual to convince a carrier to underwrite theft of trade secret because damages are so difficult to quantify*
 - Today, we'll focus on commercially available patent infringement coverage, with some mention of alternatives to commercially available coverage
- *The US intellectual property insurance market, especially for patent insurance, is an immature and under-developed market without a consistent underwriting model and with limited options and limited capacity*

Setting Expectations: That Was Then (Late 1990s)

- *Stand-alone blanket patent infringement liability coverage was available, with retentions of \$250K or less, and limits of \$5-10 million for premiums that were 3% of the policy limits*
- *Stand-alone patent enforcement coverage was available, with retentions of \$50,000 or less and limits of \$2-7 million for premiums that were 3% of the policy limits*
- *Some patent coverage was added to D&O and E&O policies as an additional covered peril*
- *Some coverage was triggered under the advertising injury clause of the old CGL policy form*
- *AIG and Chubb experienced high loss ratios on their patent infringement books*
- *Lloyd's did well on its patent infringement book, but it was a small book, and was overshadowed by Lloyd's high loss ratio on its patent enforcement book*

Setting Expectations: This Is Now

- IPISC (MGA for Gotham Insurance) - Bob Fletcher; www.ipisc.com
 - *For patent infringement coverage, will write only single products for up to \$3 million in limits (may go up to \$5 million)*
 - *For patent enforcement coverage, will write only “no-known” enforcement policies for up to \$3 million (may go up to \$5 million)*
 - *Provides “multi-peril” coverage for named perils such as business interruption costs due to patent infringement litigation and loss in IP value (\$1 million per peril)*
- Swiss Re and AIG
 - *May offer catastrophic patent infringement coverage above a \$25 million retention*
 - *Must have other lines of coverage with Swiss Re and coverage is limited to \$25 million*
- Ambridge Partners and The Hartford Specialty may write deal-specific patent infringement coverage and may write “excess” patent enforcement coverage
- Kiln offers first party patent coverage to insure the value of the patent asset and/or licensing stream - Matthew Hogg; www.4continuity.com.
- The Lloyd’s insurance market offers worldwide infringement and enforcement coverage for non-US domiciled companies with enforcement coverage up to \$4 million and with infringement coverage up to \$20 million in excess of \$5 million or lower limits above a smaller deductible - Ian Lewis; www.miller-insurance.com; this may be broadened to include US-domiciled companies in 2006
- The Lloyd’s insurance market is expected to begin offering patent infringement coverage to US providers of open source software through OSRM in the next month or so - www.osriskmanagement.com
- The Lloyd’s insurance market recently began offering a unique reps and warranties insurance product for providers of proprietary software against claims of open source license violations

What: First Identify The Intellectual Property Risk That Your Client Wants to Transfer



- *You don't want to put your malpractice carrier on notice because you advised your client to purchase patent enforcement coverage when the client should have purchased patent infringement coverage*
 - Patent enforcement/protection/offensive coverage - covers litigation costs of the patent holder to sue to enforce patent holder's IP against infringer
 - Patent infringement/defensive coverage - covers litigation costs to defend against claims of infringement and any damages owed to patent holder for past infringement
 - Also note the distinction between first party property coverage and third party liability coverage
- *Many of the IP insurance products are named-peril, specialty line coverages*
 - Although, some carriers are continuing to offer IP infringement as a covered peril in addition to E&O perils
- *The perils that can be covered:*
 - First-party coverage for damage to the value of the IP (invalidity, title dispute, compulsory licensing)
 - First-party coverage for litigation costs relating to enforcement of the IP
 - Third-party coverage for litigation costs relating to defending against claims of IP infringement
 - Third-party coverage for past damages for IP infringement (indemnity)
 - Contracts requiring coverage of others' risk, i.e. IP indemnification provided to a customer

	LITIGATION COSTS	IMPACT
Business: IP Owner Legal: Plaintiff Risk Management: 1 st Party	1. ENFORCEMENT EXPENSES	2. LOSS OF POSITION/VALUE
Business: Alleged Infringer Legal: Defendant Risk Management: 3 rd Party	3. COST OF DEFENSE	4. DAMAGES/INJUNCTION
5. TITLE	COSTS TO SECURE/DEFEND	LOSS OR IMPAIRMENT OF TITLE

Why: Understand Why Your Client Wants the Coverage and Determine Whether It's an Insurable/Fortuitous Risk



- *Insurance is intended to cover fortuitous risk*
 - Not intended to cover business risk
 - Not intended to cover the “house that’s already burning”
- *Help your client seek appropriate coverage and tailor that coverage to the risk*
- *Determine whether your client has coverage under existing policies*
 - Cyber liability: limited to web site activity
 - Media policy: provides some IP cover related to publishing, broadcasting, advertising, marketing, and promotional activities, and packaging; generally no coverage for software copyright infringement or utility patent infringement
 - Professional services: Tech E&O
 - CGL advertising injury clause: new CGL forms provide extremely limited to no coverage
- *Determine whether there is a way to invoke coverage under existing policies*
 - Carefully crafted pleadings and discovery
- *Encourage your client to be flexible and creative*
- *Encourage your client to conduct a cost/benefit analysis*
- ***Remember, IP insurance is a risk management tool, not the risk management tool - It should be part of an overall IP risk management plan.***

Who: Identify Available Insurance Markets and Types of Patent Coverage They Offer



Types of Coverage	Available Markets
1. Enforcement: Litigation Costs (First-Party Property Protection Exposure) <ul style="list-style-type: none"> ▪ Primary ▪ Excess 	<ul style="list-style-type: none"> ▪ IPISC (MGA for Gotham) up to \$3 million primary only for “no known” (may go up to \$5 million) ▪ Ambridge Partners, The Hartford Specialty for excess ▪ Lloyd’s facility through Miller up to \$4 million primary (non-US domiciled companies only)
2. Loss of Position/Value/Revenue (First-Party Property Impairment Exposure)	<ul style="list-style-type: none"> ▪ Kiln (Lloyd’s) up to \$37 million ▪ IPISC up to \$1 million
3. Infringement: Costs of Defense (Third-Party Liability Defense Exposure)	<ul style="list-style-type: none"> ▪ AIG (at least \$100 million in revenue), but not actively marketing ▪ Chubb (no patent) ▪ IPISC up to \$3 million (sometimes up to \$5 million) ▪ The Hartford Specialty and Ambridge Partners on deal-specific basis
4. Infringement: Costs of Damages (Third-Party Liability Exposure)	<ul style="list-style-type: none"> ▪ Swiss Re (\$25 million above \$25 million retention) ▪ Lloyd’s (non-US domiciled companies only) ▪ Allianz (primarily German coverage) ▪ Quanta (on excess basis)
4’. LBO/FRS: Capping of Litigation Costs and/or Damages (Third-Party Known Liability Exposures)	<ul style="list-style-type: none"> ▪ AIG (may not offer any longer) ▪ The Hartford Specialty ▪ Ambridge Partners ▪ Lloyd’s?
5. Title: Title Impairment Costs, Legal Expenses (First-Party Property & Third-Party Liability Exposure)	<ul style="list-style-type: none"> ▪ Lloyd’s?

Where: Know the Geographic Area that Your Client Needs to Have Covered

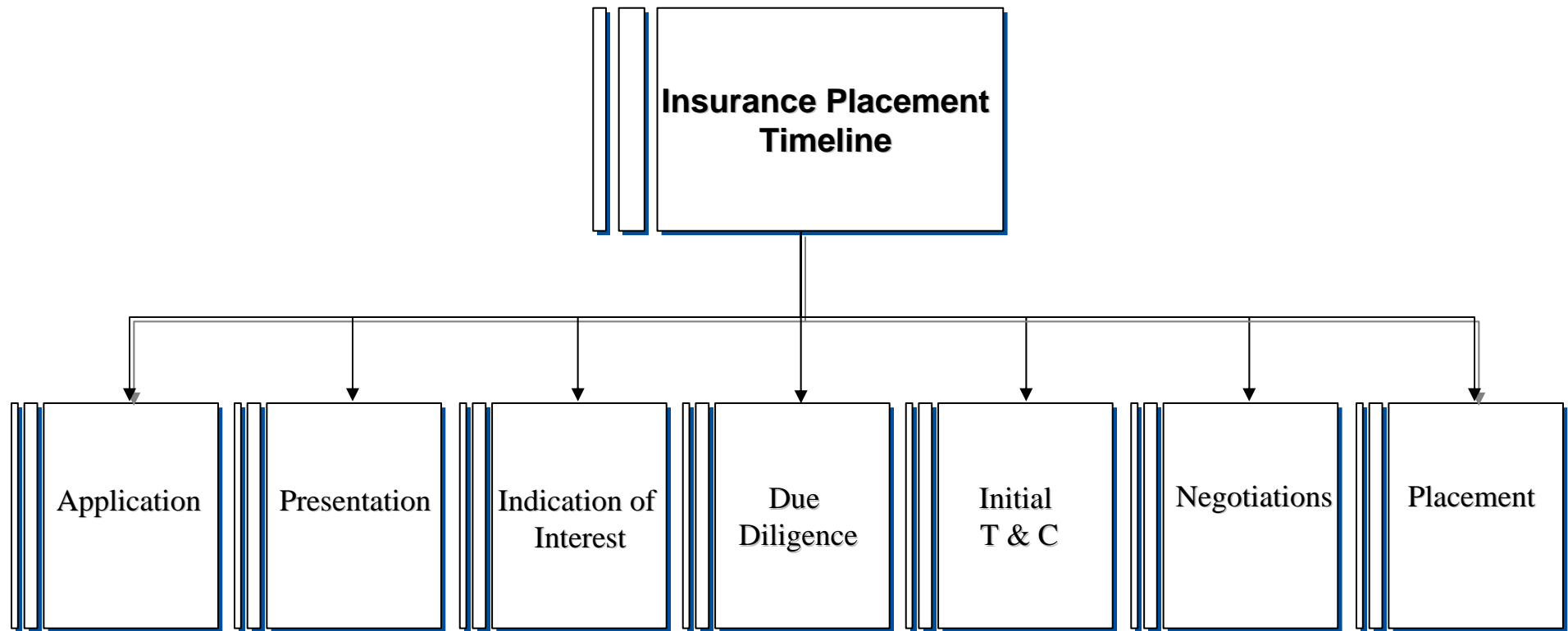


- *Where is the IP located?*
- *Where is product being made, used, offered for sale, sold?*
- *Be careful: this is another potential malpractice area*

When: Timing is Everything

- *Just like you can't buy homeowners insurance if your house is on fire, your client is not going to get coverage if the client waits until they are involved in litigation*
- *Don't wait until the deal is closing to purchase IP indemnification or reps and warranties coverage*
- *Help your client determine if the client is "risk transfer ready:" IP insurance is not likely to be an option without a demonstration of an effective IP risk management plan*

When: Timing is Everything (cont'd.)



How: Placing IP Insurance Requires Time, Money, and Effort on Both the Potential Insured and Insurer Sides



- *Don't expect uniformity or consistency in the application form, the underwriting process, the policy form, the claims process, or the pricing*
- *On the plus side, these are highly manuscripts policies leaving room to negotiate terms and conditions advantageous to your client*
- *Example IP risk inflators*
 - Client doesn't know if it owns any IP
 - Client does not own IP of its own or has not licensed in IP to protect products' key market differentiators
 - Client has received "offer to license" letters
 - Client has already been involved in patent litigation (could also be a risk deflator)
 - Client is in the technology, medical device, pharmaceutical, or biotech industries
 - Client is a threat to the market leader and the market leader owns a large IP portfolio
 - Client seeks insurance to stand behind IP indemnification to large, high profile customer
 - Client not indemnified by its vendors
 - Client takes the "what I don't know can't hurt me" approach to IP infringement due diligence

How: Avoid Malpractice by Understanding the Key Terms and Conditions

- *Who and what is covered*
- *Exclusions*
- *Claims-made versus occurrence*
- *Prior acts*
- *Selection of counsel*
- *Settlement consent*
- *Litigation costs + damages*
- *Coinsurance*
- *Retention/deductible*

IP Coverage: What to Look For

- *Who is covered:*

- Depending on the nature of the transaction and the risk being covered, it may be important for the licensee, licensor, sublicensees, distributors, or customers to be insureds or additional insureds.

- *What is covered:*

- Peril 1: What types of litigation costs are covered, i.e. assertion of IP rights, defense against declaratory judgment actions and standard counterclaims such as invalidity, reexamination or interference proceedings in the USPTO, arbitration, appeals? How is the IP to be enforced defined?
- Peril 2: Is there a formula for how the lost licensing revenue will be discounted? Will the lost value be pre-calculated?
- Perils 3 & 4: Is it for blanket coverage? Certain product lines? Only certain types of infringement? To stand behind an indemnification provision? Is it for both legal expenses and damages?

IP Coverage: What to Look For

- *What is not covered (exclusions): Fraudulent, willful, dishonest, or criminal acts are generally excluded, as are damages resulting from such acts; trade secret coverage is often excluded because it is so difficult to quantify.*
 - *Note: the cost of a going-forward license is not covered*
- *Prior acts coverage: The policy may not cover prior acts. Note carefully how prior acts are defined because a broad prior acts exclusion can effectively gut coverage. Also, enforcement policies are sometimes limited to “no known infringement” coverage.*
- *Coverage territory: Depending on the nature of the transaction and on the IP involved, you may need coverage beyond the US or coverage other than US coverage.*
- *Claims made v. occurrence: Most IP policy forms are claims made meaning that the claim must be made within the policy period.*

IP Coverage: What To Look For

- *Underwriting Process: The underwriting process and the information required varies from carrier to carrier and depends on the peril(s) to be covered. Insurers are cautious about writing IP coverage and therefore tend to require more information and to require that potential insureds bear the cost of due diligence. Certain safeguards should be put into place to protect the information being provided from being discoverable.*
- *Claims Process: Note carefully what “claim” is defined to include. Also, make sure the policy is clear about how coverage is “triggered.” For example, for enforcement policies, the insured’s counsel may need to provide claim charts, and the insurer may require some type of evaluation of the claim. For defensive policies, the insurer may require an opinion of non-infringement. As with the underwriting process, certain safeguards should be put into place to protect the information being provided from being discoverable.*

IP Coverage: What To Look For

- *Selection of Counsel: In many cases, the insured selects counsel, although the selection may be limited to selection from an approved panel or to counsel meeting certain criteria, or selection may be subject to carrier approval.*
- *Settlement Consent: In many cases, the carrier cannot settle without the insured's consent.*

Outline of Terms for Typical IP Infringement Policy



- *Declarations*
- *Insuring Agreement*
 - Coverage
 - Defense and Settlement
- *Persons Insured*
- *Territory*
- *Exclusions*
- *Definitions*
- *Limit of Liability*
- *Deductible*
- *Extended Reporting Endorsement*
- *Other Insurance*
- *Notice of Claim or Circumstance that Might Lead to a Claim*
- *Assistance and Cooperation of the Insured*
- *Action against the Insurer*
- *Subrogation*
- *Changes*
- *Material Changes*
- *Assignment*
- *Cancellation*
- *War Exclusion Clause*
- *Service of Suit*

How Much: Make Sure Your Client Purchases Sufficient Limits

- *Expect that the client will have to pay due diligence costs of at least \$10,000 in most cases*
- *Expect to pay insurance broker fees and/or commissions and possibly insurance consultant fees*
- *Expect premiums ranging from 1%-10% of the policy limit (most often in the 5-10% range)*
- *Because of capacity constraints, it may take several carriers or alternative structures to build and carry sufficient limits*
 - Layered program design
 - Quota share program design
 - Captive or other form of self-insurance as first layer
 - Integrated insurance program
- *Tips for reducing the costs*
 - Take a higher deductible
 - Have your IP house in order
 - Narrow the scope of the coverage

How to Use: Help Your Client Analyze Whether Obtaining IP Coverage Makes Sense



- *To provide leverage in deals*
- *To protect investment*
- *To protect IP assets*
- *To use in litigation planning*
- *In allocating VC \$\$*
- *As a customer incentive*
- *As part of an overall IP risk management plan*

Coverage behind IP indemnification:

- *Narrow the scope of or otherwise limit the indemnification*
- *Identify, assess, and quantify the risk and determine whether it would be material*
- *Conduct heightened due diligence on the customer*
- *Determine whether insurance is an affordable option and, if not, determine other ways to manage, finance, or transfer the risk*
- *Determine whether the client has similarly situated customers that may also require indemnification and whether an indemnification or warranty program makes sense*

Thank you!



Kimberly Klein Cauthorn

Phone: (713) 276-8627

kcauthorn@krollworldwide.com