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DEVOTED TO INTELLECTUAL PROPERTY LITIGATION & ENFORCEMENT

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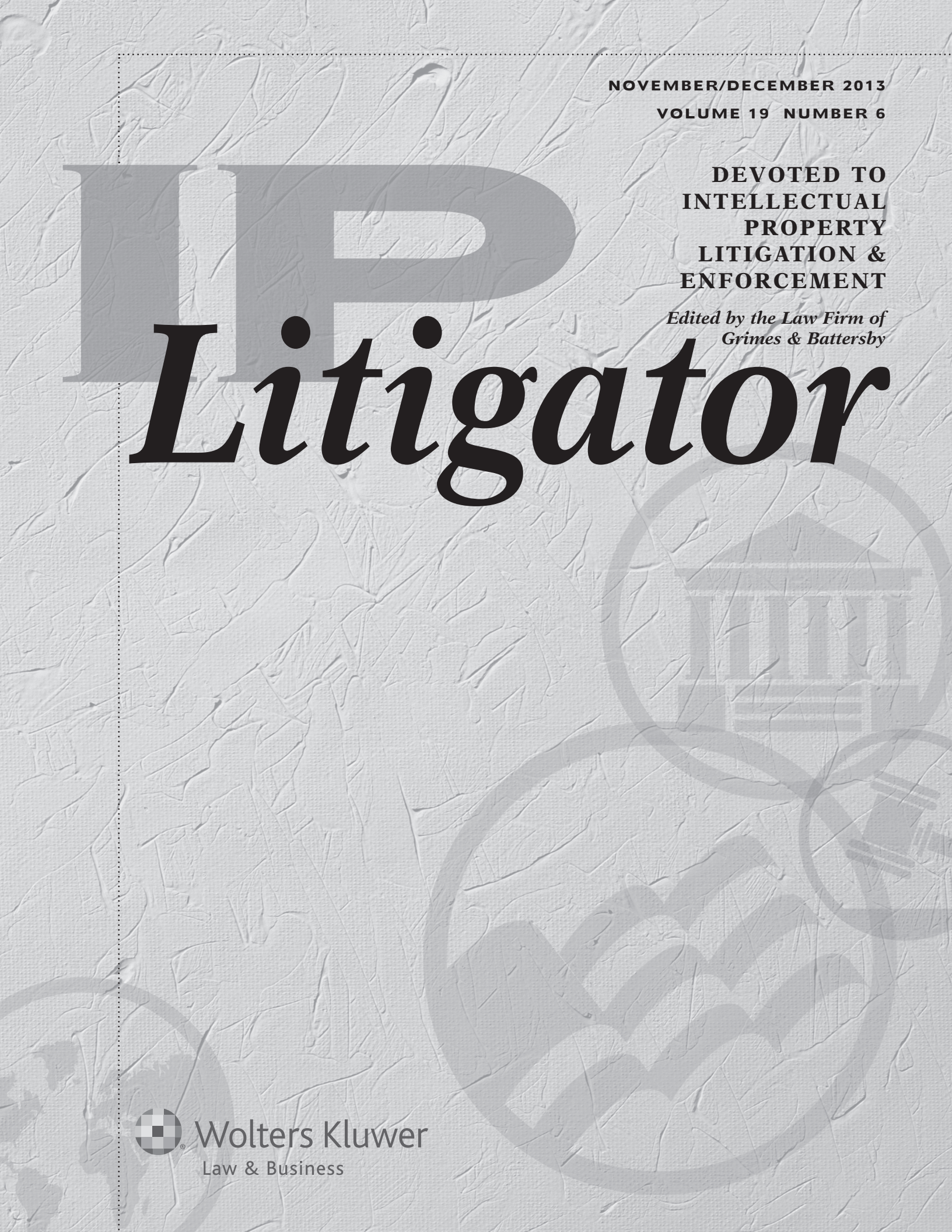

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Law & Business

Managing Risk with IP Insurance

Robert Fletcher

Robert Fletcher is the president and founder of Intellectual Property Insurance Services Corporation (IPISC), the worldwide leading provider of intellectual property (IP) insurance. Under Mr. Fletcher's direction, IPISC serves as the program manager for IP risks. In addition to founding IPISC over 23 years ago, Mr. Fletcher has more than 40 years of experience as a patent attorney and has played a lead role in conceiving and developing IP infringement abatement insurance. Mr. Fletcher holds degrees in chemical engineering and law from the University of Wisconsin and an MBA from the University of Louisville.

When a company takes into account their most important asset, its financial driver, more often than not the resounding logic is its intellectual property (IP). Companies rely on IP rights, made up of patents, copyrights, trademarks, and trade secret laws, to foster a competitive advantage and to keep it viable in an ever-changing, competitive economy.

A recent US government study concluded that IP-focused industries sustain an average of 35 percent of the US economy, affirming that it is ideas, intellectual property, that supports companies' economic success. On a daily basis, the value of IP to the global economy is reaffirmed by the number of patent lawsuits filed in the US Federal Courts. In 2012, there were 5,835 patent lawsuits filed, not including trademark, copyright, or trade secret lawsuits. The US courts have already seen 5,047 patent lawsuits filed in 2013, furthering the evidence that IP litigation is actually increasing, not decreasing. Patent infringement lawsuits have more than doubled over the past five years.[1] Keep in mind that these are patent infringement statistics only, and do not take into consideration copyright, trademark or trade secret suits filed. (*See* Exhibit 1.)

One does not have to be reminded of the havoc being brought by a vast majority of non-practicing entities (NPEs), or "patent trolls" if you like. Nearly 62 percent of all patent lawsuits are filed by patent trolls, accordingly outpacing legitimate practicing entities in total damages[2] awarded over the past several years. (*See* Exhibit 2.) No company is immune to charges of infringement brought by patent trolls. No longer are those operating in the patent-abundant industries of computer hardware, electronics, business and/or consumer industries the only ones affected by patent trolls. In fact, the reach of patent trolls is much greater, having infiltrated many other non-technology sectors of the economy such as retailers, digital advertising agencies, restaurants, supermarkets, the gaming industry, and hotel chains. Whit Askew, the American Gaming Association's vice president of government affairs, was recently quoted in a *Washington Post* article[3] as saying, "It's important to recognize that the problem of patent trolls is no longer limited to technology companies."

Patent litigation brought by patent trolls isn't cheap either. While the majority of patent troll-generated patent cases are settled before they go to trial, they are nonetheless expensive. The 2013 American Intellectual Property Law Association's (AIPLA) survey[4] (*see* Exhibit 3) reported that when $1–$10 million in damages is at stake, it costs on average $988K to merely get through the discovery phase of patent litigation when defending against patent trolls.

Joseph Mandour, Managing Partner and IP Attorney, of Mandour & Associates in Los Angeles, CA, cites a recent study from Boston University claiming, patent trolls cost US companies an incredible $29 billion in damages and fees per year. The study revealed that small- and medium-sized companies bear most of the cost burden for patent litigation. Mandour goes on to say, "Small businesses are the hardest hit because they typically do not have as much funding to devote to expensive litigation."[5]

Also, patent trolls, as well as "grasshoppers" regularly force companies into complex, intellectual property proceedings. These two types of entities have completely different methods of operation. While the patent troll accumulates patents to assert in an effort to collect royalties, the grasshoppers aggressively pursue successful products and duplicates them, with no regard to intellectual property rights, to take market share away from the legitimate inventor.

Though operating differently, they both wreak havoc with their disagreeable business practices. Generally, patent trolls do not make a product; they simply accumulate a portfolio of patent rights with the sole objective of targeting smaller companies who are unable to pay patent litigation defense costs, consequently forcing them into signing license agreements and paying royalties. Patent trolls are notorious for suing companies with the sole

Exhibit 1

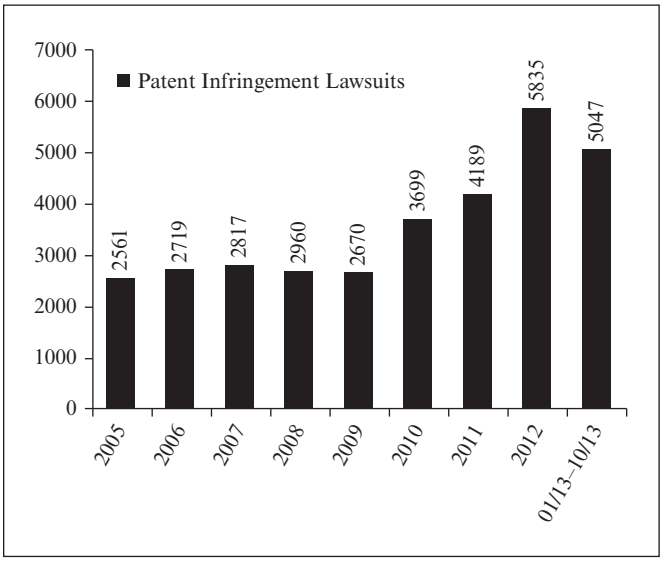
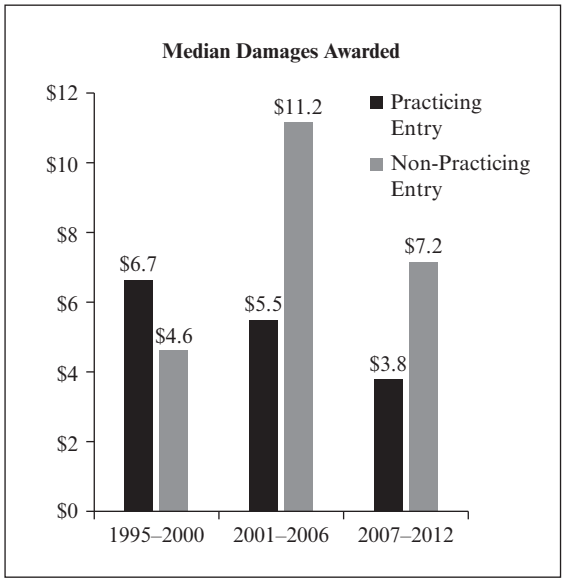


Exhibit 2



objective of extricating royalties, often irrespective of the lawsuit's merits.

Grasshoppers may sound harmless enough, but in the world of innovative, patented products, they are becoming a dreaded plague. The term "grasshopper," created by Chief Judge Randall Rader of the US Court of Appeals, refers to entities that leap in and practice an invention, knowing that the under-funded patent holder does not have the money to successfully enforce the patents against the party trying to imitate the claims of the patent.

Effect of IP Litigation on Companies

The toll that IP litigation can take on a company's time and bank account is very real. To again reference the 2013 AIPLA Survey, the average cost to litigate a patent lawsuit in the United States is $2.8 million (*see* Exhibit 4) when the amount in controversy is between $1 million and $25 million dollars. These numbers do not include damages in the event of an unsuccessful defense, which can average $4 million dollars.

Most do not have sufficient contingency funds or borrowing capability to absorb the cost of IP litigation. Companies owning significant breakthrough technologies put forth much more than just hard work and creativity; they also generate strong and sizable budgets to pay for experimentation, prototyping, product development, patent drafting, and prosecution. Many also fail to understand that the simple act of doing business, regardless of having any IP rights, puts them at risk for becoming involved in IP litigation, regardless of the level of due diligence taken to ensure non-infringement.

Exhibit 3

2013 AIPLA Survey Average Costs Patent Litigation—Defending against Patent Trolls		
Amount in Controversy	**End of Discovery**	**Through Trial**
< $1M	$516K	$820K
$1M–$10M	$988K	$1.6M
$1M–$25M	$1.3M	$2.0M
$10M–$25M	$1.7M	$2.0M
>$25M	$2.9M	$4.4M

Exhibit 4

2013 AIPLA Survey Average Costs Patent Litigation		
Amount in Controversy	**End of Discovery**	**Through Trial**
< $1M	$530K	$970K
$1M–$10M	$1.2M	$2.1M
$1M–$25M	$1.7M	$2.8M
$10M–$25M	$2.2M	$3.6M
>$25M	$3.6M	$5.9M

However, many companies often fail to plan for, or even consider, the cost associated with defending their current operations or enforcing their IP rights. Nor do they consider the effect that ensuing litigation can have on the company's future profitability or viability. Because of those shortcomings in planning, the cost of IP litigation reduces many patent holders to marginal profitability while owning an expensive, but ultimately worthless, asset.

Structuring a Company's IP Risk Management Plan

Intellectual Property often is an organization's most valuable asset, yet it also often is seriously neglected during professional IP risk management evaluations and reviews. As part of structuring an IP risk management plan, it is important to understand what a company's IP portfolio looks like or what products/services they currently are producing or offering. Knowledge of annual enforcement and defense costs should be developed. Also, potential IP litigation exposures, offensive or defensive, must be vetted, planned for, and understood by all involved parties in order to avert and/or prepare for potential IP litigation that may be foreseen or anticipated.

It is important to remember that every organization that is making, using, importing, selling, or offering for sale most goods or services in commerce is vulnerable to charges of IP infringement. Likewise, companies or organizations owning rights in patents, trademarks, copyrights, or trade secrets have the potential to be infringed on. For these entities, a critical part of protecting market share is to take steps to insure against infringement of their IP rights. IP can be a double-edged sword, because it can be used toward the good of a company, or against it. But without the funding to help protect a company against predatory business practices involving IP litigation and/or infringement, companies suffer the consequences of inadequate financial and insurance planning. The planning begins by recognition and assessment of a company's IP enforcement and defense risk.

The Solution: IP Insurance

It is imperative that companies have a comprehensive understanding of the exposure that that they have, and then properly manage these risks through appropriate IP-specific insurance products. These products have been available through a small number of insurance markets in the United States since 1989. IP insurance is the only risk management solution that offers an alternative source for litigation expense, given the unwillingness of litigating firms to accept an IP litigation case on contingency, whether offensively or defensively, without the certainty of high damages to their client. It also is the only risk management solution that fills the coverage gap left as a result of restrictive changes in commercial insurance policy forms over the past couple of decades. Many companies, insurance and legal professionals alike, are under the false assumption that coverage for IP infringement is comprised within some of the various commercial policies. This assumption is simply not accurate. Coverage gaps for IP risks exist in the following, typically-purchased commercial liability insurance policies:

1. **Commercial General Liability (CGL).** Narrowly limited patent coverage, if any, to "Advertising Injury"—patent must have claims directed to the way the product or service is actually advertised.
   - broader coverage may be available for trademark and copyright risks under old forms.
   - 2001 edition made additional modifications to limit IP claims provided some copyright coverage; however, it specifically removed copyright coverage for software explicitly removed trademark coverage for Meta Tag infringement.
2. **Errors & Omissions (E&O).** No coverage for patents, sketchy coverage may be available under some older policy forms for trademark and copyright, though generally excluded.
3. **Directors & Officers (D&O).** No coverage for IP risk generally; only protects against officers personally sued by company, not infringement litigation expenses or damages.
4. **Professional Liability.** Limited coverage if a professional has given advice or has provided services that are a direct cause of the infringement allegations.
5. **Media Liability.** Some coverage for trademark and copyright infringement may be available in some areas, such as content distributors and producers of multi-media content.
6. **Cyber Liability.** Liability coverage for security or privacy breaches. May include liability associated with libel, slander, copyright infringement, product disparagement, or reputational damage to others when allegations involve a business Web site, social media, or print media.[6]

It is important for legal professionals to embrace and recommend their clients secure an IP-specific insurance policy to transfer their IP risk. Not only is it a duty to recommend to one's clients, but it also is an obligation that companies have to their shareholders, to preserve assets and make additional revenue streams available. As more businesses suffer financial loss as a result of IP

exposure, the word is spreading that insurance is available to cover these risks.

Company Size and Organization Type Determines Coverage

Company size many times is a driving factor in the type of IP insurance coverage needed. That is not to say that each company of the same size has the same concerns or needs, though. Therefore, it is important to know the audience and target the questions accordingly to assess the most applicable policy.

Entrepreneurs, Start-Ups, and Small Companies

Entrepreneurs, start-ups, and small companies have limited revenue, and might have only one or a few issued patents that cover a product or a service representing an important portion of their business. These companies need IP insurance products to protect their market share, deter frivolous infringement charges, and to free up their working capital to be used for expansion and growth rather than litigation.

IP insurance also enables these entities to meet contractual IP indemnification obligations to carry insurance, which larger suppliers or retailers might require, or to satisfy the UCC warranty of non-infringement to customers, by including these parties as additional insureds on the policy. Also, IP insurance can be written to cover an entity against infringement by its own licensees. IP insurance evens the playing field when a small company faces better-funded competitors, ensuring the outcome of litigation is based on the merits of a case, rather than ruled by the party with the best funding.

Mid-Sized Companies

Compared to small companies, mid-sized companies tend to offer a wider array of products and/or services, and through experience have developed particular methods of how to perform the business operations. Nevertheless, in building the business, they might not have obtained patent protection on every aspect of what they do. Mid-sized companies generally use IP insurance as a means to transfer enforcement expense of their IP, to avoid exhausting working capital needed to support and expand operations. They also use IP insurance to deter frivolous infringement charges, and to fill contractual IP indemnification obligations. These companies are likely to purchase both IP enforcement and IP defense policies.

Large Companies

Very large entities tend to purchase high-limit, high self-insured retention coverage to thwart the risk of unforeseen damages. They have a team of in-house and outside attorneys that handle all of their litigation, and they have developed very specific litigation and settlement philosophies. Sometimes, these companies pass litigation expense through to other affiliates by requiring indemnification against IP litigation in their contracts. They require their affiliates carry insurance, in order to ensure that the affiliate can provide the agreed-on indemnification, should an IP lawsuit develop.

All Companies

All companies are at risk of being accused of infringement. As a result of the loss of an IP lawsuit, companies may experience business interruption, lose their commercial advantage, or incur expenses for redesign, remediation, or reparations. Coverage under a multi-peril policy ensures that the party damaged by the loss of the insured IP lawsuit is made whole and is able to get back into the market with a competing product as soon as possible.

It is important to be aware of and recommend the right insurance protection. Assessing companies' IP risk, and ensuring they have the right protection in place for this potentially costly exposure, is essential to a company's overall financial survival. The inability to protect IP is a leading cause of failure for companies and organizations. However, these failures could be avoided by purchasing specialized IP insurance products and services.

Available IP Insurance Products and Services

IP is an increasingly popular insurance. Without insurance funds to help pay for the litigation expense associated with an IP case, IP simply represents a "ticket to the courtroom." Winning depends on funding. IP insurance has been available in the United States since 1989 to help the insured sustain an IP lawsuit addressing the merits of the case.

General policy terms include:

- Standard policy limits available up to $5 million (USD), higher limits may be available;
- Policy terms available up to 3 years;
- Worldwide territory coverage available;
- Multi-peril coverage of $50K or 10 percent of policy limits, whichever is less, included with some IP policies;

- SIR—2.5 percent of Policy limits (minimum), (MPIP—$0 SIR);
- Co-pay—20 percent (minimum), (MPIP—20 percent).

The IP insurance policies discussed below are available in the United States and worldwide.

Enforcement Insurance

Enforcement insurance (often times referred to as Abatement insurance) is a unique insurance solution to help an insured enforce its IP rights against alleged infringers. Securing an IP enforcement policy increases the value of the insured IP by signaling to would-be infringers that a third party (insurance company) is willing to assume much of the financial risk of enforcing the IP rights. Thus, the underwriting due diligence alone helps validate the IP's value, validity, and enforceability. The policy is designed to help enforce the client's IP rights against infringers who often are larger and/or better equipped financially to withstand costly litigation. It also covers expenses associated with invalidity counterclaims made by an alleged infringer, as well as costs associated with post-grant and reexamination proceedings.

Defense Insurance

Defense insurance fills the coverage gap that has been created by IP exclusions in commercial and professional general liability insurance. The policy is for any company making, using selling, offering for sale, or importing goods and/or services in commerce. Basically, all companies have this risk exposure. The defense policy provides the much needed funds to defend against charges of infringing IP rights. Often times the Defense policy deters frivolous infringement brought by patent trolls or competitors who want to gain an economic advantage by filing a frivolous suit. Defense policies fund the costs associated with attempting to invalidate the accuser's patent(s), as well as costs associated with post-grant and reexamination proceedings.

Multi-Peril Insurance

Multi-Peril insurance is a first-party risk management tool that addresses the consequences associated with loss of an IP infringement lawsuit. The policy helps the insured rebuild after a devastating loss of an IP action. Multi-Peril insurance pays the affected insured, the first party, should they suffer a business interruption, loss of commercial advantage or be forced to redesign, remediate, or make reparations. The loss of a civil proceeding triggers coverage. At least one IP insurance company automatically includes some level of Multi-Peril coverage alongside their standard IP insurance policies.

Unauthorized Disclosure

Unauthorized disclosure insurance is a risk management strategy for those entrusted with third party, confidential information. The policy offers those entrusted with others confidential information or personal identifier information, the financial means to defend themselves against disclosure allegations. Unauthorized Disclosure insurance offers a blend of coverage for unauthorized disclosure activities corresponding to differing disclosure circumstances. As such, it has elements of pure insurance, a bond, and a blend of insurance and a bond. Because of these elements, a variety of employee disclosures can be addressed.

Litigation Management Services

Litigation Management Services, available through some IP insurance providers, assist clients and insureds in managing their legal fees and costs associated with IP litigation. These services alone often save insureds more money than they paid for their insurance policy. Professionals are available to help monitor and ensure that counsel adheres to pre-negotiated billing rates and guidelines, making certain that legal expenses are case-driven. This collaboration significantly contributes to the efficiency of the litigation, and money savings to the client. Litigation management services also facilitate reliable and expedient payments to litigating counsel.

Bottomline Benefits of IP Insurance

- Policies respond quickly to help fund the high cost and consequences of IP litigation.
- Defense coverage can be scheduled to defend against specific patents, products, services, and/or methods of doing business.
- Enforcement coverage can be scheduled to enforce patent, trademark, copyright, and trade secret rights against infringers.
- Allows all companies, regardless of size, to afford litigation based on the merits of the case.
- Insured products and/or IP become more valuable.
- Reduces the need to rely on investor or owner assets to operate.
- Facilitates quicker access to financial backing for start-ups and entrepreneurs.
- Litigation Management Services contribute significantly to efficient use of litigation funds, money savings to the client, and quicker, more reliable payment of litigating counsel's invoices.

Intellectual Property Counsel—Why IP Insurance Does, and Should Matter

Even though IP insurance has been available since 1989, some IP counsel have been cautious about recommending their clients to obtain IP insurance. This may be due to a misunderstanding of the availability of coverage, or uncertainty about whether counsel would be approved to represent the client in litigation.

A growing number of litigating attorneys are realizing the high value of IP insurance to their clients, and also to themselves. The need for IP insurance is increasing in response to the frequency and severity of patent litigation. IP insurance coverage is affordable and timely, benefiting both the client and counsel.

Rudy Telscher[7] of Harness Dickey & Pierce understands first-hand the benefits of IP insurance to litigating counsel and their clients. Mr. Telscher is lead counsel for Octane Fitness on the *Icon Health and Fitness v. Octane Fitness* case, which is now before the US Supreme Court. Telscher said, "Icon asserted this patent against a much smaller, yet successful competitor. It was undisputed that the invention disclosed in Icon's patent did not work and was never commercialized. If not for the insurance, Octane would have likely been forced to pay a 7–8 percent royalty, which is what Icon sought." Even though Octane proved the victor, the courts did not award attorney fees to the defendant, Octane. "Thus, without insurance, Octane would have had to have endured this long battle, and bear $1.7 million in [litigation] fees, assuming that it had that money to spend in the first instance. Without insurance, this would have been a disaster. This is really a poster child case illustrating why IP insurance is essential."

Octane also admits that without insurance, it could not have afforded to defend this lawsuit. Dennis Lee, President of Octane said, "Without patent insurance we would have been dead in the water. We did not have $1.7 million to pay lawyers to defend us. We would have had to have paid Icon, even though they had no real patent claim against our company. Further, our IP insurance provider [IPISC] helped us pick one of the best litigation teams in the country to help us win this. We had no idea where to even start to find a first-rate patent litigator."

Clients Can Keep Their Counsel

One reservation attorneys have against recommending IP coverage to their clients is the fear of loss of the representation, and their associated fees, to insurance panel counsel. However, this fear is unfounded. Most IP policies are written as reimbursement policies, and do not involve a duty to defend, nor do they mandate associated insurance panel counsel. Therefore, qualified counsel can be approved to litigate in the event of a claim.

Limits Are More Than Adequate

A second objection is that available limits are too small to make a difference in litigation. This also is a misconception. Limits have exceeded the reported cost of litigation, per the AIPLA survey's numbers, for years. Currently, $10 million dollar policy limits are available (some programs offer higher limits on a one-off basis).

IP Coverage Is Timely, Available and Affordable

A third outdated concern is that only a few, obscure sources offer IP coverage, calling legitimacy of the coverage into question. However, coverage has been available from multiple, significant sources continuously since 1989 (currently, Underwriters at Lloyd's participate with the longest established program). Increased litigation and corresponding demand has enticed multiple entrants into the market in the last 10 months. Among the seven new entrants are Liberty International Insurance, RPX, and Wells Fargo. Based on the multiple significant providers, the credibility of IP insurance as a legitimate coverage can no longer be questioned. As a result, the variety of sources for IP insurance can spur competitive price and terms. IP coverage typically is easier to apply for, and less expensive than attorney Errors and Omissions coverage.

Recommending IP Coverage Reduces Counsel's Risk Exposure

The market for IP insurance has matured. It would be unwise for any attorney to fail to advise, or to recommend against, a client obtaining a quote for IP insurance to address IP litigation risk. Attorneys could be held responsible for failing to investigate insurance coverage for IP risks. As a result, IP counsel will face growing exposure to remedy out-of-pocket litigation expenses and damages on behalf of their uninsured clients.

Recommending IP Coverage Increases Business by Increasing the Likelihood That the Client Can Pay Fees

Counsel generates fewer fees from a client who cannot afford legal expenses. Insurance can many times mean the difference between bankruptcy and success to an insured client.

IP Coverage Benefits Both Client and Counsel

The insurance market has responded to the increasing frequency of IP litigation, offering coverage that is easily accessible and affordable. In helping to pay for litigation expense, IP insurance mitigates risk and preserves income streams for both client and counsel.

Although IP counsel and clients are becoming aware of the lack of defensive IP coverage in their other business insurance policies, many are still unaware that their professional commercial policies may not provide coverage for loss of their most valuable assets, their IP, as a result of IP litigation.

IP infringement insurance is the best assurance a company can have that the financial means are available to help enforce IP through infringement litigation. IP insurance also is the best solution to protect against the potential financial hardship that defensive IP litigation can inflict, ensuring litigation is based on on the merits of the case. This insurance is as crucial, if not more so, than general liability, errors and omissions, and directors and officers insurance policies. Comprehensive risk management requires that IP risk is proactively managed with insurance, before allegations arise.

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