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INTELLECTUAL PROPERTY & *Life Sciences*

# Risk Management Basics for Protecting Intellectual Property

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Intellectual property (IP) is perhaps your client's most valuable corporate asset, and yet IP risk management is typically disjointed and misunderstood. Risk management is not merely purchasing gobs of insurance but rather a system of self-evaluation, risk identification and implementing risk reduction techniques to minimize exposure to loss. Failing to advise your client that a potential claim may be insured is not only bad practice, but it may be malpractice.

The landscape of insurance coverage and risk management is changing rapidly. To make matters worse, timing in IP insurance claims is of the essence because your client will lose its insurance rights if you do not give timely and appropriate notice. Unfortunately, IP counsel and client facing IP risk are often myopically focused upon the complexity of the claim before them, and they fail to consider whether existing insurance coverage will provide either defense or indemnity. With a little planning, a company facing IP risks can protect against punitive damages as well as both known and unknown loss.

For the past five years, we have enjoyed a soft market, a market in which insurance premiums are low. A hard market is coming quickly and insurance rates are about to rise dramatically. Even if insurance rates stay low, however, an IP risk management program is more than buying insurance. If it is not structured correctly, that insurance tower will provide no protection at all. Rather, a quality risk management program will look systematically from cradle-to-grave to verify that your company's IP rights are protected at each step, to quantify the risk and to put in place an action plan to protect your client's IP. The steps from product conceptualization, design, manufacturing, marketing, distribution, sale and even disposal or recall are steps that involve different business groups and require critical evaluation to determine whether your IP rights are seamlessly protected throughout. Before deciding what insurance to put in place, you must know what it is you are insuring, so you need to commence the risk management process with an IP audit.

### Engage Outsiders for Your Audit

The starting point for any IP audit should be a crafted audit plan, defining the scope of the inquiry, assignment of responsibility for the work to be done and the expected form of a report. You will need to look at state and federal filings, third-party ownership rights, potential defects in patent filings, infringement concerns and may need to address both key personnel and the risk of raiding by your competitors. Although in-house personnel know their product and are highly skilled, internal corporate politics will often defeat a company's ability to engage in a meaningful internal audit without using an outsider as an integral part of the audit team.

Using outside counsel is helpful for the simple reason that it is the strongest claim of attorney-client privilege (in-house counsel often wear a "business hat" as well), and because outside

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counsel should be independent enough to candidly discuss flaws in the company's structure. A second reason is that corporations are operated in large part based upon political relationships, with some placing more control in management, others in its individual manufacturing units, but uniformly the seat of power is rarely ever legal counsel and certainly not the risk manager. Given this simple political reality, it is very difficult for an in-house risk manager or even qualified in-house legal counsel to ask the difficult questions, criticize the accepted operating structure and to bluntly identify and critique gaps in your company's management of its IP rights. In short, if your client wants real results they need to get an outsider on their audit team.

### Insurance for IP Risks

After reviewing over 200 IP claims filed in New York and New Jersey over the past three years, I noticed a clear trend: approximately two-thirds of all IP complaints failed to trigger coverage under standard Insurance Service Offices (ISO), comprehensive general liability (CGL), directors and officers (D&O) or errors and omissions (E&O) coverage. Conversely, approximately one-third of the claims filed between 2009-11 triggered at least the duty to defend and potentially the duty to indemnify. In evaluating whether an IP claim triggers coverage under a standard CGL, D&O or E&O policy, the policyholder must think both strategically and quickly. A delay of a few days, or failure to notice the proper claim type, can be fatal if the claim is subject to New York or English law.

A closely related concern is forum. Forum is often dispositive in close claims and if the insured does not secure jurisdiction immediately, the insurer certainly will after being given notice of a potential underlying claim. Forum decides close cases. In a typical insurance claim, the policyholder has a number of choices on forum and there are ramifications to coverage for each choice. Providing proper notice has become more complicated in the past 10 years with the rise of London market and Bermuda form coverage, each of which often invoke New York substantive law, have unique notice provisions but nonetheless retain foreign procedural law.

If your client has arguable coverage, immediately provide instructions for a full-blown litigation hold. Given the risk posed by IP claims, the policyholder must anticipate that the insurer will invoke any and all potential defenses. Policyholders often create problems unnecessarily by failing to retain all relevant records (including, of course, electronic records), giving rise to a spoliation claim and providing the carrier with a potential adverse inference.

Having provided proper notice and engaged an effective litigation hold, the next step is to determine which lines of coverage are most likely to provide indemnity and defense to your client. The lines of coverage triggered are determined by the complaint against your client in the underlying matter. If your directors and officers are not named as defendants, it is unlikely that D&O coverage will respond. (One significant exception here is that some D&O policies provide for deposition defense costs.) If it is alleged that the company was negligent in satisfying technical obligations under a contract, look hard at your E&O and umbrella coverages. Although D&O, E&O and umbrella coverages are all worth consideration, coverage for IP claims is typically found under either Part A (Property Damage and Bodily Injury) or Part B (Personal Injury and Advertising Liability Coverage) of a CGL.

CGL coverage is occurrence-based, meaning that it insures your client based upon when the event triggering coverage occurred. But D&O and E&O policies are often claims-made policies, where the policyholder must give notice of the event during the policy year when the claim is asserted (and perhaps shortly thereafter if a reporting tail is purchased). Although it may be odd at first glance to consider an IP claim as constituting third-party property damage, such claims have occasionally succeeded and therefore must be considered. For example, where it is alleged that the IP, such as a computer program, has damaged hard drives and destroyed a company's computer banks, some courts have considered such destruction of a third party's equipment as property damage.

The most likely avenue of coverage for IP claims under a CGL is for the risk of personal injury and advertising liability coverage. The CGL's Part B coverage addresses the risk that your sales force, marketing team, advertising and sales literature offend a competitor by defaming either them or their products. In approximately 30 percent of the IP claims filed in New Jersey and New York over the last year, defamation libel, slander and trade libel have been alleged as part and parcel of the IP claim. That allegation of defamation is the critical trigger for coverage under a standard CGL. The insured's obligation is simply to establish that there is some claim within the complaint that falls within the policy. Once the policyholder has accomplished this initial step, it is up to the insurer to attempt to separate the wheat from the chafe. Because it is the carrier's burden to prove that costs claimed related solely to an uninsured event, a policyholder should think carefully regarding how it describes the work being undertaken to defend the IP claim. If a description providing coverage is just as accurate as a description that would not provide coverage, it is incumbent upon the policyholder to create a billing record supporting its later demand for reimbursement of defense costs as well as for indemnity.

### The New IP Insurance Coverage Forms

In response to the limitations of standard ISO form coverage in responding to IP claims, some carriers have begun offering coverage to address specific IP risks. These policies fall into three broad categories: IP litigation insurance, adverse cost insurance and asset protection insurance.

IP litigation insurance typically provides for defense of infringement claims and invalidity of ownership disputes. IP coverage typically is worldwide and contains specific indemnity limits for professional fees, expenses and damages. Although the new IP coverage forms hold great promise, they are quirky and require a detailed effort by the risk management team because the insurers need to know precisely what risks they are insuring. Because the new IP insurance policies are also issued in an area fraught

with risk, the carrier's willingness to grant coverage may hinge on the credibility of a competent broker. It is important to find a truly qualified broker with good experience and a solid relationship with potential insurers.

Adverse cost insurance protects the insured against a loss from existing or known disputes. In brief, this coverage places "brackets" around a claim. Adverse cost insurance is undertaken typically only by sophisticated insurers and will require copies of opinions of legal counsel on the nature and extent of current risks to which the insured is exposed. Adverse cost insurance is not cheap, but if your client is in uncharted litigation waters, bracketing the range of risk may be critical in financing corporate reorganization and other necessary aspects of corporate life.

The third form of coverage is asset protection insurance, which protects the value of IP in the revenue stream that the IP creates. This is exclusively first-party coverage and does not address legal expense. The insured events addressed by asset protection insurance include actions by governmental entities and other companies' adverse media reports. The underwriting process with regard to asset protection insurance is detailed and requires a close review of each manufacturing line of the product to be insured. For a company with hundreds or thousands of products, the underwriting process, needless to say, is detailed and painful.

### Excess Coverage

If an IP claim is filed against your client, give notice immediately to all carriers within the insurance tower. Companies and counsel commonly underestimate risk, so give notice to all potentially triggered carriers. Failure to give timely and proper notice may be fatal.

However, providing notice is not always easy because access policies such as London market and Bermuda form coverages often have very particular notice provisions. These policies are also more complicated than standard ISO forms because London market and Bermuda coverages often invoke New York substantive law but rely upon the procedural law of either London or Bermuda. One particular issue that arises is the distinction between an occurrence, an integrated occurrence and notice of a batch claim. Giving the wrong notice can be just as dangerous as giving delayed notice.

### Conclusion

It is essential to protect IP rights, and standard ISO coverage as well as some of the new IP insurance products may grant partial protection for your client's IP. If you become embroiled in an IP claim, it is incumbent upon you to inquire whether the client has coverage for that risk. Determining whether insurance will provide defense or indemnity for an IP claim is a painstaking exercise and requires a very careful parsing of the complaint and of the policy. Contrary to conventional wisdom, approximately one-third of all unfair trade practices and antitrust claims are in fact insured for the simple reason that they allege defamation libel, slander and trade libel. Approximately one-third of all IP claims incorporate disparagement of the competitor or the competitor's products, and likewise will provide for a defense if not for indemnity as well. ■