Insuring your IP risks

by Michael Rossi, president, Insurance Law Group

There are many issues that must be addressed when managing a company's intellectual property, including how to recognize it, how to value it, how to exploit it, and how to protect it. This article attempts to address an issue that is just as important as the foregoing but is often overlooked – what, if any, role can and should insurance play in connection with a company's intellectual property? In particular, I would like to examine one particular aspect of this issue - the role of insurance when doing business internationally, particularly between an Australian-based company and a US-based company.

I hope to provide some level of understanding of the insurability of intellectual property (IP) risks in the US, as it compares to and differs from the Australian experience. This is important for several reasons.

First, if an Australian company is interested in opening up operations in the US, it cannot assume that insuring IP risks in the US is the same as insuring such risks in Australia.

Second, if an Australian company is interested in joining forces with a company based in the US in a partnership, joint venture, strategic alliance or other venture to enter into another market rather than take the plunge on its own, insurance issues are very important to understand. If the Australian company accepts responsibility for insuring the venture, it needs to understand IP risk insurance issues for the locale of the venture. If the other party is accepting responsibility for insuring the venture, the Australian company should not simply assume that IP risks will be adequately covered. These issues are relevant whether the risk comes from a third party, or from the other party itself (eg. misappropriation of IP by the other party).

Third, if an Australian company is interested in buying a company based in the US, it should understand IP risk due diligence issues, and how insurance can protect against certain claim trends being seen in the M&A context, especially in the Us. More and more companies are turning to one form or another of M&A insurance to avoid the adverse consequences of third-party claims being made against them after they buy a company, especially claims brought by one or more of the seller's competitors.

The US is experiencing an alarming trend in this regard, and insurance can and is playing a vital role in addressing this very troubling risk issue (not only in the US but also the UK/Europe). Interestingly, such M&A insurance can also play an important role in transactions between two Australian-based companies, but the uptake of such insurance in Australia to date has been much slower than in the US and UK/Europe.

What are the risks?

For insurance discussions, it is important to differentiate between first-party risk and third-party liability risk. First-party risk denotes loss sustained directly by the insured. Third-party liability risk denotes loss brought on by claims made against the insured by third parties.

There are two 'big picture' first-party risk exposures that insurance professionals are reviewing with respect to IP risks. The first involves bsses sustained because an employee or third party misappropriates the insured's intellectual property (eg. trade secret) and sells that intellectual property to a competitor of the insured. The insured suffers several types of losses. Had it negotiated at arm's length with its competitor, it would have received payment for the turned-over intellectual property. That loss is the actual cash value (fair market value) of the property that was given over to the competitor.

The insured also suffers another loss in such circumstances - the lost future sales that are now going to its competitor, rather than to it, because it has to compete against its competitor that is now using the company's own intellectual property. Losses in the US under such circumstances have exceeded US$50 million, and those are just reported cases! Not only is this bad enough in the abstract. but think about the risk of loss when a company shares its intellectual property with a prospective partner, coventurer or strategic ally.

What if that hoped-for ally is really just interested in your intellectual property? If you don't believe this could happen, think again. This has happened and will continue to do so.

The second 'big picture' first-party risk involves the cost of 'enforcement actions' to Slop another party from using one's intellectual property. For example, a company believes that another company is infringing its patent, so it sues the other company, seeking an order to enjoin that other company from making/selling the allegedly infringing product. Such lawsuits are not cheap. And if the company loses that lawsuit, it then faces another type of first-party loss - lost sales to the competitor.

The array of third-party liability intellect-

tual property infringements risks is truly broad. In addition to the 'usual suspects' (ie. claims for infringement of patent. copyright and trademark), there are any number of claims that can fall within the spectre of 'intellectual property infringe ment'. The claims that seem to be getting a lot of attention as of late, at least in the US, in addition to patent, copyright and trademark infringement, are claims for misappropriation of confidential or proprietary, information, misappropriation of trade secrets and unfair competition.

Insurance issues

With respect to the first-party risks described above, other than coverage for costs of enforcement actions, finding adequate coverage in traditional insurance programmes has been difficult. Companies typically look to commercial property and crime policies, but the carriers have vigorously resisted paying such claims under such policies, and ultimately coverage has been found inadequate in any respect. Even for those insurers that will expressly recognise coverage for such risk in new, stand-alone e-commerce policies, the coverage is very limited.

What this means is that if a company is interested in entering into a partnership, joint venture or strategic alliance, it must practice god risk management with respect to its intellectual property. Good risk management techniques include making an affirmative, and informed, decision on how much intellectual property will be shared with the other party, drafting rock-solid agreements with the other party about that intellectual property (who owns it, how can it be used, how will it be given back, etc.), and monitoring the dissemination of that information from venture creation to the winding up of the venture.

With respect to insuring the costs for enforcement actions, there are policies available for such costs at least in the US. However, the market for that product does not appear to have been widely accepted, at least when it comes to the buying habits of large, multinational e-companies.

At least with respect to insuring intellectual property infringement liability risks in the US, the state of affairs, to be frank, is a mess. Coverage for claims alleging intellectual property infringement might be found in any number of policies in a company's program, depending upon the nature of the company (eg. whether a brick and mortar company, media company, technology company, internet-based company., etc.). Also, trying to create a cohesive insurance program that covers all of a company's third-party liability IP risks is anything but easy, given the patchwork of 'insurance solutions' provided by the insurance market.

Mergers and acquisitions

There are several ways to insure IP risks related to M&A activity. If, for example, the seller can represent or warrant that it has not infringed any, other party's IP rights, then insurance can be purchased to cover the risk of loss arising from a breach of that representation or warranty likewise, if one or more claims of infringement are already pending and outstanding against the target, then insurance can be purchased to cover the full ramifications of such known, but not yet fully quantified loss.

The insurance products that can be used in the foregoing settings are several, and vary by name depending upon where they are bought There are standard M&A type products that go by names such as representation and warranty insurance, warranty and indemnity insurance, loss mitigation insurance and the like. There also are IP infringement policies that can be amended to insure IP risks associated with mergers and acquisitions. These insurance products are available in Europe and the US.

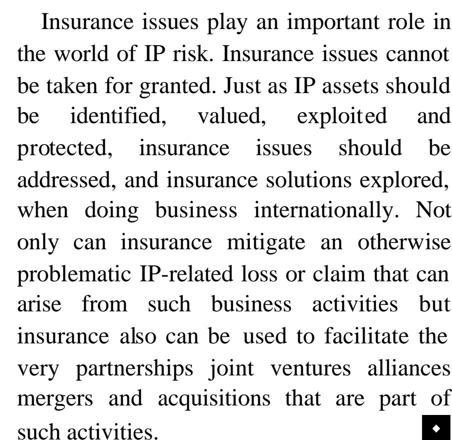
These insurance solutions can be structured any number of ways. On the one hand, the policy can be set up to have seller as the insured. The insurance acts as liability insurance. If an IP infringement claim comes in after the transaction, the buyer will make a claim against the seller for breach of representation/warranty, and the liability insurance will cover the seller's indemnity obligations to the buyer for such breach (including responding to the IP infringement claim).

On the other hand, the policy can be set up to have the buyer as the insured. The insurance acts as a hybrid first-party and third-party liability policy. If an IP infringement claim comes in after the transaction. the buyer will make a claim against the policy to respond to the claim and cover the losses sustained by the buyer as a result (not only by responding to the third-party claim. but also the first-party loss sustained by the buyer by reason of the seller's breach of representation/warranty that it had not infringed the IP rights of another).

Why are more and more companies using such M&A insurance solutions? Some companies are using the insurance to prevent a deal from cratering when the prospective buyer and seller cannot agree to deal terms on how to address the risk of loss relating to IP issues. The insurance solution functionally removes the issue from the table, so that the parties no longer have to fight about it. The insurer is assuming risk of loss other than for the premium and self-insured retention of the policy, which is a finite number that can be factored into the deal negotiations.

When using M&A insurance in the manner explained above, typically both parties know about the insurance.

However, some parties to M&A transactions are using M&A insurance without the other party knowing about it. One party will agree to assume the IP risk, in exchange for a major fluctuation in the purchase price, or some other major concession in the transaction. That party then off-loads the risk to an insurer via one of the M&A insurance solutions.



Insurance issues play an important role in the world of IP risk. Insurance issues cannot be taken for granted. Just as IP assets should be identified, valued, exploited and protected, insurance issues should be addressed, and insurance solutions explored, when doing business internationally. Not only can insurance mitigate an otherwise problematic IP-related loss or claim that can arise from such business activities but insurance also can be used to facilitate the very partnerships joint ventures alliances mergers and acquisitions that are part of such activities. ◆

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