

Understanding How Intellectual Property Insurance Can Protect Your Business

Intellectual property is an intangible business asset that often helps set companies apart from their competitors. Unfortunately, few businesses know precisely what their IP is worth, or how to protect it.

Let's step into the world of IP and explore the risks that you could be facing – and how you can build resilience for your business. This guide is put together in collaboration with CFC Underwriting, a leading provider of insurance solutions for life science and technology companies.

What is intellectual property?

Intellectual property (IP) is a broad term used to describe the legal rights arising out of intangible creations and assets, such as a product or process, a piece of software, a brand or even a customer database.

Covering a wide range of areas from inventions and algorithms to products, manuscripts and design including a name, image, symbol or logo, intellectual property rights allow the original creator to apply for legal protection of their IP in the form of a patent, copyright or trademark.

Intangible assets, including IP, now make up to anywhere from 70 to 80 percent of a typical company's balance sheet.¹

Businesses are also investing more in intellectual property – like research and development, software, branding and design – than they are in physical assets, creating more value in IP.

Understanding IP Risk

The biggest IP exposure a small or medium-sized enterprise (SME) will often face is a claim of infringement by another company, rather than a direct threat to their own IP. Many businesses assume they're immune to this risk because they hold some form of IP rights (i.e., a patent, copyright or trademark) or because they simply don't understand what constitutes infringement.

Infringement can arise out of a business activity – i.e. the import, sale or manufacture of a product – or the delivery of a service. It doesn't matter whether a business holds IP rights or not. Holding a patent, copyright or trademark doesn't protect a business from infringing on someone else's IP.

Given the volume of IP rights in existence, it's nearly impossible to guarantee that a company isn't infringing on someone else's IP. IP rights also often overlap, and patents rarely cover an entire product. For example, a business may think that it holds the IP rights for a pen, but may lack the rights to the cap, the ink or the spring.

Intellectual property is highly relevant to companies of all sizes and in all industries.

It's not just Large Organisations that Need to Worry About IP Risks SMEs may also find themselves targeted by large competitors who want to prevent competition and who have more established IP

portfolios because of their size and age. IP can present a classic David versus Goliath scenario, and without sufficient resources, the smaller organization can face more dire consequences.

Smaller businesses can present an easy target for IP infringement claims because they lack the resources to properly address or defend them. Many SMEs could struggle to survive an IP dispute. Consider what would happen should your business face an injunction preventing you from selling your product? Or if you were required to pay significant damage or royalties to the rights holder?

The cost of simply defending a claim can be significant for a small business even if they believe they are not infringing.

How does IP insurance work?

A claim of IP infringement can have a devastating impact on a firm's finances and reputation. Protecting your business with IP insurance can help fund legal action against an infringer or defend a patent's validity. Simply having IP insurance in place can be a powerful deterrent to any potential infringer.

IP insurance provides cover for claims alleging infringement of IP rights, including patents, trademarks, copyright and trade secrets. It can also provide cover for contractual indemnities, the enforcement of IP rights and the costs associated with loss of IP rights or loss of profits. The insurance will only cover claims which the insured was not aware of at inception.

Typical IP insurance policies include:

- Patent and IP infringement liability
- Contractual indemnities cover
- Pursuit of infringers
- Loss of IP right cover
- Loss of future profit
- Let's explore these in more detail.

Defence of Patent and IP Infringement

This part of the policy will cover the costs of defending against allegations of infringement by a third party and can also cover the out of court settlements, or damages awarded by a court, as a result of the claim. Defence costs are often substantial due to the complexity of IP litigation and expertise required by lawyers. Aside from infringement allegations, the defence cover can also include claims of entitlement by employees and certain elements of contract breach arising out of IP. Directors and officers are also automatically included should a claim involve both the company and the director.

Contractual Indemnity

For many companies, their main exposure arises out of their obligations under contracts, typically with customers or licensees. For instance, a supplier's customer may insist that the supplier warrants that the product does not infringe on IP rights, otherwise the customer will refuse to buy the product. Ideally, the supplier should negotiate to minimise this contractual risk, but the balance of power between the parties may not allow for such negotiation, and in some sectors it is more or less standard to provide non-infringement indemnities. IP

insurance will cover the insured if a claim is made against them, but also if a claim is made against their customer, or further down the line of contracts if it is a complex supply chain. This section can insure a single contract exposure or a number of contracts and exposures. It is particularly relevant for companies operating in traditional supply chains (e.g. automotive).

Pursuit of Infringers

This section covers the enforcement of intellectual property that is owned by or licensed to the insured, as long as the claim has reasonable prospects of success and is commercially justified. This includes the legal costs of negotiating with the alleged infringer or taking court action, as well as the costs of defending a counterclaim if the infringer claims that the right should not be valid. If an infringer alleges that the insured is actually infringing on their rights, then this type of linked claim may also be covered by the insurance.

Loss of IP Rights

If the insured's registered right is invalidated as a result of a covered infringement claim, then the policy can cover the costs that the insured incurred in registering and maintaining the right up until the point that it was invalidated.

Loss of Future Profit

While defence cover will typically cover historical damages or settlements arising out of a covered claim, this clause provides cover for the loss that may be incurred after final disposition, for example, if the company is prevented from selling a product due to the infringement.

IP Insurance in Action – A Case Study

Renewable energy company pursues competitor's patent infringement. A small UK domiciled renewable energy company develops and sells energy saving devices for use in renewable energy enabled housing. These devices incorporate machine learning to capture and assess data which provides the most effective heating programmes all year round. The company's routes to market include distribution via energy consultants and direct marketing to large landowners. Their goal is to incorporate their products into new build projects globally.

Research and development is very important for the company's business model and their innovations are protected by registering patents in territories worldwide. This strategy provides the company with exclusive rights to their proprietary technologies. They commercialise their technologies by manufacturing products containing the technologies themselves, as well as licensing a small number of their patents to third party partners better positioned to commercialise the technology.

The company, insured with CFC, became aware of a competitor selling a household heating kit in the US. They believed this product was likely to be infringing one of their US patents.

The renewable energy company had purchased an IP insurance policy with pursuit coverage included from CFC. This pursuit coverage provided legal costs cover for any costs incurred enforcing intellectual property rights against third-party infringers.

The company worked with CFC's claims handlers to appoint a suitable legal representative in a timely manner. Initially they considered using an IP lawyer they had used previously, however CFC's claims team were able to recommend three additional law firms to ensure the company had the best legal representation. The company selected one of the recommended law firms because they

had the most extensive experience in handling patent infringement disputes in the US, despite the company operating in the UK.

The cost of using the legal representative was negotiated and monitored by CFC's claims team throughout the process. This service was a benefit to the company because it improved the value for money of the legal representative's work and the company's IP insurance claims history was in a healthier position going forward.

The legal representative was able to undertake a preliminary assessment of the competitor's product and the technologies protected by the company's patent. The costs of the investigation were £3,500 which was paid by the insured but eroded their £10,000 policy deductible.

Between the legal representative and CFC's claims team it was successfully established that:

1. Patent infringement was likely to be occurring
2. There were good prospects of success pursuing the competitor
3. The infringement was likely to be causing lost revenues for the insured so enforcing their patent against the third party was commercially proportionate.

The CFC claims team approved legal representative's legal expenses to communicate and negotiate with the third-party infringer.

After issuing a cease-and-desist communication, followed by subsequent correspondence to outline the company's intention to issue proceedings, the competitor agreed to negotiate a license agreement with them. The terms of the license agreement firstly required a compensatory payment of £50,000 to reflect extent of infringement to date and it also required ongoing royalty payments to the company on all future sales of the heating device.

The legal costs for the case amounted to £125,000 which was the least the energy company would have had to pay if they did not have IP insurance. Instead, the energy company paid £33,000 and the insurer paid the remainder of the fees.

The £50,000 settlement received was also split between the company and insurers, with the energy company retaining £10,000 and the insurer receiving £40,000. This meant the total outgoings for the company during this case were just £23,000, all for the successful resolution of the infringement of their patent.

Not only did the company save money on their pursuit action, but they secured a future revenue stream having had access to quality legal representation at a competitive price with the support of an experienced claims team who were able to handle the claim on the insured's behalf saving many hours of their management's time.

IP Insurance and M&A

Mergers and acquisitions activity (M&A) can involve a buyer acquiring an entire business or simply the acquisition of specific assets. In both cases, M&A will have implications relating to IP.

IP will often play a significant role in an acquisition, as for many businesses much of their value lies in their IP which is what makes them unique.

When an acquisition takes place, the buyer will obtain representations (reps) and warranties from the seller regarding the



assets being acquired. This is primarily a means of risk allocation, providing the basis for which they can recover damages if those reps and warranties are false. Frequently buyers will purchase R&W insurance to protect themselves against financial loss resulting from breaches of the reps and warranties.

In most cases, these reps and warranties will include statements in relation to the target company's IP. It is common for the seller to represent and warrant that the operation of the target business does not infringe, misappropriate, or violate any other party's IP rights; that no other party is infringing, misappropriating, or violating the target's IP rights; and that there is no litigation or claims covering any of the foregoing that is pending or threatened.

The IP protection under R&W insurance can vary depending on the scope of the IP reps and warranties in the acquisition agreement. For instance, the relevant IP reps and warranties may include knowledge qualifications (i.e. may be subject to seller awareness) and will likely be historic or 'retro' in nature.

On the other hand, IP insurance is designed to cover the legal expenses and damages arising from any allegations of infringement, both historic and prospective, regardless of seller awareness.

With this in mind, IP insurance can be an invaluable tool for a buyer in establishing or enhancing protection against IP associated risk during M&A transactions as the policy will cover infringement allegations that would not be otherwise covered by R&W insurance.

It is also provides peace of mind that any IP infringement allegations relating to the target's new business activities will be covered going forward.

In many cases, IP insurance can act as a deal facilitator by helping the buyer avoid protracted IP reps and warranty negotiations, or by acting as a bid differentiator at auction.

In Summary

Apart from helping protect what you already own, intellectual property insurance can also help your business grow. Allowing you to licence your idea to others can make your business attractive to potential investors, knowing your invention or unique idea can't be stolen by someone else.

Intellectual property insurance is key to supporting your business when defending itself against claims of IP infringement and can help you pursue those who are infringing on your patent, copyright or trademark.

REFERENCES

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