THE INSURANCE AND MANAGEMENT OF INTELLECTUAL PROPERTY RISKS

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I. INTRODUCTION

This paper explores the primary risk management devices upon which intellectual property owners and users may now rely for protection. In recent years, recognition of the value of intellectual property has increased. Indeed, one commentator has stated that "the intellectual property capacity of a company is now more valuable than its buildings, machinery, and fixed assets."[1] Increased recognition of the value of intellectual property has led to increased competition for such property. One of the ways this increased competition has manifested itself is in an increasing number of infringement lawsuits. There were 1198 more intellectual property infringement lawsuits filed in the federal courts in 1996 than there were in 1992.[2] This is an increase of twenty percent over the five-year period.

Increased intellectual property litigation means increased risk for intellectual property owners and users. In this atmosphere of increased risk, intellectual property owners and users need to maximize their use, or at least their awareness, of intellectual property risk management devices.

The most obvious risk management device available to intellectual property owners and users is insurance. After all, what is insurance but a way for individuals and businesses to reduce risk? In exchange for paying the stipulated premium to the insurer, the insured transfers its risk of loss to the insurer for a relatively small fee. Meanwhile, the insurer, in order to manage its own risk, insures a large number of parties which pose similar, yet independent risks. The insurer classifies groups of insureds by degree of risk, and attempts to price coverage in accordance with such classi-

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1 J. Donald Francher, *How Insurance Can Reduce Intellectual Property Risks*, NAT'L UNDERWRITER, Feb. 24, 1997, at 9.

2 *See* BUREAU OF JUSTICE STATISTICS, U.S. DEP'T OF JUSTICE, JUDICIAL BUS. OF THE U.S. COURTS, REPORT OF THE DIRECTOR tbl. C-2A at 140 (1996).

fications. The insurer bears any residual risk that the loss actually suffered will be larger than the insurer's risk calculations.

Intellectual property owners and users put themselves at a substantial competitive disadvantage, however, if they rely only upon traditional insurance policies to manage risk. They should also use other risk management devices, including legal compliance programs, new types of litigation insurance, and net loss insurance. To best compete in the "new global economy," intellectual property owners and users must fully understand these risk reduction devices, and effectively use those which are best suited to them.

Section II of this article discusses legal compliance programs, which include strategies businesses can implement to avoid infringing the intellectual property rights of others, and to maximize the value of the businesses' own intellectual property. Section III discusses various intellectual property insurance policies, including media liability and errors and omissions policies, patent insurance policies, comprehensive or commercial general liability policies, and Internet related policies. Section IV discusses several new methods of intellectual property risk management, such as plaintiffs' insurance, defense cost-only insurance, net loss insurance, and asset securitization.

II. Legal Compliance Programs — Providing One's Own "Insurance"

It is axiomatic that the best way to limit one's potential liability is to take steps to insure that one does not become involved in a dispute in the first place. Thus, the first step a company should take to manage intellectual property risks is to initiate an effective intellectual property legal compliance program. This is conduct designed to insure that appropriate steps are taken (1) to avoid infringement of others' intellectual property rights, and (2) to protect one's own property from infringement while maximizing its value. In many instances, companies initiate such programs only defensively, in reaction to events such as a major litigation, a government or media investigation, or public scrutiny. Rarely is legal compliance adopted as a truly preventive or offensive effort designed to maximize a company's potential to succeed both in disputes and in day-to-day business.

A. *The Elements of an Intellectual Property Legal Compliance Program*

1. Establishment and Dissemination of a Policy

The first step in establishing an intellectual property legal compliance program is to adopt a formal written policy statement. This statement should affirm the importance of the program and state its goals. It should alert managers and employees to the fact that intellectual property issues must be brought to the attention of in-house counsel or appropriate supervisors, and it should specify what behavior is acceptable and what is not. Employee handbooks can be used to convey the company's policy statement. Such handbooks should indicate procedures for reporting violations, and should outline the company's policies toward investigating and disciplining such violations. The handbooks should also include examples of instances when employees should contact the legal department or other responsible personnel for assistance. The company should regularly distribute memoranda to employees and hold training seminars to address new issues and review old ones. Independent contractors or other non-employees who do work for the company should also be advised of the compliance policy and should be required to follow it.

2. Assignment and Training of Appropriate Personnel

An intellectual property legal compliance program must depend heavily on in-house counsel where such counsel exists, and on management where counsel does not. It is vital that these people are educated about basic intellectual property law so that they can spot issues. It is also important for them to be given clear direction so that they know when and where to go for expert advice. The company should further the education of these responsible persons on a regular basis.

In businesses of appropriate size, certain employees should be charged with conducting investigations of potential infringements, entering into appropriate licenses for the use of third parties' property, and ensuring that proper terms are included in licenses of the company's property. Likewise, specific personnel should be charged with registering the company's intellectual property, and with taking all appropriate steps to preserve the business' intellectual property rights. The company should use written contracts to ensure that it unambiguously owns all intellectual property created for it by its employees or outsiders. If possible, the company should assign specific personnel to participate in various government regulatory processes, including lobbying and testifying in relevant inquiries.

3. Documentation and Monitoring

The legal department or other responsible personnel should maintain documentation of compliance. Records which should be retained include: license agreements; copyright, trademark, and patent registration certificates; notes and memoranda relating to the creation of intellectual property; certificates of compliance from employees and vendors; attendance sheets from compliance seminars, and; copies of policy statements and other compliance-related materials. It is important to establish appropriate safeguards to preserve confidentiality and privilege regarding some of these documents, especially those concerning internal investigations of alleged improper or illegal conduct.

When the company is a plaintiff in a lawsuit, compliance documentation can be used to establish its ownership and rights. In addition, when the company is a defendant, such documentation can be used to establish a defense of good faith and to reduce the chances that the business will be found guilty of willful infringement. Compliance documentation can also be used to audit the effectiveness of the compliance program. The company should conduct such audits on a regular basis. If the auditors discover shortcomings in the compliance program, the company should take remedial action immediately.

4. Involvement of Outside Intellectual Property Specialists

The company can out-source its compliance program to organizations and law firms with intellectual property law expertise. In many instances, and for almost all smaller businesses, out-sourcing is the most efficient means of achieving legal compliance. At a minimum, businesses which do not have an intellectual property legal compliance program should seek the assistance of intellectual property specialists to establish one. Even those with a program already in place should periodically consult with outside counsel to be sure that the program is current.

B. *The Benefits of an Intellectual Property Legal Compliance Program*

Adoption of an intellectual property legal compliance program yields numerous benefits. Primarily, a company benefits when its compliance program highlights situations that are ripe for future legal troubles before they occur. Other significant benefits include: improved corporate image; reduced instances of findings of willful infringement by the business, its employees, contractors, agents, consultants, licensees, and franchisees; reduction in the cost of litigation as a result of a more streamlined process of gathering and producing evidence; reduction in the number of registration applications not timely filed; prevention of constructive abandonment of trademarks, and; reduction in the number of lost chances to augment the equity of the company's intellectual property portfolio.

A well-run legal compliance program can reduce the likelihood that a judge or jury will find the company and its managers responsible for the illegal acts of lower-level employees. The existence of a compliance program does not, in and of itself, mean that illegal activities of lower-level employees will never be imputed to the company. If employee actions clearly contradict company policy, however, there is a significant chance that the company and its managers may not be held responsible.

In addition, there is a benefit to be gained by adopting a business philosophy that recognizes the value of a preventive approach to law generally, and intellectual property law particularly. Such an approach enhances the overall ability of the business to recognize pitfalls and opportunities that might otherwise be overlooked. Employees are more likely to be aware of legal issues and risks. Thus, they are better equipped to know the limits of permissible conduct, and the reality of their personal exposure when laws are violated.

Finally, as will be discussed, a business must establish an effective legal compliance program in order to avail itself of outside protection, namely specialized intellectual property insurance.

C. *Caveat: The Risks of Poor Compliance*

Evidence of a weak or poorly implemented intellectual property legal compliance program can actually hurt the business in litigation. Adversaries will seek to use such evidence to establish corporate responsibility for the acts of employees based on the company's failure to adequately follow its own pre-established compliance program.

II. Insurance Coverage For Intellectual Property Disputes

A. *Media Liability and E & O Policies*

Entities that create or exploit non-useful (that is, non-patentable) intellectual property, such as media or entertainment businesses, should purchase insurance policies specifically designed to cover the types of risks they face. Those insurance policies are typically called "media liability" policies, "errors and omissions" policies, or simply "E & O" policies.[3] Although there is no standard E & O policy,[4] it is possible to make certain generalizations about these policies.

1. What is Covered

E & O policies generally insure against liability for the dissemination of any portion of an insured's creative works, as well as the dissemination of advertising for those works. By an endorsement to the policy, E & O policies may also cover the insured's merchandising activities. E & O policies generally are written on a "named peril basis." This means they generally cover only the works specified on the insured's application, not the insured's business as a whole. Each work to be covered must be listed in the policy or it is not covered.[5]

For the listed works, E & O policies typically cover liability arising out of the following causes of action, each of which must be expressly listed in the policy: copyright infringement; trademark infringement; misappropriation of ideas, titles or other items not covered by copyright; breach of an implied contract stemming from the alleged use of the submission of an idea or other material; defamation of a person or organization, including libel, slander, product disparagement, trade libel, and infliction of emotional distress, and; violation of rights of privacy and publicity. For these claims, E & O insurance generally pays for the following categories of loss: litigation defense expenses (largely attorneys' fees), including those costs incurred defending injunction motions; damages awarded to the insured's adversary; settlement payments, and; pre-judgment interest. Each of these categories of loss will be included in the total amount of the insurance coverage. Thus, the amount of coverage remaining to pay damages will be reduced by the cost of an unsuccessful defense.

2. What is Not Covered

Notable causes of action generally not covered under an E &

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3 We will refer to all of these as E & O policies.

4 Because the policies we have reviewed in preparation for this portion of the article reflect private contracts between the insurer and the insured, rather than "specimen policies," that is, form policies, we have refrained from quoting or citing any one policy directly. For a generally available form policy, see Chad E. Milton & Michelle W. Tilton, *Trademark and Unfair Competition Litigation From the Insurer's Perspective*, 410 PLI/Pat 61 (1995). Two companies that sell E & O insurance are Media Professional Insurance and the Chubb Insurance Group.

5 For example, all episodes of a television series are typically considered part of a single work.

O policy are: patent infringement; false advertising; claims brought by former employees or independent contractors who created or helped create the insured's works, and; liability arising out of an express breach of contract (such as a failure to pay license fees). Coverage typically does not extend to "offensive" litigation costs, that is, claims that another entity has infringed the insured's works, though certain counterclaims will be covered. In addition, coverage generally does not extend to: willful infringement; known infringement claims which arose before the policy period, and; antitrust type claims. The cost of defending against a claim for an injunction usually is covered. Should an injunction issue, wasted advertising and promotional expenses may also be covered, but the insured's economic loss resulting from an injunction, including production costs and lost opportunity costs, is not.

3. Scope of Coverage

E & O policy coverage typically extends worldwide. It usually covers the insured's subsidiaries, as well as claims asserted against directors, officers, and employees, as long as the latter two were acting within the scope of their employment.

E & O policies are "occurrence" policies. This means that such policies allow limits to be set on the amount of coverage allocated to an individual "occurrence." An occurrence is typically defined in the same way as an infringement under the Copyright Act of 1976.[6] Thus, exploitation of a work that infringes another work constitutes one occurrence, no matter how widespread the infringing work's dissemination.

On an application for E & O insurance, the applicant is likely to be required to identify any pre-existing works incorporated into the applicant's work, certify that it has performed certain clearance procedures and obtained appropriate licenses, and represent that it is not aware of any potential claims. In many cases an attorney must certify that the applicant's clearance procedures are sufficient. We have seen at least one policy that specified that an attorney, satisfactory to the insurer, would be required to supervise the clearance process. In this circumstance, the applicant is required to have the attorney review the work to make sure it does not contain any defamatory material, investigate the origin and originality of the work, conduct copyright and title searches, purchase appropriate licenses, obtain releases which allow for editing and elimination of material, and enter into written contracts with all talent.

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6 *See* 17 U.S.C. §§ 501 - 511 (1994).

Sometimes an E & O policy will provide that the insured is obligated to defend a lawsuit. Sometimes the insured can retain counsel subject to the insurer's approval. Typically, the E & O policy will provide that if the insured is covered by another policy, coverage under the E & O policy is secondary. As case law continues to develop regarding coverage of intellectual property disputes under so-called "Commercial General Liability Policies" (also called "Comprehensive General Liability Policies"), this provision could soon provoke disputes between the E & O carrier and the Comprehensive or Commercial General Liability carrier.

4. Cost

Depending on the amount of the deductible, that is, the amount the insured must pay before the insurer is obligated to pay, E & O policies providing coverage of several millions of dollars can be purchased for under ten thousand dollars.

5. Special Considerations

An important consideration regarding all insurance applications, not just E & O policies, is that they are discoverable, as are most communications between the insured and its insurer. This is a particular problem regarding E & O policies because the E & O application may request that the insured list any potential claims. Responses to these questions must be carefully framed to avoid harmful admissions which could be used later in litigation.

A potential area of conflict between the insurer and the insured exists when the E & O policy provides, as many of them do, that the insured is obligated to mitigate damages by ceasing dissemination of its allegedly infringing work, or that the insured must print retractions as the insurer instructs. The insurer is compelled to mitigate damages as much as possible. On the other hand, the insured is unlikely to want to cease selling its product, and also may not want to print a retraction.

An insurer may seek to deny claim coverage based on the fact that the complaint in a litigation alleges willful infringement. The law in the Southern District of New York, however, is that even if the complaint alleges a willful infringement, the insurer must defend the entire case even though it may only be required to cover that portion of costs and damages not allocable to willfulness.[7]

Many E & O policies also give the insurer the right to limit

[7] *See* Massachusetts Bay Ins. Co. v. Penny Preville, Inc., No. 95 Civ. 4845, 1996 WL 389266 (S.D.N.Y. July 10, 1996).

coverage to the amount of a proposed settlement plus expenses incurred prior to receipt of the settlement offer, if the insured refuses to accept what the insurer thinks is a reasonable offer.

State law may require certain modifications to an insurer's standard E & O policy. New York law, for example, often does. Such modifications generally will be listed on a separate schedule attached to the policy and should be reviewed thoroughly.

B. *Patent Insurance Policies*

In the last several years, coinciding with the explosion in intellectual property litigation in general, and patent litigation in particular,[8] at least two insurance companies, American International Group, Inc. ("AIG") and Lloyd's of London, have begun offering separate insurance policies covering losses due to patent infringement. These policies typically cover patent infringement resulting from the use, distribution, sale, and advertising of the insured's products. AIG provided a specimen policy for inclusion in this article, and thus, our discussion focuses on the AIG policy.

1. What is Covered

Like E & O policies, AIG's patent insurance policy covers liability for: defense expenses (largely attorneys' fees), including costs incurred defending injunction motions; damage awards; settlement payments, and; pre-judgment interest. As with E & O policies, each of these items will be counted against the total amount of the coverage. Thus, the amount of the indemnity remaining to pay damages will be reduced by the cost of an unsuccessful defense. This fact is more important in the patent infringement context because such lawsuits can be more expensive than copyright and trademark suits, thereby leaving less coverage to satisfy a judgment.

2. What is Not Covered

As with E & O policies, coverage typically does not extend to "offensive" litigations, that is, claims that another entity has infringed the insured's patents. Coverage also does not extend to: willful infringements; claims based on a failure to pay royalties; criminal acts; known prior infringements; claims by a government entity other than for infringement of government patents; failures to maintain a patent, and; litigation that was pending prior to the

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8 The number of patent lawsuits increased from 1474 in 1992 to 1840 in 1996, an increase of nearly 25%. *See* BUREAU OF JUSTICE STATISTICS, *supra* note 2, tbl. C-2A at 140.

policy's effective date. As with E & O policies, however, infringements prior to the date of the policy may be covered if the insured pays for the extra coverage.

3. Scope

The covered territory is limited to the United States, although the insured may extend the territory by an endorsement.

4. Cost

Patent insurance, as one might imagine, can be expensive. The cost may be as much as, if not more than, $3000 annually for each patent insured.

5. Special Considerations

On AIG's application for patent insurance, the applicant is asked detailed questions about the legal compliance program it uses to guard against infringement, the applicant's past history of infringement, and the applicant's own patents. The answers to these questions can affect the cost and availability of coverage. The applicant may also be required to supply opinion letters regarding non-infringement. If a reasonably prudent patent attorney would have conducted a patent search for the insured prior to the latter's exploitation of its covered product, the insured will be required to have done so, or coverage will be denied.

As with E & O policies, a patent insurance policy may provide that the insured has the right to select counsel of its choice, or the insurer may have the right to assume the insured's defense. In any event, as with E & O policies, the insured will be obligated to cooperate with the insurer in the defense or settlement of a patent infringement claim, and the insured will be required to obtain the insurer's permission prior to settling such claim.

A shortcoming of AIG's patent infringement policy is that reimbursement to the insured may not be due until final disposition of a claim, that is, judgment after appeal or final settlement. This provision can eviscerate the value of obtaining patent infringement insurance if the insured's attorney is not willing to wait for payment. What benefit does an insured receive when insurance reimbursement arrives at the end of litigation, long after the attorneys' bills are overdue and payroll must be met?

As with E & O policies, AIG has the right to limit coverage to the amount of a proposed settlement, plus expenses incurred prior to receipt of the offer, if the insured refuses to accept what the insurer thinks is a reasonable settlement offer.

C. *Comprehensive or Commercial General Liability Policies*

Most businesses have what is called either a Comprehensive or a Commercial General Liability Policy ("CGL"). A CGL insures against a wide variety of risks, such as bodily injury and damage to physical property, many of which have nothing to do with intellectual property. The industry-wide standard CGL policy is written by an insurance industry organization called the Insurance Services Office ("ISO").[9] For years, intellectual property specialists assumed, and case law supported the view, that intellectual property infringement disputes were not covered by CGL policies.[10] Though the law appears settled that patent infringement is not covered,[11] recent court decisions, particularly the federal district courts located in the State of New York, have found that copyright infringement, trademark infringement, and actions related to trademark infringement, such as trade dress or trade name infringement, are covered by a provision in the CGL policy providing coverage for "advertising injury."[12]

"Advertising injury" coverage was first offered as an endorsement to the 1973 ISO CGL policy form.[13] The endorsement defined "Advertising Injury" as "injury 'arising out of an offense committed during the policy period in the course of the named insured's advertising activities, if such injury arises out of libel, slander, defamation, violation of right of privacy, piracy, unfair competition, or infringement of copyright, title or slogan.'"[14] In 1986, the ISO further amended its CGL policy to provide coverage for

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9 *See* Richard L. Antognini, *What You Need To Know About Intellectual Property Coverage*, 31 TORT & INS. L.J. 895, 897-98 (Summer 1996).

10 *See, e.g.*, Jerry Madison Enter., Inc. v. Grasant Mfg. Co., No. 89 Civ. 2346, 1990 WL 13290 (S.D.N.Y. Feb. 14, 1990); A. Meyers & Sons v. Zurich Am. Ins. Group, 545 N.E.2d 1206 (N.Y. 1989).

11 *See, e.g.*, Simply Fresh Fruit, Inc. v. Continental Ins. Co., 94 F.3d 1219 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 388 (1996); Energex Systems Corp. v. Fireman's Fund Ins. Co., No. 96 Civ. 5993, 1997 WL 358007, at *2 (S.D.N.Y. June 25, 1997).

12 *See, e.g.*, *Energex Systems Corp.*, 1997 WL 358007 (holding that trademark and trade dress infringement claims are covered); *Massachusetts Bay Ins. Co.*, 1996 WL 389266 (holding that copyright and trade dress infringements are covered); Stratford Homes, Inc. v. LaRusso, No. 94-CV-0517E(M), 1995 WL 780977 (W.D.N.Y. Dec. 29, 1995) (holding that a copyright infringement is covered); A Touch of Class Imports, Ltd. v. Aetna Casualty and Surety Co., 901 F. Supp. 175 (S.D.N.Y. 1995) (holding that trademark infringement of a slogan is covered); Ben Burger & Son, Inc. v. American Motorist Ins. Co., 36 U.S.P.Q.2d (BNA) 1105 (S.D.N.Y. 1995) (holding that the insured is obligated to defend trade dress and copyright infringement claims).

13 *See* Antognini, *supra* note 9, at 898.

14 *Id.* (quoting a standard 1973 ISO CGL policy) (citations omitted in original).

"Advertising Injury" "'[c]aused by an offense committed in the course of advertising . . . goods, products or services'"[15] only when the injury

> "[arises] out of one or more of the following offenses" (1) oral or written publication of material that slanders or libels a person or organization, or disparages a person's or organization's goods, products or services; (2) oral or written publication of material that violates a person's right of privacy; (3) misappropriation of advertising ideas or style of doing business; or (4) infringement of copyright, title, or slogan.[16]

Though there has been a good deal written about the differences between the 1973 and 1986 provisions, particularly with regard to the elimination of "piracy" as a covered offense, the ISO has stated that the language changes between the two policies were not intended to change the scope of coverage.[17] Thus, at least for purposes of copyright and trademark actions, the scope of coverage should be the same, and thus, the test for whether coverage exists should be the same.

To receive coverage under the advertising injury provisions of the CGL, the insured must show: (1) that the injury complained of was committed in the course of the insured's advertising activities during the policy period, and (2) that the offense is one of those enumerated, and not excluded, in the policy.[18] The extension of coverage seen in recent decisions hinges largely on an expanded construction of what constitutes injury committed "in the course of advertising."

For example, in *Energex Systems Corp. v. Fireman's Fund Ins.*,[19] the court held that there was coverage for trademark and trade dress infringement under the CGL because "the claim for trade dress or trademark infringement includes as an element of proof some communication between seller and consumer" and that such communication constitutes advertising.[20] Regarding copyright, the court in *Massachusetts Bay Ins. Co. v. Penny Preville, Inc.* held that, the

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15 *Id.* (quoting a standard 1986 ISO CGL policy) (citations omitted in original).

16 *Id.* (quoting a standard 1986 ISO CGL policy) (citation omitted in original).

17 *See Massachusetts Bay Ins. Co.*, 1996 WL 389266 at *9 (citing INSURANCE SERVICES OFFICE, ISO COMMERCIAL LINES POLICY AND RATING SIMPLIFICATION PROJECT (Introduction and Overview, Commercial General Liability) (2d ed. Apr. 1985)).

18 *See, e.g.*, Energex Systems Corp. v. Fireman's Fund Ins. Co., No. 96 Civ. 5993, 1997 WL 358007, at *3 (S.D.N.Y. June 25, 1997).

19 *Id.*

20 *Id.* at *4.

> complaint claimed that the advertisement and display of allegedly imitation pieces of jewelry resulted in harm from the sales of these articles. In view of such claims, it would be artificial to deny coverage by constructing a distinction between the injuries arising from the manufacture and sale of infringing goods and injuries arising from the marketing of these same goods by means of display or advertisement of the goods.[21]

The aforementioned cases go too far. Every sale, and every offer for sale, involves some form of communication between buyer and seller. To say that every sale therefore involves advertising, results in coverage for many acts which may at best have a remote relationship to advertising content.[22]

Moreover, the expansive reading given to the advertising injury provision by recent case law disregards both the overall purpose of CGL coverage, namely, to provide base coverage for a wide range of risks faced by all types of businesses, and the realities of the insurance market, namely, that businesses which exploit intellectual property can purchase E & O policies.[23] Some businesses are not exploiters of intellectual property. The advertising injury provision, in our view, was clearly designed to provide protection for the only use of intellectual property common to all businesses, that is, use in advertising.

Insurance law requires that the scope of a policy be determined by the insured's reasonable expectations.[24] It is hard to believe, however, that when they purchased their CGL policies, insureds thought they were getting any more than protection for harms caused by their actual advertisements.

Moreover, the result of these decisions is to distort the risk management process. Suddenly, risks that were not appropriately measured by insurance actuaries have, nevertheless, been shifted to insurers, ultimately to the detriment of the remaining insureds in the same category of risk. Not surprisingly, insurers have reacted to recent case law by revising their policies. One policy, issued in 1997, states that

> [t]his policy does not apply to any claim against the [insured] based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged

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21 *Massachusetts Bay Ins. Co.*, 1996 WL 389266 at *7.

22 *See* Robert Bowden, Inc. v. Aetna Casualty and Surety Co., 977 F. Supp. 1475, 1480 (N.D.Ga. 1997).

23 In addition, both the *Massachusetts Bay* and *Stratford Homes* decisions bring into question whether clever pleading alone can lead to a finding that coverage exists.

24 *See* Antognini, *supra* note 9, at 900.

> infringement of any patent, copyright, trademark or service mark, including any actual or alleged violation of any law or statute, or rule or regulation promulgated thereunder or of any provision of the common law imposing liability in connection therewith.[25]

Though creative attorneys may find a way to argue that infringement liability is not excluded by this provision, the fact that insurers are taking steps to exclude such coverage strengthens the view that CGL policies were never meant to provide a broad infringement defense, and that they are insufficient for this purpose.

After a lawsuit begins, defense attorneys should review their jurisdiction's case law concerning CGL policies to determine if coverage may exist, and should seek coverage if the law is favorable or unclear. Plaintiffs' attorneys should style their pleadings to allege, or not allege, advertising activities depending on whether they want the insurer to be brought into the case. Businesses, however, should not rely on their CGL policies to cover intellectual property disputes. There are several reasons for this. First, it is not clear whether infringements generally are subject to coverage.[26] Not only does this mean that coverage may not be held to apply in a given case but, as a practical matter, it means that an insured which seeks coverage under the CGL may face a battle with its insurer. Second, even those courts which have expanded the scope of the CGL policy have held that there must be a nexus between the alleged wrong and the advertising, and there is always a chance that such a nexus might not be found. Third, there is a shrinking universe of policies to which this case law will apply. Insurers already are changing language in new policies to circumvent such case law, thereby closing the loophole as policies are being rewritten.

D. *Internet Related Insurance Policies*

This article does not address specialized insurance coverage for Internet Service Providers, such as America Online and various other companies, a portion of whose business is to provide connection to the Internet. These businesses face a host of specialized liability and vicarious liability issues, such as liability for the dissemination of computer viruses. There are specialized insurance policies written for these businesses. For example, AIG provides such specialized policies.

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[25] *See supra* note 4.

[26] *See, e.g.*, *Robert Bowden, Inc.*, 977 F. Supp. at 1475 (holding that copyright infringement not in the course of advertising is not covered under insured's CGL policy).

For the majority of businesses, which only provide "content" for the Internet, the following comment applies. "[T]hough the world of the Internet might seem overwhelming at first, it is good to envision it as a new ball field with the same old rules . . . ."[27] In reality, the Internet changes intellectual property risks very little. Just as traditional legal principles with minor tinkering have been adapted to most legal issues, such as personal jurisdiction on the Internet, so too will these principles apply to other Internet-related intellectual property issues. Multimedia providers on the Internet must address the same copyright and trademark concerns that multimedia providers previously have addressed. Similarly, Internet content providers must still license the music they use; they must still clear their use of any names or likenesses, and; they still cannot label their products in a confusing way.[28]

At the end of 1996, Chad Milton, a senior vice president of the Media Professional Company, one of the nation's largest providers of E & O insurance, was quoted as saying: "It doesn't matter to us if the content is print, broadcast or put on CD-ROM . . . . [The Internet is] just another means of expression. We need to make sure policies are broad enough to cover [all the exposures]."[29] E & O insurance policies that are marketed for the Internet resemble those previously in use. They are only somewhat broader, as Milton indicates. For example, the Chubb Insurance Group's Internet policy expands its prior definition of covered "matter" to include "printed, verbal, numerical, audio or visual expression or any other form of expression," in an effort to cover not only published or performed material, but computer code as well.[30]

There are, however, several potential risk management pitfalls unique to the Internet. The Internet by its very nature is global. Thus, an insurance policy covering only the United States is inadequate. If a business is planning to disseminate intellectual property on the Internet, the coverage territory of the insurance policy must be worldwide. In addition, many businesses, which traditionally have not been intellectual property users, now maintain websites

27 Stephanie D. Esters, *Cyberspace Creates Risks, Opportunities For Insurance*, NAT'L UNDERWRITER, Nov. 25, 1996, at 40, *available in* LEXIS, Insure Library, NUPROP File.

28 Music licensing on the Internet is currently the subject of an interesting battle to determine whether music played on the Internet constitutes a performance, thereby requiring a performance license, or a reproduction, thereby requiring a so-called "mechanical license," or both, requiring both types of licenses.

29 Chad Milton, *quoted in*, Mavis Allen, *Specialty Carriers Carve Niches In Media Liability*, NAT'L UNDERWRITER, Nov. 11, 1996, at 9 (alteration in original), *available in* LEXIS, Insure Library, NUPROP File.

30 Rodd Zolkos, *Liability Grows With Technology*, BUS. INS., Jan. 26, 1998, at 3, *available in* LEXIS, BUSFIN Library, BUSINS File.

that may utilize intellectual property. Unaccustomed as they are to the use and protection of intellectual property, such businesses must still be sure to obtain licenses for the use of others' software, music, and visual materials on their websites. They may also need to obtain E & O insurance.[31]

The so-called Internet "chat room" also poses unique problems. By maintaining a chat room, a business suddenly may be considered to function as a publisher, depending on the amount of control the business exercises over its room. In this way, businesses could become liable for violations of the right to privacy and for defamation committed in their chat rooms.[32]

E. *Practical Considerations*

There are many practical concerns which intellectual property specialists must keep in mind. Many, if not all, of the above policies, including those Internet related, require the applicant to certify that the information provided to the insurer is accurate. False certification can lead to denial of coverage. The timing of when coverage begins can be critical. Some policies only cover claims where the insured is first informed during the policy period, regardless of when they occurred. One must also promptly inform the insurance carrier about the existence of a claim. Most insurance policies provide that notice of a claim must be given to the insurer as soon as possible, or else coverage will be denied. Thus, an attorney's failure to provide timely notice could lead to malpractice liability.[33]

When both covered and uncovered claims are asserted in a lawsuit, the insurer is liable only for indemnification of the insured claims. An insurer, however, has a duty to defend its insured against a lawsuit so long as it appears on the face of the plaintiff's pleading that the alleged wrongs potentially may come within the coverage of the policy.[34] If an insurance policy potentially covers even one claim in a multi-claim lawsuit, the insurer must defend all claims.[35]

Mergers, acquisitions, sales, and other events affecting the insured's ownership or structure may affect its insurance policy, and

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[31] *See* David Halbreich et. al., *Intellectual Property On The Internet: Surfing through Liability and Coverage Issues*, 1 MEALEY'S EMERGING INS. DISP. 21, 31 (1996).
[32] *See* Zolkos, *supra* note 30, at 3.
[33] *See* David A. Gauntlett, *IP Attorneys' Failure To Provide Notice Of Suits Against An Insured Client Is Legal Malpractice*, 15 IPL NEWSL. No. 2, Winter 1997, at 12.
[34] *See* Seaboard Surety Co. v. Gillette Co., 476 N.E.2d 272 (N.Y. 1984).
[35] *See id.*

may trigger a duty to notify the insurer so as to allow it to re-evaluate coverage.

IV. Expanding the Scope of Intellectual Property Risk Management

A. *Plaintiffs' Insurance: Coverage for the Infringed*

One of the consequences of the soaring cost of litigation is that many businesses simply cannot afford the expense of bringing an infringement suit, even if attorneys' fees may be recovered in the end.[36] This problem is exacerbated by the fact that many significant technological innovations are developed by smaller businesses lacking the financial resources to sue larger companies which are likely to defend vigorously. Furthermore, many intellectual property lawyers are unwilling to litigate such cases on a contingency fee basis.

In response to this problem, at least two insurance companies, Litigation Risk Management, Inc. and Intellectual Property Insurance Services Corp. ("IPISC") have begun writing insurance policies to provide funding for plaintiffs' litigation against intellectual property infringers. Although this insurance is not yet widely available, its mere existence is extremely significant because it allows those businesses that can afford the premiums, but not the costs of a lawsuit, to vigorously enforce their rights against potential infringers. Whether such insurance becomes widely available, and whether such availability leads to increased litigation, remains to be seen.

1. What is Covered

Litigation Risk Management, Inc. did not provide a specimen policy in time for examination in this article. IPISC policies, however, were made available. IPISC offers both a so-called intellectual property infringement "abatement policy" and two patent infringement "abatement policies," one for individually named patents, and the other for all of the insured's patents. Depending on the type of policy, IPISC's policies cover seventy-five or eighty percent of the insured's cost of prosecuting an infringement action, including attorneys' fees, expert witness fees, deposition and court costs, and any costs incurred in defending against a counterclaim based on the invalidity of the insured's patent, trademark, or copyright.

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36 *See* Lisa A. Small, Note, *Offensive And Defensive Coverage For Patent Infringement Litigation: Who Will Pay?* 16 Cardozo Arts & Ent. L.J. 707, 710 (1998).

The insured must pay the balance. The insurance will also cover the same percentage of the defense for a declaratory judgment action, provided the insured can assert a counterclaim for infringement, that is, provided that there is potential for monetary recovery.

The infringement must be discovered, and the suit must begin, during the policy period. Moreover, the insured must obtain an independent attorney's opinion that the insured's claim is legitimate, and IPISC must then approve the lawsuit.

2. What is Not Covered

IPISC's policies do not cover liabilities for judgments or damages; they are only for the costs of an infringement suit. IPISC's policies also do not cover breach of contract suits against licensees, although such coverage can be obtained by endorsement.

3. Scope of Coverage

Coverage is limited to lawsuits in the United States, although additional territories may be added by endorsement.

4. Cost

For IPISC's policy covering individually named items, coverage ranges from approximately $100,000 to $500,000 per item. IPISC charges premiums ranging from roughly $1500 to $3100 per property insured. IPISC's blanket policy coverage ranges from approximately $1,000,000 to $3,000,000 in the aggregate, with premiums ranging from roughly $15,000 for ten patents to roughly $170,000 for 300 patents.

5. Special Considerations

IPISC's policies are indemnity policies which allow the insured to choose its own counsel, subject to the insurer's approval. Moreover, IPISC reserves the right to approve a litigation budget. IPISC's failure to approve either counsel or the budget constitutes grounds for denial of coverage.

A significant drawback to the IPISC policies is their approval process. IPISC requires the submission of a substantial amount of detailed information, as well as the opinion of an independent counsel, before giving its approval. This seems unmanageable in the context of emergency litigation, particularly when the insured might want to seek a temporary restraining order. It appears that Litigation Risk Management, Inc., on the other hand, conducts its approval process up front, forcing the insured to obtain an opinion on the strength of its property prior to receiving coverage.[37] While such process undoubtedly raises the initial cost of coverage, it makes for greater efficiency when it is time to file a lawsuit.

IPISC shares pro rata in any recovery that the insured obtains, up to 125% of the amount it spends on all litigation costs under the policy. IPISC policies also have a provision (which may be eliminated by endorsement) that allows it to charge the insured for the "economic benefit" the insured receives as a result of obtaining an injunction or other relief that benefits the insured economically, despite the fact that such benefit may not be quantifiable. The policy provides that if such "economic benefit" cannot be calculated, it will be presumed to be twice what the insurer has spent on the litigation.

6. Very Special Consideration

"Offensive" insurance underwritten by IPISC is not available in the State of New York. A search of the New York State Superintendent of Insurance's records failed to uncover a formal opinion on the issue. Nevertheless, the office of the New York State Superintendent of Insurance confirmed what IPISC had previously told us, namely, that the Superintendent had ruled that such policies were not authorized under New York State Insurance Law section 1113(a),[38] and thus cannot be offered in the State of New York.

B. *IPISC's Defense-Cost Only Insurance*

Besides its "offensive" insurance described above, IPISC also offers "Patent Infringement Defense Cost Reimbursement Insurance." This insurance is designed to cover only the cost of defending a patent infringement lawsuit in the United States. The policy does not cover judgment or settlement liability. Depending on the size of the insured, premiums can range from approximately $2500 a year for a $25,000 policy, to approximately $20,000 a year for a $500,000 policy. Like the other "defensive" insurance policies described above, the application for this insurance requires the applicant to attach legal opinions demonstrating its "freedom to manufacture" — another phrase for non-infringement. The approval process for IPISC's Patent Infringement Defense Cost Reim-

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[37] *See generally Anco: Intellectual Property Insurance* (visited Feb. 2, 1998) <http://www.anco.com/intel.htm>; Suzanne Sclafane, *Both Sides Seek Infringement Battle Cover*, NAT'L UNDERWRITER, Nov. 24, 1997, at 20.

[38] N.Y.S. INS. LAW § 1113(a) (McKinney 1998).

bursement Insurance is similar to the process for IPISC's abatement insurance.

Whether or not the marketplace accepts this type of policy remains to be seen. Such policy nevertheless represents another risk management option available to intellectual property owners and users.

C. *Insurance Other Than for Disputes: Intellectual Property Net Loss Insurance*

On February 13, 1998, *Daily Variety* reported that Sony Pictures was in the process of negotiating a $500 million insurance policy to protect a portion of its investment in a pool of films to be made by certain independent producers.[39] The story quoted an anonymous source as stating that the deal was designed to insure a certain amount of Sony's risk, thus reducing the volatility of its earnings.[40] This arrangement takes intellectual property risk management to a new level.

Although *Daily Variety* stated that "details of the deal are a closely guarded secret,"[41] the existence of the deal itself is not surprising. Other than the novelty of the concept, why wouldn't an insurer — if actuarially reasonable — write a policy to insure against this type of intellectual property loss? If insurance is considered part of risk management, earnings volatility can be considered another risk that an insured can transfer to an insurer.

It is understandable why movie studios would want to moderate their earnings swings by offsetting some risk in exchange for a fixed stream of payments. It is particularly desirable to studios which invest in independent films, because only one in ten of such films ever earns a profit.[42] From the insurer's perspective, increased awareness of the value of intellectual property and the concrete income these intangible assets generate will merge with demand to make the market feasible or not. It is foreseeable that record companies, publishers, and other entertainment businesses will at least explore the possibility of insuring their future losses.

It is also not surprising that the Sony insurance policy is being written for a substantial number of films. It is more feasible to insure all of a studio's given productions, rather than an individual

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39 *See* Martin Peers & Dan Cox, *Sony Covers Assets: Studio Insuring Its Indie Prod'n Stake*, DAILY VARIETY, Feb. 13, 1998, at 1.

40 *See id.*

41 *Id.*

42 *See St. Patrick Film Producers Seek Bond Investors*, AUSTIN AMERICAN-STATESMAN, Sept. 20, 1997, at 7.

production, because the insurer's risk is more broadly distributed among numerous films. When a group of films — albeit future productions — are evaluated for risk, more statistics are readily available, probabilities can be better calculated and, therefore, the parties can more easily negotiate a premium.

D. *Intellectual Property Asset Securitization*

Investment banks are realizing the value of intellectual property and are tapping into that value at the same time as insurance companies. This realization on the part of investment banks and their clients has opened a new avenue of intellectual property risk management, namely, intellectual property asset backed securitization. Insurance companies are realizing that there is money to be made in insuring the risks created by these types of deals, as well as by investing in such deals themselves.

During 1997, singer/songwriter David Bowie successfully issued $55 million in bonds, securitized only by the royalty stream earned by the twenty-five albums he recorded before 1990, an intellectual property asset with a measurable track record of success over decades.[43] The Bowie bonds were "guaranteed" (another word for "insured") by Bowie's music publisher, EMI.[44] Rumors abound that other recording artists, such as Rod Stewart, Crosby, Stills & Nash, and Luciano Pavorotti, are considering similar bond issuances.[45] Such deals can be attractive to the artist from a variety of standpoints, including tax and estate planning.[46]

Some believe that the securitization and insurance of recording artists' royalty payments constitutes only the tip of the iceberg.[47] They see more potential in bond issuances based on the entire music catalogs of large record companies and movie studios,

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43 *See* Sam Adler, *Bowie Bond Buy Explains Investment*, 13 ENT. L. & FIN. 6, 6 (Sept. 1997) (interviewing Andrea Kutscher, Vice President of Structured Finance for Prudential Investments).

44 *See* Sam Adler, *Bowie Breakthrough; Structuring Music Bonds*, 13 ENT. L. & FIN. 6, 1 (Sept. 1997).

45 *See* Sue Ziedler, *Rod Stewart Poised to Rock Wall Street*, AAP NEWSFEED, Feb. 2, 1998; Erica Copulsky, *Can Ethan Penner Securitize Rock 'n' Roll?*, INVESTMENT DEALERS' DIG., Dec. 15, 1997, at 16, 16; Kathy Bergan, *A Star Turn Banking on the Future; Rockers And Pavorotti Have Put Securitization On Stage, But the Secret to the Investment Tool's Rapid Growth is More Mundane*, CHI. TRIB., Dec. 5, 1997, at N1.

46 *See* Sam Adler, *David Bowie $55 Million Haul: Using A Musician's Assets to Structure A Bond Offering*, 13 ENT. L. & FIN. 5, 1 (Aug. 1997) (explaining the various advantages of this type of financing).

47 In fact, some think we will not see many individual artist issues at all simply because most artists either do not control the majority of their catalog, do not have sufficient income stream to back the securities, or do not need the money. *See* Copulsky, *supra* note 45, at 17.

as well as bond issuances by technology companies.[48] "What the Bowie Bonds show, says David Pullman, managing director of Fahnestock & Co., the issuing bank, is that intellectual property of all kinds can be securitized."[49] For high tech firms, issuance of such bonds can help them get the advance money they need for further research and product development.[50] Private companies in particular benefit because they can raise cash without going public.[51] In addition, brokers hope to target sports teams, utilizing as collateral the tremendous merchandising revenues from their trademarks.[52]

Hollywood has already jumped in. Last year, the St. Paul Film Foundation, a group of Catholic filmmakers seeking to make a film about Saint Patrick, began offering what they anticipate will be a total of $31 million in high yield bonds to fund the project.[53] Two years ago, Walt Disney sold bonds with returns linked to a pool of its films.[54]

Recently, Dreamworks SKG, the company co-founded by Steven Spielberg, securitized the film rights and future revenues of a series of films not yet released.[55] These bonds, like Bowie's, are guaranteed, in this case by Capital Markets Assurance Corporation.

Prudential Securities has announced that it will provide up to $200 million in financing to CAK Universal Credit Corp., a company headed by long time music industry executive Charles Koppelman, for purposes of making loans to copyright owners backed by income from the sales of their works.[56] Koppelman has indicated that he expects the CAK bonds to be insured by one or more insurers specializing in bond insurance, and that insurance companies will be the principal buyers of the bonds,[57] a statement echoed by others.[58]

The Wall Street Journal reported that CAK anticipates that its

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48 *See id.*

49 Jeff Wise, *Sex, Bonds, and Rock and Roll*, 22 WORKING WOMAN 10, 14 (Oct. 1997).

50 *See* Carol Haber, *IP Bond Plan Draws Interest of High-Tech*, ELECTRONIC NEWS, May 5, 1997, at 1.

51 *See id.*

52 *See Smart BONDS, David Bowie's Brokers Set Their Sights on Silicon Valley's Intellectual Property*, SAN FRAN. EXAMINER, Mar. 25, 1997, at D1.

53 *See St. Patrick Film Producers*, *supra* note 42, at 7.

54 *See id.*

55 *See* Erica Copulsky, *Asset-backed Hollywood*, INVESTMENT DEALERS' DIG., Dec. 15, 1997, at 19, 19.

56 *See* Patrick McGeehan, *Rock 'n' Roll Bonds Tap Investors' Faith in Future Royalties*, WALL ST. J., Feb. 10, 1998, at B2.

57 *See Rollin' With The Rock: Entertainment Impresario Charles A. Koppelman Marries Hollywood and Wall Street In New Venture*, PR NEWSWIRE, Feb. 9, 1998.

58 *See* Copulsky, *supra* note 45, at 17 (quoting Lisbeth Barron of Bear Stearns media and entertainment group).

loans will be secured by future royalties.[59] Thus, the CAK bonds, like the Dreamworks bonds, are a significant step forward from the Bowie deal because they securitize future earnings, a process allowing for far less precise valuation, thereby confirming investors' increasing faith in intellectual property values. Intangible asset backed securitization, based on future intellectual property revenues, may become a significant opportunity for insurers to make money by guaranteeing that sufficient revenues will exist to pay off the bondholders.

IV. Conclusion

Modern intellectual property risks threaten not only one's ability to preserve intellectual property values, but also one's ability to enhance those values. Management of these risks can now be accomplished by self-help means, in the form of legal compliance programs, and by outside means, in the form of insurance coverage. One must select the method (or methods) of risk management that best serves one's business from all of the available devices. This selection periodically must be reviewed because, as new intellectual property risks develop, legal compliance and insurance will contemporaneously evolve to provide protection against them, and new risk management devices will become available.

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[59] *See* McGeehan, *supra* note 56, at B2.