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Can Insurance Coverage Provide Meaningful Protection from Patent Trolls and Other Infringement Claims?

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Notwithstanding two recent Supreme Court decisions making it easier to recover attorney's fees from non-practicing entities (NPEs), or "patent trolls" as they are commonly known, insurers continue to market policies that provide coverage for lawsuits brought by NPEs or others asserting patent-related claims. The question becomes whether policies that provide coverage for these lawsuits, which previously have been considered niche products, can provide meaningful value or protection to insureds.

In April 2014, the U.S. Supreme Court handed down two unanimous decisions that made it easier for federal courts to impose attorneys' fees on NPEs that bring meritless patent infringement suits. In Octane Fitness LLC v. Icon Health & Fitness Inc., Case No. 12-1163, the Supreme Court held that attorneys' fees may be awarded against NPEs in cases that "[stand] out from others," rejecting a stricter standard requiring lawsuits that were "objectively baseless" and "brought in subjective bad faith" in order to recover fees. In Highmark Inc. v. Allcare Health Management Systems Inc., Case No. 12-1184, the Supreme Court ruled that an appeals court must defer to a lower court's decision to award attorney's fees, using an "abuse of discretion" standard, in contrast to the previous practice by appeals courts of reviewing all such awards without such deference.

Around the same time that the Supreme Court issued these decisions, there was a noticeable spike in the filing of patent infringement lawsuits, including by NPEs. This has been attributed to a proposed bill in Congress that would increase the number of cases where the losing party in a patent case would be forced to pay the winning party's legal fees. This proposed law would be retroactive to any case filed on or after April 24, 2014. As a result, on April 23, 2104, 190 new patent infringement suits were filed, many of them by NPEs, in the Eastern District of Texas, a common venue for these types of suits.

Although the Supreme Court decisions may aid defendants in recovering their attorney's fees, these new standards would not apply or result in attorneys' fees awards unless the parties reach final judgment. Given that the vast majority of these cases settle before they reach final judgment, the issue of whether a party's attorney's fees can be recovered through insurance coverage is still an important one.

Comprehensive general liability (CGL) policies currently being issued commonly contain standard exclusions for typical patent infringement lawsuits. However, it may be possible to secure coverage for patent infringement claims in CGL, directors and officers, and errors and omissions policies. When faced with an intellectual property lawsuit, these types of policies should be examined to determine potential coverage.

A handful of insurers are marketing specialized coverage that covers claims asserting infringement of patents and other intellectual property, including NPE lawsuits. Intellectual property infringement liability policies cover the defense costs (and sometimes damages) associated with an action for infringement of patents and other intellectual property. Defense costs and damages (where covered) both typically erode (that is, count against) the limits of liability of these policies.

This coverage is not a panacea as the limits tend to be relatively small, up to $5 or $10 million, compared to potential exposure in defending an infringement lawsuit. Although higher limits may be negotiated, insurers may require higher deductibles or self-insured retentions where higher limits are sought.

Intellectual property infringement liability policies typically are "claims made and reported" policies, meaning that coverage will only apply for claims made against the insured and reported to the insurer during the policy's coverage period. There are two important caveats to this general framework. First, some policies purport to exclude coverage for infringement claims made during the first 90 days of the policy period. There is a significant question whether such a purported limitation is enforceable, given that it renders coverage illusory for a significant portion of the policy period. Second, courts have been reluctant to enforce strict within-the-policy-period reporting requirements for claims made near the end of the policy period, because as a practical matter they may render coverage for such claims illusory. Recognizing this fact, the policies ordinarily provide a short grace period after the policy period for reporting claims. There may be a basis to contend that such short grace periods are unenforceable, particularly where insurers otherwise accept notice on claims made earlier in the policy period with longer delays.

Like other claims-made-and-reported policies, these policies also may exclude coverage for acts prior to a retroactive date, which is a negotiated date but is often the inception date of the first policy purchased from the insurer in question. First-time buyers should seek to negotiate an earlier retroactive date with the insurer. Otherwise, insurers will contend that the coverage does not apply to claims made against the insured and reported to the insurer during the policy period if they arise out of alleged acts of infringement before the policy inception date, as will often be the case, particularly in the first year or two of coverage.

Standard exclusions in these policies include: (1) fines or penalties, including punitive, exemplary, treble, or multiple damages; (2) infringement actually known by the insured prior to the policy period; and (3) losses or expenses arising from willful infringement, although this exclusion often requires final adjudication by a court or other body before it becomes effective. These policies also typically exclude coverage for any counterclaims, retaliatory lawsuits, or administrative proceedings, including proceedings before the International Trade Commission, and require authorization for an appeal should the insured not prevail in the initial lawsuit. These last few exclusions are unique to these types of policies, and the insured could attempt to negotiate the removal or amendment of these exclusions

Companies concerned about potential exposure to claim by NPE or other patent infringement claims should familiarize themselves with coverage for such claims potentially available under traditional types of coverage such as CGL, D&O, and E&O policies. Specialized intellectual property infringement liability coverage is worth considering as well. But companies that are interested in such coverage should actively negotiate the policy terms in order to strengthen the protection available in the event of a claim.