Navigating Shakedown Street

Risk Management Options for Dealing With Patent Trolls

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One of the shocking observations from a recent joint report from The National Economic Council and Council of Economic Advisors was that a majority (62%) of patent infringement lawsuits filed the past two years were not brought by inventors or innovative companies seeking to enforce their patents against competing products in the traditional sense, but rather by entities commonly known as "patent trolls." Patent trolls, a.k.a. Non-Participating Entities ("NPEs") and Patent Assertion Entities ("PAEs") are entities whose primary function is to acquire patents for the purpose of pursuing infringement lawsuits against companies in hopes of scoring lucrative payoffs. Much harder to measure are the number of cease and desist letters sent by PAEs resulting in pre-litigation settlements, often for substantial sums (but less than the cost of litigation). The joint report estimates that in 2012 alone, over 100,000 companies were threatened with lawsuits by NPEs.

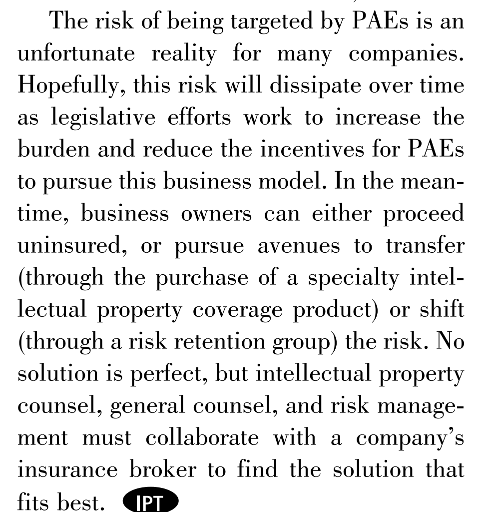
With the recent anti-troll advocacy from several high-profile sources, including outspoken billionaire and champion of entrepreneurship Mark Cuban, as well as the six bills currently in committee in the House and Senate and another under consideration aimed squarely at the patent troll problem, the good news is that help in managing the risk appears to be coming. The bad news, however, is that statutory changes will be slow to take effect against the sharp rise in PAE-initiated lawsuits, and will provide little solace to businesses facing current exposure. With the median cost of defending a patent lawsuit at around $650,000, it makes good business sense to be paranoid and explore all available means to manage this evolving risk.

Historically, insurance coverage has been limited for patent infringement claims. In recent years, policyholders scored high-profile victories against insurance companies with several reported decisions holding that patent infringement claims might be covered under the 'advertising liability' coverage in standard Comprehensive General Liability policies. However, the reach of those decisions is relatively narrow, as such coverage is typically limited to claims where the patent infringement claim itself involves an advertising element (e.g., the patent involved relates to advertising, or the act of infringement somehow involves advertising). Another option to explore is "intellectual property insurance" coverage, a line of specialty coverage typically available through both market niche brokers and most major all-service brokerage firms.

Recently, news reports have surfaced regarding a new option specifically designed to address the risk of claims by PAEs. Last October, BusinessInsurance.com ran an article describing a new "insurance policy" specifically designed to "manage and mitigate the growing issue of 'patent trolls'." The product, according to the article, would be distributed exclusively by Aon Risk Solutions, and would be underwritten by RPX Insurance Services, Inc. a unit of RPX, Corporation.

A closer examination of RPX Insurance Services' website, however, provides a fuller picture of the program. BusinessInsurance.com and other similar write-ups appear to describe the product as an insurance policy that companies can buy from an insurance company to cover this risk. According to RPX's website, that does not appear to be an accurate description. The "insurance company" that sells the policy is actually an entity called "RPX Risk Retention Group", and it's not actually an insurance company; it is (wait for it), a risk retention group. A risk retention group is a conglomeration of members who come together to decide that they are going to pool assets together and, collectively, self-insure their risk. Public entities often do the same thing through entities called joint powers authorities, whereby multiple public entities agree to form a new entity solely for the purpose of retaining the members' risk. The risk retention group then sells coverage to each of its members. Thus, in order to buy this PAE "insurance" from RPX, a company must first buy into RPX and become a "member" of the risk retention group. These arrangements have pros and cons to traditional insurance. They often have more flexibility than traditional insurance companies and may offer coverage that traditional insurers do not. Also, by pooling risk, the group may have more affordable access to excess insurance or reinsurance, so that while the group is technically "retaining" the risk, it has actually shifted much of the risk off to an excess carrier or reinsurer (at a more affordable price than would otherwise be available).

There are also drawbacks. As explained above, coverage is contingent on buying into the pool. Depending on how the entity is structured in its formation documents, the "coverage" product might not technically be "insurance" (the actual coverage document is often called something like a "Memorandum of Coverage" or some similar substitute for "insurance policy"). Many risk retention groups claim (and some courts have agreed) that this means state insurance law does not govern the "policies" and the group cannot be sued for insurance bad faith, limiting the remedies available to a member in the event the group (or perhaps the third party administrator hired to handle the program) wrongfully denies coverage for a claim. It's also probable that the group will have an alternative dispute resolution policy that will limit (if not eliminate) a member's access to the court system to enforce its rights under the program. That's not to say that these groups can't be an advantageous means of transferring risk – they absolutely can be. But any company exploring this option must fully investigate the pros and cons (even more so than would be the case in a more traditional insurance transaction).



The risk of being targeted by PAEs is an unfortunate reality for many companies. Hopefully, this risk will dissipate over time as legislative efforts work to increase the burden and reduce the incentives for PAEs to pursue this business model. In the meantime, business owners can either proceed uninsured, or pursue avenues to transfer (through the purchase of a specialty intellectual property coverage product) or shift (through a risk retention group) the risk. No solution is perfect, but intellectual property counsel, general counsel, and risk management must collaborate with a company's insurance broker to find the solution that fits best. IPT