

Comparative Review Of IP-Insurance Coverage In The U.S. and Germany

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I. Introduction

An intellectual property system is a crucial part of a country's economic infrastructure and enhances the ability to strengthen and advance its technological base in a sustained way. Furthermore, it allocates financial resources and fosters the movement of technical knowledge across borders. Increasingly, much of a company's true value relates to intellectual property and the financial community is making the presence or absence of a company's IP strategy a factor in its investment decisions.¹ Therefore, in today's hypercompetitive marketplace, businesses try to guard these assets. If a company feels that a competitor has infringed on any of its holdings, it has the option to bring claims for monetary damages, injunctive reliefs and temporary restraining orders to stop the offending activities. Thus, businesses pursuing claims against other businesses who may have infringed on their intellectual property rights or businesses who want to guard themselves from commercial claims must have a strategy to handle intellectual property claims. In general, larger companies can afford to maintain patent litigation, while smaller companies or individuals who pursue judicial recourse often do not have the

necessary capital to sustain a long court battle against a well-financed opponent. Because the firm's protection of intellectual property is essential for its market position and its future development, insurance coverage of intellectual property is becoming increasingly important from both an offensive and a defensive perspective.

Because of the growing business interaction between the two countries and the personal interest of the authors of this article, the purpose of this article is to analyze the differences of IP-insurance coverage in the U.S. and Germany. Another goal of this note is to emphasize the importance of establishing risk management regarding the preservation of intellectual property from infringement and expropriation. In order to understand the different strategies with respect to intellectual property claims in both countries, it is necessary to appreciate the various kinds of insurance products available to address intellectual property exposures. Therefore, Section II of this article will analyze the different coverage strategies available to intellectual property holders in the U.S. and recent court decisions broadening the insurer's responsibility for defending and indemnifying claims for intellectual property violations. In Section III, the discussion will continue with a consideration of the legal expenses in German litigation and the specific agreements providing coverage for legal expenses and other intellectual property exposures. Finally, Section IV will examine the different strategies businesses must identify in the U.S. and Germany to make their own cost/benefit analysis about buying additional policies specifically for

intellectual property disputes.

II. Insurance Coverage For Intellectual Property Claims in the U.S.

The patent laws permit the patent holder to recover civil damages from companies who are infringing on its patent. In recent years, however, this liability risk has undergone a dramatic development. "Swiss Re New Market's research" shows that the annual number of patent infringement awards in the U.S. exceeding US\$ 10 million has doubled in the last five years and even patent infringement awards of US\$ 100 million or more are no longer uncommon. As a consequence, over the past several years, a number of insurance companies have developed specific agreements to provide coverage for intellectual property exposures. To evaluate them, it is critical to understand that each is unique in concept and design and should be evaluated based on the client's needs and objectives, along with the coverage afforded by the policy. There are three basic types of policies: (i) a *commercial liability insurance policy* which is often accompanied by an advertising injury coverage, (ii) an *infringement liability insurance* which is a type of policy

1. See also Koos Rasser, IP strategy can tip balance, *LEXIS Financial News*, January 14, 2002 (referring to a survey conducted in the UK among more than 100 fund managers, analysts, private equity firms and venture capitalists after which one of four respondents would turn down an investment opportunity if a company's IP strategy seemed inadequate and of whom 94% believe that the presence and quality of a company's IP strategy is important to the protection of its market position).

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providing defense coverage for the insured in the event of a patent infringement suit and, in the event of liability, pays damages, including prejudgment interest and (iii) an *infringement enforcement insurance* which is an offensive policy designed to reimburse the insured for legal expenses associated with pursuing an infringing party.

a. Commercial General Liability Insurance

Most businesses have what is called a "Comprehensive or a Commercial General Liability Policy" (CGL). The industry wide standard CGL policy is written by an insurance industry organization called "Insurance Services Office" (ISO). The CGL insures against a wide variety of risks, such as bodily injury, damage to physical property and advertising injury. "Advertising injury" coverage was first offered as an endorsement to the 1973 ISO CGL policy form and was defined 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."² 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.

As patent litigation increased in the 1980's, companies concerned with the risk of defending themselves against patent infringement suits referred to the coverage under their existing "advertising injury" clause of the CGL insurance policy. From 1988 to 1993, California courts, which are among the most influential state courts in the area of insurance law, construed CGL policies to cover patent infringement cases. In *Aetna Casualty & Sur. V.*

Watercloud (Watercloud I),³ the District Court of the Central District of California held for the insured under a CGL policy, because the terms "piracy" and "unfair competition" could reasonably encompass claims for copying another's goods, including claims for patent infringement. However, the acts of piracy or unfair competition must occur in the course of the insured's advertising activities. Because the defendant in the underlying infringement suit had actively induced infringement by providing advertising material containing instructions on how to construct an infringing product, the court found that the injury had occurred within the course of the insured's advertising activities. In *John Deere Inc. v. Shamrock Indus.*,⁴ the court extended coverage under a CGL policy where the patented device had been advertised to no more than one potential customer. Going even further, the District Court for the Central District of California in *Intex Plastics v. United Nat'l Ins.*,⁵ extended coverage even to claims with no connection between the insured's advertising activity and the underlying plaintiff's injury. Since 1993, however,

California courts denied companies such coverage under a CGL policy. In *Aetna Casualty & Sur. V. Superior Court (Watercloud II)*,⁶ the California State Appellate Court held that patent infringement cannot be committed in the course of advertising activities. The patentee is not injured because a product incorporating its invention is advertised, but because the infringer, without consent, used or sold a product utilizing a protected invention. As a result, *Watercloud II* completely changed the direction of jurisprudence governing CGL coverage of patent infringement. Subsequent federal diversity cases in California have followed *Watercloud II* and found for the insurer.⁷ As a result, patent infringement damages today, whether based on direct, contributory, or induced liability, will not cover "advertising activities" or "personal injury" clauses in CGL policies.⁸

Though the law appears settled that patent infringement is not covered by CGL policies, courts are split on the question whether copyright infringement, trademark infringement, and actions related to trademark infringement, such as trade dress or trade name infringe-

2. See also Melvin Simensky and Eric C Osterberg, The Insurance and Management of Intellectual Property risks, 17 *Cardozo Arts & Ent LJ*, 1999 at 331 (noting that in 1986 the ISO further amended its CGL policy to provide coverage for "Advertising Injury" caused by an offense committed in the course of advertising only when the injury arises out of (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. 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).

3. *Aetna Casualty and Surety Co. v. Watercloud Bed Co., Inc.*, Richard La Bianco Industrial Indemnity Co., 1988 U.S. Dist. LEXIS 17572.

4. *John Deere Ins. v. Shamrock Indus.*, 696 F. Supp. 434 (D. Minn. 1988).

5. *Intex Plastics v. United Nat'l Ins.*, 25 U.S.P.Q.2d (BNA)1317 (N.D. Cal. 1992).

6. *Aetna Casualty & Sur. V. Superior Court (Watercloud II)*, 28 U.S.P.Q. 2d (BNA) 1424 (Cal. Ct. App. 1993)

7. See *N.H. Ins. V. R.L. Chaides Constr.*, 847 F. Supp. 1452, 30 U.S.P.Q.2d (BNA) 1474 (N.D. Cal.1994) (founding for the insurer and mentioning that *Watercloud II* would not alter the result); see also *Iolab v. Seaboard Sur.*, 15 F.3d 1500, 29 U.S.P.Q.2d 1534,1536 (BNA) (9th Cir. 1994) (emphasizing that the underlying defendant infringed the patent because it sold the patent product and as a result, the infringement loss "was caused by patent infringement not by advertising activities").

8. See also Jason A. Reyes, Patent and Insurance: Who Will Pay for Infringement, 1 *B.U.J.SCI.&TECH.L*.3, 1995 at Paragraph Number 18 and 19 (arguing that Article 28 of the Final Act of GATT contains language imposing infringement liability for the "offering for sale" that may reopen the door closed by *Watercloud II* with regard to the scope of the CGL coverage).

ment, are covered by the CGL provision providing coverage for “advertising injury.” While the Sixth Circuit concluded that “no trademark or trade dress claims are covered under the CGL’s advertising injury coverage, the California appellate court indicated that “a trademark is but a species of advertising” and because of this, advertising “is a way in which infringement may occur.”⁹ In a recent decision from July 25, 2001,¹⁰ the U.S. District Court for the Eastern District of Pennsylvania distinguished the insurer’s duty to defend from the legally independent duty to indemnify and hold that the duty to defend arises “whenever an underlying complaint may potentially come within the insurance coverage.” Consequently, if a single allegation of a complaint is potentially covered by a policy, an insurer has an obligation to defend its insured against all trademark infringement claims until there is no possibility of recovery for a covered claim.

b. Infringement Liability Insurance-Defense Cost and Reimbursement Coverage

Specialized IP-infringement insurance grew up in response to the increasing risk of infringement liability and courts’ narrow construction of CGL policies. Most common is the patent infringement liability insurance, which is professional liability insurance for manufacturers, users and sellers who are accused of infringing a patent holder’s rights. In an industry first, American International Group (“AIG”) introduced standardized patent infringement insurance in 1994. AIG and its subsidiaries claimed that specific requests from technology industry and their own market research indicated a large demand for such insurance.¹¹ Later, specialty insurers started to provide coverage for defense and indemnity, which can include coverage for profits and royalties that a losing defendant must relinquish to patent holders. Typically, these are claim-made policies, meaning the claim

must be first made during the insurance policy period in order for the insurer to cover it. An important exclusion in the policy is for a claim of willful or intentional patent infringement where the insured has prior knowledge that his manufacturing, using or selling of covered products would result in allegations of patent infringement. Some policies also exclude claims for infringement of design and plant patents, claims for breach of contractual obligation, including licensing agreement provision, claims involving a related business not named previously, claims arising out of pending or prior litigation, claims by another policyholder, claims brought by a governmental entity unless the entity holds the relevant patent, claims based on antitrust conduct by the insured and punitive, exemplary, or multiple damages. According to the definitions of most policies, coverage is available for claims of injunctive relief as well as for damages and applies to relief granted in arbitration. Usually, products are not considered covered unless, prior to first manufacture, use or sale, a qualified patent attorney prepares a competent legal opinion concluding that the product does not infringe any valid patent. In summary, infringement liability insurance policies require the insured to jump through a number of significant and

expansive procedural hoops, first to retain a reasonable premium and then to retain sufficient coverage.

c. Infringement Enforcement Insurance

Known as “infringement abatement insurance” or “enforcement” coverage, an infringement enforcement insurance is designed to reimburse the insured for legal expenses associated with pursuing an infringing party. Unlike CGL and infringement insurance, enforcement insurance insures IP holders, not potential infringers. Premiums are significantly lower than premiums for infringement liability insurance. A large market, especially for patent enforcement insurance, already exists and patent enforcement insurance agencies have strong connections to companies that invest in patent lawsuits. For small companies and individual investors, enforcing a patent against a well-funded infringer is a very expensive and time-consuming proposition. Lawyers rarely take on the enforcement of a patent on a contingent-fee basis, absent some proven track record of success. As a result, such insurance policies fill the need to protect against future infringement of patents because they are triggered in the event of litigation to enforce the patent. The so called “Intellectual Property Insurance” is a broadened form of patent enforcement insurance which expands coverage to include trademarks, copyrights and computer software design.

The IP enforcement insurance entails many of the same problems encountered with IP infringement insurance, such as procedural hoops for the insured and the risk of insurance litigation. However, the insured and the insurer are both potential beneficiaries of a large damage award, which might keep the insurer interested because a lot of money may be available.¹² Another important issue from the insured’s perspective is the prospect that its relationship with the insurer might affect the success of the lawsuit, especially when the settle-

9. See Bryon L. Romine, Notes & Comments: Advertising injury coverage analysis for Trademark and Trade Dress Infringement claims in Texas: As easy as one, two, three, 6 Tex. Wesleyan L. Rev. 211, 2000 at 218-221. The opinion of the California Appellate court is supported by *Ben Burger & Son, Inc. v. American Motorist Ins. Co.*, 36 U.S.P.Q.2d (BNA) 1105 (S.D.N.Y. 1995), after which the insured is obligated to defend trade dress and copyright infringement claims and by *Energex Systems Corp.*, 1997 WL 358007, after which trademark and trade dress infringements are generally covered.

10. *Cat Internet Systems Inc., Internet Supply Inc. v. Providence Washington Insurance Co., York Insurance Company*, 2001 U.S. Dist. LEXIS 10756.

11. Bruce Rubenstein, *New Product: Insurance for Patent Infringers*, 4 Corp. Legal Times 1, 1994 at 1.

ment value of the lawsuit is lower for the insurer than for the insured. In such case, the insurer might pressure the insured to accept a settlement offer because both the insurer and the alleged infringer have an interest in minimizing litigation expenses.¹³ As a consequence, the insured IP holder might face a premature settlement to his own detriment.

III. Insurance Coverage For Intellectual Property Claims in Germany

To compare insurance coverage in Germany with insurance coverage in the U.S. a short introduction of how claims are handled by the German judicial system is believed helpful. While actions for damages and actions for injunction are brought before the civil divisions of the district courts in Germany, patent nullity actions are handled by the Federal Patent Court. Consequently, a patent owner is frequently involved in two separate lawsuits in different courts at the same time. As jury trials are not recognized in civil proceedings, lawsuits in both courts are only decided by judges. In a proceeding before district courts, the judges may consider only the facts brought forward by the parties in the decision-making process during trial, so called "principle of party presentation" (*Verhandlungs- or Beibringungsgrundsatz*). In contrast, in

12. *see also* Jason A. Reyes, *supra* note 9, at footnote 144 (arguing that in some states recovery sharing between patent holder and the insurer faces difficulties due to champerty laws, which ban the sharing of damage awards with third parties; however, to evade the reach of the champerty laws, affiliated companies of the insurer may take an ownership interest in the patent at issue).

13. *See id.* at footnote 145 (claiming that the insurer and the alleged infringer might have an interest to enter into a "Mary Carter" agreement after which one party allies itself with another to the detriment of one or more remaining parties to a lawsuit; while a number of states ban such agreements altogether, most jurisdictions in the US tolerate "Mary Carter" agreements and implement procedural guidelines to offset their prejudicial effects).

a procedure before the Federal Patent Court, the court is obliged to clear up the circumstances independently, so called "principle of judicial investigation" (*Untersuchungs- oder Amtsermittlungsgrundsatz*).

In Continental tradition, experts are selected and commissioned by the court, although with great attention to safeguarding party interests. It must be noted that in Germany, in contrast to the American perception, experts are not witnesses, but court-appointed aides of the judge in making his decision. The court may decide to seek expertise on its own motion, or at the request of one of the parties and the court is free to decide whether or not to follow the expert's report. The German system of court appointed experts is based on the assumption that an expert who has been appointed by a neutral tribunal rather than by one of the parties will not easily take a one-sided and biased view of the facts, because he is responsible to the court and subject to forfeiture of his expenses and possibly contempt proceedings if he can be proven not to have been neutral and detached in his findings.¹⁴ Furthermore, witnesses are questioned first by the presiding judge and only afterwards are the parties and their attorneys allowed to interrogate the witnesses. If the judge's preparation of the hearing is adequate, there will practically be very few questions left for the lawyers as the judge will have asked all the important ones. As a result, German civil procedure leaves behind all traces of the American system of partisan preparation, examination, and cross examination of witnesses.¹⁵

The defeated party basically carries the burden of paying all the expenses of a lawsuit (court fees and attorney's fees included). If there is a partial victory or defeat, the expenses are divided proportionally among the litigating parties. The winning party is refunded only for the legal expenses set forth in the Federal Regulation on Attorneys' Fees (*Bundesgebuehrenordnung*)¹⁶.

On the contrary, a client does not get his expenses fully recovered when he and his lawyer have privately agreed on a higher fee. In Germany, statutes and regulations require what a lawyer or patent agent may charge his client as a consideration for his legal work. According to Section 49b, Paragraph 1 of the Federal Regulation on Attorneys (*Bundesrechtsanwaltsordnung*, BRAO), an attorney may not agree to a lower remuneration than is set forth in the Federal Regulation of Attorneys' Fees because it is considered unethical. A higher fee than legally intended is only permitted if arranged in writing. However, it is prohibited for lawyers as well as patent agents, to agree on contingency fees or on profit-sharing ("*Quota litis*") with clients.¹⁷ Every possible type of litigation activity that a lawyer might engage in is defined in detail and for each activity, a monetary amount based on a fraction of what is called a "basic fee" is assigned. The basic fee is set as a percentage of the amount in controversy and is retrogressive: when the amount in controversy is low, the basic fee percentage is high and when the amount in controversy is high, the basic fee is low and maybe less than one percent. The

14. *See* Michael Bohlander, *The German Advantage Revisited: An Inside View of German Civil Procedure in the Nineties*, 13 *Tul. Eur. & Civ. L.F.* 25, 1998 at 11 (noting that the expert is, however, paid for by the party whose contention he is supposed to prove according to the burden of proof. That party has to make an advance down-payment to the court who formally reimburses the expert, and if the expert does prove the alleged facts, the successful party may claim his expenses from the loser- yet the party has no influence over whom the judge will appoint).

15. John H. Langbein, *The German Advantage in Civil Procedure*, 52 *U. Chi. L. Review*, 1985, at 848.

16. It has to be noted that in case of a fee arrangement with a patent agent, fees which are higher than those specified by Section 11 Federal Code of Lawyers' Fees, are not refunded.

17. *See* Section 49b, Paragraph 2 BRAO and Section 43a, Paragraph 1 of the Regulation on Patent Agents (*Patentanwaltsordnung*, BOPA).

difficulty of the case, the lawyer's reputation, the results achieved, the client's wealth and other factors are ignored under the statutory tariff system. This can only be overcome by substituting a contractual fee for a statutory one but with regard to competition within the legal market, the statutory tariffs have traditionally made for modest attorney fees in Germany, especially since contingent fees are condemned by the rules of professional responsibility. In general, contingent fees are prohibited to limit lawsuits to those parties who are immediately affected. Furthermore, they are considered to give attorneys too personal a stake in the outcome of cases. Given the lack of contingent fees, government-sponsored legal aid and legal expense insurance have become popular alternatives to contingent fees as means of avoiding the risks of litigation costs.¹⁸

As a result, when speaking of "costs", one must keep in mind that the legal costs overseas are almost always lower than in the U.S. because of lower or nonexistent discovery costs and the existence of statutory tariffs on lawyers' fees.¹⁹ With this background information in mind, Section III will (i) examine the general "Industrial Liability Insurance", (ii) analyze the "Legal Expenses Insurance" which provides coverage only for legal costs, (iii) consider arrangements with "Legal Expenses Finance Corporations" which provide funds for lawsuits, and (iv) emphasize on "Patent Infringement and Enforcement Insurance" in particular.

a. Industrial Liability Insurance

Industrial Liability Insurances basically cover the legal liability and the financial loss caused by personal injury and damage to real property (including financial loss directly

resulting from personal injury or real property damage). But financial losses in any other cases are not covered by such insurance. It has to be noted that IP-claims in actions for damages or injunction as well as patent nullity actions are neither concerned with personal injury nor damages to real property. Therefore, the Industrial Liability Insurances provides no protection against IP-claims. In difference to the Commercial General Liability Insurance in the U.S., the Industrial Liability Insurance does not even include an "advertising injury" coverage.

b. Legal Expenses Insurance

The purpose of a Legal Expenses Insurance is to ensure the policy holder's protection of his legal interest. In return for the policy holder's premium, the insurer is required to carry the legal expenses for such protection.²⁰ In Europe, the Legal Expenses Insurance was introduced more than 60 years ago and has become a popular opportunity to avoid the risks of litigation costs. In Germany, 17 million households (approximately more than 45 percent of all households), carry some form of Legal Expenses Insurance.²¹ Although, at first glance, one might think that the existence of these policies leads to an increasing number of lawsuits, experience has shown that the existence of Legal Expenses Insurances has not increased litigation.²²

With respect to the German "fee shifting rule," after which the defeated party carries the financial burden of the legal action, the insurer of the defeated party has to reimburse the opposing party's legal fees (entirely or proportionally in a partial victory situation). It is

thereby insignificant whether the policy holder is the plaintiff or the defendant in the litigation. Besides, the Legal Expenses Insurance covers all extra-judicial costs arising from the engagement of an attorney. It has to be noted that the Statute on Legal Advisers (Rechtsberatungsgesetz, RBerG) does not allow insurers to give legal advice by themselves. Consequently, each policy holder has to contact an attorney independently if he seeks legal advice. As already mentioned, the coverage set forth in the Federal Regulation on Attorneys' Fees will not allow the client to receive full recovery of his legal expenses when he privately contracted for higher fees with his attorney in writing.

The insurer will only cover the legal expenses if the policy holder informs the insurer timely, basically before suing or defending himself in court. Thereupon, the insurer examines whether there is a sufficient chance for victory of the insured policy holder. This examination by the insurer continues whenever the case reaches a higher instance. If the insurer values the chances of success positively, he gives a coverage promise and assumes the entire risk of legal expenses of the lawsuit.

However, the German insurance industry organization, called "German Insurance Association" (Gesamtverband der deutschen Versicherungswirtschaft e.V.) recommends in their industry wide standard "General Policy Conditions for Legal Expenses Insurers" (Allgemeine Bedingungen für die Rechtsschutzversicherung), which was revised in 1975, 1994 and 2000, that no protection should be given for intellectual property rights, such as patents, trademarks and copyrights.²³ Until 1994, the General

18. See also Werner Pfenningstorf, *The European Experience with Attorney Fee Shifting*, 47 *LAW & CONTEMP. PROBS.* 37, 1984.

19. W. Kent Davis, *The International view of Attorney fees in civil suits: Why is the United States the "Odd Man Out" in how it pays its Lawyers*, 16 *Ariz. J. Int'l & Comp. Law* 361, 1999 at 24.

20. It has to be noted that for the above mentioned reason, such insurance is also called a "Legal Protection Insurance".

21. Andreas Schiller, *Rechtsschutzversicherung und Anwaltschaft – ein Spannungsverhältnis? [Legal expenses insurance and legal professionals – a conflicting relationship?]*, *Versicherungswirtschaft [Insurance Business]* 1999, at 107.

22. W. Kent Davis, *supra* note 20, at 15.

Policy Conditions for Legal Expenses Insurers were not only industry wide standard conditions but also statutory provisions because the “Federal Supervisory Office for Insurance Companies” (Bundesaufsichtsamt für das Versicherungswesen) was obliged to officially authorize such industry wide standard conditions. This obligation of the “Federal Supervisory Office for Insurance Companies” became only obsolete by implementing the European Union’s “Third Implementing Statute on Insurance Supervisory Laws” on July 29, 1994. It has to be noted that until that date, all insurers had used the authorized industry wide standard conditions. Since July 30, 1994, each insurance company is free to formulate and use their own “General Policy Conditions.” Consequently, since 1994, policy holders and insurers are free to extend individually the scope of insurance coverage. Therefore, even expenses in connection with IP-disputes may nowadays be covered by legal expenses insurers. However, such extended coverage for IP-claims is generally the exception and not the rule. An observation of the “General Policy Conditions” of the leading legal expenses insurance companies shows that most of them still use the “General Policy Conditions for Legal Expenses Insurers” by the “German Insurance Association” (now in its revised version from 2000). As a result, the exclusion of coverage for IP-claims is part of standard contracts by most legal expenses insurers.

c. Legal Expenses Finance Corporations

As the rules of conduct make it impossible for an attorney in Germany to agree on contingency fee basis with his client or to disclaim remuneration by his client, the client basically has to carry all legal costs

by himself. For this reason, the so called “Legal Expenses Finance Corporations” were established. Such corporations provide funds for lawsuits when the claimant cannot or does not want to pursue the case and is neither entitled to legal aid nor covered by a relevant Legal Expenses Insurance. The Legal Expenses Finance Corporations initially bear all the costs of a legal proceeding and therefore assume all risk. In exchange for assuming the financial burden of the action, the Legal Expenses Finance Corporations receive between 20-30% of the recoveries of the lawsuit. As a consequence, such mechanism takes the place of the contingency fee system in the U.S.

In principle, funds are provided for all legal proceedings, which aim to secure monetary claims or a right with a monetary value in order to receive a part of the interest as result of a successful litigation. Like Legal Expenses Insurers, Legal Expenses Finance Corporations also examine the chances of a claim’s success and assess whether the opposite party is financially able to pay for the sued amount of money in case of loss of litigation. With regard to Intellectual Property claims it is clear that only actions for damages may be profitable for a Legal Expenses Finance Corporation. However, in order to protect his intellectual property rights, it is oftentimes important for the claimant to ask the court for an injunction or to institute a patent nullity action before the Federal Patent Court. In theory, the costs of an injunction or a patent nullity action are only eligible for financing by a Legal Expenses Finance Corporation if their carrying out is necessary in order to win a following action for damages. However, such procedural necessity is a rare exception, since a German civil court may incidentally check the validity of a patent in an action for damages. As a consequence, a Legal Expenses Finance Corporation will only be an alternative to protect IP-rights in an action for damages, while the IP-holder generally has to carry the legal expenses in actions

for injunctions and patent nullity actions by himself.

d. IP-Infringement and Enforcement Insurance

As the foregoing summary of the German IP-insurance market shows, there were only insufficient possibilities for intellectual property holders to protect their IP rights in the past. Until recently, insurers agreed only on an individual basis to cover certain IP-rights of the insured and such agreements did not provide for transparency regarding an IP-insurance coverage. With respect to costly litigation experiences in different European countries and especially in the U.S. and the insurer’s critical notion of intellectual property as an insurable business risk, most insurance companies were also skeptical about the extension of IP-insurance coverage to more than one country. However, recently, a few insurance companies in Germany, like AXA Colonia Versicherung AG in cooperation with Roland Rechtsschutz Versicherungs AG, started to offer standard policies protecting intellectual property rights in all contracting states of the 1973 European Patent Convention (EPC).

In general, these policies provide coverage for legal expenses in offensive and defensive actions and include indemnity provisions. Like a normal Legal Expenses Insurance, the Patent Infringement and Enforcement Insurance covers all legal costs (court fees and attorney’s fees included) resulting from an intellectual property dispute. But besides, such coverage also includes indemnification and as such provides coverage for profits and royalties that a losing defendant must relinquish to patent holders. In contrast to the above discussed alternatives, a Patent Infringement and Enforcement Insurance therefore exclusively provides for indemnification resulting from IP disputes. In the case of an offensive action by the policy holder against an infringer, all costs related to an injunction or an action for damages

23. See Section 3, Paragraph 2 (d) of the General Policy Conditions for Legal Expenses Insurers (Allgemeine Bedingungen für die Rechtsschutzversicherung) in its revised version from 2000.

are covered. Besides, should a patent owner ask for an injunction or damages against the policy holder, the Patent Infringement and Enforcement Insurance also provides coverage for costs related to a responsive patent nullity action by the policy holder. On the contrary, in the case of a defensive action by the policy holder, the Patent Infringement and Enforcement Insurance provides coverage for the costs of defense in any legal action and indemnifies the policy holder for damages.

As a result, the Patent Infringement and Enforcement Insurance offered on the German insurance market by various German insurers, constitutes a complete insurance coverage for all IP disputes. For an IP-holder in Germany, a contract with a German insurer has certainly the advantage that the venue will generally be in Germany in the case of any future dispute between the insured and the insurer. However, an interested IP-holder has to examine such contracts carefully, since the territorial scope of the coverage differs. While very few insurance companies started providing a worldwide coverage, most insurers only cover the territory of the contracting states of the European Patent Convention (EPC).

IV. IP-Coverage: Strategies For Businesses

At present, intellectual property rights have to be enforced in the individual countries where they are registered. Therefore, the national application procedure and the process for litigating intellectual property varies widely depending on the individual national legal systems. With regard to patents, this is so whether the patents are granted on the basis of a national application procedure or the European Patent Office application procedure because the 1973 European Patent Convention (EPC) and the 1975 Community Patent Convention (CPC)²⁴ do not provide the same protection in all Member States, as it continues to be also subject to national patent laws. Therefore, the

management of patent infringements in the European Union is complex, since actions have to be brought before the national courts of each country for which the patent has been granted.

Consequently, to compare the client's needs regarding IP-insurance coverage in the U.S. and Germany, it is critical to consider the major differences between the German and the U.S. legal system with respect to civil proceedings. In general, continental lawyers are skeptical about American civil litigation: the concepts of jurisdiction under long-arm-statutes, jury-trials and discovery (depositions, procedure of documents and interrogatories) arouse suspicion among German business managers and lawyers. In particular, the procedure for selecting jurors, the uncertainty of a jury trial, the possibility of taking contingency fees and the obligation to bear one's own attorney's fees differ from the German civil litigation system. Section IV will therefore analyze the different civil proceedings with regard to legal cost issues in both countries and will develop strategies for businesses with respect to IP insurance coverage.

a. Differences in lawsuits and legal costs in the U.S. and Germany

In general, the greater responsibility of the bench for fact gathering

24. See The Community Patent System, ECU. Committee of the American Chamber of Commerce in Belgium - Business Guide to E.U. Initiatives, Chapter 6 - Intellectual Property, 1998/99 (noting that the 1973 EPC establishes a mechanism which enables an applicant to submit a single application at the European Patent Office (EPO) in Munich, Germany, for a patent in as many of the European signatory states as he/she wishes. By contrast, the 1975 CPC was intended to provide a single protection right valid throughout the E.U. and designed to contribute to the achievement of the single market, with special reference to fair competition and the free movement of goods. The definitive version of the CPC was adopted in 1989 (OJ L 401 December 30, 1989), but has yet to take effect due to delays in ratification by the twelve signatory Member States).

is what distinguishes the Continental from the American tradition. In German civil litigation, investigation and presentation of evidence is not only a private function run by lawyers, but also a public function. According to Section 139 ZPO (Code of Civil Procedure), the court must at all stages of the proceeding give notice to the parties if it considers their presentation of the case defective in crucial points and give them opportunity to mend those defects. Failure to give sufficient warnings will result in reversal and remand because of grave procedural error on appeal by the aggrieved party.²⁵ Apart from the court's duty to give notice of defects it is the parties' duty to state the exact facts of their respective versions of the case and to nominate witnesses or other evidence for each disputed fact. However, differing from the Anglo American procedural world, a German court may,²⁶ on its own motion look at public documents and carry out a judicial inspection of any piece of evidence.

Another fundamental difference in German procedure is the virtual absence of any counterpart to the Anglo-American law of evidence. As a consequence, the German procedure functions without the main chapters of the American law of evidence, including such rules as hearsay, that exclude probative evidence for fear of the inability of the trier of fact to evaluate the evidence purposively. A court may listen to a hearsay witness, but must be careful as to whether the testimony may form a solid basis for the judgement.²⁷

Viewed comparatively from the

25. See Bohlander, *supra* note 15, at 6 (claiming that German appellate courts have widely used the power given by the ZPO to reverse and send back a case to the court of first instance if grave procedural error has occurred without even looking at the merits of the case).

26. See also Section III (The German Federal Patent Court is even obliged to clear up the circumstances independently).

Anglo-American perspective, the greater authority of the German judge over fact-gathering and the German system of court appointed experts comes at the expense of the lawyers for the parties. As discussed, the legal costs overseas are almost always lower than in the U.S. because of lower or nonexistent discovery costs and the existence of statutory tariffs on lawyers' fees in many European countries. Despite these factors which tend to decrease legal costs to individual clients, the legal cost risks can be quite high in Germany because of the "fee shifting rule," which permits the winner in a suit to recover his attorney fees from the loser. In addition to his own modest attorney fees, the loser also has to pay the modest attorney fees for the winner and two modest costs can add up to one large bill. Thus, it is important to consider how these litigation risks are taken into account for intellectual property owners to ensure that they reasonably analyze the various kinds of insurance products available to address intellectual property exposures in the U.S. and Germany.

b. Alternatives to a Worldwide IP Coverage

Since stakes are high, intellectual property claims must be carefully handled and each business must make its own cost/benefit analysis about buying additional policies specifically for International intellectual property disputes. Legal claims and legal cost risks are different in the U.S. and Germany, but some general guidelines can help to provide a frame of reference.

First, businesses have to examine the different insurance products in both countries with regard to the litigation risks and the legal expenses which are associated with legal proceedings. Especially smaller

companies who need an IP insurance to sustain court battles against well financed opponents, should look for alternatives to an expensive worldwide infringement and enforcement coverage. On the German market, one possibility to reduce premiums is individually to extend the scope of legal expenses insurance coverage with the insurer to be protected in defensive IP actions, while contracting with legal expenses finance corporations for offensive IP actions. However, businesses have to keep in mind that legal expenses insurers usually do not cover actions outside of Germany and that legal finance corporations will only be an alternative to protect IP rights in offensive damage actions, so the IP holder still has to carry the legal expenses in offensive actions for injunctions and patent nullity actions.

Another alternative to worldwide IP insurance is separate infringement and enforcement insurance for the European Union and the U.S. to take advantage of the scope of coverage associated with IP insurance in Europe and the U.S. For example, most German insurers who offer such IP coverage already cover the territory of the contracting states of the EPC. In addition, certain IP holders may benefit from recent court decisions in the U.S. after which copyright and trademark infringement (including actions related to trademark infringement, such as trade dress or trademark infringement) are already covered by the existing GCL provision providing coverage for "advertising injury." Consequently, only patent holders might feel the necessity to get an additional infringement liability insurance in the U.S. because the law appears settled that patent infringement is not covered by the CGL policies. Businesses, however, who rely on their CGL policies to cover trademark and copyright disputes should keep in mind that even those courts, which have expanded the scope of the CGL policy 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.

Generally, as in other areas of insurance disputes, businesses always face the danger that IP infringement and enforcement policies contain terms that are sufficiently ambiguous to litigate at length in court or arbitration. In order to retain and gain customers, an insurer may appear to abide by the spirit of a policy, but, as shown in the CGL litigation described above, that same insurer will litigate to deny coverage if that course appears more profitable than paying claims. Therefore, businesses should avoid the inclusion of ambiguous terms in IP insurance contracts, carefully study the exclusions in such policies and retain sufficient coverage for their IP rights. To reduce costs associated with such coverage, IP holders have to be aware of litigation risks and examine the different insurance products available to address IP exposures. As the key to success for any company is its ability to attract investment capital, ultimately determined by the market's assessment of its future earnings potential, companies could be missing out on financial backing by not taking IP seriously enough. Consequently, a company's ability to attract future investment capital will largely depend upon the company's strategy with regard to the protection of IP assets, including a reasonable assessment of IP litigation risks.

27. See Bohlander, *supra* note 15, at 10 (explaining that the general position would appear to be that any kind of evidence may be looked at, regardless of how it was obtained, unless this would violate fundamental civil liberties of third persons).