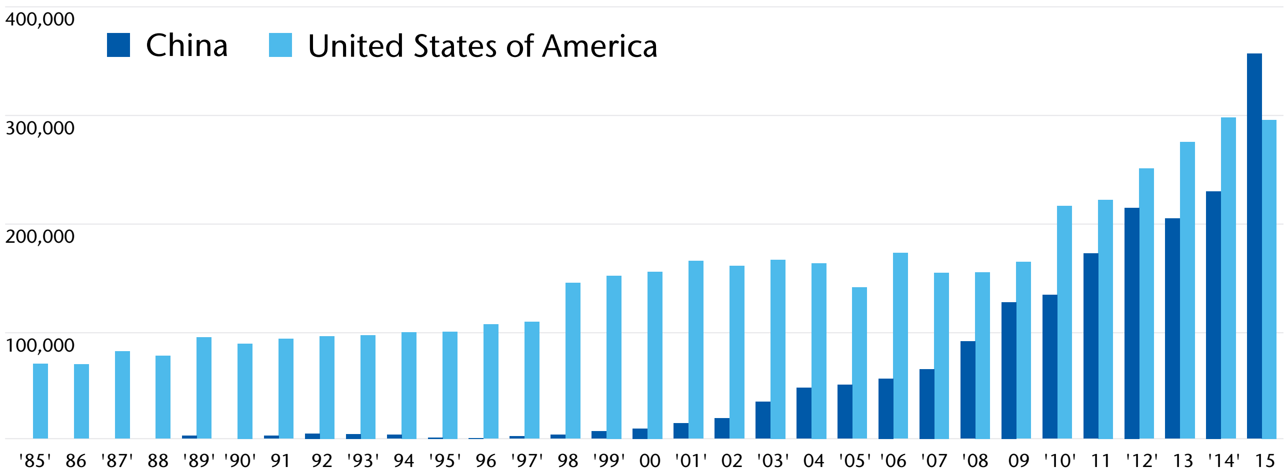
Intellectual Property:

Risk Landscape

Empower Results®

Asset Value Rotation and the Financial Market Response

In the last 40 years, the global economy has undergone a value rotation from tangible to intangible assets, with intangibles now estimated to comprise 84% of value or roughly $20 trillion of the S&P 500 alone in 2018. In 1975, the five largest companies (by market capitalization) were: IBM, Exxon Mobil, Proctor & Gamble, GE and 3M. In 2018, that list includes Apple, Alphabet, Microsoft, Amazon and Facebook, with Apple being first to crest a $1T market capitalization in August. Intellectual property is one of the most important intangible asset classes driving the modern global economy. Intellectual property includes patents, trademarks, copyrights, trade secrets, and know how, all of which factor ever more prominently in the above companies' success and other organizations' ability to succeed. The global expansion of IP as an intangible asset class is reflected in a variety of statistics. For example, looking at patent grants, the US Patent and Trademark Office granted 71,611 new patents in 1985, a number which grew 316% to 298,407 in 2015. This growth in assets is even more pronounced in China, where annual patent grants grew from 44 to 359,316 over the same period.



Accompanying this explosion in intangible assets has been an explosion in the number of lawsuits filed claiming infringement of intellectual property rights. For example, from 2005 to 2015 the number of patent lawsuits filed annually in the US more than doubled. Despite the significant risk these lawsuits present, many companies have struggled to properly manage this risk, potentially resulting in loss of revenue, business disruption or even bankruptcy, and damage to brand and reputation.

Innovation:
Threat and Opportunity

The shift to intangible property has created a highly competitive and highly nuanced business environment. Compared with tangible property, intangible property is simpler and less expensive to copy - as a general proposition, it is easier to copy computer code than a car. This property can fuel technologies across the broad marketplace and make distributing new products, processes, and services much more efficient, allowing organizations focused on intangibles to position themselves as an essential driver of a new interconnected marketplace. It is this environment that, in turn, is driving businesses to introduce new ideas and technologies at a faster pace than ever before to stay competitive and relevant. This pressure to innovate can come at a price. Organizations often do not engage in a thoughtful, strategic approach to intellectual property management, and profits derived from innovative products can be subject to demands by competitors and non-practicing entities or "patent trolls" who own intellectual property in the space. These risks can significantly threaten an organization's success and sustainability.

A STRATEGIC APPROACH

The value of intellectual property is multi-faceted. On one side, there is the business' vision and strategy. It is critical to articulate how a new offering fits within the company's larger intangible asset portfolio. The business opportunity must be weighed against the cost of development or purchase and the cost of maintaining and protecting the products enabled by the intellectual property against threats. In the absence of a strategy, an intellectual property portfolio can become too big, leading to excessive upkeep costs. On the risk side, the products can be under threat from competitors looking to leverage ownership rights of their intellectual property or non-practicing entities whose goal is to monetize their intellectual property without contributing any products to the marketplace. Due to the complexity of managing intangible property, many organizations have yet to create an adequate structure supported by multidisciplinary staff. Frequently, intangible property is evaluated only through the lens of a narrow legal framework, which can leave businesses exposed. A considerably stronger approach is to include a dedicated team to direct the development of intellectual property from conception through launch through risk assessment and mitigation.

By applying a broad view of the development process and instituting stronger intellectual property diligence and insurance programs, businesses can be better positioned to overcome the many facets of IP risk.

PROTECTING INTELLECTUAL PROPERTY ASSESTS

Companies have many options to establish legal ownership over their intellectual property. Two of the most common are filing a patent or keeping it a trade secret. Both approaches come with benefits and disadvantages.

PATENTS

The main benefit of protecting an innovation with a patent is that patents provide legal protection against other parties copying it via their product or service. The downside is that when filing a patent, a company is required to fully disclose its inner workings, which in turn exposes the innovation to copying after the time limit of 20 years in the United States for that protection. Also, if the patent is not well drafted, it may leave competitors open to copying the core idea and changing it just enough to avoid infringement.

TRADE SECRETS

The main benefit of protecting an innovation as a trade secret is that a company is not required to disclose how it works, better protecting it from the type of competitive reengineering that can follow a patent filing. Trade secrets also do not have an expiration date. However, it is not without risk. Should a competitor independently develop your idea, there is no legal framework to stop them from using it.

Intellectual Property Risk

The costs associated with intellectual property risk can be significant and have a lasting detrimental effect on a company's business operations and future success. The average damages for a successful patent claim in the US are $6 million, with many awards going significantly higher and a few above the $1 billion mark. In addition to the financial judgement are the defense costs incurred, which may be in the millions regardless of whether a claim was successful or not. Companies may also be liable for paying past royalties, which can date back for years, or they can be forced to pay licensing fees going forward. Even worse, they may be forced to stop all delivery of their product or service that is built upon the intellectual property in question.

The potential costs, disruption of revenue streams and damage to brand make intellectual property one of the greatest areas of risk a company faces in the current environment. With this broad scope of risk, companies are recommended to institute best practice processes and governance to help ensure that they are sufficiently protected.

When looking at areas of risk, Aon focuses on three areas where companies can have significant exposure: intellectual property infringement; employee theft; and source code vulnerability.

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INTELLECTUAL PROPERTY INFRINGEMENT

As discussed earlier, both patents and trade secrets can cause a company to be subject to costly infringement claims. Often, best practice protection against these claims begins with the due diligence conducted prior to a new offering being brought to market. With a proper process in place, intellectual property specialists will work closely with the company's engineers and developers to avoid infringing upon competitors' patents as the product or service is being developed. Specialists can also help ensure that no stolen trade secrets make their way into the product by training developers, ensuring teams are properly segmented and making sure teams maintain strong documentation of their work to refute potential claims that the innovation is a result of stolen property.

Intellectual property liability insurance is another tool that should be considered when implementing an intellectual property risk strategy. These flexible insurance products can protect an individual asset or a broad product portfolio, and cover certain costs associated with an infringement claim, such as litigation damages and expenses.

EMPLOYEE THEFT

Trade secrets are especially vulnerable to employee theft. Companies with trade secrets should have processes in place that address how the secret can be accessed and by whom. They should also use caution when terminating employees who have had access to trade secrets.

Limiting access offers the most obvious protection. The fewer employees who know the secret sauce, the less likely it is to leak.

Depending on the type of secret, an employee can also be limited to a part of a formula or product component, preventing any one individual from having access to the full makeup of the intellectual property.

A comprehensive exit process for employees who are terminated should be in place to protect trade secrets, along with formal exit interviews that include a forensic sweep of all company and personal devices to ensure that information has not been downloaded, printed or transferred.

SOURCE CODE VULNERABILITY

Source code is the backbone of our digital world, with companies relying on code to power their products and services, making it increasingly important to understand the issues that can leave companies exposed to risk. Employee turnover in software jobs was over 22% in 2017, leaving this type of intellectual property highly vulnerable, as developers can easily copy and paste a string of protected code into software at their new company. There are also external threats to consider. If not properly protected, a company's software can be an entry point for hackers looking to disrupt functionality or steal information.

A strong defense a company can institute is a program of proper and ongoing diligence of its source code. Diligence should be conducted upfront and as part of a regular review process.

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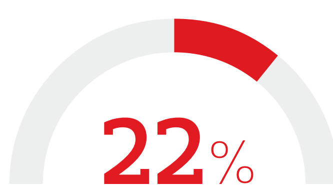

Best Practices

With intellectual property powering today's business, it is critical that companies have a strategy around innovation to help ensure that their intellectual property development plan and current portfolio line up with the company's goals and vision and that their products and services are protected against infringement claims and theft.

When developing its intellectual property strategy, a company should consider the following best practices:

1. Create a holistic strategic plan that addresses innovation development and protection. Execute that plan consistently and review regularly.

2. Align dedicated intellectual property specialists with product developers to help you understand the patent landscape and reduce the likelihood of infringement claims.

3. Proactively buy or license patents that might threaten your ownership claim to your current innovation.

4. Refine your employee training and exit program to reduce your exposure to intellectual property theft.

5. Institute a diligence program to review new and existing patents and software.

6. Develop an insurance program that provides sufficient protection against the potential damages resulting from intellectual liability infringement claims and theft.

With these steps in place, your company will be better positioned in this competitive environment.

Contacts

If you have questions about your specific coverage, or are interested in obtaining coverage, please contact your Aon broker.

For general questions about Aon's Intellectual Property Liability Insurance, please contact one of the following Intellectual Property Solutions team members:

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