

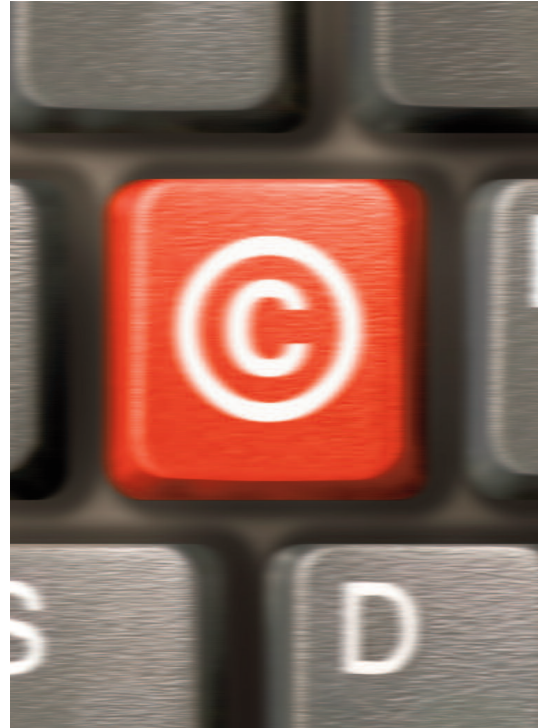
GOVERNMENT CONTRACT INDEMNITY: NEVER ASSUME

Assumptions can put your company at risk. Take, for example, the popular wisdom regarding government contracts. Most contractors assume that government contractors are given blanket indemnity from third-party lawsuits. While true in most cases, the assumption is *not* correct with regard to intellectual property (IP).

In many industries, IP liability issues have the potential to overshadow all others in terms of maintaining a company's competitive edge. Many contractors face this risk. Agencies such as the Department of Defense and the Department of Energy spend over half their budgets on contracted products and services. With more than \$350 billion in contract work transacted annually, the U.S. government is a favored client for businesses – in part because of the assumptions about indemnity.

A GROWING PROBLEM

Since the 1980s, the economic value of intellectual property has increased exponentially, particularly in the software, engineering and biotechnology industries. As a result, companies across all sectors have begun to recognize the strategic importance of protecting their intangible assets, and likewise, the necessity of guarding against liability for infringement of another company's intellectual property – including infringement by third-party vendors. Legislation on this issue is usually complex and often deficient, owing to the evolving scope and significance of the concept of intellectual property.



This makes a company's risk for IP infringement liability in regard to federal contracts all the more pressing. Ironically, IP infringement liability risk is better defined in government contracts than in most spheres of business. While specific language relating to intellectual property is vague, or even absent, in many standard contractual agreements, the Federal Acquisition Regulation (FAR) statutes clearly state:

(h) Patent indemnity. The Contractor shall indemnify the Government and its officers, employees and agents against liability, including costs, for actual or alleged direct or contributory infringement of, or inducement to infringe, any United States or foreign patent, trademark or copyright, arising out of the performance of this contract, provided the Contractor is reasonably notified of such claims and proceedings. **(FAR Clause 52.212-4)**

A lawsuit involving third-party infringement¹ now working its way through the courts has put this clause to the test. If federal immunity in this dispute is acknowledged by the courts, and the government fails to indemnify its contractor in the process, the company might be in position to take full responsibility for IP infringement that was enacted by a third party. While the outcome of the case is uncertain, the suit highlights the fact that if your company enters into a government contract, there is a possibility that you may be held liable for third-party IP infringement.

WHAT TO DO

Contractors should take a two-pronged approach in responding to this exposure. They should make a risk assessment and then develop a risk transfer program. A company's IP risk assessment practices should examine all the possibilities for infringement of others' intellectual property brought on by working with both upstream and downstream third-party vendors that are part of the supply chain required to satisfy contractual agreements. Since your company will not be adequately protected from such lawsuits in cases of government contracts, specific IP liability coverage is prudent to ensure that your company will not bear the financial burden of such infringement.

Intellectual Property Liability programs are available in the insurance marketplace. They can be written to include coverage for patents, copyrights, trademarks, trade dress, trade secrets, and open-source software – in addition to deficiencies in indemnification provided in contract-specific clauses. For government contractors, the latter could offer some of the most important coverage in their overall risk management package. Contractors should work with their broker to be sure that the specifics of their programs are a match for the specifics of their situations.

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¹ *Zoltek Corporation v. Lockheed Martin Corporation*