# THE DEVELOPMENT AND STATUS OF THE INTELLECTUAL PROPERTY INSURANCE MARKET

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## The Development of IP Insurance

Intellectual property (IP) being an intangible asset is not thought of as being destructible in the physical sense. Consequently, Intellectual Property was not thought of as being the subject of generally known forms of insurance. Moreover, accountants have long been perplexed in their attempts to value intellectual property for purposes of reflecting its worth on the corporate books thus, further frustrating attempts at traditional insurance coverage. Conventional thinking led to the conclusion that without knowing its value it was impossible, or at least impractical, to insure IP. However, the simple observation that IP serves as a "ticket to the courtroom" leads to the inescapable conclusion that, for most coverages which transfer legal risk, it is not necessary to value the IP. Instead it is more important to determine the "amount in controversy". For it is the "amount in controversy" according to the American Intellectual Property Law Association (AIPLA) studies that determines the litigation costs and thus the amount of insurance required.

In the years since 1990, the focus has been on creating and managing IP insurance programs. The first policy, which is now a core product, intellectual property enforcement, provides funds to enable IP owners to litigate to enforce their patent, copyright and/or trademark rights against infringers.

The second IP policy introduced, also a core product, is a defense policy that provides indemnification of litigation expenses in the event that an infringement allegation was made against the Insured. The defense policy also includes coverage for damages payable to the adversary if the defense is unsuccessful.

Other additional IP insurance policies were created, the most important of these being Multi-Peril, a first party coverage for ancillary losses caused by various adverse happenings to IP or as a result of an IP lawsuit; and, the IP Collateral Protection Insurance product which offers parties the ability to use their interest in a specific item of IP as collateral for a loan.

## The Development of IP Defense Insurance

As competition developed among insurance companies for commercial business, broader and broader coverage was sold. In keeping with this movement, ISO, an organization supported by the insurance industry to standardize policy language and forms, promulgated in 1973 a broad form liability endorsement for Commercial [then called Comprehensive] General Liability ("CGL") policies. It was this broad form policy which gave rise to litigation against insurance companies seeking to require them to cover IP defense lawsuits.

For the most part, coverage of IP defense suits was forced upon insurance companies by the courts. For example, policies designated as comprehensive general lines (CGL) policies have been held by courts to

include a duty to defend and indemnify the insured in the event of patent litigation. See Aetna Casualty & Surety Co. v. Watercloud Bed Co., U.S. Dist. Lexis 17572 (1988) and Intex Plastics Sales Co. v. United National Insurance Co., 18 U.S.P.Q. 2d 1567 (C.D. Cal. 1990). Needless to say, the issuers of such policies have vigorously resisted the broadened interpretation of coverage – and with a significant degree of success. See National Union Fire Insurance Co. v. Siliconix, 729 F. Supp. 77 (N.S. Cal. 1989). Thereafter, ISO issued successive model CGL policies, each being successively more restrictive in coverage of IP litigation until today the coverage is only found if the asserted patent claims cover an act of advertising which the Insured is performing.

## The Development of Enforcement Insurance

Concomitantly with the judicial development of defense insurance, the market was developing IP infringement/enforcement insurance policies. There were two obstacles to overcome in insuring patents. The first was how to determine the amount the policy should pay. To solve this problem one must recognize that a patent need not be valued in absolute dollars for purposes of insuring its enforcement. This is because the loss that the insurance will pay is the cost of suing on the patent i.e. litigation costs. Thus the valuation difficulty is by-passed. This was the first innovative step in a business method patent on Intellectual Property Insurance.

The second obstacle was to determine how to make insurance work in the context of a small base of Insureds and high claims amounts. This second problem is best illustrated by comparing IP coverage to automobile insurance. There are in excess of 220 million registered automobiles in the United States, and the typical claim for an injury accident is $61,600.00. In contrast there are only approximately 3.1 million unexpired patents in the United States and the median claim for enforcement, is 2.5 million dollars. These high claims costs and the small base suggests that spreading the risk according to the law of large numbers will be a challenge in the patent insurance scenario. It is important to realize, however, that when a patent suit is won there is an Economic Benefit in the terms of recovery of a reasonable royalty or loss of profits. The second innovative step was to require insureds to share this "Economic Benefit".

Consequently, it is only when the suit is lost, i.e. there is no recovery, that the insurance company can realize a substantial loss. Upon making these observations the challenge becomes selecting as insurable only those intellectual properties which more likely than not would be held to be valid and enforceable.

## The Development Of Multi-Peril IP Insurance

The next policy to be developed was the multi-peril policy. In essence it is a policy that provides first party coverage. The logic was simply that coverage should be available for the insured to cover losses such as business interruption and like consequences arising from an IP lawsuit loss. The analysis for the three above coverages is always the same: will there be a lawsuit and will the insured win or lose? The multi-peril coverage can easily be added to defense or abatement coverage as a rider.

Other policies such as Unauthorized Disclosure of Trade Secrets, IP Troll Defense Insurance, Post-Grant Defense Policy and IP Damages Only Policy have been created to serve niche markets associated with the core policies.

# The Status Of The Intellectual Property Insurance Market

Intellectual Property Insurance is on the rise to notoriety worldwide. This rise in popularity is long overdue. In the '90s and thereafter many caustic articles berating intellectual property insurance were written. [(1)] Nevertheless, IP insurance made sense simply because the high cost of litigation prevented average intellectual property owners from being fully engaged in enforcing their IP rights and enhancing their competitive position. But the challenge of establishing IP insurance was formidable. When the concept was first introduced three primary business groups stood staunchly against it.

First, the lawyers did not endorse it because they were concerned that insurance companies would behave like they had in some of the commodity insurances and appoint their own defense counsel when a claim was made. The perceived high probability of losing very profitable litigation was a major factor in the resistance.

Second, the insurance agents were against it because it was very complex to learn and understand; sales were infrequent and so the investment of time to learn the products did not promise to result in adequate compensation. Moreover, the rationale of both lawyers and agents for not recommending it was the limits were too low, the cost was too high and there was limited coverage provided by only one carrier.

Lastly, the insurance carriers had no experience in intellectual property claims and had concerns about the profitability of such insurance.[(2)] Unfortunately these concerns were exacerbated by major carriers such as AIG and Chubb getting into the business without understanding it and suffering very significant losses. Thus, it was the perfect storm focused against intellectual property insurance ever becoming a standard, widely accepted insurance.

However, as time passed and small policies were successfully written, the insurance carriers became satisfied that the IP book could be profitable. Likewise the lawyers saw the benefits of a stable insurance payer of claims on a regular basis and the agents and brokers became somewhat more familiar with the products. This did not start a rapid transition but slowly the tide turned. Two landmark cases in patent law catalyzed a change in intellectual property when business methods and software were held to be patentable. [(3)]

A flood of patents covering these subjects were applied for and summarily passed to issue through the patent office. As time progressed, legal opportunists realized that this flood of hurriedly granted patents, were extremely broad and of low quality; and could be exploited; they were inexpensive to acquire, yet nevertheless could be used to leverage settlement money from unsuspecting victims fearing high litigation costs. Certain entities which are now referred as Patent Assertion Entities (sometimes pejoratively referred to as Trolls) recognized a business opportunity and began to acquire and assert these patents in an extortionist, but nonetheless completely legal manner.

With respect to the development of Intellectual Property insurance and the Collateral Protection Insurance counterpart, the "*Science and Technology Law Review"* article of J. Rodringo Fuentes [(4)] is a good starting place since it was specifically critical of IP enforcement and defense policies. The article begins by referring to Amedee Turner's work in studying the feasibility of a mandatory European Union-wide patent insurance scheme in early 2006. [(5)] It finally concludes in typical scholarly fashion that more money was needed for more studies to "detail a functional program which avoids the identified pitfalls of the policy specimens and provides the statistical feasibility of a sub $1000 premium". Note: currently each of the provisions identified as pitfalls still remain in the policy ten years later and the premium floor, not ceiling, is $1,000.

Things continued to brighten for the intellectual property insurance industry and finally, favorable articles started appearing. In 2010 an IP litigation attorney, Rudy Telscher of Harness, Dickey & Pierce, wrote a supportive newsletter article read by many colleagues.[6] Thereafter articles with titles such as *"CEOs/Insurers Finally Ready to Embrace Intellectual Property Insurance"* (9/9/2013) followed. [7] Then blogs were written and enthusiasm grew. An article was published in December 2015 entitled *"Intellectual Property Insurance is Evolving."* [8]

Concurrently, in April 2015 the US Supreme Court decided a landmark case, Octane Fitness v. Icon Health and Fitness that makes it easier to recover litigation defense expenses where the case against the defendant is "exceptional" in the sense of being particularly ill-founded. It soon became known that the case had been paid for in major part by an insurance policy (issued by IPISC) and things continued to expand from there.

In 2016 a flurry of articles began appearing, written principally by lawyers encouraging the use of intellectual property insurance. For example, one such article was entitled *"How Insurance Can Save You Millions in IP Litigation."* by Tara Kowalski, Partner and Alexis A. Smith, Associate, Jones Day, April 19, 2016. [9]

The articles are not limited to the United States in as much as one is entitled *"India: Intellectual Property Insurance: A Future Game Changer"* by Martand Nemana of Singh and Associates from India. [10] Another article originally appearing in "The Scotsman" appeared at the end of September 2016. It was the product of a British firm, Marks & Clerk of London. It suggests the use of intellectual property insurance for funding IP litigation in Scotland. [11] In September of 2016 an article with the *title "Why Intellectual Property Insurance Makes Sense"* was published. It was written by Lawblogger and can be found at htpp://legalteamusa.net/tacticalip/2016/09/20/. [12]

## The Development Of The Market For CPI Insurance

Concurrently with the development of the market for the more customary forms of intellectual property insurance there arose, a demand for collateral protection IP insurance.

This insurance was not new to IPISC since it had been proposed by IPISC as documented in an article entitled *"Patent Backed Securitization: Blueprint for a New Asset Class"* by David Edwards, Gerling NCM.[13]

Interestingly, the former XL CEO Bryan O'Hare, proposed the same collateral protection insurance in 2012 as revealed in an article appearing in *The Official Journal of the Bermuda Insurance Industry*. [14] This announcement was eleven years after the David Edwards article which mentioned XL in connection with the earlier CPI policy. Mr. O'Hare announced that he and his business partners are/were "on the goal line" as they pursue regulatory approval for a new product (CPI) that could generate one billion dollars in premium in the Bermuda insurance market…..

In the fall of 2014, another reference to using intellectual property as collateral appeared in a publication by Stout, Risius and Ross, a global financial advisory service. It suggested purchasing intellectual property enforcement insurance to compliment the CPI insurance. [15]

Also an article appeared in the January 2016 ABF Journal entitled *"Intellectual Property Asset Value as Collateral: The Increasing use of Patents as Collateral in Asset Based Lending."* [16] The author, Sung Kim of Appraisal Economics, discussed the emerging trend of using patents as collateral in asset based lending.

This corroborated an initiative to calculate the potential of the CPI insurance market. Experts were consulted and final result was a base case projection of potential gross written premium and (consistent with Mr. O'Hare's suggestion) an upside case was derived.

The projections of the potential for CPI premium [17] under both cases are:

| Program Premium Projections - NEW Products: | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 10-year GWP by product line: | | | | BASE CASE | | | | | | |
| | Projections>>>>>>: | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
| IP CPI Policies: | | | | | | | | | | |
| IP CPI | $2,940,000 | $5,110,000 | $8,580,000 | $14,400,000 | $22,570,000 | $25,130,000 | $27,690,000 | $30,460,000 | $33,790,000 | $37,120,000 |
| Required Abatement & Defense for CPI | $2,195,100 | $3,837,360 | $6,064,980 | $9,772,260 | $15,268,140 | $16,926,660 | $18,585,180 | $20,422,560 | $22,633,920 | $24,845,280 |
| | | | | | | | | | | |
| Total CPI Related: | $5,135,100 | $8,947,360 | $14,644,980 | $24,172,260 | $37,838,140 | $42,056,660 | $46,275,180 | $50,882,560 | $56,423,920 | $61,965,280 |

| Program Premium Projections - NEW Products: | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 10-year GWP by product line: | | | | UPSIDE CASE | | | | | | |
| | Projections>>>>>>: | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
| IP CPI Policies: | | | | | | | | | | |
| IP CPI | $10,820,000 | $32,850,000 | $66,750,000 | $131,560,000 | $271,040,000 | $433,810,000 | $565,390,000 | $675,520,000 | $830,330,000 | $1,026,660,000 |
| Required Abatement & Defense for CPI | $5,658,480 | $14,780,340 | $30,454,980 | $57,479,100 | $115,104,540 | $182,616,060 | $236,843,160 | $282,875,220 | $347,898,960 | $430,369,680 |
| | | | | | | | | | | |
| Total CPI Related: | $16,478,480 | $47,630,340 | $97,204,980 | $189,039,100 | $386,144,540 | $616,426,060 | $802,233,160 | $958,395,220 | $1,178,228,960 | $1,457,029,680 |

An article appeared in the National Trademark Review in November of 2016. [18] It pointed out that intellectual property insurance is becoming ever more popular overseas and is being supported by the governments of several countries. The British government is one example where their concern is that there is less innovation since innovators are unable to see a clear path to exclusivity. Moreover, both the Japanese and Chinese governments are creating financial incentives for their domestic companies to obtain IP insurance. The caveat here is that in the future, Japanese and Chinese competitors may be well funded by IP insurance as they penetrate international markets.

## Continuing Updates:

Patent Reform and the New Insurance Market that May Follow [19] Cambridge Network Ltd. of England predicts growth of IP insurance in US. (11/29/2016)

The beat goes on as Wilbur Ross, the new Secretary of Commerce, a pro-patent advocate , described using patents as collateral for loans as not controversial or exotic. [20]

The Betterly Report for 2017 [21] identifies Tokio Marine Kiln as providing IP Financial Loss coverage. Represenative agents have described this coverage as being similar to CPI coverage. Also in the report, Liberty Specialty Markets is reported to offer coverage which "can also be tailored to insure IP portfolio value". And OPUS Underwriting offers a product called OPUS Value ™ which "provides cover for loss of revenue following an impairment of rights. (Worldwide jurisdiction available)".

Most surprisingly, a foreign country is now seeking to insure all the US Patents granted to its inventors for enforcement.

In total it is clear to see that interest in intellectual property insurance and, specifically in Collateral Protection Insurance, is burgeoning. The time is right to take advantage of this embryonic market.

## End Notes


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