

Insuring the Intangible

Electronic intellectual-property exposures are growing rapidly for companies and businesses, while new technologies and practices also may put individuals at risk.

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"Imagination made real." That's how the U.S. Patent and Trademark Office defines intellectual property. In the insurance industry, however, intellectual property can mean anything from company trademarks and proprietary information to downloaded music videos.

And while the area of cyber intellectual property is growing as fast as the technology industry, electronic intellectual-property insurance law is trailing behind. Attorneys working in cyber space still see intellectual property as a somewhat intangible area. But they say it's a field set to explode in coming years.

Intellectual-property insurance is advancing, though it's not an industrywide concern at this point, said Scott Schwartz, a member of the intellectual-property department at Cozen O'Connor law firm in Philadelphia. Schwartz specializes in trademark, copyright and unfair competition law.

"I don't think that overall the framework of intellectual-property law is making any great change to accommodate the new technologies," Schwartz said.

Currently, intellectual-property insurance includes coverage for:

- Trademarks: Design and source of origin
- Copyrights: Expressions of ideas (computer programs, music and music videos)
- Trade secrets: Proprietary information held by one company (such as Coca-Cola Corp.'s recipe for original Coke); and
- Patents: Protection of novel expressions.

"Let's say I'm in a big company and they've developed a piece of software that goes on a palm device that helps me interact with the company's proprietary information," Schwartz said. "That piece of software can be protected by copyright, it can be a trade secret, and in certain unique circumstances, it can even be protected by a patent."

Changes in Intellectual Property

Until recently, the commercial property/casualty industry has been addressing cyber intellectual property solely as company data, said Brad Gow, vice president for technology administration and liability for Ace USA Professional Risk. Gow focuses on underwriting large technology risks and has seen a lot of "cyber coverage"—both Internet and media-related coverage for intellectual property.

Intellectual-property insurance has always meant protecting some sort of data—its intrinsic value—against a hacker or a virus attack or other type of deletion or corruption, Gow said. "It could also be media exposure for content on a company's Web site where it infringes on another's copyright."

Yet the Internet has changed the way businesses conduct business. Ten years ago, media liability was something that belonged to publishing and broadcast venues; now it applies to all businesses.

"Nearly every company's got a Web site with more than local reach—it's worldwide reach," Gow said. "It exposes companies in every industry that have no experience in publishing to publishing-type exposures: content on a site that may be copyrighted and should not be there; trade dress too close to a competitor."

That includes Web sites such as eBay and Google, which a competitor would "dearly like to lift parts of, or copy," Gow said. It also includes manufacturing companies and even insurance companies—any business that is publishing content on the Internet and is inexperienced in clearing content and getting content approved before publishing it. "It opens up normal nonpublishing companies to all of these publishing risks."

Most had not thought of these risks ahead of posting their first Web information, he added.

And so it's mostly large commercial entities, not yet individuals, who are seeking cyber-intellectual-property protection, Gow said. The value of a song downloaded into an iPod or MP3 player is "relatively insignificant" compared with the losses a company might face were it to lose its intellectual-property data, he noted. "The buyers of this type of insurance are larger technology companies that need high limits and need to protect very valuable data."

Margaret Reetz, a member of the Chicago office of Cozen O'Connor, does have one client who has cyber-intellectual-property insurance for his personal blog—a chief executive officer who waxes philosophically on industry issues—as part of the company's overall intellectual-property coverage, she said.

Personal Exposure

In some cases, intellectual-property infringement does affect the individual consumer when a company's data system is hacked.

"The big thing now is identity theft and viruses," said Reetz, who concentrates her practice on insurance, reinsurance and e-commerce matters. "A case in point would be ChoicePoint, where company tapes went missing."

In February 2005, ChoicePoint Inc. of New York, a national provider of identification and credential verification services, confirmed that personal information on some 140,000 consumers—names, addresses, Social Security numbers and credit reports—was stolen when criminals posing as legitimate businesses gained access to their database. ChoicePoint sent warning letters to some 35,000 consumers in California, the only state that at the time required companies to disclose security breaches.

It was just one of several such company breaches in 2005.

Cyber intellectual-property came along about four or five years ago, when insurance industry forms—property forms used for large commercial carriers—began to distinguish between tangible and intangible property, Gow said.

"Say there's a fire at a factory that destroys the mainframe or server, and there's business interruption—there's coverage," Gow said. "If a hacker or virus breaks in, and the network is interrupted and the company stops production, there is no coverage under the traditional property form now. There's no damage to tangible property."

The need for a specialty market for cyber property and liability insurance grew from there, Gow said.

A Growing Market

"Returns now for the total [intellectual-property] market premiums are \$300 million to \$400 million," Gow said. "But it's an open area of the market that's growing very quickly; more companies are recognizing that they've got exposure in these areas. Certain drivers, like changes in recent privacy legislation (HIPAA, Gramm-Leach-Bliley and Sarbanes-Oxley), have specific requirements around the protection of networks to protect the integrity of the financial information, and put senior management in the game when it comes to network security."

Because of these recent privacy information requirements, companies who suspect a breach of information now have to notify everyone—customers, clients and work force—of an increased potential for identity theft, Gow said. It's opened up "a whole new era of huge reputational losses" in addition to the actual expense and class action lawsuits, he said.

Another big area of intellectual-property intrusion occurs if a company's software consultant "tweaks" a trademarked software product—say, PeopleSoft—to tailor it to the company's needs, Reetz said. While companies do protect themselves via internal IT controls, monitoring provisions and licensing, if the company's work force is not reporting or the controls are not solidly in place, there's potential that the software is being used in ways that are outside of an agreement.

"These entities would be the people that are trying to go out and work at a client site. Once you're out there—you're not in the fold of the company—things can be stretched a little bit," Reetz said. "I can see even more that the technology makes it easier to be more remote. One policyholder's inside counsel said people are swapping these things off-site and that's how the software gets traded around instead of it being downloaded at the home base, with all kinds of controls in place."

It's a matter of keeping track of who's using it and who's using it with the policyholder group's standards and practices, she said.

Reetz has had some policyholders that have had claims brought against them by the Software and Information Industry Association. "They have a law firm to make sure everybody gets the proper license when they're using that software," she said.

"Through audits and investigations, lawyers will target a cell phone user who they think has either not been using the software with the license, or outside of the licensing agreement terms that they have," Reetz said. "We've had a couple of claims where entities have been sued because they're outside of the Adobe licensing agreement, or using it in uses that were unintended."

The field of insuring and protecting electronic intellectual-property is only going to get larger, Gow said.

"We're getting more and more responses from retailers and manufacturers in other nontechnology type companies that recognize they have these cyber exposures that aren't being addressed by their normal P/C programs," Gow said. "Today I see certain companies offering homeowners insurance providing an extension for identity theft. That's a big development. I don't know if it's going to get down to deductible situations."

Cell-Phone Potential

Schwartz recently discovered a new legal threat—and a new use for cell phones—when he came upon a public art display of photographs taken with a camera phone.

"They were surprisingly good, actually, which makes me think that someone had messed with them to make them look better. But also it was a professional photographer taking them with a really good eye," Schwartz said. Such a client would be insured for intellectual property maintained in electronic form on one's person, he said.

Advertising on cell phones can't be far behind, Schwartz added. From downloading ring tones to its use as an MP3 player to its use as a means of creating art, the commonplace cell phone is opening up an entirely new avenue of intellectual-property liability. "It's a marketplace that I think is ripe for a lot more advertising content—the cell phone as a multimedia vehicle," he said.

Cell phones are ripe for a lot of privacy issues, such as someone taking photos where there is no permission granted, "And even if one asked, they wouldn't get the permission," Schwartz added.

Still, it's the commercial market that needs to first catch up with intellectual property, not the personal cell phone user, Reetz said.

"The big technology companies do a lot of due diligence; it's a lot of back and forth for underwriters. But for the insurer, the growth in the market will be the people that you can write without having to do all of that due diligence," Reetz said. One would be Internet retailers, or "e-tailers."

"There are a lot of entities that put themselves in that kind of world these days," Reetz said. The mom and pop e-tailers also are seeking cyber-intellectual-property insurance. "Whether they sell cards, trinkets, T-shirts or whatnot, the same issues arrive in terms of copyright and trademark."

Yet, at a recent insurance seminar, an underwriter asked audience members to raise their hands if they've ever heard of intellectual-property coverage for electronic or intangible information. "It was remarkable that there were very few in the room that would raise their hand," Reetz said.

"In the reviews that we've done, in some of the research there's still a little bit of a gap in terms of what companies you would think should have this kind of coverage, and the percentage of companies who do have this kind of coverage," Reetz added. "It's not necessarily in everyone's portfolio yet."

But as the area of cyber intellectual-property grows, along with technology advances, law firms have been scrambling to keep up, "trying to build their capability," said Bryan Blakeman, a managing partner for risk management with Kaye-Bassman International Corp., Dallas. "There are a lot of potential lawsuits out here that are going to be thought up."

"When it finally does come around, it's going to be enormous," he added.

"In the next 12 months I see privacy and identity theft really driving the market," Gow said. That includes new privacy regulations, state privacy regulations, mandatory disclosure and notification laws. "That has so many people in executive suites nervous—not only about legal liability, but also the potential for a huge reputational loss. They're asking their insurance brokers, 'Are there risk transfer options available?'"

Eventually cyber intellectual-property will be a very common coverage, akin to companies who buy property policies or equipment coverage, Gow said. "Changes in the legal environment are really going to drive it."

"I don't know if protecting a bunch of songs on an iPod is ever going to get there, but it may well," Gow added. The high-tech insurance industry is only moving in one direction—forward. "How it manifests itself is going to be pretty interesting."