

Time to take the plunge? Patent insurance: the need to grow the risk pool

In the UK, the quality of our intellectual property rights judicial system is recognised as one of the best, if not the best, in the world. However, that quality costs money and the price is frequently prohibitive for most private inventors and small businesses. As a result, our process of IPR enforcement is biased in favour of those with deep pockets and many small businesses are deterred from patenting their technologies.

After all, what is the value of a patent if you cannot afford to enforce it?

This problem is well recognised and has been the topic of much debate within the Intellectual Property Advisory Committee (IPAC)¹, the IP Court Users Group² and the UK Patent Office. Efforts have been made to improve the situation and, in the UK, we now have available a Streamlined Procedure for litigation. However, even with this in place, patent litigation is still too expensive for many inventors.

Either the cost of litigation needs to be further reduced, or an alternative means needs to be found, to level the playing field.

In Europe, particularly in Germany and Holland, much cheaper procedures do exist.

The IPAC paper³ published in November 2003, *The Enforcement of Patent Rights*, reported that, “Although it is difficult to make exact comparisons, costs in the English Patent Court can be of the order of four times greater than in its counterpart court in Germany”. The report compares the cost of litigation in selected European jurisdictions (see figure 1)⁴.

Should we follow the European example?

Personally, I believe that cheap justice runs the risk of being rough justice, and that is no justice at all. I would be reluctant to see the quality of the UK system compromised.

With the aim of reducing uncertainty and avoiding litigation altogether, the UK Patent Office has introduced a service to provide ‘opinions’ on validity and infringement.

Whilst this is a welcome step in the right direction, it is my view that, unless the opinion on validity is binding, it will merely provide another costly and time consuming layer of procedure rather than avoiding the need for litigation.

Mediation could also help but, unless this is mandatory, it is very difficult for a small company or individual inventor to persuade an infringer with deep pockets to give up their tactical advantage and submit to mediation.

To me it is obvious that IP insurance holds a potential key to solving the problem. I cannot understand why this view is so unpopular amongst lawyers and patent professionals. I have heard of several instances where patent agents have actually advised inventors and companies against IP insurance, saying that it is ‘too expensive and claims are never paid anyway’.

It is therefore no surprise that the insurance industry perceives a lack of demand for IP insurance. With the exception of a few individuals within the London insurance market, such as representatives from Miller Insurance Services and R.J. Kiln and Co., the potential opportunity for a suitable product has not been recognised⁵.

When I litigated to enforce my patent in 1998, I was only able to do so because I had insurance. As it happened, it wasn’t nearly enough – but that’s another story. The point is that insurance gave me the choice and ability to proceed. As a result, I was able to enforce my monopoly and the business flourished.

That is how the patent system is supposed to work. However, the insurance premium required for substantial cover can easily be £40 – 50,000 (excluding the US), which is well beyond the reach of most private inventors and start-up small- and medium-sized enterprises.

It is also the case that many inventors have an unrealistic approach to insurance and expect to be insured for millions at the cost of a few hundred pounds. Neither extreme is practical and a more balanced approach is needed.

In mainland Europe, the benefit of an effective, affordable system of IP insurance has long been recognised. Despite the fact that the European process of enforcement is cheaper than ours, they have been quicker than us to see the light and much research on developing an insurance market has been done.

The report published by CJA Consultants⁶ in 2003 advocated a European insurance policy involving a fixed premium for each individual patent. However, some UK and German insurers feared that the scheme proposed by CJA, whilst well intended, would not be practical. An alternative proposal put forward by the Danes (summarised in the article by John Horsted in Patent World, March 2003)⁷ also expressed the belief that a European insurance policy had the potential to level the playing field. Their scheme acknowledged the need for an initial pump-priming subsidy in order to make the proposition viable but, by creating a European scheme, they anticipated that adequate numbers of policies would be sold in order to ensure that a sufficiently low premium could be achieved. However, such a scheme would need the support of the insurance industry but, as yet, insurers are not convinced.

The PEP proposal

More recently, the UK Patent Office commissioned Michael Edwards and Associates to produce a scoping study, Report of the Patent Enforcement Project Working Group⁸, published in June 2004. This report proposes a “mutual” scheme, funded by its members, and pump-primed by Government.

In the event of a member’s patent being infringed, the mutual would provide cover to fund preliminary investigations and would purchase insurance to cover litigation costs.

Whilst the PEP report is to be applauded for concluding that a form of IP insurance is required, Ian Lewis, of Miller Insurance Services, believes that, “A mutual is not the panacea to the problems of SMEs trying to protect their idea.” He argues: “A mutual will seek to exclude those entities most at risk... Most mutuals that exist provide indemnity insurance to protect against liability issues; they rarely provide “offensive” covers such as is proposed.” As a result he believes “it is not correct to assume that the success of a mutual model elsewhere would work here”, but that “it is highly probable that a mutual could form an effective part of an overall industry solution”.

Perhaps the reason for the insurance industry’s lack of support for IPR insurance results from the difficulty in calculating the insurance risk as applied to patents. IP insurance covers patents in application as well as granted patents; therefore, that the risk tail can be very long, with many years elapsing before the insurance company knows the outcome of a claim.

In addition, patents are peculiarly volatile rights, since grant only expresses a likelihood of validity. The patent system relies upon infringers to dig up any additional prior art that their examiners might have missed and to expose any instances of prior use.

Currently, the only way of establishing true validity is in court and therefore, cases that might appear to the insurers to stand a good chance of success at the outset are often lost.

In addition, the results of litigation may vary in different territories. Consequently insurers have, in the past, lost considerable sums, causing them to withdraw from the market. However, times are changing and there are three factors that should significantly reduce the risk:

- 1) Increasing interest in corporate social responsibility and corporate governance will raise awareness of IPR and should have a positive effect on the rate of wilful infringement.
- 2) The Streamlined Procedure and increased use of mediation should reduce the cost and incidence of litigation.
- 3) The UK Patent Office’s non-binding opinion on validity and infringement may also help. (However if, before resorting to litigation, a patentee and infringer could present all available prior art to the Patent Office and receive a binding opinion on validity, that would really make a difference.) Clearly, despite this progress, significant risk remains for the insurer but, is there potential for a viable scheme? Can these risks be insured? There are eight general principles for determining insurability⁹. Provided the patent market complies with these principles, viable insurance should be possible:

- 1) The insured loss must be random.
- 2) Frequency and magnitude of loss can be assessed.
- 3) Adverse selection should be minimal.
- 4) Circumstances of loss must be well-defined.
- 5) Excessive exposure for the insurer should be avoided.
- 6) Premium should be affordable.
- 7) The insurer should be able to create a large pool of risks.
- 8) Insurance should not threaten the public interest.

The patent market does comply with these principles but there are areas of concern, specifically with regard to principles 2, 3, 6, and 7.

Point 2 – Assessment of frequency and magnitude of loss: The magnitude of loss can easily be established but more research is needed into the rate of infringement. This cannot be assessed purely by the numbers of disputes that reach court. Many patent holders simply give up the fight because court costs are prohibitive.

If affordable insurance were supplied to the majority of patent holders, the playing field would be levelled. It might be argued that providing patentees with the financial ability to challenge infringers, would lead to a greater numbers of actions but, conversely, I believe, it could reduce the number of cynical infringements.

Point 3 – Minimal adverse selection:

Insurance companies must be able to charge premiums appropriate to the risk. Therefore schemes which involve flat rate premiums are unlikely to work. Each policy must be assessed according to the risks involved. Historical data exist on the number of patents granted each year and the percentage that are commercially exploited. Infringement doesn't generally occur unless a patent is a commercial success, so the incidence of infringement should be very low.

Points 6 and 7 – Affordable premiums and scope for pooling: Patent insurance will only be a viable solution if the premium for adequate cover, in all territories, is affordable. At the moment it is not. What private inventor or fledgling business can afford to pay an annual premium of circa £50,000 (excluding the US)?

Consequently, few buy insurance.

From the insurance company's perspective there is not currently a wide enough pool of risks. When the risk pool is small in size, the insurers include a risk loading in the premiums, in order to protect themselves.

This means that the premiums are higher for each policy than if the pool were bigger. It is a vicious circle. Unless insurers take the plunge and reduce premiums, they will never succeed in achieving the volumes they require.

General insurance rates naturally peak and trough every five to ten years and, according to industry sources, we are just beginning to enter a downward cycle, so rates should start to fall and insurers will be looking for new products to sell.

SMEs represent the biggest growth area of our economy and the Government recognises that IPR is the new currency of global business.

That there is a desperate need and potentially a substantial market for affordable, effective IP insurance, is evident. I believe that insurance could provide the answer but that the policy design requires an innovative rethink.

To this end, Patent Offices and legal and patent professionals need to overcome their reticence and assist the insurance industry to improve their knowledge of IP problems.

The patent system was created in part to encourage and promote innovation. Now an innovative approach, with perhaps a little courage and vision, is needed from the insurance industry to take advantage of this timely opportunity.

Notes

1 IPAC is a high level body formed to give independent advice to Ministers and their officials.

Further information can be found at www.intellectual-property.gov.uk.

2 The IP Court Users Group is made up of IP Judges and representatives from the Bar, the solicitor and patent attorney professions and industry.

3 www.intellectual-property.gov.uk/ipac/pdf/enforce.pdf.

4 This article deals with the problems of enforcement in Europe but, it should be noted that more serious problems exist for European inventors with patent rights in the US.

5 See chapters 5 and 6 by Ian Lewis and Matthew Hogg respectively in *Valuing Intellectual Property in Japan, Britain and the United States* Editor, Ruth Taplin, 2004, Routledge Curzon, for a thorough discussion of insurance solutions.

6 *Patent Litigation Insurance: A Study for the European Commission on Possible Insurance Schemes Against Patent Litigation Risks*, January 2003, CJA Consultants.

7 *Economic Consequences of Legal Expense Insurance for Patents*, June, 2001. See also Danish Patent website (www.dkpto.dk), see *Legal Expense Insurance for Patents - A Danish idea for EU*.

8 <http://www.patent.gov.uk/about/enforcement/finalreportv1.pdf>.

9 Notes from Cass Business School, City University, Lecture Notes: Introduction to Actuarial Methods.

About the author

Mandy Haberman is private inventor and IP rights campaigner.

She successfully defended her patented Anywayup Cup against a large corporation and as a result is a well known figure in the IP world. She is a member of the Intellectual Property Advisory Committee, but is writing here in a personal capacity.

This article was published by Intellectual Property Magazine (Informa Law 2004)