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Note

Patents and Insurance: Who Will Pay for Infringement?

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I. INTRODUCTION

1. Today's technology companies face a rising and seemingly unpredictable tide of patent infringement lawsuits. Damage awards for patent infringement entail large, sudden losses, and the costs of defending these suits are high. As a result, many companies are turning to risk-spreading insurance to protect themselves from infringement liability. At the same time, smaller companies have begun to realize that asset value often depends on ownership of a patent portfolio seasoned by successful enforcement suits. An enjoyable and healthy market for patent enforcement insurance currently offers companies of any size the ability to enforce their patents cheaply in exchange for annual premium payments.

2. This Note describes and analyzes three types of insurance that apply to patents: commercial general liability ("CGL") insurance,[1] patent infringement insurance, and patent enforcement insurance. As this Note will discuss, insurance provides only a limited solution to the risk of infringement and can also lead to expensive litigation.

3. From 1988 to 1993, California courts construed CGL insurance policies to cover patent infringement cases. Since 1993, however, they have denied companies this coverage. Because California courts are among the most influential state courts in the nation, especially in the area of insurance law,[2] other court systems are likely to follow the California trend and deny coverage for patent infringement under CGL insurance policies. Recent changes to the language of federal patent law,[3] as required by the General Agreement on Tariffs and Trade ("GATT"), may reopen the door to CGL coverage. If this happens, companies may once again resort to CGL insurance to protect themselves from patent infringement lawsuits, at least until insurers alter their policies to exclude coverage for patent infringement.

4. Specialized patent infringement insurance grew up in response to the increasing risk of infringement liability and courts' narrow construction of CGL policies. The anticipated resurgence of CGL coverage after GATT is likely to hurt the patent infringement insurance market. Because patent infringement insurance is new, whether it is effective in protecting companies from patent infringement liability remains untested. CGL coverage, on the other hand, is broader and has few, if any, procedural requirements.

5. Unlike patent infringement insurance, patent enforcement insurance will continue to thrive in some form. Premiums for patent enforcement insurance are significantly

lower than premiums for patent infringement insurance. A large market for patent enforcement insurance already exists, and patent enforcement insurance agencies have strong connections to companies that invest in patent infringement lawsuits. These insurance companies need to sell patent enforcement insurance so that they can become involved in potentially lucrative lawsuits at as early a stage as possible.

6. From a policy standpoint, all three types of insurance pervert patent policy. From a business standpoint, given the limitations of the policies and their cost, companies may do better to invest the money they would otherwise spend on premiums on educating themselves about existing patents in their areas of operation.

II. COMMERCIAL GENERAL LIABILITY INSURANCE

7. As patent litigation increased in the 1980s, companies concerned with the risk of defending themselves against patent infringement suits looked for coverage under their existing insurance policies. For most companies the relevant insurance policy was their CGL policy.[4] CGL insurance generally insures against "'advertising injury,' which is the language often construed to include intellectual property claims."[5] The policy usually defines advertising injury as follows: "[I]njury arising out of an offense committed during the policy period occurring in the course of the named insured advertising activities if such injury arises out of libel, slander, defamation, violation of right of privacy, *piracy*, *unfair competition*, or infringement of copyright."[6]

8. The most important policy language for the purposes of this Note are "piracy" and "unfair competition." Typically, "[n]one of the predicate acts is defined"[7] in the insurance policy. In addition, for legal and public policy reasons, the CGL policy usually excludes intentional acts.[8]

9. The following chart lists developments in the case law construing CGL policies to cover patent infringement.

"Now You See It, Now You Don't" Cases

Case	Year	Coverage?
Aetna Casualty & Sur. v. Watercloud (Watercloud I)[9]	1988	YES
John Deere Ins. v. Shamrock Indus.[10]	1988	YES
A. Meyers & Sons v. Zurich Am. Ins.[11]	1989	NO
Intex Plastics v. United Nat'l Ins. (Intex I)[12]	1990	YES
Continental Ins. v. Del Astra Indus.[13]	1992	YES
Aqua Queen v. Charter[14]	1993	YES
Omnitel v. Chubb Group[15]	1993	YES
St. Paul Fire & Marine Ins. v. Advanced Interventional Systems[16]	1993	NO
Aetna Casualty & Sur. v. Superior Ct. (Watercloud II)[17]	1993	NO
N.H. Ins. v. R.L. Chaides Constr.[18]	1994	NO
Iolab v. Seaboard Sur.[19]	1994	NO
Everest & Jennings v. AMI[20]	1994	NO
Intex Plastics v. United Nat'l Ins. (Intex II)[21]	1994	NO

A. *The Early Cases*

10. In *Aetna Casualty & Sur. v. Watercloud (Watercloud I)*[22], the first case to treat the issue of CGL coverage for patent infringement liability, the District Court for the Central District of California held for the insured under a CGL policy, construing the terms "piracy" and "unfair competition" against the insurer because the terms were vague and undefined.[23] Rather than define the terms or inquire into the parties' intent, the court decided that "piracy" and "unfair competition" could reasonably encompass claims for copying another's goods, including claims for patent infringement.[24] The court confirmed this conclusion by noting that patent cases frequently mention "piracy" of patents and, on this basis, assumed that "piracy" of patents was actionable under federal law.[25] According to the court, "this construction alone did not bring the asserted patent infringement claim within the insured's coverage. For there to be coverage," the court reasoned," the acts of 'piracy' or 'unfair competition' must also occur in the course of the insured's advertising activities."[26] Because the defendant in the underlying infringement suit had actively induced infringement by providing advertising material containing instructions on how to construct an infringing product,[27] the court found that the injury had occurred within the course of the insured's advertising activities.[28]

11. In *John Deere Ins. v. Shamrock Indus.*,[29] the District Court for the District of Minnesota extended coverage under a CGL policy where the patented device had been advertised to no more than one potential customer.[30] Going even further, the District Court for the Central District of California in *Intex Plastics v. United Nat'l Ins.* ("*Intex I*")[31] extended coverage even to claims with no connection between the insured's advertising activity and the underlying plaintiff's injury.[32] During this period of expansion, the New York Court of Appeals took a more restrictive approach. In *A. Meyers & Sons v. Zurich Am. Ins.*,[33] that court established the "New York rule," categorically denying CGL coverage for patent infringement.[34]

12. In 1992 and 1993 federal courts in California continued to refine the *Watercloud I* doctrine. In *Continental Ins. v. Del Astra Indus.*,[35] the District Court for the Northern District of California, using the same reasoning as had the court in *Watercloud I,* held that advertising alone could state the basis of a claim for infringement under 35 U.S.C. § 271(b), if the advertisement actively induced another to infringe.[36] Because inducement could occur in the course of advertising activities, the allegations potentially stated a claim for advertising injury, and the insurer had a duty under the policy to defend the insured.[37]

13. In *Aqua Queen v. Charter,*[38] the District Court for the Central District of California found patent infringement to be within the definition of piracy, as had the court in *Watercloud I.*[39] In *Omnitel v. Chubb Group,*[40] a California state superior court followed the rule established at the federal level and also found for the insured. The court acknowledged that intent was an element of inducing and contributing to infringement and stated that intent was vital to the insured's theory as to how advertising injury coverage tied into the patent holder's infringement claim.[41] In addition, the *Omnitel* court declined to enter into a labyrinthine analysis of whether intent to induce or contribute to patent infringement was the same as intent under the insurance policy's exclusions for intentional acts.[42]

B. *The Aftermath of* Watercloud II

14. A shift against insureds began in 1993. The landmark case, ironically, was *Aetna Casualty & Sur. v. Superior Court* (*Watercloud II*),[43] the California state court companion case to *Watercloud I.*[44] Although an intermediate state appellate court decided *Watercloud II,* the opinion carried the weight of a California Supreme Court decision because the California Supreme Court directed the appellate court to hear the case[45] and declined to review the court's decision.[46] The *Watercloud II* court, citing dictum in the important 1992 California Supreme Court case of *Bank*

of the West v. Superior Court[47], a non-patent case, stated simply that "[p]atent infringement cannot be committed in the course of advertising activities."[48] The court reasoned that the "patentee is not injured because a product incorporating its invention is advertised, but because the infringer, without consent, used or sold a product utilizing a protected invention."[49] As a result, *Watercloud II* firmly closed the door on CGL coverage for direct infringement under 35 U.S.C. § 271(a).[50]

15. But the *Watercloud II* court went even further to deny CGL coverage for contributory or induced infringement under 35 U.S.C. § 271(b).[51] The court reasoned that if the insured infringed at all, it did so directly; thus, the insured could not be liable for contributory infringement. Because direct infringement was the only potential basis for liability and was not covered by the insurance policy, the insurer had no duty to defend the insured and, in turn, no duty to indemnify. In addition, even if the insured "could be liable for inducement of the patent infringement, there would still be no duty to defend."[52] Clearly stated, the court found it "against public policy for an insurer to provide coverage for willful conduct."[53]

16. The court in *Watercloud II* based its reasoning on federal court interpretations of patent law, which can change independently of a state court decision.[54] Therefore, if federal patent law were to change, the *Watercloud II* decision might lose its impact. As it is, however, *Watercloud II* completely changed the direction of jurisprudence governing CGL coverage of patent infringement. Four subsequent federal diversity cases in California have followed *Watercloud II* and found for the insurer. In *N.H. Ins. v. R.L. Chaides Constr.,*[55] the District Court for the Northern District of California independently found for the insurer and then mentioned that *Watercloud II*, decided during the course of the *Chaides* proceedings, would not alter the result.[56] In *Iolab v. Seaboard Sur.,*[57] the Ninth Circuit, basing its rationale on *Watercloud II*, emphasized that the underlying defendant infringed the patent because it sold the patented product. As a result, the infringement loss "was caused by patent infringement not by advertising activities."[58] In *Everest & Jennings v. AMI*,[59] the Ninth Circuit extended this reasoning to find for the insurer on the "advertising activities" clause of the insured's CGL policy.[60] The *Everest* court also thwarted an attempt by the insured to construe patent infringement as disparagement of title under policy protection for personal injury.[61] Finally, in *Intex Plastics v. United Nat. Ins. ("Intex II")*,[62] the Ninth Circuit reversed *Intex I*, noting

that the recent decision in *Watercloud II* foreclosed the possibility for coverage under a CGL policy for induced infringement.[63]

C. *The Future*

17. Because California courts are among the most influential state courts in the nation, especially in the area of insurance law,[64] other states' courts are likely to follow *Watercloud II* and its progeny and deny coverage for patent infringement under CGL insurance policies. As a result, patent infringement damages, whether based on direct, contributory, or induced liability, will not cover "advertising activities" or "personal injury" clauses in CGL policies. Furthermore, the trend and the tone of the decisions discussed above in subsections II.A and B indicate that CGL coverage of patent infringement will probably not be allowed under any other policy clause.

18. Interestingly, however, an upcoming change in United States patent law may reopen the door closed by *Watercloud II*. Article 28 of the Final Act of GATT contains language imposing, for the first time in the United States, infringement liability for *"*offering for sale*"* anything covered by the patent in question.[65] Congressional legislation implementing GATT,[66] due to take effect on January 1, 1996, contains the same language.[67]

19. Because the reasoning of *Watercloud II* and subsequent cases relies heavily on current patent law, which limits infringing activities to making, using, selling, or importing, courts are likely to find that "offering for sale" infringement damages accrue "in the course of advertising activities."[68] For example, *Bank of the West* specifically discussed patent infringement, stating that "a claim of patent infringement does not 'occur in the course of … advertising activities' within the meaning of the policy even though the insured advertises the infringing product, if the claim of infringement is based on the sale or importation of the product *rather than its advertisement.*"[69] As a result, more litigation involving the scope of CGL coverage is likely when GATT-implementing legislation takes effect in January 1996, unless, and until, CGL insurers reform their policies to exclude patent infringement.

III. PATENT INFRINGEMENT INSURANCE

20. "Forget about earthquakes. Now you can buy insurance coverage for a modern-day disaster that can cost your company millions — patent infringement suits."[70] In

an industry first, American International Group ("AIG") introduced patent infringement insurance in 1994.[71] AIG and its subsidiaries claimed that specific requests from the technology industry and their own market research indicated a large demand for patent infringement insurance.[72] Media coverage of the new type of insurance was intense.

A. *The Marketing*

21. AIG sells patent infringement liability insurance through its subsidiary companies. For example, the Pittsburgh-based National Union Fire Insurance Co. ("NUFI") targets retailers and traditional manufacturers.[73] The Boston-based Lexington Insurance Co. ("Lexington") targets "high-tech" companies.[74] NUFI's policy sets a minimum premium of $50,000 and a maximum liability limit of $5 million.[75] The corresponding numbers for Lexington are $25,000 and $1 million respectively, with a $25,000 deductible.[76]

22. AIG's marketing effort is aggressive and specifically points out that "[s]everal recent court decisions[77] have found in favor of the insurance companies stating that coverage does not exist under the CGL form."[78] In its background material, AIG also states that "[p]atent infringement actions … have oftentimes resulted in very large damage awards, which normally include prejudgment interest from the date infringement first began."[79] AIG then adds that "awards over one billion dollars are now occurring."[80] Lexington's product bulletin highlights that "[m]ultimillion dollar judgments awarded to the patent holders are becoming commonplace."[81]

23. After strongly suggesting that companies should be concerned about infringement liability, AIG's marketing material describes methods for reducing a company's exposure to such liability.[82]

24. AIG then explains that it uses a number of factors to determine whether to grant coverage and calculates the size of the premium for a particular policy.[83] These factors include the company's industrial subject-matter area, competition within the industry, age of technology in the industry, and litigation within the industry.[84] The policy determination process also includes the company's prior claims history with respect to intellectual property, the company's methods for avoiding patent infringement,[85] the types of products to which coverage would apply, and the company's product distribution methods.[86] AIG notes that for large companies in industries in which patent litigation is a cost of doing business and for those

companies where the amount of maximum liability coverage is too low, special, individualized insurance policies may be available.[87] Finally, AIG offers insureds a list of patent litigation law firms. AIG does not require the use of these firms but strongly recommends them because of their expertise and experience in patent law and their ability to litigate aggressively.[88]

B. *The Policy*

25. Lexington's policy contains provisions detailing the temporal nature of the coverage.[89] The policy also limits its coverage to acts "that took place and resulted in damages within the United States, its territories or possessions" and to claims "made and brought within" the same.[90] The policy contains provisions detailing the duty to defend, settlement permission, limits to claim expense liability, and various exclusions.[91] Finally, the policy provides definitions, describes the limits of liability and the deductible, explains the duty of the insured to report a claim to Lexington as soon as practicable when a claim occurs, provides for transfer of rights of recovery, and lists other conditions, including an important binding arbitration requirement for any controversy arising out of the policy.[92]

26. An important exclusion in the policy is for a claim of "willful or intentional Patent Infringement where the Insured has prior knowledge that his manufacturing, using or selling of Covered Products would result in allegations of Patent Infringement."[93] The policy also excludes claims for infringement of design and plant patents, claims for breach of a contractual obligation, including a licensing agreement provision, claims brought by a governmental entity unless the entity holds the relevant patent, claims involving a related business not named previously, claims arising out of pending or prior litigation, claims by another Lexington policyholder, claims based on anti-trust or anti-competitive conduct by the insured, and punitive, exemplary, or multiple damages.[94] Under the policy, coverage does not apply to any claim brought by the insured against a third party.[95] Lexington, however, retains sole discretion to commence a declaratory action to have the third party's patent declared invalid or not infringed.[96]

27. According to the definitions section of the policy, coverage is available for claims of injunctive relief as well as for damages and applies to relief granted in arbitration.[97] Claim expenses, which are charged against the liability limit, include defense expenses.[98] Products are not considered covered unless, prior to first manufacture, use, or sale, a qualified patent attorney prepares a competent legal opinion concluding that the product does not infringe any valid patent.[99] Damages

covered include "lost past profits and past royalties an insured is legally obligated to pay … by way of judgments or settlements" and specifically exclude "any future payment of any nature subsequent to a settlement or judgment."[100]

C. *The Reaction*

28. NUFI has indicated that it "does not want just high-tech customers because they have so much exposure," but high-tech companies have responded to NUFI's policy offers anyway.[101] Legal counsel at Sun Microsystems, Hewlett-Packard, and CHIPS and Technologies have expressed interest in exploring the possibility of coverage. CHIPS' counsel, however, has commented that insurance coverage will not end the in-house disruption caused by patent litigation.[102]

29. One commentator predicts that insurance coverage "will level the field when [patent] litigation is undertaken" because it protects smaller competitors against aggressive campaigns by larger ones.[103] Given the huge sums of money at stake, another commentator doubted that "insurance would have a major damping effect on the aggressive intellectual property litigation policies of big electronics companies, at least in the short term."[104] An underwriter for Lexington claims that larger companies, "realizing that the $1 million limit isn't enough to cover potential liabilities in a big case, will use [the insurance] more as a budgeting mechanism [and for] covering defense costs."[105] A NUFI underwriter predicts that "over time companies with this kind of coverage will make less inviting targets."[106]

30. On the other hand, commentators have noted the possibility that companies with aggressive patent litigation strategies may prefer to choose those who are insured over those who are not insured.[107] The social stigma of insurance litigation may also be important. At least one patent attorney has observed that some patent firms may recoil at the prospect of defending insurance companies instead of the underlying technology companies.[108]

D. *Analysis*

31. In marked contrast to the sizable exposure described in AIG's marketing information, its Lexington subsidiary offers severely limited coverage. As described above,[109] the policy requires the insured to jump through a number of significant and expensive procedural hoops, first to obtain a reasonable premium and then to retain coverage. Because many companies, especially smaller companies, do not have sophisticated procedures for avoiding infringement, they will have to make significant organizational changes merely to qualify for the coverage.

32. More importantly, the coverage may not give companies the protection they need. Most companies will not view expensive insurance litigation or arbitration as a solution to their perceived exposure to infringement actions. As in other areas of insurance disputes,[110] the policy described above[111] contains terms that are sufficiently ambiguous to litigate at length in court or arbitration. Ambiguous terms include when the claim was made, whether the claim was reported as soon as practicable, whether a particular expense was a defense expense, whether the claim arose from pending litigation or litigation prior to the policy's effective date, and whether the insured had knowledge of an upcoming claim prior to the policy's effective date. In addition, the provisions of the policy read like a list of issues litigated in almost every patent infringement suit: competency of the opinion letter, place of infringement, willfulness of infringement, date of first manufacture, use, or sale, existence of a licensing agreement, classification of damages as past profits and royalties, or as punitive, exemplary damages, or multiple damages.

33. In order to retain and gain customers, an insurer may appear to abide by the spirit of a policy, but, as shown in the CGL litigation described above,[112] that same insurer will litigate to deny coverage if that course appears more profitable than paying claims. In doing so, the insurer then exposes the insured to two stages of loss: insurance litigation, and infringement damages for which the insured purchased insurance in the first place. Any issues not decided in the original infringement litigation are then "fair game" for the insurance litigation. As a result, the insurance policy may actually increase the insured's patent litigation problems.

34. Finally, as discussed above,[113] courts may again decide after GATT is implemented that CGL policies do in fact cover patent infringement damages. If so, companies may prefer to seek protection under their CGL policies rather than deal with the procedural hoops and other restrictions posed by these special infringement policies. Insurers, faced with large patent infringement suits, may reform their CGL policies to specifically exclude patent infringement liability.

IV. PATENT ENFORCEMENT INSURANCE

35.

> Unfortunately for small companies and individual inventors, enforcing a patent — especially against a well-funded infringer — is a very expensive and time-consuming proposition. Lawyers rarely take on the enforcement of a patent on a contingent-fee basis, absent some proven track record of success.… What then can the majority

of patent owners do to protect themselves from future infringement of their patents? Insurance policies that are triggered in the event of litigation to enforce the patent against infringement seem to fill this need.[114]

36. The goal of patent enforcement insurance is to pay for the legal fees of prosecuting patent enforcement litigation.[115] Unlike CGL and infringement insurance, patent enforcement insurance insures patent holders, not potential infringers.

A. *The Marketing*

37. Intellectual Property Insurance Services Corporation ("IPISC") of Louisville, Kentucky, sells patent enforcement insurance as "infringement abatement insurance."[116] IPISC's marketing information states that a patent is a valuable asset and that "[e]very act of infringement lowers its value and indeed unabated infringement can render it totally worthless …"[117] After claiming that "[l]itigation is expensive … and [typical] litigation costs [are] in excess of $396,000 nationally," IPISC lists additional advantages of obtaining the insurance.[118]

B. *The Policy*

38. IPISC's insurance policy covers seventy-five percent of enforcement costs and seventy-five percent of "financial loss due to the defendant's insolvency" up to the policy limit.[119] Coverage may be either per patent or per claim.[120] The annual premium for $500,000 of coverage is approximately $3000 to $4000.[121] IPISC's policy covers both actual infringement and claimed infringement, but IPISC authorizes payment of litigation costs only after an independent outside patent counsel has rendered a favorable opinion letter on validity and infringement.[122] To benefit from the coverage, the defendant must have committed the acts of alleged infringement in the United States, and the insured must seek remedy in a federal district court, federal appellate court, or before a board of arbitrators.[123] Preexisting infringement is an important exclusion from coverage.[124]

39. IPISC's policy covers the cost of defending counterclaims of invalidity, "but only to the extent that [the cost is] a direct consequence of an authorized litigation …."[125] The insured may appeal a lower court outcome only after obtaining authorization from the insurer.[126] The policy provides for pro rata coverage if insured patents and uninsured patents are included in the same lawsuit.[127] The pro rata share is "determined by multiplying the fraction of insured intellectual property to the total intellectual property involved in the lawsuit by the lawsuit costs."[128]

40. The insurer shares in the damage award on the pro rata basis of its contribution to litigation expenses, up to a limit of one-hundred-and-fifty percent of the payments it owed the insured as reimbursement for litigation expenses.[129] The insurer then credits the insured's aggregate coverage by the amount of these payments.[130] If an injunction is awarded and its value cannot be readily ascertained, its value "is presumed to be twice the [insurer's] total reimbursement payments."[131] Some of these provisions can be waived by one or more endorsements,[132] but these endorsements would presumably raise the premium. The policy does not provide coverage if the litigation results in a finding of fraud or inequitable conduct.[133] As discussed above with respect to infringement insurance,[134] disputes between the insured and insurer must be referred to binding arbitration.[135]

C. *The Reaction*

41. As of November 1993, IPISC insured approximately 1000 patents and was collecting approximately $500,000 in premiums per year.[136] One commentator has observed that with such resources mounting for individual inventors, corporations feel they need to brace themselves financially for an avalanche of patent litigation, and have created a market for patent infringement insurance.[137] Another commentator notes a possible connection between the emergence of patent enforcement insurance and the increase in patent litigation, reasoning that patent enforcement insurance brings to court plaintiffs who were unable to sue in the past.[138]

42. IPISC may also be courting potential partners for its related entity, Intellectual Property Reserve Corporation ("IPRC"), which is mentioned in IPISC's marketing information.[139] IPRC invests in patent litigation and receives up to forty percent of the recovery if a suit is successful.[140] These investment activities are controversial; some companies and their lawyers contend that profiting from lawsuits perverts the judicial process.[141]

D. *Analysis*

43. Patent enforcement insurance entails many of the same problems encountered with infringement insurance,[142] including tricky procedural hoops for the insured and the risk of insurance litigation. In addition, some of the policy exclusions may drive potential infringers to use defensive tactics to take a case outside the policy coverage.[143] With patent enforcement insurance, however, enough money may be

available to keep the insurer interested because the insured and the insurer are both potential beneficiaries of a large damage award.

44. Recovery sharing between the patent holder and IPISC faces difficulties in some states due to champerty laws, which ban the sharing of damage awards with third parties.[144] Although IPISC's literature does not mention this problem, in practice it makes little difference because IPISC often refers these cases to its affiliate IPRC. IPRC will then take an ownership interest in the patent at issue, thus evading the reach of the champerty laws.

45. Parts of the policy are so simplistic that litigation over the terms seems almost inevitable. For example, the use of a simple fraction under the provision for pro rata coverage is strangely imprecise in the case of a lawsuit involving both insured and uninsured patents. For many reasons, patents vary widely in value. To calculate coverage by dividing, for example, three patents by five patents, assumes far too much about the relative value of the five patents. In addition, this provision encourages both the insured and the insurer to bring as many patents as possible into the lawsuit, whether relevant or irrelevant. As a result, it is likely that this provision will lead to wasted resources and conflict between insured and insurer.

46. Also important from the insured's perspective is the prospect that its relationship with the insurer will affect the lawsuit in ways commonly found in contingency-fee tort litigation. For example, because the settlement value of a lawsuit may be much lower for the insurer than for the insured, the insurer may pressure the insured to accept a settlement offer. The arrangement also creates an incentive for the insurer to enter into a "Mary Carter" agreement with the alleged infringer.[145] Under such an agreement, one party allies itself with another, usually to the detriment of one or more remaining parties to the lawsuit. Due to the perverse incentives these agreements sometimes create, a number of states ban them altogether and others impose disclosure requirements.[146] With respect to enforcement insurance, both the insurer and the alleged infringer have an interest in minimizing litigation expenses, especially if the insurer expects only a limited profit from protracted litigation. Consequently, the insurer may want to ally with the alleged infringer. The result might be premature settlement to the insured's detriment.

47. Other questions and issues arise under patent enforcement insurance policies wholly separate from the issues raised above.[147] For example, because the insurer pays the insured's enforcement expenses, which party accepts the settlement offer?

What happens if the insurer and the insured disagree over whether to seek an injunction? The long-term value of patent enforcement insurance depends on answers to these kinds of questions. Unfortunately, if arbitration clauses are consistently upheld,[148] case law answering these questions may be slow in coming.

V. CONCLUSION

48. When the District Court for the Central District of California rendered the *Watercloud I* decision, some commentators welcomed it. As one commentator explained, expansion of the CGL policy would encourage competition among inventors because small competitors would be able to litigate cases on the merits.[149] Over time, however, this approach has lost its appeal,[150] probably because it seems unfair to expect insurers to pay large patent infringement awards under a policy that does not contemplate such awards.[151] As discussed above, the courts may change direction again after Congress implements GATT.[152]

49. Questions remain. What will be the effect of insurance on the patent community?[153] Insurance and other risk-spreading measures make sense as protection against unpredictable events such as acts of God and theft. Patent infringement lawsuits are arguably less unpredictable, because a potential infringer may check for preexisting patents in the prior art and may obtain a patent attorney's opinion before undertaking potentially infringing activity. The fact that some patent holders turn to insurance instead[154] seems to indicate that at least these patent holders view patent infringement liability in much the same light as an act of God. This perspective may be due to a lack of awareness about intellectual property in general. As a result, interest in insurance coverage may wane as companies learn how to comply with intellectual property laws. Nevertheless, as long as the uncertain potential for financially crippling damage awards exists, companies may require at least some insurance protection in this area.

50. The question remains whether any insurance policy could, in practice, provide the kind of protection that insurers and insureds expect. The policies reviewed in this Note leave much to be desired.[155] Unless insurers raise the policy limits on infringement insurance, perhaps even to a billion dollars, some patent holders, especially large companies, will find coverage inadequate. Moreover, patent enforcement insurance requires, in essence, a partial assignment of patent rights in certain cases.[156] Finally, the insured faces the prospect of expensive litigation

against the insurer. This is especially true because the field is relatively new and the case law offers little guidance to the parties. These insurance policies are like an engineering prototype or the first draft of a screenplay: inexperience readily shows and there are many rough edges to be smoothed out. The process of refining patent insurance will be expensive for the insurers and insureds who decide it is worthwhile to undertake.

51. Assuming these problems are overcome, will all future infringement suits be litigated by insurance companies on both sides? One can imagine a typical patent infringement suit of the future, where the plaintiff's insurer sits on one side with its well-honed team of patent litigators and the defendant's insurer sits on the other side with its team. In a subsequent suit, the litigating teams are the same but they have switched sides. The underlying plaintiffs and defendants are nowhere to be seen because they have coverage and therefore have little interest in the outcome of the suit.[157] Viewed optimistically, the scenario includes parity of bargaining power on the two sides, which provides strong incentives to settle most cases. Viewed pessimistically, the scenario is analogous to the health care industry in that the arrangement appears to channel valuable capital from businesses to insurance companies with no real productive gain and with a diminished incentive to modify behavior to reduce losses.

52. Even if the effect of patent insurance is as intended by the parties, from a public policy perspective it is unclear whether the effect will be beneficial. First, the patent system rewards inventors with monopolies enforceable through infringement litigation. If a potential infringer has insurance protection, however, the threat of a suit loses some of its deterrent power. Second, the argument that insurance coverage will encourage competition rests on the assumption that "the little guy needs protection from the big corporations." If this is the case, patent enforcement insurance is beneficial for public policy reasons because it gives the "little guy" an opportunity to litigate, particularly against large corporations backed by insurance companies willing to fight to avoid paying damages under the large corporation's infringement insurance policies. Because patent enforcement insurance gives the small company some parity in bargaining power, large companies will be less able to restrain market competition through predatory patent litigation.

53. Recently, however, many commentators and patent attorneys have become dismayed at what they perceive as increasing instances of patent extortion by the "little guy."[158] One attorney recently described the strategy as follows:

54. What you try to do is patent a basic process, then sign up as many licenses as you can for a decent price to build a war chest .... Then you pick out a target to test the patent against. Depending on the circumstances, you either pick out a big target, figuring if he falls everyone will fall behind him, or you pick out a medium target that will put up a decent fight so people will respect what you've done, but it won't cost as much.[159]

55. If this view is correct, patent enforcement insurance simply exacerbates the problem by providing the small corporation with greater resources to instigate and carry out the extortion.

56. Insurance coverage makes sense when a company needs to spread risk over time and across the industry. Earthquakes and traditional tort liability fit the bill. But patent infringement is predictable and avoidable, at least in most cases. Due to the limitations of the policies and the financial and other costs of acquiring them, many companies may find it more profitable to investigate patents in their industrial areas rather than pay insurance premiums. In other words, once a company understands where the patent fault lines are in its industry, it can direct its activities in ways that dramatically reduce the need for insurance protection.

ENDNOTES

[1] Also known as Comprehensive General Liability Insurance.

[2] Ellis Horvitz, *An Analysis of Recent Supreme Court Developments in Tort and Insurance Law: The Common-Law Tradition*, 26 LOY. L.A. L. REV. 1145, 1145 (1993); *see, e.g.,* David W. Miller, *Whether Governmentally Compelled Cleanup Costs Constitute "Damages" Under CGL Policies: The Nationwide Environmental Liability Dilemma and a California Model For Its Resolution*, 16 COLUM. J. ENVTL. L. 73, 75 (1991).

[3] 35 U.S.C. § 271(a) (1988).

[4] "Most business firms have some form of ... CGL ... insurance to protect themselves from claims of bodily injury or property damage." Bradford P. Lyerla & Manuel A. Abascal, *Insurance Coverage for Intellectual Property Claims: The California vs. the New York Approach*, 19 A.I.P.L.A. Q.J. 189, 192 (1991).

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.* at 197.

9 No. SA CV 88-200, 1988 U.S. Dist. LEXIS 17572 (C.D. Cal. Nov. 17, 1988).

10 696 F. Supp. 434 (D. Minn. 1988).

11 545 N.E.2d 1206 (N.Y. 1989).

12 18 U.S.P.Q.2d 1567 (C.D. Cal. 1990).

13 25 U.S.P.Q.2d 1317 (N.D. Cal. 1992).

14 830 F. Supp. 536, 26 U.S.P.Q.2d 1940 (C.D. Cal. 1993).

15 26 U.S.P.Q.2d 1933 (Cal. App. Dep't Super. Ct. 1993).

16 824 F. Supp. 583, 27 U.S.P.Q.2d 1624 (E.D. Va. 1993).

17 28 U.S.P.Q.2d 1424 (Cal. Ct. App. 1993).

18 847 F. Supp. 1452, 30 U.S.P.Q.2d 1474 (N.D. Cal. 1994).

19 15 F.3d 1500, 29 U.S.P.Q.2d 1610 (9th Cir. 1994).

20 23 F.3d 226, 30 U.S.P.Q.2d 1534 (9th Cir. 1994).

21 23 F.3d 254, 30 U.S.P.Q.2d 1652 (9th Cir. 1994).

22 No. SA CV 88-200 AHS (RWRx), 1988 U.S. Dist. LEXIS 17572 (C.D. Cal. Nov. 17, 1988).

23 1988 U.S. Dist. LEXIS 17572, at *16-*20.

24 Lyerla, *supra* note 4, at 200.

25 1988 U.S. Dist. LEXIS 17572, at *18-*19.

26 Lyerla, *supra* note 4, at 200 (second alteration in original).

27 1988 U.S. Dist. LEXIS 17572, at *14.

28 Lyerla, *supra* note 4, at 200-01.

29 696 F. Supp. 434 (D. Minn. 1988).

30 Eugene R. Anderson & David A. Einhorn, *Patent Infringement Actions — Insurance to the Rescue*, 73 J. PAT. [& TRADEMARK] OFF. SOC'Y 527, 533 (1991). Although *John Deere* was contemporaneous with *Watercloud I*, it seems not to have had a similar influence on subsequent jurisprudence. For example, the District Court for the Eastern District of Virginia in *St. Paul Fire & Marine Ins. v. Advanced Interventional Systems*, 824 F. Supp. 583, 27 U.S.P.Q.2d (BNA) 1624 (E.D. Va. 1993), which cited *Watercloud I* and other California decisions, did not mention *John Deere* at all.

31 18 U.S.P.Q.2d (BNA) 1567 (C.D. Cal. 1990).

32 Lyerla, *supra* note 4, at 201.

33 545 N.E.2d 1206 (N.Y. 1989).

34 The underlying plaintiff alleged that the insured infringed its patents by importing and selling infringing plastic fasteners. Lyerla, *supra* note 4, at 208. In affirming the grant of summary judgment to the insurer, the court held that the infringement did not occur in the course of the insured's advertising activities. *Id.* The fact that the insured had circulated a price list for the infringing fasteners, and that the plaintiff had complained of it in the underlying case, did not mean that the claim arose in the course of the insured's advertising activities because there was no claim that the price list made false or deceptive claims or that it harmed the plaintiff. *Id.*

35 25 U.S.P.Q.2d (BNA) 1317 (N.D. Cal. 1992).

36 *Id.* at 1319.

37 *Id.*

38 830 F. Supp. 536, 26 U.S.P.Q.2d (BNA) 1940 (C.D. Cal. 1993).

39 830 F. Supp. at 538.

40 26 U.S.P.Q.2d (BNA) 1933 (Cal. App. Dep't Super. Ct. 1993).

41 *Id.* at 1937-38. The insured argued that the patent holder was really claiming that the insured's advertising, which stated that the insured's modems were compatible with patent holder's, induced users of the modem to violate patent holder's patent. *Id.* at 1937. The insured also argued that it was being accused of contributing to the infringement of the patent holder's patent by users. *Id.* at 1938.

42 *Id.*

43 28 U.S.P.Q.2d (BNA) 1424 (Cal. Ct. App. 1993).

44 The federal district court remanded the case to state court after the addition of a party eliminated federal diversity jurisdiction. David B. Goodwin & A. Mari Mazour, *The Advertising Injury Endorsement in Insurance Disputes: Its Scope and Application 1993*, 661 PRAC. L. INST./COMM. 69, 74 (1993).

45 28 U.S.P.Q.2d (BNA) at 1426.

46 Intex Plastics v. United Nat'l Ins., 23 F.3d 254, 257 n.1, 30 U.S.P.Q.2d (BNA) 1610 (9th Cir. 1994) [hereinafter *Intex II*] ("[W]e will generally follow an intermediate appellate court's decision unless there is compelling evidence that the state supreme court would decide the issue differently .... This is particularly true where, as in [*Watercloud II*], the California Supreme Court has denied review.") (citations omitted).

47 "It has been held that a claim of patent infringement does not 'occur in the course of ... advertising activities' within the meaning of the policy even though the insured advertises the infringing product, if the claim of infringement is based on the sale or importation of the product rather than its advertisement. Similarly, there is no coverage for a bank's failure to provide an advertised service in a proper manner." 833 P.2d 545, 559 (Cal. 1992) (citations omitted). "[*Bank of the West*] stemmed from a consumer class action brought against [a bank] for failing to explain a loan program it offered customers for financing insurance premiums." Susan Orenstein, *A Big Win for Insurers, Maybe*, RECORDER, Sept. 24, 1993, at 1

[hereinafter *Big Win*]. "In denying coverage to the bank for the cost of settling the class action, the Supreme Court gave a narrow reading of advertising injury, emphasizing that to trigger coverage there must be a link between the advertising and the injury." *Id.*

48 28 U.S.P.Q.2d (BNA) at 1427.

49 *Id.*

50 "Except as otherwise provided in this title [35 U.S.C. §§1 et seq.], whoever without authority makes, uses or sells any patented invention, within the United States during the terms of the patent therefor, infringes the patent." 35 U.S.C. § 271(a) (1988).

51 "Whoever actively induces infringement of a patent shall be liable as an infringer." 35 U.S.C. § 271 (b). A direct infringer — one who makes, uses or sells another's patent invention — cannot be liable for inducing or contributing to patent infringement. (See *Self v. Fisher Controls Co., Inc.* (9th Cir. 1977) 566 F.2d 62, 64....) In *Aro Mfg. Co. v. Convertible Top Replacement Co.* (1961) 365 U.S. 336 [128 U.S.P.Q. (BNA) 354], the United States Supreme Court held that under section 271(c) there could be no contributory infringement in the absence of direct infringement. (Id. at pp. 341-342.) With the enactment of the Patent Act of 1952, the concept of contributory infringement was divided between "active inducement" and "contributory inducement." (35 U.S.C. Section 271(b), (c); see also *Hewlett-Packard Co. v. Bausch & Lomb Inc.* (Fed. Cir. 1990) 909 F.2d 1464 at p. 1469 [15 U.S.P.Q.2d 1525].) However, the legislative history indicates no change in the scope of what constituted "contributory infringement" was intended by the enactment of the Act. (*Aro Mfg. Co. v. Convertible Top Replacement Co.* (1964) 377 U.S. 476, 485-486.) Thus, contributory infringement will not lie against one who is a direct infringer.

28 U.S.P.Q.2d (BNA) at 1427.

52 28 U.S.P.Q.2d (BNA) at 1428.

53 To be liable for inducing infringement, a party must have the specific intent to induce another to infringe. (*Manville Sales Corp. v. Paramount Sys., Inc.* (Fed. Cir. 1990) 917 F.2d 544, 553.) Accordingly, it must be shown that "the defendant possessed *specific intent* to encourage another's infringement and *not merely that the defendant had knowledge* of the acts alleged to constitute infringement." (*Id.* at p. 553, emphasis added.) *Id.*

54 *See, e.g., infra* notes 65-69 and accompanying text with respect to GATT.

55 847 F. Supp. 1452, 30 U.S.P.Q.2d (BNA) 1474 (N.D. Cal. 1994).

56 847 F. Supp. at 1459 n.10.

57 15 F.3d 1500, 29 U.S.P.Q.2d (BNA) 1610 (9th Cir. 1994).

58 15 F.3d at 1507 (emphasis added).

59 23 F.3d 226, 229, 30 U.S.P.Q.2d 1534, 1536 (BNA) (9th Cir. 1994).

60 23 F.3d at 229.

61 [The insured] argues that allegations of patent infringement necessarily imply a disparagement of title. If

this were true, all claims of patent infringement would fit within a standard personal injury clause. This interpretation would permit coverage far exceeding the objectively reasonable expectations of the insured based on the explicit language of the policy.

23 F.3d at 230.

[62] 23 F.2d 254, 30 U.S.P.Q.2d (BNA) 1652 (9th Cir. 1994).

[63] 23 F.2d at 256-57.

[64] Horvitz, *supra* note 2, at 1145; *see, e.g.*, Miller, *supra* note 2, at 75.

[65] Rights Conferred

1. A patent shall confer on its owner the following exclusive rights:

(a) where the subject matter of a patent is a product, to prevent third parties not having his consent from the acts of: making, using, *offering for sale*, selling, or importing for these purposes that product;

(b) where the subject matter of a patent is a process, to prevent third parties not having his consent from the act of using the process, and from the acts of: using, *offering for sale*, selling, or importing for these purposes at least the product obtained directly by that process.

General Agreement on Tariffs and Trade — Multilateral Trade Negotiations (The Uruguay Round): Agreement on Trade-Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods, Dec. 15, 1993, Part II, Section 5, Article 28, 33 I.L.M 81, 94 (1994) (emphasis added).

[66] Sec. 532. Patent Term and Internal Priority.

(a) Patent Rights.–

(1) Contents and term of patent.– Section 154 of Title 35, United States Code, is amended to read as follows:

"Sec. 154. Contents and term of patent

"(a) In General.–

"(1) Contents.–Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, of the right to exclude others from making, using, *offering for sale*, or selling the invention throughout the United States or importing the invention into the United States, and, if the invention is a process, of the right to exclude others from using, *offering for sale* or selling throughout the United States, or importing into the United States, products made by that process, referring to the specification for the particulars thereof."

Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809, 4983-84 (1994) (emphasis added).

[67] Sec. 534. Effective Dates and Application.

(a) In General.–Subject to subsection (b), the amendments made by this subtitle take effect on the date that is *one year after the date on which the WTO Agreement enters into force with respect to the United States.*

(b) Patent Applications.–

…

(2) Section 154(a) (1).–Section 154(a)(1) of title 35, United States Code, as amended by section 532(a)(1) of this Act, shall take effect on the effective date described in subsection (a).

Id. at 4990 (emphasis added). Although January 1, 1995 is a date often referred to as the "in force" date, *see, e.g.*, Robert Evans, *WTO Urges Trade Powers Help Pakistan Reform*, REUTER EUROPEAN BUSINESS REPORT, Feb. 16, 1995, there has been some controversy on the issue.

The legislation implementing GATT was signed into law by President Clinton on Dec. 8. The GATT legislation provides that most of the statutory amendments affecting intellectual property will take effect "one year after the date on which the WTO agreement enters into force with respect to the United States." GATT also stipulates that the WTO will enter into force as early as possible after Jan. 1, 1995. This will occur when GATT ministers determine that a sufficient number of countries have ratified the agreement, and the ministers will meet shortly to make that determination. The WTO enters into force "with respect to the United States" when President Clinton "accepts" the agreement. The Copyright Office takes the position that the copyright restoration provisions will become effective Jan. 1, 1996. But nothing is ever simple: Because of the promptness in which President Clinton acted, many opine that the effective date of the GATT copyright restoration [is] Jan. 1, 1995, not 1996. If so, the statutory duties of the Copyright Office may be impossible to fulfill in the required time frames.

Alan J. Hartnick, *GATT Copyright Restoration*, N.Y.L.J., Feb. 3, 1995, at 8.

[68] See *supra* section II.B.

[69] *Intex II*, 23 F.3d at 256 (emphasis added). Starting in 1996, every patent-holder's infringement complaint is likely to include a count alleging "offering for sale" infringement based on the alleged infringer's advertisements of the allegedly infringing product.

[70] Susan Orenstein, *A New Hedge Against Infringement*, RECORDER, Apr. 4, 1994, at 3 [hereinafter *Hedge*].

[71] Bruce Rubenstein, *New Product: Insurance for Patent Infringers*, 4 CORP. LEGAL TIMES 1, 1 (1994).

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Id.*

[76] *Id.*

[77] *See supra* section II.B.

[78] AIG Marketing Information (1994) (on file with author).

[79] *Id.*

[80] *Id.*

[81] LexLetter 1 (Apr. 1994) (on file with author).

[82] Methods of reducing exposure to patent infringement include:

(1) obtaining right-to-use opinions;

(2) updating the opinions periodically;

(3) developing an internal search policy to screen potentially relevant patents;

(4) assigning personnel for the administration of screening;

(5) establishing a policy to deal with potential claims of infringement;

(6) obtaining opinion letters on a timely basis;

(7) communicating to employees the need to bring knowledge of a patent to management's attention;

(8) establishing a document retention policy;

(9) training employees about implications of their actions with respect to patent matters;

(10) establishing a policy on submission of ideas by outsiders; and

(11) establishing a policy to acquire and maintain a patent portfolio.

AIG Marketing Information (1994) (on file with author).

[83] *Id.*

[84] *Id.*

[85] *See supra* note 82.

[86] AIG Marketing Information (1994) (on file with author).

[87] *Id.*

[88] *Id.*

[89] Lexington Insurance Company Patent Infringement Liability Insurance Policy, Specimen Copy (May 18, 1994) (on file with author).

90 *Id.*

91 *Id.*

92 *Id.*

93 *Id.* As discussed *infra* in section III.D., litigation on the question of willful infringement is already commonplace.

94 *Id.*

95 *Id.*

96 *Id.*

97 *Id.*

98 *Id.*

99 *Id.*

100 *Id.*

101 *Hedge*, *supra* note 70, at 3.

102 *Id.*

103 Rubenstein, *supra* note 71, at 1.

104 *Id.*

105 *Id.*

106 *Id.*

107 *Id.*

108 Interview with a Silicon Valley patent attorney, anonymity respected (June 1994).

109 *See supra* part III.B.

110 *See generally* issues of TORT & INS. L.J. and articles and citations therein.

111 *See supra* section III.B.

112 *See supra* sections II.A and B.

113 *See supra* section II.C.

114 David M. Halbreich & Nicky Espinosa, *Paid to Prosecute*, 4 COVERAGE (ABA SECTION OF LITIGATION) 1 (1994).

115 *Id.* at 4.

116 IPISC Marketing Information (Oct. 1994) (on file with author).

117 *Id.*

118 The following are advantages of obtaining patent enforcement insurance:

(1) Deters infringement by demonstrating ability to financially protect your intellectual property;

(2) Reduces pressures on the intellectual property holder to settle because of mounting legal expenses;

(3) Insured patents are more attractive to investors who may be asked to fund a business; and

(4) Insurance strengthens the "licensability" of your intellectual property. *Id.*

119 *Id.* The maximum policy limit is $500,000. *Id.*

120 *Id.*

121 *Id.*

122 Intellectual Property Infringement Abatement Policy, Homestead Insurance Company, specimen copy (Oct. 1994) (on file with author).

123 *Id.*

124 *Id.* "In the event, after AUTHORIZED LITIGATION is commenced, it is discovered that infringement of the INSURED INTELLECTUAL PROPERTY actually began prior to the effective date of the present policy period, or any previous continuous policy period(s) … , the policy shall no longer cover AUTHORIZED LITIGATION and … [i]nsured shall return all LITIGATION EXPENSE paid …." *Id.*

125 *Id.*

126 *Id.*

127 *Id.*

128 *Id.* For example, if the litigation involves two insured patents and one uninsured patent, and the total cost of the lawsuit is $300,000, then the pro rata share covered would be $200,000, which is two-thirds of $300,000.

129 *Id.*

130 *Id.*

131 *Id.* Since an injunction is almost always awarded when a patent holder prevails over an accused infringer, this provision, in effect, guarantees the insurer that it will make a profit equal to twenty-five percent of litigation expenses.

132 *Id.*

133 *Id.*

134 *See supra* note 92 and accompanying text.

135 One insurer has successfully used this arbitration clause to prevent an insured from litigating in court. *Pioneer Labs., Inc. v. Homestead Ins. Co.*, No. 2:93-cv-197, 1994 U.S. Dist. LEXIS 4842 (W.D. Mich. Mar. 15, 1994). The insurer refused to pay litigation costs for patent infringement counterclaims raised by the insured in a trademark infringement suit. *Id.* at *2. The insured sued for coverage, arguing "that the policy exempt[ed] from arbitration the issues of the validity and the infringement of the insured intellectual property." *Id.* at *4. In addition, the insured claimed that patent disputes were exempt from arbitration. *Id.* at *6. The court rejected these arguments, calling the dispute "a pure question of contract law." *Id.* at *7. Insured was "correct in asserting that [the insurer's] own affirmative defenses … raised the issues of … validity and infringement." *Id.* at *6. "However, [the insurer] ha[d] framed these substantive matters as sub-issues only." *Id.* And if the "matters ultimately prove[d] to be material, the arbitrators [could] simply decline to address them." *Id.* Citing "the Congressional policy to strictly enforce arbitration clauses in commercial contracts," *id.* at *7, "the Court [found] th[e] case to be arbitrable." *Id.*

136 Linda Himelstein, *Investors Wanted — For Lawsuits*, BUSINESS WEEK, Nov. 15, 1993, at 78.

137 *Id.*

138 Teri B. Varnell & R. Eugene Varnell, Jr., *Changes in the World of Patent Litigation*, 34 IDEA 205, 211 (1994).

Depending on the value of the invention and other factors, [patent enforcement] insurance may be a prudent decision by certain patent holders. Insurance gives the patent holder the opportunity to control the litigation …. For the potential defendant, who is often a foreign entity in patent cases, securing [patent infringement] insurance may prove to be a worthwhile alternative. This decision will depend on many factors, including the value and life of the protected market, the amount of the premiums, liability coverage, etc. Certainly, increases in litigation costs … will lead to increases in the premiums charged by insurance providers….

[The insurance companies] are predicting an avalanche of patent litigation…. The net result may … be an increase in patent litigation, since the emergence of these [patent enforcement insurance] companies brings to the court a category of plaintiffs, who in the past, were not able to sue. The increase in litigation from the newcomers will be a function of the size of the category of patent holders who would sue "but for" the lack of financial capability, and the percentage in that category who will qualify for investment under the criteria established by these new private investment companies …. *Id.*

139 IPISC Marketing Information (Oct. 1994) (on file with author).

140 Himelstein, *supra* note 136, at 78.

141 *Id.*

142 *See supra* section III.D.

143 With hopes that insurers will take the opportunity to deny coverage, alleged infringers may, for example, claim that their activities began before the policy period.

144 State law varies substantially. Some states have statutes which specifically prohibit champertous agreements. For example, under a Georgia statute, contracts for maintenance or champerty are deemed contrary to public policy and cannot be enforced. By Kentucky statute, a contract for the purpose of aiding in the prosecution or defense of a lawsuit in exchange for any part of the thing sued for is void as a champertous contract. Under New York's Judiciary Law, no corporation may buy an interest in any claim for the purpose of instituting a lawsuit. In Maine and Mississippi, champerty is a crime. Several states have statutes specifically prohibiting attorneys or others connected with the judicial process from engaging in maintenance and champerty.

At least ten states have statutes which although not prohibiting maintenance generally, prohibit barratry, that is, exciting groundless judicial proceedings or stirring up quarrels to harass defendants. A few states have repealed their barratry statutes. Florida has a statute that incorporates into Florida law British statutory and common law of a general nature, specifically noting, *inter alia*, British statutes barring champerty. Missouri, Nevada, and Utah have statutes incorporating British statutes and common law and through case law have adopted British common law rules against champerty and maintenance. A few other states have also adopted the common law of maintenance and champerty. Connecticut, Idaho, and Louisiana have rejected the common law of maintenance and champerty. In New York, too, there is no common law prohibition against champerty; the doctrine prevails only as provided by statute. Wisconsin is the only state with a statute that prohibits the dismissal of any action on the ground that a party to the action is a party to a champertous contract; however, in Wisconsin, common law holds that champertous contracts are void.

Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?*, 30 AM. BUS. L.J. 485, 488-89 (1992) (citations omitted).

145 Over the past twenty years, the Mary Carter agreement has quietly developed into a confusing and unsettled doctrine in civil litigation throughout the United States. Mary Carter agreements are recognized in … jurisdictions under different names, and the variations are "limited only by the ingenuity of counsel and the willingness of the parties to sign." Despite these variations, three characteristics are found in the typical Mary Carter agreement. First, one or more of the potentially liable obligors or tortfeasors guarantees a specific, minimum recovery for the plaintiff. Second, the agreement requires reimbursement, or [payback] (sic), of all or part of the guaranteed settlement as determined by the amount, if any, the plaintiff successfully recovers from the non-settling defendant(s). Third, the agreeing party is required to remain as a party in the trial of the case. Historically, Mary Carter agreements also contained secrecy provisions that left the non-settling party, the court, and the jury completely unaware of the terms or even the existence of the agreement. However, the case law development of the modern Mary Carter doctrine has practically eliminated secrecy in such contexts. In reality, the Mary Carter agreement is simply a hybrid form of the common-law release and a covenant not to sue…. [Besides Florida,] only two other jurisdictions, Nevada and Wisconsin, have explicitly held Mary Carter agreements void as contrary to public policy. In a related fashion, the Oklahoma Supreme Court held that when dealing with Mary Carter agreements, the trial court should review the circumstances of the agreement and either hold the "guaranty" provision unenforceable, as against public policy, or dismiss the settling defendant(s) from the suit. Most other jurisdictions tolerate Mary Carter agreements and implement procedural guidelines to offset their prejudicial effects.

Ray J. Black, Jr., *Mary Carter Agreements Are Void In Texas As Contrary To Public Policy:* Elbaor v. Smith, 845 S.W.2d 240 (Tex. 1992), 35 S. TEX. L. REV. 183, 190-94 (1994) (citations omitted).

146 *Id.*

147 *See supra* section IV.

148 *See supra* note 135 and accompanying text.

149 Thomas J. Stueber, *Insurance Coverage for Patent Infringement*, 17 WM. MITCHELL L. REV. 1055, 1082-84 (1991).

[P]roviding insurance coverage for patent infringement under the CGL policy will encourage competition. At present there is a strong incentive to use patents as anti-competitive weapons. Most patents do not issue to individual inventors but to large corporations which can spend large sums of money on research and development.… Having an insurer with a duty to defend the accusation of patent infringement will allow the small competitor to litigate the case on the merits. *Id.*

150 *See supra* section II.B and C.

151 *Id.*

152 *See supra* section II.C.

153 Insurance has had significant effects in other market areas. *See*, *e.g.*, Bryan Ford, *The Uncertain Case for Market Pricing of Health Insurance*, 74 B.U. L. REV. 109 (1994).

154 *See supra* note 101-02 and accompanying text.

155 *See supra* sections III.B and IV.B.

156 *See supra* note 144 and accompanying text.

157 The patent enforcement insurance company has an interest both in defending validity and in proving infringement because the insurer probably will not be able to collect future premiums from the patent holder for enforcement insurance for an invalid patent.

158 Howard Banks, *Torpedoing "Submarine" Patents*, FORBES, Aug. 1, 1994, at 33; David Rubenstein, *The Loneliness of the Contingency Infringement Patent Lawyer*, ILL. LEGAL TIMES, Aug. 1993, at 1.

159 Daniel F. Perez, *Exploitation and Enforcement of Intellectual Property Rights*, 10 COMPUTER LAW. 10, 11 (Aug. 1993) (quoting a New York patent attorney).