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LEGAL ISSUES AFFECTING NONTRADITIONAL PRODUCTS

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Panelists: JAMES ADDISON HARRIS, JR.*
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The panel will review recent class action and other large legal actions against insurers, including an update on Alabama settlements and outstanding cases. Panelists will explain what effect the outcomes of the cases can have on pricing, reserving, compensation, and future marketing activities.

MR. JAY M. JAFFE: Our first speaker, Jim Harris, will talk about the situation in Alabama. Not only is the credit insurance business facing a crisis in Alabama, but my fear is also that this could be the tip of the iceberg for the entire insurance industry.

The second presentation will be from Peter Trzyna. Peter will talk about intellectual property law, a topic with which actuaries should become familiar. It's a subject that affects all of us in our daily practices even though not many actuaries understand intellectual property law.

Jim Harris is a senior partner in the law firm of Harris & Brown in Birmingham, AL. He will speak to us on the subject of the current litigation climate in the state of Alabama. He is an undergraduate and has a law degree from the University of Alabama. For the last 15 years or so, Mr. Harris's focus has been on handling complex civil cases involving class actions, consumer fraud cases, and product liability cases. We are very pleased to have Jim with us to speak about the litigation climate in Alabama.

MR. JAMES ADDISON HARRIS, JR.: It seems that about every month or so I find myself standing before a group such as this, or sitting around a conference table, looking into the eyes of some distraught executives who are trying to push away a complaint that has come to their attention. When I'm introduced as a lawyer from Alabama, you can feel the chill in the room. The old ritual of killing the messenger who bears the bad news is still alive and with us in the U.S. I've been the messenger but I want to get across to you before I start that I defend lawsuits.

I have divided my remarks into three segments: What's happening in Alabama? Why is it happening in Alabama? and What can we do to prevent it from happening in Alabama?

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The ultimate question is whether the situation in Alabama with big verdicts is the tip of the iceberg or whether it is merely an aberration. I'm not even qualified to speculate on that issue.

What's happening in Alabama? I've tried to divide this into three segments for organizational purposes, and I call them the good, the bad, and the ugly. I will start with the good because there is some good news from Alabama. You would have to count as good news the situation with regard to the chief justice of the Alabama Supreme Court. It appears as though conservative Republican Perry Hooper will be installed as the new chief justice of the Supreme Court of the State of Alabama. It appears as though he has defeated liberal Democrat Sonny Hornsby, who some people characterize as the political and philosophical leader of a plaintiff-oriented court. I use the term *appears*.

That election occurred a year ago, and if you've been following it at all in the papers, you know there was a great controversy about absentee ballots. It found its way into the federal courts. The good guy, Perry Hooper, won in the federal court in Mobile. There was an appeal to the U.S. Court of Appeals for the Eleventh Circuit. That court affirmed the trial court and directed that Perry Hooper be installed two days ago as the new chief justice of the Alabama Supreme Court, and we were all excited. Sonny Hornsby, an ex-trial lawyer and a very good trial lawyer, wasn't giving up there. He went to the U.S. Supreme Court, and Justice Kennedy issued a stay, which is in effect right now, so the U.S. Supreme Court could review this. It is rather unusual, from a legal standpoint, for federal courts to be telling states who will be sitting as chief justice of that state's supreme court. I'm concerned, but I'm optimistic, that Perry Hooper will eventually take that position.

The significance of the matter is that to change the climate in Alabama you must change the composition of the Supreme Court of Alabama. Electing Perry Hooper is a step in the right direction. It has to be done repeatedly with respect to seats that become available on the Alabama Supreme Court.

A second piece of good news: I see in Alabama the absence of judgment against insurance companies in bad-faith cases. I think insurance companies have dramatically overreacted to a few judgments that were entered in extraordinary cases. I read an article recently that said several insurance companies had told their claims departments to pay all claims from Alabama. The situation is not that bad. The big judgments that are being rendered do not fall in the category of bad-faith cases.

A bad-faith case exists when an insurance company refuses to pay a claim for no arguable reason. It just refuses to pay the claim, or, alternatively, the insurance company fails to investigate the matter to determine whether there is a basis for denying the claim. That's the tort of bad faith in Alabama. It's unusual because the tort arises out of an insurance contract. I don't see that as creating jeopardy for insurance companies in Alabama. I think they've overreacted. The recommendation I've made to the companies that I represent is to look at all the claims from Alabama carefully. If they're going to be denied, have them denied at a senior level. If necessary, employ local counsel in Alabama to give an opinion to protect the company that there is an arguable basis for denying the claim, and then deny it. Also, if the company gets sued in a situation such as that, it should defend the lawsuit. Not every

case in Alabama results in a multimillion-dollar verdict for the plaintiff, and not every case in Alabama is lost. For example, defendants in Jefferson County are winning 70–80% of the lawsuits.

A third item of good news: Governor Fob James indicates but hasn't committed that in November [1995] he will call a special legislative session to consider a tort reform package. This is an excellent idea, but don't get too enthusiastic over it. I think something will be passed in November, but a comprehensive tort reform package was passed in 1987. After 1987, the Alabama Supreme Court, proceeded every year to dismantle that tort reform package, and right now I don't think anything is left of it and it's all been declared unconstitutional. To change the litigation climate in Alabama, you must change the weather reporters. The weather reporters are the justices of the Alabama Supreme Court.

I've given you the good news. Can you handle the bad? The bad news is the continuation of the huge-verdict syndrome, with huge verdicts occurring more frequently and in greater amounts than anyone has ever anticipated. It shocks me, and I live with it every day. I will mention a few of these because these are current events in Alabama.

Let me make this caveat before I get into this. The names of the insurance companies in the lawsuits are correct but other specifics about the cases come from sources that may not be totally unbiased. You need to recognize that getting information about lawsuits that have been tried and where there has been no appeal and no reported statement of facts is hard. I have received my information from a collection of sources. If I talk about your company, and I get some of the facts wrong, please don't hold it against me.

Because we are sitting in the shadow of Prudential Center, we'll start with Prudential. Approximately 30 days ago, Prudential suffered its second $25 million verdict within the last 12 months in Alabama. In each case there was the allegation that the agent misrepresented benefits due under the policy or that would be paid under the policy. In one case the agent literally fabricated the benefits and grossly misrepresented policies to hundreds of people. The fire in the case came from the fact that there was an allegation by the plaintiff and evidence to the effect of, I'm told, that Prudential either knew or should have known at the managerial level what that agent was doing and that Prudential neglected to supervise that agent because he was a superior producer.

The second lawsuit, I understand, was basically the same allegation. With regard to the first agent and the group of lawsuits, including the $25 million judgment, Prudential paid, from what I understand, $18 million to settle all those cases.

Foremost Insurance Company is one of the largest insurers of mobile homes in the U.S., as I understand it. Approximately 90 days ago it suffered a judgment of $15 million in Bullock County. The problem there and the allegation was that there's a proviso in every one of these mobile home policies that adjacent structures are covered, and there's a premium charge for adjacent structures. Mobile homes don't have any adjacent structures. They sit on leased property. The insurance company is collecting a premium for risk that it never insures or has to insure. That's improper. I

understand there was evidence put into the record that Foremost made over some period of time $280 million off this fine print. The Bullock County jury gave the plaintiff's lawyer exactly what he asked for: $15 million.

Liberty National Life Insurance Company about a month ago got hit for $5.4 million. This is a strange case. Several years ago Liberty National Life Insurance Company changed its interpretation of the cancer policy. For a period of two months it started paying less than it had paid previously. After two months, it decided to go back to the old way. It changed back to the old way, but apparently some people complained. The allegation was that Liberty National improperly interpreted the policy. That to me doesn't generate any big deal. Liberty National corrected the problem. The folks out there who had been hurt received all their money back. So where is the fire? Somebody, who will go unnamed, explained that the problem was that Liberty National was unrepentant. It wouldn't admit it made a mistake. It came into court admitting it changed the interpretation of this policy, saying it was right in doing it for two months, and if it wants to do it next year, it will change the interpretation again next year. "We were wrong for 20 years when we paid benefits under the policy in greater amounts. We made that mistake." Now why anybody would do that, I don't know. It's like pouring gasoline on a lawsuit.

Please save me from unrepentant clients. The best defense in the world, if you've done something wrong, is to go in and say you made a mistake. We're human. Everybody can make mistakes. "We have character and integrity enough to correct our mistakes, and that's what we've done." Juries love to hear that. People love to hear that. I could tell by your reaction when I made that statement that you like to hear that. That's the way, in my view, you take the heat out some of these lawsuits, assuming a mistake has been made.

Now for the *Mercury Finance* case. In the early part of this year, Mercury Finance Company suffered a verdict of $50 million in a one-day trial in Barbour County, Alabama. I read the transcript in that case to try to find out what had happened there. I couldn't tell too well from the transcript, but here's some of the evidence that was developed.

It appears that the plaintiff was able to present sufficient evidence to indicate that he could argue to the jury that there was a kickback scheme between used-car dealers and Mercury Finance Company. The used-car dealer would increase the price of the automobile sufficiently so that a kickback could be paid to Mercury Finance Company. Mercury Finance Company would then finance the automobile. Two used-car dealers who had previously dealt with Mercury Finance Company testified that Mercury Finance Company's conduct was so unethical that they stopped dealing with it. Ponder that for a minute. If you're defending a lawsuit, and you hear that sort of testimony, it's time to do something. I don't know what you're going to do, but it's time to do something.

The last two cases I'm going to talk about involve identical judgments of $22.5 million each. Ninety days ago General Motors got hit for $22.5 million in Macon County, Alabama. A black automobile dealer was recruited under the affirmative action plan of General Motors from North Carolina to come to Macon County and open an automobile dealership. He opened the automobile dealership, and it went out

of business. It went under. He was unsuccessful. He sued General Motors, claiming fraud. Let me see if I can state this correctly. The fraud was that General Motors, in connection with recruiting him, had failed to disclose to him that black-owned automobile dealerships were more likely to fail than other minority-owned automobile dealerships. If I had been the judge, that would never have gotten to the jury. That's not fraud. That's not misrepresentation of anything. The irony here is that the plaintiff had two white partners, and apparently both those white partners are going to share in the windfall of this judgment. The questions now are whether the trial judge does anything more with the case, or whether the appellate court does anything with it in terms of cutting the award, or whether it will be reversed on appeal.

Tuesday of last week a Mobile anesthesiologist suffered a judgment for $22.5 million in a wrongful-death case. The negligence occurred during the course of a routine gallbladder operation. A healthy 61-year-old woman went in for a routine gallbladder operation. She came out of the operation a vegetable. She lived for six months and then died. As I understand it, hearsay has it that the anesthesiologist's conduct was so gross that the surgeon who did the gallbladder operation testified against him. (A doctor in a community usually does not testify against another doctor.) The plaintiff's lawyer asked the jury for a verdict of $17.5 million and the verdict returned was $22.5 million. How in the world does that happen? The jury believed that the anesthesiologist had falsified and hidden documents to try to exonerate himself from his grossly negligent conduct. They couldn't stand that. That anger translated itself into not just what the plaintiff asked for but an extra $5 million. That extra $5 million was for those documents. I repeat the statement that I made earlier: if you do something wrong, sometimes the best defense in the world is, "I did it, I'm sorry, and be gentle with me."

Now for the ugly. I have reserved for the special category of the ugly the recent decision in the Alabama Supreme Court in what is being called the *McCullars* case. This decision goes beyond bad and deserves to be categorized as ugly. In my mind it represents a very poor example of appellate court judges.

For years retailers and lenders wrote life insurance and disability insurance for the total of payments and loans where interest was precomputed. That was standard and had been approved by the Alabama Banking Department and the Alabama Insurance Department. The Alabama Supreme Court came along in the *McCullars* case and said that what had happened in the past was illegal and violates the minicode. All those contracts are a violation of the minicode and also may be fraudulent.

Let me tick off a few reasons as to why I think this decision can only be characterized as being ugly. First, it was absolutely unnecessary for the Alabama Supreme Court to reach the minicode issue in deciding that case. The case only came up from a summary judgment being granted. It was sent back down for more discovery to be done and for a trial to occur. There was no reason to reach the minicode issue. It was gratuitously drawn out.

Second, the decision contains clear, factual errors. It is clear from reading that decision that the Alabama Supreme Court does not understand credit life insurance, nor does it understand credit disability insurance. They are not complex questions but they take some time to understand. The Alabama Supreme Court looks like amateurs

in writing that decision. You don't write decisions if you're an appellate judge unless you have a complete record and understand what you're writing about.

The decision was just poorly written. Three justices clearly gave their opinion for the majority that credit life insurance cannot be written for gross payments. Another justice seems to agree that this conclusion appears to impose a duty on retailers and lenders to make certain disclosures not required by truth in lending and not required by the Alabama minicode. In his view, a failure to give those disclosures would be tantamount to fraud. Two other justices wrote an ambiguous concurrence in the result. Finally, two justices did not participate in the decision in any way. The suggestion has been made that these two justices are going to be up for reelection at the next election and didn't want to participate in a controversial decision. If that's true, it is a sad commentary on the quality of judging at the Alabama Supreme Court level.

Now insurance companies don't like uncertainty. Because of the uncertainty created by this decision, I think insurance companies are at great risk. My prediction is that tremendous sums of money will be paid to avoid that risk.

I've talked about the good and the bad and the ugly. Now I will talk about why big verdicts are happening in Alabama. I'm going to talk about three things: jury composition, judges, and the Alabama trial lawyers' association, which is the association of plaintiffs' lawyers in Alabama.

The perfect juror for the plaintiff's lawyer is the antipathy of the people in this room. Plaintiffs' lawyers want people who are at the bottom of the socioeconomic bracket because those people have a tendency to be undereducated, uneducated, poor, and sometimes angry. They have a tendency to make decisions based on emotion rather than reason. Education causes people to aspire to be able to assimilate facts and make objective decisions and to see a picture beyond a single case in a single courtroom. Plaintiffs' lawyers want very poor people from a low socioeconomic bracket.

I have some demographic information from a county in Alabama, which will go unnamed, that has a reputation for rendering big verdicts. Here are the demographics from which a pool of jurors is going to be selected. One-third to one-half of the adult population is functionally illiterate. The annual per-capita income is $8,500 per year. The annual per-capita income for nonwhites is $4,500 per year. When you get to that level you begin to think in terms of Third-World countries. Approximately 40% of the people in this county live below the poverty line. The unemployment rate is 43%. That rate does not take into account underemployment or those residents working for less than 40 hours per week. Fifty-two percent of the working-age population receives some form of public assistance. Less than 8% of the county's residents have a college education. Twenty-seven percent of the adults have a ninth-grade education or less.

Now you can get jurors such as them anywhere, but imagine, if you're a plaintiff's lawyer, what you can do if there are 12 of them and there is no leader. You don't have anybody from a different socioeconomic bracket to try to lead and control that group. Those people are angry when they are confronted with evil as described in some of these lawsuits. They are not people who feel as though they missed the brass ring when they were on the merry-go-round. They know that they never had a chance to get on the merry-go-round, and those people feel that. Forces beyond their control

prevented them from getting on that merry-go-round. And when they're presented with an opportunity to correct evil and make people do right, make them do the right thing, the fair thing, the correct thing, not to take advantage of consumers, they react angrily, and they react with huge sums of money.

The same plaintiff's lawyer who tried the *Mercury Finance* case had tried another case earlier in the week. He asked the jury for a million dollars, and they gave him a million dollars. He thought that maybe the jury would give him whatever he wanted. When trying the *Mercury Finance Company* case two days later, a one-day trial, he requested $50 million in this case because that was what was necessary to make Mercury Finance behave itself. The jury gave him what he asked for: $50 million. That judgment was cut to $1 million by the trial judge. It was eventually settled for between $1 and $2 million. But I give you that as an example of how jurors react to the type of conduct that I've described in some of the other cases. I'm not suggesting that Mercury Finance Company in that situation did anything wrong at all, but there was evidence from which the jury could conclude that something happened improperly.

Let's talk about judges now. Twenty-five years ago when I began practicing law in Alabama, there were no contested judicial races. A judge would retire in a nonelection year. The governor would appoint a new judge from three lawyers, as suggested by a committee from the particular county, or he appointed one of them on the supreme court. That person would serve until retirement, he would retire, and a new judge would be appointed. They ran every six years, but they were unopposed, so it wasn't necessary to go out and raise campaign funds. It wasn't necessary for them to go to a political action committee (PAC) or to the trial lawyers' association and say they needed money and ask for support.

That's all changed now. Judgeships in Alabama have become very political. You know politicians as well as I do. At a conscious or subconscious level, they have a tendency to favor those people who put them in office. The trial lawyers' association in Alabama knows that it wants judges who share its political, economic, and legal philosophy about the world. So, while there's been some suggestion of corruption in Alabama, I suggest to you it's politics. You can put the label of corruption on it if you want to, but I suggest to you it's politics. The other thing is that judges don't render verdicts but juries do. In analyzing the situation in Alabama, you certainly have to talk about judges, but you have to talk about juries, too.

I need to talk about the plaintiffs' lawyers' association. The plaintiffs' lawyers' association became politically active 20 years ago. It became active at a time when nobody was involved in judicial races and running for judicial office. So, it ran. It raised a good war chest and started putting its people up as judicial candidates. There was no opposing business unit to fight with them and the business community didn't react. And now what we have are many judges in many places who are beholden to politically active and economically powerful plaintiff's lawyers.

Only one group that I know of, the business community, can combat the plaintiffs' lawyers. A number of organizations in Alabama allow businesspeople to be active in making certain that votes are cast for the people that they think will be fair. In the American system, they have the right to cast votes for folks they think will be unfair,

but there needs to be a balance. You don't need to have a supreme court with eight plaintiff-oriented judges and one defense-oriented judge or a conservative judge.

Earlier I told you there is one man on the court whom I would now consider to be conservative. The next most conservative fellow is an ex-plaintiff's lawyer who's spent his entire life trying plaintiffs' cases. Generally, he sides with the plaintiff's position, but sometimes he doesn't. He likes very good opinions. He has a different judicial philosophy. There needs to be a balance on that court.

MR. JEFFREY S. MORRIS: In the decision of the *McCullars* case, there was an indication that retailers might need to include certain disclosures. I wonder if you have information on the nature of those types of disclosures.

MR. HARRIS: The judge said that in this situation, and as in most situations, the sales pitch is that you need to buy insurance to pay off this loan in the event that you die. He said that if that representation is made, you must tell the customers, if you're selling for the total of payments, that you are selling them more insurance than they need to pay off the loan if they die; otherwise you are misrepresenting the product to them.

If you don't make that disclosure, then that's fraud, and the sad thing about fraud is that it involves punitive damages. That's the magic thing that everybody wants to get to. If all that was a minicode claim, then you take the minicode penalties, whatever they are, and you deal with them. In a single case, the minicode penalties are not going to be so bad as to scare anybody. Less than 1% of the people file lawsuits, and you go and deal with that. If it's a class action, you deal with that. But when you start talking about punitive damages with regard to a tort that affects a large number of consumers adversely, then you're talking about the fodder from which huge punitive damage awards result.

FROM THE FLOOR: Could you please talk about the preventive measures to avoid lawsuits?

MR. HARRIS: I think the first decision every company has to make is whether to do business in Alabama. I think that's a purely economic decision, involving profits from the state of Alabama, the effect on national business if the company doesn't do business in Alabama, the affordability of defense costs in Alabama, and so on. If you're going to be actively involved in business in Alabama, be actively involved in politics in Alabama. You no longer can ignore judicial political races. They must be attended to. A number of organizations are available to businesspeople to join and donate money to.

Also, and I wish I could talk about this for a long time, identify the big case early. There are big cases. If you have a fraud claim, and you get to the jury on the fraud claim, does it affect many people or only one person? If it's only one person, it doesn't have larger ramifications. We try those all the time. Sometime the plaintiff gets two, three, or four times his or her actual damages. No big deal, but you need to evaluate your cases early. If it is a big-verdict case, it needs to be settled early, or it needs to be vigorously defended, and I mean vigorously defended.

You can't go into court and dance through the process. When you dance around problems in certain counties, you end up with a one-day trial, such as the one with Mercury Finance Company, and you ease out of the county carrying a $50 million judgment with you.

The supervision and investigation of agency employees in Alabama is an absolutely critical issue and needs to be implemented by every company right now. If your company has agents and employees in Alabama, investigate them before you hire them to determine their character and integrity. Don't take anybody who is marginal.

The last point is to not pay extortion. It disturbs me when every defendant who gets sued in Alabama wants to know how much to pay to get out of there. I say, "This is a defensible case." Nuisance cases need to be tried. You're going to lose some of them. But you're actuaries and you deal with laws of probability. Long term, trying those marginal cases is the way you're going to win based on laws of probability. I think paying nuisance value is extortion, and extortion lets that plaintiff's lawyer go work on other cases that perhaps are large cases and have big potential, and it gives him or her resources for filing his or her lawsuit.

MR. JAFFE: We had the good, the bad, and the ugly. Jim has told us about judgments in the millions of dollars. Unfortunately, our next speaker, Peter Trzyna, will talk about judgments potentially in the billions of dollars.

Peter Trzyna and I are going to have a dialogue about the concept of intellectual property law and how it will affect actuaries. Peter is a partner in the firm of Keck, Mahin, & Cate in Chicago. Peter has three degrees from the University of Wisconsin: one in engineering, one in public administration, and his Juris Doctor.

If you are not familiar with intellectual property law, I suggest you read *The New York Times* on Mondays. In the business section there is a column on patents, which is one form of intellectual property law.

Peter is coauthor of an article that was published in the *National Insurance Law Review* titled "Toward the Exclusive Right to Market Innovative Insurance Products: The Use of Intellectual Property Law in the Business of Insurance." This article is an excellent introduction to the subject or a source if you want to learn more about intellectual property law.

I'm going to ask a series of questions and Peter will answer them. Peter, let's start out by asking this question: What is intellectual property law?

MR. PETER TRZYNA: A large category of intellectual property law involves many different individual rights, some of which you probably are familiar with, and some which may be more esoteric. A copyright protects works of authorship, books, for example; patents protect inventions, including computer programs; trademarks are used to identify the source of goods and services; trade secrets, such as customer lists, formulas for Coca-Cola, etc., can be protected; and other less important areas of intellectual property include employment agreements, confidentiality agreements, and unfair competition practices.

MR. JAFFE: Which areas of intellectual property law do you think would affect the actuarial business and the insurance business and, broadly, the financial services business? In other words, which are the areas to which we should start paying attention?

MR. TRZYNA: The first area is copyright. Perhaps in the course of your work you decide to research what's been going on in a field, and you ask someone to reproduce a journal article or two to help you understand the field. Copying the journal article would probably be a copyright infringement. Simply making a photocopy or scanning an article into your computer could be a copyright infringement.

If, for example, in the course of naming a new product you decide you're going to call it "Blue" something, you could be involved with a trademark issue. Could the name "Blue" be violating the Blue Cross/Blue Shield trademarked name? So the selection of the name of a product can raise trademark issues.

If your company were contemplating employing someone who used to work for a competitor, trade secrets could come with that person or, perhaps, that individual might be under contract with his or her former employer through an employment agreement to not take work in the same field. By hiring the person you may be breaching that individual's employment contract.

Finally, there's the area of patents. Most recently patent law has been opened up because patents now can be granted covering computer software. Essentially, anything that runs on a computer or is stored on a disk is patentable subject matter, and essentially everything that is done in insurance of any scale shows up in a computer somewhere. So it is possible that simply by offering a competitive product you're walking into a patent infringement if the product involves a computer.

MR. JAFFE: Let's talk about the areas of intellectual property law that are of most importance to actuaries. Would that be patents and copyrights?

MR. TRZYNA: Most commonly, that's correct.

MR. JAFFE: Let's start with patents. This is very difficult, but in 25 words or less, what is a patent, exactly?

MR. TRZYNA: A patent is the exclusive right to make, use, or sell an invention for approximately 17 years. If a patent covers the use of a computer to do the illustration of a particular product or perhaps compute a premium, a patent would give a company the exclusive right to do that for about 17 years. To obtain a patent right you must go to the government, file an application, and go through a very detailed process to obtain the patent. When it is approved and comes out, it is presumed valid and it becomes sort of the nuclear weapon of intellectual property law. Patents offer a tremendous amount of protection.

Copyright, by contrast, involves the right to reproduce a work of authorship, make derivative works, or display the works. If there is no copying and if you come up with the same idea, then there's no copyright infringement. Even if there's no copying, there can be patent infringement.

A copyright lasts for 100 years plus the life of an author, usually. A product from the Civil War still could be protected by a copyright. It needs no government registration, and it does not have to have a notice on it. A registration is needed before you file suit, but the notice only goes to damages defense. So if you see a document, and you copy from it, it probably is protected by a copyright.

FROM THE FLOOR: If I haven't defended a copyright, do I lose the right?

MR. TRZYNA: If many people copy your documents for a long time, and you've done nothing about it, of course they'd probably say that you've abandoned your right, but that's a simple answer.

MR. JAFFE: You were talking about notice of a copyright. Is that the "©" that I see normally on a document, or are there other types of copyright notices?

MR. TRZYNA: A notice of copyright, a "©," or the word *copyright,* or *CPR* plus the name of the owner of the copyright, plus the year that the work was first published would be copyright indicators.

MR. JAFFE: The concept of intellectual property law in the financial services environment is somewhat new. Please give us examples of financial services products that have been patented and copyrighted. Don't only tell us what the product or service was but explain what item was patented or what item was copyrighted for that product or service.

MR. TRZYNA: Among the high-profile cases, Merrill Lynch obtained a series of patents to protect its cash management account about a decade ago. I was on the defense side of the patent infringement case that it brought against Paine Weber and Dean Witter. Generally, the patents covered the use of the tiered investment system. If you made a withdrawal from a lower tier, the portfolio would be rebalanced, and the case was settled favorable to Merrill Lynch.

College Savings Bank in Princeton, NJ several patents pertaining to the use of a striped zero coupon bond to set aside money for college expenses. It successfully enforced its patent against another bank, and it is currently suing the state of Florida because of a tuition prepayment plan offered by Florida, which is alleged to infringe these patents.

Among insurance companies, Lincoln National perhaps gets credit for being among the first to use a patent. Andersen Consulting is so into using patents that it has an in-house patent counsel. Andersen is obtaining new patents now at a rate of about one every other month.

MR. JAFFE: Specifically, what about insurance products? Can you name a few examples of patents on insurance products?

MR. TRZYNA: There is a patent in the area of computing premiums for weather-related insurance, and there's also a system involving medical claims processing that has also been made the subject of a patent.

MR. JAFFE: Yesterday MIT Professor Franco Modigliani (1985 winner of the Nobel Prize for Economic Science) mentioned that he has a patent for converting a balance of a 401(k) plan into a credit card. What about copyrights? What are examples in the area of intellectual property law that have been used by insurance companies?

MR. TRZYNA: First, a copyright would exist from the moment the word is written. So any kind of literature, any advertising, any policies or documents inherently will have a copyright that goes along with them. Among the most interesting examples of enforcement, but slightly out of the insurance field: a company had a copyright on a reoffering circular. Another company used large portions of that text, and of course, was successfully sued for copyright infringement. It had to withdraw the reoffering, rewrite the documents, and then do it again.

MR. JAFFE: If one of us came up with a new idea or a new insurance product, what would we have to do to get a patent?

MR. TRZYNA: Several general requirements will have to be met, and then there's the general issue of how to approach the question. The requirements will involve very precisely defining what the invention is. If you define the invention so broadly that it encompasses something that was done previously, then that definition of the invention is not patentable and is invalid. The invention is to also involve patentable subject matter. That's clearly important because in your field, any kind of programmed computer is where the protection could be. Then, in addition, the patent application must disclose in great detail how to make the programmed computer, including flow charts, and how to use the programmed computer.

Getting a patent is something of a trade. You exchange a complete disclosure about the invention in exchange for the exclusive right to make, use, or sell this invention for about 17 years.

To obtain a patent, a patent attorney starts the process. He or she does a patentability search to determine if it's worthwhile to go forward and then writes the patent application if it is. If you've invented something that's potentially worth billions of dollars, it's important to find a way to protect it. Patenting costs could be trivial in comparison to the value of the new product.

MR. JAFFE: How long does it take to get a patent?

MR. TRZYNA: In a rush, with a petition, about a year, but left to its normal course, it takes perhaps as much as three years.

MR. JAFFE: What's the difference in the process of copyrighting material rather than patenting material?

MR. TRZYNA: Copyright occurs from the moment you write the words. To register the copyright, which gives you some bonus rights, it involves filling out two sides of a one-page form with questions such as who's the author, what is the title, and so on? You provide a copy of the work and $20. It's usually so straightforward that I don't do the work. I'll just give the client the forms and have the client do it.

MR. JAFFE: That sounds much easier, but now that we have a patent or we have a copyright, what happens if somebody infringes upon another person's patent? Are there penalties?

MR. TRZYNA: Patent protection is really the nuclear weapon of intellectual property law. The protection that it can provide is very broad because you can define it as you want, and the damage awards and the potential for damage awards are very, very large. As an example, Litton Industries had received a damage award for $3.1 billion. It appealed the case because it thought the award should be tripled. Damage awards into the billion-dollar and very high hundred-million-dollar range do occur. A damage award in a patent case that essentially wipes out a company is not unusual.

MR. JAFFE: If I had been smart enough 10 or 15 years ago to invent universal life insurance, a product that many life insurance companies sell, and if I had written a computer program to calculate the cash values of universal life insurance, could that program have been patented?

MR. TRZYNA: At one point in time, yes.

MR. JAFFE: If I had been the first?

MR. TRZYNA: Right.

MR. JAFFE: Would anybody else today who is calculating cash values by using a computer be in violation of my patent?

MR. TRZYNA: Yes, if the calculations occurred within the 17-year period.

MR. JAFFE: So I could have been receiving royalties from everybody for every universal life policy sold, or could they have gotten around this somehow? What happens if they wanted to calculate all the cash values manually?

MR. TRZYNA: The patent would be limited to the use of a computer, and so if people calculated it in their heads, there would be no infringement.

Another point is that patent attorneys will be hired sometimes to help companies design around a protection so that they can make use of various things that were done previously. Perhaps whoever obtained the patent just made a mistake and didn't protect something. Designing around protection is very viable and often not a problem.

MR. JAFFE: Is the copyright area as bad as the patent area with billions of dollars of infringements? What happens when I use a copier and copy a document that I shouldn't copy? What could happen to me?

MR. TRZYNA: A copyright is a very efficient kind of intellectual property. The application's very simple and very straightforward. What's protected is very straightforward. You can't copy from a document or some other work of authorship. You can easily avoid infringement by simply not copying. A copyright protects the creativity and some expression in a work of authorship but not your ideas. So if you

read a document and understand the ideas and then you write your own, there's no copyright infringement because the only thing that has been reproduced is the idea. A copyright of *Romeo and Juliet* would protect against somebody paraphrasing the language but would not prevent anyone from writing some other story about a couple whose families didn't get along.

MR. JAFFE: Could I copyright an insurance policy?

MR. TRZYNA: There have been many, many cases on the use of a copyright to protect an insurance policy. In 19 of those cases, courts found that there often was no copyright infringement, even when there was word-for-word copying because again, the copyright only protects creative expression. But in a case that I recently handled, we wrote the policy so that when the first letter of each word in various paragraphs is pulled out and the letters are strung together, they spell out things such as the author's name, phrases such as "do not copy my work," "I am a copycat," "I'm a dummy," "you're copying," and so on. The offending company scanned that all into its policy. We sued the company for copyright infringement, and when it came out that we had this very interesting pattern of letters that had nothing to do with the insurance coverage, it was a very straightforward case.

Copyright cases typically go very efficiently. You show up in court and say that you have a copyright, that the other party had exposure to the work, and that the party reproduced it. Damages provided by the statute are up to $100,000, and the entire case usually involves only a half-day trial.

MR. JAFFE: Do you have any advice for actuaries as to how we can respect the patents and copyright protections that others have?

MR. TRZYNA: The general advice is to know what you're doing when you copy. If you're just taking ideas, such as something that's very old and redoing it, it is probably not a problem. If there's a chance that there's a patent in the area–for example, the product has just been put out in connection with Andersen Consulting–then it probably makes sense to check. Hire a patent attorney and have him or her look to see if there's a patent. You may also want to start looking in the literature to watch for announcements of patents. Some people who are looking for the exclusive right to a product give advance notice that a patent is coming. Their literature will say patent pending, or they may have a U.S. patent number.

MR. JAFFE: What's possible for us to do to learn more about intellectual property law? Can you recommend materials or other sources that would be particularly good, not too technical, and also somewhat concise?

MR. TRZYNA: Well, you had mentioned previously an article that I authored in the *National Insurance Law Review*. Chapter 35 of a book titled *Financial Engineering*, published by Wiley, is a general discussion of the use of intellectual law property in the financial field. In about a year, Wiley will publish a book that I will author, titled *The Use of Intellectual Property in the Financial Industry*.

MR. JAFFE: Intellectual property law is obviously not a static field. I presume it's a fairly quickly changing environment. If you could look into a crystal ball, what would

you see as some of the areas pertaining to the financial services industry that will be affected by intellectual property law?

MR. TRZYNA: The use of patents is a relatively new opportunity because the U.S. patent office has proposed almost freely giving a patent on the subject matter of programmed computers, and I expect that a great deal of patenting in the financial field will occur. Andersen Consulting is getting patents at the rate of every other month and probably it will soon be once a month. After half a decade all of a sudden many exclusive rights to various consulting activities will belong to Andersen only, and other consultants will likely be closed off unless they start paying attention to what's going on.

I also expect the use of intellectual property to indirectly protect financial products and innovations internationally. Right now this kind of protection exists in some countries. It is only vaguely available in Europe, but there's a lot of pressure for Europe to come into compliance with the new U.S. point of view. Canada grants protections similar to the U.S., and there's some protection in Japan. I expect the world to increase the availability of this protection and change its laws.

FROM THE FLOOR: There are big questions regarding the Internet and copyrights and patents. Can you tell us a little bit about it?

MR. TRZYNA: There is no way to neatly answer your question about the Internet. It is an extremely complex issue. The problem here is that it's global technology with a very small, geographic, different protection, and the world is still sorting it out with no easy answer.

MR. PAUL G. SCHOTT: I have a question about patent infringement suits in general. Over the years I have seen articles that suggest that defending a patent infringement case is very frequently a wonderful theory but practically useless. The general comments seem to be that the people infringed upon have so few resources that they're just unable to sue, or, if they do have the resources, the suit takes so long, is so cumbersome, and is so expensive, that even if they win, they end up losing more than they gain. Can you please clarify or refute that?

MR. TRZYNA: Yes. You'll remember that I mentioned that a good deal of patent work that you may encounter will be very frustrating. In a patent infringement case with an attorney who knows what he or she doing, there is a good chance that the law firm would be willing to take the case representing the owner of the patent on a contingency fee.

A patent is presumed valid. It requires clear and convincing evidence to show that each definition is invalid, with clear and convincing evidence, meaning in the 75% range. So the chances of success on validity of the patent may be good, at least if the patent was well written. Many patents in your field are not well done and are just clearly invalid. Proving the infringement can be straightforward.

The length of a lawsuit depends on what you're trying to do. One of the approaches that I like is to find a "rocket docket." Courts in locations such as Virginia and Wisconsin, move cases very fast. If you're the plaintiff, you prepare your case in

advance, you show up at the court, file the complaint, have all your discovery requests ready to go, have your damages calculated, and have everything all set. Then you complain to the court because the other side is dragging its feet.

Eighteen months is a very short period of time to go from the beginning to the end of a patent case. Usually the defendant has to show that there's something invalid with your patent. By the time the defendant gets technical experts and whatever, the case is half over. If you do it right, it should be fast and not terribly expensive. The expense will come with a big fight if it involves the survival of the offending company.

MR. JAFFE: I will make a prediction that at some point there will be a section of the SOA devoted to intellectual property law, and I hope you'll all become members in the year 2000-and-something.