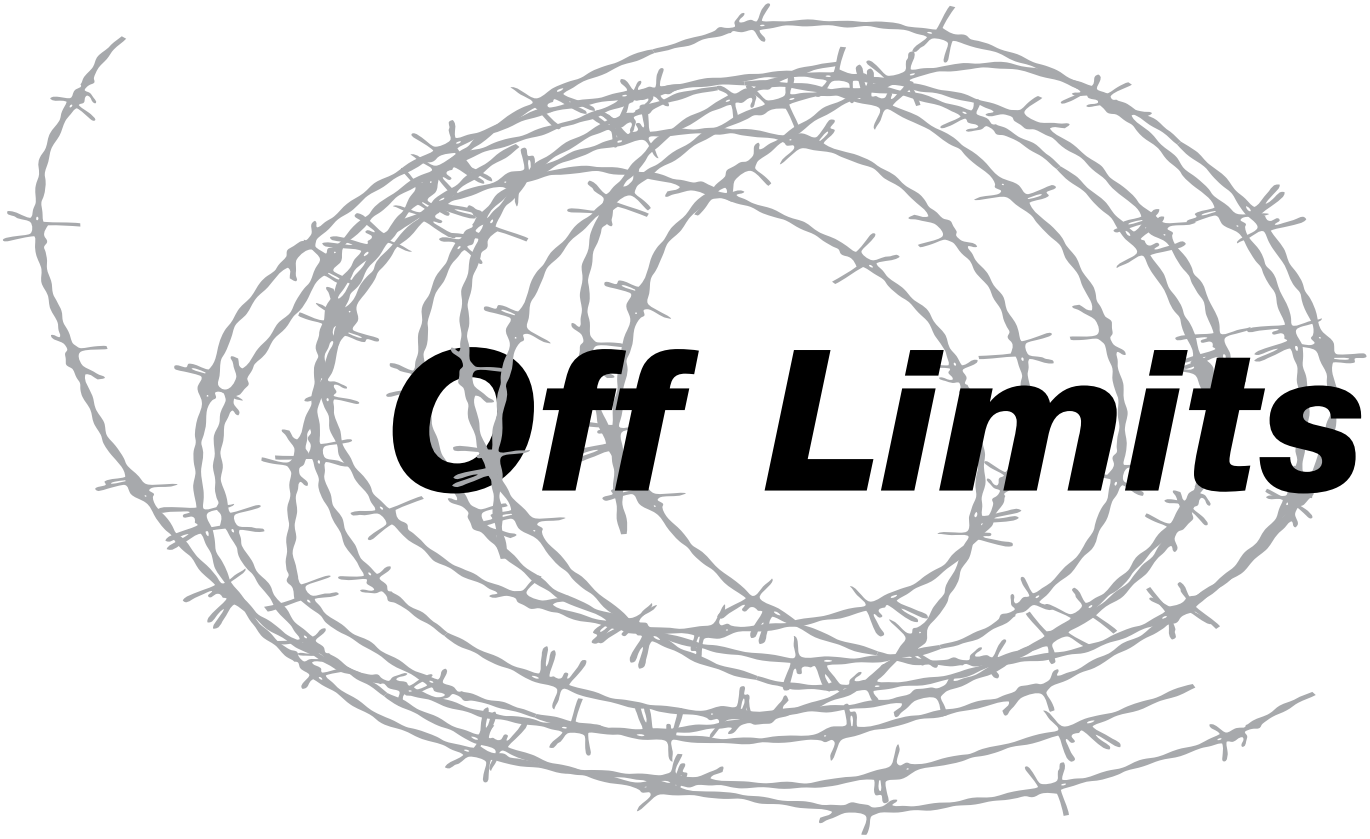

Off Limits

Trade-secret status is the best way to keep a book of business safe from competitors.

by Matthew E. Farmer

The phrase "book of business" is insurance industry shorthand that describes a list of policyholders along with contact information, general insurance needs and, perhaps most importantly, policy expiration dates.

The book of business is perhaps the most valuable asset of any insurance company. It is the lifeblood of the industry and gives the owner tangible value in its insurance business as a going concern.

To understand how valuable a book of business can be, imagine an insurance broker starting business from scratch. The broker would have no book of business. To build one will require time, money and effort marketing both the broker and the firm's services.

From there, the broker would begin to build a book of business—that is, clients—and could start to mine that book for additional insurance sales, since these clients have demonstrated a proclivity to purchase certain insurance products. The broker's knowledge of these clients' insurance preferences and dates of expiration give valuable insight on how most effectively to market and sell new insurance products to those customers.

Building a book of business requires hard work and a significant investment of time and money. It is a highly valuable asset that, in the hands of a competitor, would allow the competitor to market and sell insurance products tailored to clients' specified needs and preferences with relatively little effort and expense. Instead of mining a mountain for "gold nuggets," the competitor could literally cherry-pick the largest nuggets from a previously mined "bucket." Understandably,

Key Points

- **The Situation:** The broker's book of business is an extremely valuable asset in the insurance industry.
- **The Background:** Given the inherent value of the 'book,' all efforts should be made to keep its contents confidential.
- **The Bottom Line:** Keeping the book confidential may confer trade-secret status to it, affording its owner the legal ability needed to preclude its use by competitors.

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the latter exercise is much easier and more effective.

Undoubtedly it is the time, effort and expense involved in building a book of business that makes it valuable. As a valuable asset, two key questions arise: Who owns the book of business, and can the use of a book of business by a competitor be precluded?

Who Owns the Book?

Ownership of a book of business can be complex; there can be a single owner or multiple owners. Ownership can turn on the nature of the relationship between competing parties and principles of contract law.

Generally speaking, insurers sell their products through brokers, agents or both. Brokers are, in the truest sense, independent contractors authorized to sell insurance products on behalf of multiple and oftentimes competing insurers. The broker usually owns, operates and fully finances the brokerage independently and, in turn, actively seeks out clients. The broker then has the discretion to sell the insurance product that is the best fit for the client, regardless of insurer.

Ascertaining ownership rights in a particular book of business should always begin with a review of any existing contracts between parties.

So, since brokers are independently engaged in these activities, they are generally deemed to own the book of business.

Agents on the other hand are captive, generally speaking, to a particular insurance company, which in turn has greater control over the agent. The agent is generally restricted to selling insurance products (or a particular line) for that insurance company and is precluded from placing insurance with competing carriers. Under this framework, it is most likely the insurance company that owns the book of business.

Whether a producer is acting as an agent or as a broker can materially impact ownership of a book of business. However, the relationship of the parties is only a starting point; contract principles can guide and set the boundaries.

For example, joint ownership or varying percentages of ownership can be set by contract. Similarly, parties can agree to contract provisions stipulating that a party may purchase another party's ownership rights once the relationship has ended.

Illustrative of the role contract principles can play in this area, from a legal standpoint, is the California case of *State Farm Mutual Automobile Insurance Co. v. Dempster*, decided in 1959. Though *Dempster* is more than 50 years old, it explains and discusses issues that remain relevant even in today's insurance industry. Consequently, ascertaining ownership rights in a particular book of business should always begin with a review of any existing contracts between parties.

Keeping Competitors Away

If a competitor can freely use the information in a book of business compiled by another, all value in the book of business is lost.

By the same token, there is no incentive to build a book of business if a competitor can readily access and use the gathered information. Generally speaking, how-

INDUSTRY SNAPSHOT

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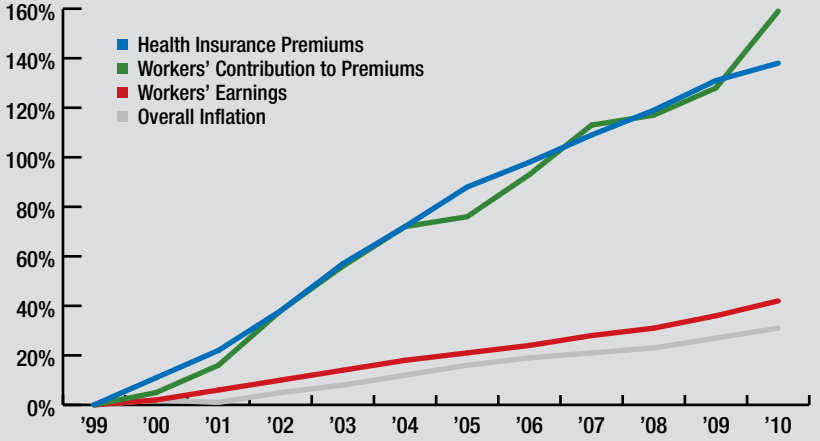
Health

Health Insurance Premiums Still Rising Faster Than Wages, Inflation

Annual increases in health insurance premiums, worker contribution to premiums, worker earnings and overall inflation, 1999-2010.



Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2010

Explore today's insurance business environment through A.M. Best's extensive line of information products highlighted in **Insurance Facts and Stats 2011 Edition**. This handy reference focuses on the many lines of business within the property/casualty, life, health and reinsurance industries, with rankings of top writers. To order copies and see the entire A.M. Best's Guide series, visit *www.insurancebookstore.com* or *www.amazon.com*.

ever, the law does protect one's value in the book of business and, in the process, rewards a producer for exerting the time, money and effort needed to build a profitable book of business.

While state laws vary to some degree, a few universally accepted principles play a vital role in precluding a competitor from using one's book of business. Chief among these are laws granting trade-secret protections to the owner of a book of business. If something is considered a trade secret, it cannot be used by a competitor.

Typically, information comprising a book of business can be considered a trade secret because it is a creation requiring a significant investment of time, money and effort to build and compile. However, just because it may meet the definition of a trade secret does not mean it will automatically be afforded trade-secret protection.

In order to be a protected trade secret, reasonable efforts must be undertaken to maintain the secrecy of a book of business. Such efforts typically include limited internal access to, and disclosure of, the book of business, such as the client list, on a "need-to-know" basis. Another is implementing and maintaining password protection and other computer and Internet security protocols for computer databases containing client information.

Other common-sense measures should be applied to paper files containing client information, such as locking file cabinets; preventing the general public from gaining access to such information; and other efforts to maintain physical security over the tangible files.

Moreover, a book of business is more likely to retain trade-secret status if employees with access to it are required to sign confidentiality agreements. These documents should require employees to acknowledge the secrecy of the information retained in the book of business and agree not to disclose or use such information except in connection with the performance of their authorized job duties on the owner's behalf.

Every effort must be made to keep the contents of a book of business confidential. Trade-secret protection is essentially dependent upon the implementation of such measures.

In regard to the reach of preclusion, state laws vary widely. For example, some states may only preclude use of the information for a limited period of time and upon certain terms; other states afford broader protections.

As such, agents and brokers should consult legal counsel to ascertain the exact level of protections afforded by the states where their businesses are located. BR