

THE INSURANCE COVERAGE/IP COUNSELOR

NEWSLETTER

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“INSURANCE COVERAGE FOR TERRORIST ACTIVITIES?”

I. DIRECT PROPERTY DAMAGE COVERAGE

The September 11, 2001 terrorist attack on the World Trade Center rocked not only the country but the insurance industry. The Twin Towers were the principal offices of the two largest worldwide insurance brokerage houses, Marsh & McLennan Companies (“MMC”) www.marshmac.com and AON Risk Services, as well as a number of other insurers.

Direct losses to tenants of the building and of surrounding buildings which are either destroyed or



uninhabitable should be covered by most standard form property coverages. The ISO’s latest form (ISO CP 10 20 06 95 form ©1994) includes as covered causes of loss: “fire; smoke causing sudden and accidental loss or damage; riot or civil commotion including (a) acts of striking employees while occupying the designated premises; looting occurring at the time and place of a riot or civil commotion.” The exclusions for “war and military action” are unlikely to be interpreted so as to encompass a terrorist attack. The result in such cases should not change if a sovereign entity ratifies, or is deemed by the U.S. to have ratified, Tuesday’s attacks.

II. BROADENING OF WAR EXCLUSION TO INCLUDE TERRORIST ATTACK

Nevertheless, after the 1993 bombing of the World Trade Center, which cost insurers \$510 million in property damage, some insurers included “terrorist” exclusions. These

may be enforceable if they are clear and if the insurer gave appropriate notice to the insured that they would be added to the policy. Where there is no reduction in premium at the time they were made available or the broker did not bring to the insured’s attention their lessened coverage, claims against

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If you have a topic you would like to see addressed in future issues, please feel free to contact us with your suggestions.

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In This Issue

INSURANCE COVERAGE FOR TERRORIST ACTIVITIES Page 1

SUCCESSFUL G&A COVERAGE CASES Page 3

PUBLICATIONS BY DAVID A. GAUNTLETT Page 4

ARTICLES ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY BY DAVID A. GAUNTLETT Page 4

UPCOMING SEMINARS ON INSURANCE COVERAGE AND IP Page 4

the broker and/or insurer under the policy may still arise.

Given the political climate, a narrow insurer perspective on coverage is unlikely to be a winning position in courts. Property policies typically cover collapse, which includes “*direct physical loss or damage to covered property, caused by collapse of a building or any part of a building insured under this coverage if the collapse is caused by one or more of the following: fire; explosion; smoke; aircraft or vehicles; civil commotion; vandalism; falling objects, where such are insured in the coverage part.*”

Companies such as Chubb¹ which sell “*worldwide accident protection*” have clarified that the “war exclusion” does not include terrorism and have express coverage for “*hijacking, skyjacking, bomb scares, explosions, and extraordinary commutation.*” The latter coverage includes “*[in the event of] a strike, major breakdown or shutdown of public transportation that the insured regularly uses, alternative means of commuting is covered.*” For example, an attorney with a hearing in the Connecticut Supreme Court, which was delayed due to the terrorist attack, returned promptly to his office, was unable to secure a rental car, and was forced to buy a car to return home. This “extraordinary business expense,” less any resale value of the car upon its ultimate return, should be covered.

III. BROADER INTERRUPTION OF BUSINESS CLAIMS MAY TRIGGER COVERAGE

Dean R. O’Hare, Chairman and CEO of Chubb, stated Chubb will do everything in its power to quickly process claims and make payment for losses related to today’s events. He

¹[www.chubb.com/businesses/accident/com
pare.html](http://www.chubb.com/businesses/accident/compare.html) (09/26/01)

also indicated that Chubb did not intend to apply the war exclusion to this terrorist event. Chubb admits that it has “*significant property exposure related to the attacks Reinsurance should limit its pre-tax losses to between \$100 million – \$200 million*” according to its spokespeople. Reinsurers are not so sanguine. The European stock markets fell 13% upon the September 11, 2001 incident. Munich Re Group’s subsidiary, American Re, was expecting losses and suffered a 14% drop in the stock market that same day.

The overall exposure could be as significant as the 1992 Hurricane Andrew in South Florida, which led to damages of \$18.6 billion, or the Northridge earthquake in 1994, with damages of \$13.67 billion when all business interruption claims are factored in. Indeed, domestic insurers have already girded themselves for major claims activity.

Organizations that heavily rely on paper documents and smaller companies that do not routinely back up their information are vulnerable to significant business interruption losses. Most larger financial services firms routinely back up data and store it at remote locations and should not have such exposure. Even larger companies may be at risk, where key employees are missing, to being incapable of performing their services on a timely basis. Competitors could step in and take over the business that they cannot perform as effectively. This kind of injury is hard to quantify under any form of “business operations loss” coverage. This circumstance, however, would justify significant and immediate expenditures to keep the company as close as possible to its prior operational status.

It is not just property damage

claims, including business interruption losses, that are at issue. Workers compensation for injured workers, life insurance coverage, disability insurance coverage, costs for damage to surrounding businesses, apartments, and automobiles, as well as indirect losses for businesses who were stymied by the closure of airports, including package delivery service companies, etc.

IV. NEWER POLICY FORMS EXPAND COVERAGE TO ADDRESS RISKS OF TERRORISM

These new risks suggest broader coverage than that previously available to avoid insurer disputes in the future, especially as insurers are likely to include terrorism exclusions as standard elements of property coverage prospectively. One insurer, Tatilco,² includes special peril coverage such as “*fire, lightning, riot and strike, earthquake, hurricane and flood,*” as part of an endorsement to standard form property damage for commercial insureds. It also sells “sabotage and terrorism” insurance which encompasses “*riot, strike, civil commotion, malicious damage, and loss by looting.*”³ Kidnap/ransom and extortion coverage is available through Chubb.⁴ Such policies apply to situations where a person is actually abducted or ransom is paid in the belief

²www.tatil.co.tt/propty.html (09/26/01)

³Sabotage is defined therein as “*damage by persons who are members of an organization whose aim includes the overthrowing of the government by terrorism or violence.*”

⁴www.chubb.com/businesses/ep/kr (09/26/01)

that a person has been taken.⁵

The other forms of policies cover Net Security Issues. MMC,⁶ ironically, offers one of the broadest as part of its MarshNet program. Other competitors include Zurich Re, AIG/American International Specialty Lines Insurance Co., Chubb, J.S. Wurlizer, and Media Professional Insurance Agency.⁷ The pertinent coverage issued in MarshNet, which is characteristic of these policies, includes, as part of the claims-made form, business interruption to electronic information processing systems.⁸ There is a computer crime exclusion only to Coverage A, which includes “*criminal use of any computer system by a perpetrator to destroy your computer system.*” While this might apply to a virus, it would not apply to a terrorist attack that had the indirect effect of destroying the data processing

equipment because the building in which it was lodged was destroyed. Coverage B references the “*business income and extra expense coverage*” for same. The NetSecure policy also includes forms of third-party protection against a range of litigation risks that constitute “content injury.”⁹ While there is a “war acts” exclusion, there is no “terrorist” exclusion, and the express coverage for an attack implies that it is within the scope of same. Whether the NetSecure Policy will retain such breadth without a terrorist exception remains to be seen.

V. CONCLUSION

In short, this is a good time to buy the broadest coverage possible. The impact of the instant terrorist attack has not yet been visited in policy forms. The hardening in the insurance market due to the claims exposure insurers will sustain and the higher cost reinsurers will experience may lead to higher premiums for domestic carriers that they will then pass on to insureds. Insureds who purchased policies before Y2K exclusions were included as endorsements would have been in a far stronger position to respond to Y2K claims than those who were burdened by the Y2K exclusions that first appeared in most Commercial General Liability forms in 1999.

⁵Extortion coverage includes: “(1) damages to premises or tangible property located on the insured’s premises; (2) contamination of raw materials or products of the client; (3) dissemination and divulging or utilization of proprietary information of the insured; or (4) introduction of a computer virus against the insured.”

⁶www.marshmac.com (09/26/01)

⁷See Journal of the American Corporate Counsel Association, *ACCA Docket*, Vol. 19 No. 5, May 2001, pp. 18-39, David A. Gauntlett and John L. Maxin, “Tort Claims and Insurance in Cyberspace: Is Your Company Covered?”

⁸Coverage in the insuring agreement extends to a “direct loss resulting from damage to forms of electronic data, information assets, computer programs or data processing media” arising out of (3) an attack.” Coverage A provides, “We will pay for your actual loss of business income and extra expense that you sustain due to ‘disruption, interruption, delay or suspension of your internet or network activities during the period of recovery.’”

⁹It includes but is not limited to “infringement of copyright, title, slogan, trademark, trade name, trade dress, service mark or service name; . . . 5. unfair competition involving the misuse of material, including trademark dilution, deceptive trade practices, passing off, and violations of section 43(a) of the Lanham Act or similar statutes; . . . 7. false advertising or misrepresentation in advertising.”

SUCCESSFUL G&A COVERAGE CASES

In *El-Com Hardware, Inc. v. Fireman’s Fund Ins. Co.*, ___ Cal. Rptr. 2d ___, 2001 WL 1029639 (Cal. App. 1st Dist. Div. 5, Sept. 10, 2001) the court reversed the trial court, finding a duty to defend appropriate in this case for trade dress with concurrent claims for patent infringement. Having denied a defense, the court intimated that upon remand, all reasonable fees would be owed. At issue was a 1986 ISO policy provision which included, as a variant version, express coverage for infringement of trademark.

The insureds claimed the insurer was obligated to defend them under the insurance policy’s advertising injury coverage after they were sued in federal court for trade dress infringement. Trademark infringement was among the policies’ predicate offenses defining advertising injury. However, to raise a potential for coverage, the underlying complaint had to show that the insureds’ advertising caused the third party’s injury. Trade dress infringement was caused by the advertising of the insureds’ product using the infringing trade dress of another company. With this evidence of a potential for coverage, the insurer’s duty to defend attached.

The court found the causal nexus satisfied by the implicit character of the advertising in relation to the claims asserted. It reasoned:

The Penn Fabrication complaint alleged that appellants infringed the trade dress of the Penn Fabrication handle by, inter alia, copying the Penn Fabrication

THE INSURANCE COVERAGE/IP COUNSELOR

handle so as to confuse customers between appellants' handle and the Penn Fabrication handle. To cause customer confusion, appellants would have had to call attention to the appearance of their own handles, and an obvious method for doing so was to depict the handles in their catalog. **The catalog, therefore, potentially establishes that, as used in the Penn Fabrication complaint, the allegations of "passing off," "palming off," and "offering to sell" the infringing handle connote advertising the disputed handles.** Thus, when respondents resubmitted their tender of defense, respondent had before it sufficient facts to show that appellants' trade dress infringement was caused by the advertising of their handles using the infringing trade dress of the Penn Fabrication handles. With this evidence of a potential for coverage, respondent's duty to defend attached.

Id. at *24-25 (emphasis added).

In *Fossil, Inc. v. Fireman's Fund Ins. Co.*, No. 99-05023 MHP (N.D. Cal. June 22, 2001), the court ruled that although trade dress infringement was not plead in the original complaint, it alleged facts sufficient to trigger the duty to defend by raising the possibility of a claim for trade dress infringement. Therefore, Fireman's Fund must defend from the date of the original complaint, not from the date of tender of the Third Amended Complaint.

PUBLICATIONS BY DAVID A. GAUNTLETT

David A. Gauntlett is the author of *Insurance Coverage for Intellectual Property Assets*, which is published by Aspen Law & Business. Both the book and the supplements are available for \$160.00 plus 8.5% tax; shipping and handling are free when full payment is enclosed with the order. Call 1-800-638-8437.

ARTICLES ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY BY DAVID A. GAUNTLETT

"Offer for Sale" Patent Infringement Lawsuits: New Opportunities for Insurance Coverage, *New Controversies*, will appear in the Fall 2001 issue of SMU Law Review.

"Recent Developments in Insurance for Intellectual Property Claims" will appear in the Tort & Insurance Law Journal's Annual Survey Issue – more details to follow.

UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

David A. Gauntlett serves as Vice Chair for a new Insurance Committee within the Intellectual Property Owners Association ("IPO"). Its next meeting is scheduled for Nov. 4-6, 2001 in New York City.

Mr. Gauntlett will be speaking on insurance coverage for patent claims at the University of Texas School of Law's 2nd Annual Advanced Patent Law Institute on Dec. 6-7, 2001 in San Jose, CA.

Mr. Gauntlett will also be speaking and leading a panel discussion re

Insurance Coverage for Intellectual Property Claims at the ABA IPL Section Spring CLE Program on April 11-12, 2002 in Washington, DC.

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