

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

NEWSLETTER

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THE PERILS OF SAYING “NO” TO A RULE 26(f) INQUIRY: INTELLECTUAL PROPERTY PRACTITIONERS MAY NEED TO DO MORE THAN SIMPLY INQUIRE AS TO WHETHER THEIR CLIENTS BELIEVE THAT THEY MAY HAVE NO POTENTIAL COVERAGE

To Understand When Insurance Coverage Might Arise Requires Knowledge Of How Liability May Attach In An Underlying Intellectual Property Litigation

Corporate risk management as well as insurance brokers (typically used as a resource for a preliminary assessment of potential coverage) lack the expertise to analyze insurance coverage for intellectual property claims under most forms of coverage likely to be possessed by the company. This is especially true for claims potentially triggering “advertising injury”/“personal injury” coverage.

Moreover, risk managers or insurance brokers may not have the institutional knowledge needed to: (1) understand the company’s long-term IP strategy; (2) utilize insurance products to protect those assets from intellectual property exposure; or (3) use insurance to minimize company expenses in intellectual property and antitrust litigation.

Intellectual property defense counsel is in the best position to advise corporate counsel about insurance benefits. However, insurance coverage counsel retained to represent the policyholder, coordinating with IP corporate counsel and outside IP defense counsel, is in the best position to:

- (1) Evaluate whether the company’s historic insurance program offers opportunities for present IP/antitrust litigation;
- (2) Assess whether past lawsuits that were the subject of “actual” or “constructive” notice entitle the company to monies paid for past litigation;
- (3) Determine what new policy forms might enhance the company’s ability to defend and settle IP litigation at its insurer’s expense;
- (4) Decide whether insurance can enhance the company’s ability to achieve litigation goals, including the role the defendant/counter-defendant’s insurance can play in making the company whole for its IP litigation expenses; and
- (5) Pursue coverage litigation immediately or when settlement contribution or indemnity issues arise.

Unless outside intellectual property counsel is prepared to take on these tasks, it should disclaim any such obligation in its retention letter and suggest that corporate counsel consult knowledgeable insurance coverage counsel about these issues. The better practice would be to confirm in writing that the client has determined that no potential coverage for the asserted claims exists when responding to a Rule 26(f) inquiry.

Failure to Advise a Client of the Opportunity to Tender a Claim for Insurance Coverage May Be Legal Malpractice

Two cases from the highest state courts of their respective jurisdictions, New York and California, conceded that a failure to give notice could constitute legal malpractice. *Darby & Darby, PC v. VSI Int'l, Inc.*, 739 N.E.2d 744 (N.Y. 2000); *Jordache Enters., Inc., v. Brobeck, Phleger & Harrison*, 18 Cal. 4th 739 (1998). However, they both found that, as of the date notice was provided, the CGL policy's potential coverage for a patent infringement claim was not sufficiently established to compel a finding that no notice was malpractice or that the injurious acts had occurred over one year ago (outside the applicable statute of limitations). *Darby & Darby*, 739 N.E.2d at 748 (no malpractice); and *Jordache Enters.*, 18 Cal. 4th at 764, respectively.

New York's highest court stated, "We agree that attorneys should familiarize themselves with current legal developments so that they can make informed judgments and effectively counsel their clients However, plaintiff in this case should not be held liable for failing to advise defendants about a novel and questionable theory pertaining to their insurance coverage." *Darby & Darby*, 739 N.E.2d at 748. *Darby & Darby* intimated that if case law developed to the point where it was evident that a trademark infringement claim was potentially covered, then the failure to give notice could be legal malpractice. The California Supreme Court implied that it may be malpractice to not tender, or at least make inquiry of the client as to whether insurance coverage exists that may potentially apply to require a defense of an intellectual property claim. *Jordache Enters.*, 18 Cal. 4th at 764.

The failure to follow "Best Practices" as discussed in this article is not the test for evaluating whether an attorney has failed to meet the "standard of care," but the practices recommended herein are an effective way to avoid litigation with a former client over issues arising from the insurance/intellectual property overlap. *Khan v. Richey*, 927 So. 2d 1267, 1271 (La. Ct. App. 2006) ("An attorney is not required to exercise perfect judgment in every instance, but his license to practice and his contract for employment hold out to a client that he possesses certain minimal skills, knowledge, and abilities."); *Denzler v. Rouse*, 180 N.W.2d 521, 525 (Wis. 1970) ("In between these two alternative evaluations – competence and malpractice – lies a broad area of difficult and complex situations in which an attorney is bound to exercise his best judgment in the light of his education and experience, but is not held to a standard of perfection or infallibility of judgment.").

Rule 26(f) Requires Intellectual Property Defense Counsel to Advise the Court Whether There Is Potential Coverage

Pursuant to Fed. R. Civ. P. 26(f), a party litigating an intellectual property claim in federal court is required to advise the court and the opposing party of any existing insurance policy that might cover the asserted claims. A negative answer to this question posed by Fed. R. Civ. P. 26(f) – a request for information about any insurance policies that might cover a pending lawsuit – could deprive the insured of subsequent insurance benefits.

Where intellectual property defense counsel is unable to formulate an informed opinion so as to properly respond to this inquiry, insurance coverage counsel should be retained. Disclosure of such an insurance policy should not be delayed until the date for responding to the Rule 26(f) request because, in some forums such as New York, a delay of as little as four (4) months from the date of filing and service of the complaint in the underlying action could bar all potential for coverage. *Professional Prod. Research Inc. v. General Star Indem. Co.*, No. 06 Civ. 5685(CM) (GWG), 2008 WL 2627612, at *6 (S.D.N.Y. June 30, 2008) ("*Technaoro Inc. v. U.S. Fidelity & Guar. Co.*, 2006 WL 3230299, at *7 (S.D.N.Y. Nov. 7, 2006) (five month delay unreasonable in advertising injury case).").

Having to respond to a Rule 26(f) inquiry regarding whether there is insurance that may cover an underlying intellectual property lawsuit places IP practitioners in the position of having to represent to the court the client's knowledge regarding insurance coverage. Intellectual property counsel's ability to properly take a position on this issue makes them counsel for the client on insurance issues for the limited purpose of communicating whether the suit they are defending might implicate coverage under the client's insurance policies.

To properly discharge this duty, intellectual property counsel need to do more than simply make inquiries of the client as to whether it believes such coverage potentially exists. Where counsel does not possess expertise to

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evaluate whether such coverage is implicated, it is incumbent on IP counsel to either associate competent coverage counsel or advise the client in writing to secure same to opine on this issue. This retention should occur in sufficient advance of the date for representing whether potential coverage arises so that the 26(f) form can be properly completed before late notice would preclude an insured from obtaining policy benefits.

Where the client has in-house coverage expertise, the counsel should write to advise that: (1) IP counsel has not formulated any opinion or has been asked to formulate an opinion as to whether a defense may be owed under the applicable state's law for the claims pursued against the insured; (2) IP counsel relies on the client to conduct whatever investigation is necessary to formulate its opinion as to whether the claims are potentially covered; (3) Where a denial letter is obtained from any carrier, it would be referenced and produced in response to the Rule 26(f) inquiry.

A failure to secure proper coverage advice could subject the client to a subsequent challenge by its insurer, not only that it provided late notice (if none was given) but also that its representation to the court on the absence of insurance coverage is a binding admission barring the insured from changing its position in subsequent coverage litigation. Although little authority exists on this issue, the insurer's ability to make this argument cannot be avoided by IP counsel's contention that they did not represent the insured on coverage issues.

The Better Practice Is to Alert the Client in the Retention Agreement that the IP Litigation Counsel Does Not Purport to Represent the Insured on Any Aspect of Coverage Analysis

A sample provision which a firm could include in its retention agreement follows:

Our representation of you is limited to the Subject Matter and does not include additional issues such as the availability of insurance to cover the defense of this claim.

This Problem Is Especially Highlighted Under New York As Well As Illinois Law Where the Failure to Give Prompt Notice from the Date Suit Is Filed and Served Against the Insured May Preclude the Insured from Obtaining Any Coverage Benefits

In Illinois as well as New York, a delay as short as four (4) months can eviscerate all potential coverage. See *Amerisure Ins. Co. v. Laserage Tech. Corp.*, 2 F. Supp. 2d 296, 305 (W.D.N.Y. 1998) (applying Illinois law) (“‘Lack of prejudice to the insurer is a factor to be considered only where the insured has a good excuse for the late notice or where the delay was relatively brief.’”); *Professional Prod. Research Inc. v. General Star Indem. Co.*, 623 F. Supp. 2d 438, 445 (S.D.N.Y. 2008). (“New York law provides that notice be given promptly; even periods of delay as short as two months have been found to be unreasonable as a matter of law.”).

Intriguingly, when New York changed its law on late notice recently, it only applied to CGL claims of “bodily injury” and “property damage,” not AI/PI injury – the coverages typically indicated in intellectual property lawsuits. New York Insurance Law § 3420. This despite the legislature's alarming recognition that the late notice rules in NY were a “trap for the unwary.” Texas, through case law from its Supreme Court, found an early statutory provision, which on its face limited relief from late notice rules (applying a notice prejudice standard), did not bar the court from finding the intention of this statute was to encompass advertising injury and personal injury coverages which had not been issued at the time the Texas statute was adopted. *PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630, 634 (Tex. 2008) (“Texas requires a showing of prejudice for insurer to avoid coverage because of untimely notice under an occurrence policy, even for types of insurance not covered by Board Order 23080 . . .”). This same argument may be unavailable in New York and require further legislative action to remedy the oversight.

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NETSCAPE COMMUNICATIONS CORP. v. FEDERAL INS. CO., NO. 08-15120, 2009 WL 2634945 (9TH CIR. (CAL.) AUG. 27, 2009)

The court reversed the finding in favor of St. Paul Mercury. The court agreed that there was a personal injury offense implicated because "AOL had made known to any person or organization material that violated a person's right of privacy." It reasoned:

Although the underlying claims against AOL were not traditional breach of privacy claims, given that coverage provisions are broadly construed, the underlying complaints sufficiently alleged that AOL had intercepted and internally disseminated private online communications. While some cases have stated that coverage is triggered by a disclosure to a third party, they do so in dicta while deciding whether the personal injury clause covers invasion of "seclusion privacy" claims. See, e.g., *ACS Sys., Inc. v. St. Paul Fire & Marine Ins. Co.*, 53 Cal.Rptr.3d 786, 795-96 (Cal.Ct.App.2007).

Id. at *1 (citation omitted).

The court found that an exclusion relied upon by the district court to avoid a defense was too broadly interpreted.

The SmartDownload utility does not provide an Internet connection, and, in fact, is useless without one; AOL therefore did not provide Internet access in making the SmartDownload utility available. Since the other enumerated activities included in the "online activities" exclusion also do not apply to the SmartDownload program, we reverse the district court's grant of summary judgment and remand for further proceedings.

Id. at *1.

AUTO-OWNERS INS. CO. v. WEBSOLV COMPUTING, INC., ___ F.3D ___, 2009 WL 2750263 (7TH CIR. (ILL.) 2009)

In another blast fax case under the Telephone Consumer Protection Act ("TCPA"), 47 U.S.C. § 227, the Seventh Circuit found no duty to defend. Reversing the trial court, the decision by a panel including Justices Easterbrook as chief judge, Cudahy and Sykes, and authored by Sykes, reached a conclusion inconsistent with a number of cases including that by the Supreme Court of Illinois in *Valley Forge Ins. Co. v. Swiderski Elec., Inc.*, 223 Ill. 2d 352 (2006).

The acts of wrongful conduct included sending an unsolicited fax advertisement to a dental office from one Websolv Computing, Inc., the insured seeking a defense obligation from its carrier.

Iowa, not Illinois law, applied in reaching a contrary conclusion from that reached by *Swiderski*. The court found that the pertinent Illinois choice of law principles compelled the application of substantive Iowa law, to wit, the insurance policy was delivered to Websolv, an Iowa corporation, at its Iowa headquarters through an Iowa agency, and the risk is located in that state. *Id.* at *2.

The court found that the earlier opinion of Judge Easterbrook in *American States Ins. Co. v. Capital Assocs. of Jackson County, Inc.*, 392 F.3d 939, 941 (7th Cir. 2004) limiting the invasion of privacy offense to the protection of secrecy interest was not addressed by a suit that only involves seclusion issues.

It predicted that Iowa would follow the *Capital Assocs. of Jackson County* language, choosing to embrace a minority view on this point.

Gortho does not contend that Websolv's fax advertisement revealed secret or proprietary information about it; rather, it alleges that the unsolicited fax intruded on its right to be left alone. Therefore, the question in this case is whether the

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“advertising injury” coverage in the CGL policy requires Auto-Owners to defend Websolv in a suit claiming an infringement of Gortho’s seclusion interests.

Id. at *4 (footnote omitted).

Absent precedent, the court in effect anticipated that the Supreme Court of Iowa would reach a decision which was in marked contrast to the rule in Illinois and the majority rule developing nationally.

The court articulated its rule in *Capital Assocs.*, again claiming that it had properly interpreted the policy in accord with applicable principles that Iowa courts would apply.

“Publication” is implicated only where the relevant concern is secrecy; one can violate another’s right to seclusion without publicizing anything. *See, e.g., Doe v. Mills*, 212 Mich.App. 73, 536 N.W.2d 824, 832 (1995) (“An action for intrusion upon seclusion focuses on the *manner* in which information is obtained, not its *publication*; it is considered analogous to a trespass.”) . . . One who knocks repeatedly on another’s door late at night or takes photographs of another from across the street may violate the person’s seclusion rights even though no “publication” has occurred. We think it stretches the advertising-injury language too far to interpret “publication” to include the type of activity at issue in this case. The TCPA protects seclusion interests irrespective of publication, but the “publication” language in subsection (b) of the policy’s definition of “advertising injury” strongly suggests that this coverage only applies to alleged invasions of secrecy interests.

Id. at *5.

Claiming that “context” helps make its definition the only reasonable one, it avoided facing the question as to whether there was ambiguity or even multiple reasonable interpretations requiring construction of the term “publication” against the insurer. It found, instead, that only one potential meaning was pertinent.

The other subsections of the definition of “advertising injury” also support this interpretation. The other three provisions of the advertising-injury definition focus on harm arising from the *content* of an advertisement rather than harm arising from mere *receipt* of an advertisement. The surrounding provisions cover advertising-injury claims for libel, slander, misappropriation, and copyright infringement – all of which require the examination of the content of the offending advertisement. It is therefore reasonable to infer that subsection (b) also concerns harm emanating from the content of an advertisement; that is, it is reasonable to read subsection (b) to refer only to violations of secrecy interests. Here, Gortho is not complaining about the content of the fax; rather, it complains that the very fact the fax was sent violated the corporation’s right to be left alone under the TCPA. Accordingly, we conclude that the advertising-injury provision does not cover claims brought under the TCPA.

Id. at *6 (footnote omitted).

The court also rejects coverage under the property damage provision.

The court rejected the notion that no intent was involved. The court noted that since the complaint in the underlying action alleged that Websolv sent the fax and that one Pabrai (the individual defendant in the case) merely “authorized and approved” it, he was acting as Gortho’s agent; therefore there is no separation of insureds; therefore no different standard comes into play for evaluating whether an intent is at issue.

Citing other cases involving often variant and more narrow language, the court reasoned:

See Resource Bankshares Corp. v. St. Paul Mercury Ins. Co., 407 F.3d 631, 639 (4th Cir.2005) (“It is obvious to anyone familiar with a modern office that receipt is a ‘natural or probable consequence’ of sending a fax, and receipt alone [results in] ... depletion of the recipient’s time, toner and paper....”); *Am. States Ins. Co.*, 392 F.3d

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at 943 (“[J]unk faxes use up the recipients’ ink and paper, but senders anticipate that consequence.”).

Id. at *6.

Notably, the court rejected certification to the Iowa Supreme Court anticipating the court would not agree with it on this point, claiming that while the outcome certainly would be determined by the court’s resolution, this is not one of vital public concern more likely to recur since the insurance industry in 2005 began issuing a standard endorsement specifically excluding coverage for TCPA claims.

THE PERILS OF BLOGGING & TWITTERING . . . ARE YOUR CLIENTS COVERED?

According to the Citizen Media Law Project, lawsuits over web postings rose by 70% between 2006 and 2008. Cases have primarily been filed alleging copyright infringement or defamation.

For the private blogger and twitter, there is possible coverage under an individual’s homeowners or renters insurance policy. But, if the blogger or twitter is receiving a fee for their services then there is a probable exclusion since the event may be defined as a “commercial risk.”

If you or a client is faced with this kind of lawsuit, as well as any anti-trust, intellectual property, FACTA, TCPA or other business tort claim, a call to our office would be advisable since we have an initial no fee service in which we will review you or your client’s relevant insurance policy and compare it to the complaint and then provide an oral report as to whether we believe there is pathway to coverage. If you are interested in this service please call Richard A. Beserra at (949) 553-1010 Ext 208.

PUBLICATIONS BY DAVID A. GAUNTLETT

David A. Gauntlett is the author of *Insurance Coverage of Intellectual Property Assets* published by Aspen Publishers. The book and supplements are available for \$250.00 plus tax where applicable; shipping and handling are free when full payment is enclosed with the order. To order, call Aspen Publishers at 1-800-638-8437.

UPCOMING PUBLICATIONS BY DAVID A. GAUNTLETT

- ◆ *Intellectual Property Due Diligence in Corporate Transactions*: § 12A (West 2007) (contributor)
- ◆ *Assets & Finance: Audits and Valuation of Intellectual Property-Internal Controls, Materiality and Investment* (West/Thompson Reuters) (Westlaw AFAVIP) (contributor)
- ◆ Also soon to be published are three books:
 - *A Primer on Insurance Coverage Law, and Intellectual Property Claims Under Commercial General Liability Policies* (Insurance of IP assets) (contributing authors for Chapter 7) (Tod Zuckerman, Bob Chesler, Mary Hildebrand and Christopher Keegan)
 - *Free and Open Source Software and Content Desk Reference: A Legal and Risk Management Guide* (Browntree Publications) (contributing author of chapters on F/OSS and F/OC adoption and corporate risk management policies and procedures)
 - *Intellectual Property Practitioner's Handbook on Insurance Coverage* (ABA 2009)
- ◆ *The Licensing Journal* regularly features articles written by Mr. Gauntlett, the latest entitled *Inapplicability of the Fortuity Doctrine as Applied to Offense-Based Coverage for Intellectual Property Risks* (West/Thompson Reuters 2009) (publication pending).
- ◆ *Mealey's Emerging Insurance Disputes* (7/23 edition) and *Intellectual Property* (7/20 edition) will feature Mr. Gauntlett's article *How Insurers Limit Policy Benefits to Policyholders in Intellectual Property, Antitrust and Business Tort Lawsuits*.
- ◆ *TIPS-ICLC 2009 Annual Survey* will also feature an article by Mr. Gauntlett on latest developments in Insurance Coverage Litigation.
- ◆ *New Appleman Insurance Law Practice Guide* chapter on “Understanding Intellectual Property Insurance Law” (LexisNexis December 2009) (contributor).
- ◆ *ICLC's CGL Handbook* (ABA 2009) (contributing editor to chapter entitled “The Principal Exclusions in Coverage B”).

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UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY WHERE DAVID A. GAUNTLETT IS SPEAKING OR ATTENDING

Mr. Gauntlett was recently named a *Super Lawyer* (Southern California) for the following practice areas:

Insurance Coverage, Intellectual Property and Antitrust Litigation

October 15 – 18, 2009	NYSBA IP Conference, Bolton Landing (Lake George), NY – Speaking
February 11-14, 2010	2010 Committee on Corporate Counsel CLE Seminar, Rancho Mirage, CA – Attending
March 4-6, 2010	ABA Litigation Section Insurance Coverage CLE Seminar, Tucson, AZ - Attending
April 21-23, 2010	ABA Litigation Section Annual Meeting, New York, NY - Attending

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Gauntlett & Associates specializes in policyholder insurance coverage and litigation re copyright, antitrust, patent, trademark, trade secret, business and general coverage disputes, including:

1. Insurance Coverage Litigation Focusing on IP, Antitrust and Business Tort Claims
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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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