

# THE INSURANCE COVERAGE/IP COUNSELOR

Volume 4, Issue 2: Spring 1999

*The Insurance Coverage/IP Counselor* is a quarterly newsletter which addresses the interests of intellectual property practitioners, corporate counsel, chief financial officers, risk managers, insurance brokers and business owners who seek insurance coverage for a full range of intellectual property and business tort claims.

We hope you find *The Insurance Coverage/IP Counselor* informative and useful. If you have a topic you would like to see addressed in future issues, please feel free to call me with your suggestions.

Sincerely,

David A. Gauntlett  
Editor  
(949) 553-1010  
E-mail: [dag@gauntlettlaw.com](mailto:dag@gauntlettlaw.com)

*Gauntlett & Associates  
Specializes in policyholder insurance  
coverage and litigation re patent,  
trademark, copyright, trade secret,  
business, labor, environmental, and  
antitrust disputes*



## **GAUNTLETT & ASSOCIATES OBTAINS INSURANCE COVERAGE FOR OKLAHOMA POLICYHOLDER FOR CLAIMS OF FALSE ADVERTISING, UNFAIR COMPETITION AND MISAPPROPRIATION OF TRADE SECRETS**

On January 21, 1999, Oklahoma District Court Judge P. Thomas Thornbrugh granted summary judgment in favor of Nusonics, Inc. and against its insurer, Northwestern Pacific Indemnity Co., in *Nusonics, Inc. v. Northwestern Pacific Indemnity Co.*, Tulsa County District Court Case No. CJ-97-04194. Wheatley Gaso, Inc. sued Nusonics for unfair competition, false advertising and misappropriation of trade secrets. Nusonics tendered defense of the Wheatley Gaso action to its insurer, Northwestern Pacific, a member of the Chubb Group of Insurance Companies. Northwestern Pacific refused to defend the Wheatley Gaso action, contending that the commercial general liability ("CGL") policy it issued to Nusonics did not provide coverage for the claims asserted by Wheatley Gaso. Nusonics then sued Northwestern Pacific, contending the Wheatley Gaso action was

### **In This Issue**

#### **Page 1:**

G & A Obtains Insurance Coverage for Oklahoma Policyholder for Claims of False Advertising, Unfair Competition and Misappropriation of Trade Secrets

#### **Pages 2, 3:**

Choosing Sides: Right to Cumis Counsel May Be Triggered As A Matter of Law

#### **Page 4:**

Upcoming Speeches and Publications on Insurance Coverage and Intellectual Property

# THE INSURANCE COVERAGE/IP COUNSELOR

covered under the “personal injury” and “advertising injury” provisions of its CGL policy. In granting summary judgment in favor of Nusonics, Judge Thornbrugh ruled that as a matter of law Nusonics had a reasonable expectation that its CGL policy provided coverage for the claims asserted by Wheatley Gaso.

Nusonics, Inc. was represented by David A. Gauntlett and Leo E. Lundberg, Jr. of Gauntlett & Associates, and Brian J. Rayment of Kivell, Rayment & Francis of Tulsa, Oklahoma. Northwestern Pacific Indemnity Co. was represented by John H. Tucker of Rhodes, Hieronymus, Jones, - Tucker & Gable, P.L.L.C. of Tulsa, Oklahoma.

## LEGAL NEWS YOU CAN USE

In three distinct cases in which G&A is involved, two in State Courts of Appeal and one in a State Supreme Court, courts have specifically requested substantive briefing on coverage issues related to patent infringement claims.

On November 4, 1998, the Texas Supreme Court requested substantive briefing on the merits by all parties in *CIGNA Lloyd Insurance Co., v. Bradleys Electric, Inc.* Case No. 98-0773. The trial court had found that Bradleys was entitled to a defense for claims of inducement of patent infringement under both piracy and successor “misappropriation of advertising ideas or style of doing business” advertising injury policy language. Although initially reversed by the Court of Appeal, that decision was withdrawn, and a new one issued

addressing venue concerns which both parties agreed should not interfere with the court’s ability to address substantive issues. The Texas Supreme Court agreed and requested substantive briefing.

*ABB Flakt, Inc., Combustion Engineering, Inc. v. National Union Fire Co., Pittsburgh, PA* Delaware Supreme Court Case No. 299, 1998. On March 10, 1999, following oral argument the Court requested further oral argument before the *en banc* without further briefing in the Delaware Supreme Court, Case No. 299-1998. (on whether direct infringement claims based on demonstration of flue desulfurization (“FGP”) business at a plant visit was a form of advertised “use” directly infringing a process patent which patent falls within the “advertising injury” coverage for piracy within the policy.”

In *Mez Industries Inc. v. Pacific National Insurance Co.* Second Appellate District, Division One, Case No. B121209, on April 10, 1999, at the invitation of policyholder counsel, Justice Croskey, speaking for the Court of Appeal, asked for a briefing on the issue of whether California Insurance Code section 533 could bar, as a matter of law, claims for inducement of patent infringement given the pertinent scienter for inducement claims and whether the advertising injury offense of “infringement of copyright, title or slogan,” could encompass the ownership to patent rights as a form of title. The court sought input from intellectual property counsel on this issue.

## CHOOSING SIDES: RIGHT TO CUMIS COUNSEL MAY BE TRIGGERED AS A MATTER OF LAW

By M. Danton Richardson and Eric R. Little

The law in California is well-settled that an insured must be provided independent counsel whenever the carrier’s obligation to indemnify the insured “can be controlled by counsel first retained by the insurer for the defense of the claim.” *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App. 3d 358 (1984); *Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 20 Cal. App. 4th 1372 (1993).

One way in which such a conflict of interest arises is when the insurer reserves its right to deny coverage if there is a finding that the conduct on which the potentially covered claim is based occurred willfully. Practitioners should note, however, that a conflict of interest can also exist as a matter of law and is not always dependent on a carrier’s express reservation of rights.

For example, as recently confirmed by the 2nd District Court of Appeal, Insurance Code section 533, which provides that an insurer is not liable for a loss caused by willful conduct, represents the public policy of the State of California and therefore cannot be waived. *Downey Venture v. LMI Ins. Co.*, 66 Cal. App. 4th 478 (1998). Therefore, where the insured is charged with conduct that is potentially covered, and that conduct could be deemed to have occurred nonwillfully (and therefore be covered) or willfully (and therefore be barred from coverage), there is a conflict of interest as a matter of law.

# THE INSURANCE COVERAGE/IP COUNSELOR

Insurance Code section 533 states: “An insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured’s agents or others.” Section 533 is deemed included in every contract of insurance: It is an implied exclusion that is read into all insurance policies. *J.C. Penney Casualty Ins. Co. v. M.K.*, 53 Cal.3d 1009 (1991).

Similarly, Civil Code section 1668 provides that “[a]ll contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own ... willful injury to the person or property of another are against the policy of the law.”

Thus, under California law, even if there is no express exclusion in the policy, an insurer still cannot provide coverage for an insured’s willful acts. *J.C. Penny; Tomerlin v. Canadian Indem. Co.*, 61 Cal. 2d 638 (1964) (insurer is precluded from indemnifying insured for the insured’s willful acts pursuant to Insurance Code section 533 and Civil Code section 1668).

Accordingly, the *Downey Venture* court ruled: “We also reject the related argument made by the Downey plaintiffs that LMI, by its unconditional acceptance of the initial tender of the defense ... waived its right to thereafter assert section 533 as a bar. ... The provisions of a statute established for a public purpose and constituting an expression of public policy may not be waived.”

Because the provisions of a statute embodying public policy cannot be waived (Civil Code section 3513), a carrier cannot waive section 533. As

evidenced by *Tomerlin*, however, where an insurer defends through panel counsel who has a conflict without reserving a right to deny coverage, and the insured detrimentally relies upon that defense, the carrier may be estopped from denying its obligation to indemnify its insured.

The 2nd District also recently documented an instance in which an insurer agreed to defend, without a reservation of rights, and employed panel counsel with a conflict of interest to deliberately prejudice the defense in a manner designed to reduce the insurer’s liability. *Mosier v. Southern California Physicians Ins. Exch.*, 74 Cal. Rptr. 2d 550 (1998). In *Mosier*, the court found a conflict of interest arose as a matter of law, based upon the canons of attorney ethics, and by analogy to Civil Code section 2860 and the *Cumis* case.

Southern California Physicians Insurance Exchange agreed to defend a physician, Neil Jouvenat, in a malpractice lawsuit, even though SCPIE’s insurance policy had lapsed and SCPIE no longer had a duty to indemnify. SCPIE’s apparent motivation in agreeing to defend was that the liability of its other insureds would be diminished to the extent that Jouvenat was held liable for damages. SCPIE retained counsel to defend the other insureds, and that counsel recommended that SCPIE retain separate counsel to defend Jouvenat, even though Jouvenat was no longer an insured.

As a result, SCPIE retained panel counsel to defend Jouvenat, who had been proceeding in pro per. Neither SCPIE nor panel counsel ever advised Jouvenat that panel counsel had a conflict of interest. At trial, panel

counsel elected to serve the interests of SCPIE, to the detriment of Jouvenat, by controlling the evidence. Jouvenat’s liability was increased and SCPIE’s liability was greatly reduced. In fact, panel counsel did not even oppose a motion brought by the other insureds that enhanced Jouvenat’s liability and reduced SCPIE’s liability.

Although there never was a reservation of rights by SCPIE, the Court of Appeal held there was a conflict of interest as a matter of law, precluding SCPIE from defending Jouvenat through SCPIE’s panel counsel. The *Mosier* court stated: “The reason this situation is analogous to that mentioned in *Cumis* is that while SCPIE was providing a defense to Jouvenat, it insisted that it would not indemnify him ... [I]t does not require much sophistication to understand the conflict which existed: SCPIE was in a position to mold the outcome of the underlying litigation to the benefit of its own financial interests by diminishing the liability of its insureds at the expense of Jouvenat. While the similarity of the conflict is significant, the reason the analogy to *Cumis* is so compelling is because *Cumis* is based on ethical standards, not insurance concepts.”

The *Mosier* court continued: “While this situation is not identical to the situation addressed by *Cumis* and Civil Code section 2860, we adopt that framework for the application of duty in this case.”

As set forth in *Mosier*, there does not have to be a reservation of rights for a right to independent counsel to exist. The right to independent counsel arises out of the existence of a conflict of interest. Thus, where a conflict of interest exists, an insurer cannot attempt to force its insured into

# THE INSURANCE COVERAGE/IP COUNSELOR

accepting the insurer's panel counsel. Rather, the insured has a right to conflict-free independent counsel.

## UPCOMING SPEECHES AND PUBLICATIONS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

*David Gauntlett will speak at the following forums:*

- Mealey's New Liabilities Confronting the World Insurance Market Conference held in London, England on June 23-24, 1999.
- ABA, Tort and Insurance Practice Section at their annual meeting in Atlanta, Georgia on August 5 - 11, 1999.
- All Ohio Annual Institute on Intellectual Property Law seminar on September 30, 1999 (Cleveland, OH) and October 1, 1999 (Cincinnati, OH).

\*\*\*

David Gauntlett is the author of numerous works including "Exposing the Duplicity of Insurer Analysis of 'Advertising Injury' Offenses" published in Mealey's Emerging Insurance Disputes, Vol. 3, #18, September 17, 1998 and Mealey's Litigation Report Intellectual Property, Vol. 7, #1, October 5, 1998.

\*\*\*

Mr. Gauntlett is currently working on two projects for publisher Matthew Bender.

The first is an update for his existing Chapter 29 entitled "Insurance

Coverage for Intellectual Property Lawsuits" found in Matthew Bender's *Intellectual Property Counseling and Litigation* volumes.

His second project is to prepare a new chapter on Y2K for the next release of *Intellectual Property Counseling and Litigation*. Mr. Gauntlett's chapter will discuss "Insurance Coverage for Y2K Risks Utilizing New As Well As Old Policy Provisions."

\*\*\*

Mr. Gauntlett is Editor of the ABA Tort and Insurance Practice Section, Intellectual Property Committee Newsletter.

\*\*\*

We invite you to visit our web site at [www.gauntlettlaw.com](http://www.gauntlettlaw.com)

## FIRM MEMBERS

### Principal

David A. Gauntlett

### Associates

M. Danton Richardson  
Eileen Spadoni  
James A. Lowe  
Leo E. Lundberg, Jr.  
Eric J. Schindler  
Stanley H. Shure  
Richard Wm. Zevnik  
Daniel C. Carmichael, III  
Eric R. Little  
Dean H. McVay  
Julia C. Weisman  
Raymond J. Liddy  
Richard E. Masson

### Law Clerks

Najwa Tarzi  
Andrea C. Okura

Gauntlett & Associates' **The Insurance Coverage/IP Counselor** is published quarterly to inform clients, friends and other professionals of developments in insurance coverage and IP law. This newsletter is available free of charge to interested parties.

The Articles appearing in **The Insurance Coverage/ IP Counselor** do not constitute legal advice or opinions. Such advice and opinion are provided by the firm only upon situations.

G&A places in high regard its relationship with referring entities and will not take any actions inconsistent with the entity's wishes respecting a client.

For more information, contact Eleanor Booth at Gauntlett & Associates.

Phone: (949) 553-1010 x255

E-mail: [marketing@gauntlettlaw.com](mailto:marketing@gauntlettlaw.com)

©1999 Gauntlett & Associates  
All rights reserved.

**G GAUNTLETT & ASSOCIATES**  
ATTORNEYS AT LAW

18400 Von Karman, Suite 300,  
Irvine, California 92612  
(949) 553-1010  
fax (949) 553-2050

[www.gauntlettlaw.com](http://www.gauntlettlaw.com)  
[info@gauntlettlaw.com](mailto:info@gauntlettlaw.com)