

# THE POLICYHOLDER ADVOCATE/IP COUNSELOR

## NEWSLETTER

Volume 5, Issue 3: Spring 2000

### **“INSURANCE COVERAGE FOR INTELLECTUAL PROPERTY CLAIMS AND ITS IMPLICATIONS FOR E-COMMERCE”**

#### **I. Insurance Coverage for Intellectual Property Lawsuits**

In analyzing “advertising injury” coverage, the courts have been faced with the dilemma in intellectual property lawsuits that questions, asked by the policy language, are rarely answered either on the face of the pleadings or even in other documents typically filed in connection with such lawsuits. These questions include whether 1) the elements establishing liability under the asserted intellectual property claim bear a causal nexus to the insured’s advertising activities; 2) the liability theory depends upon facts which fall within the meaning of one or more enumerated “advertising injury” offenses, such as “misappropriation of advertising ideas or style of doing business” or “infringement of copyright, title or



slogan”; and 3) damages sought in the lawsuit are such that the injury suffered will be connected with liability that constitutes an enumerated “advertising injury” offense.

In the past year, a number of courts have wrestled with these issues in analyzing coverage for different forms of patent infringement claims, trade secret misappropriation claims, and trademark lawsuits.

#### **II A Brief Overview of Coverage Case Law Addressing Intellectual Property Lawsuits for 1999**

##### **A. Patent Infringement**

The most problematic area for policyholders to obtain insurance coverage has been patent infringement lawsuits. In analyzing an “offer for sale” patent infringement lawsuit in the case of *Everett Associates, Inc. v. Transcontinental Insurance Co.*, 57 F. Supp. 2d 874 (N.D. Cal. 1999), Judge Conti found it significant that the liability in the underlying action would depend solely upon the insured’s

advertising activities as they related to the “offer for sale” claim reasoning:

*Under the Clark court’s express ruling, Everett could have been held liable at trial for damages for patent infringement solely by virtue of its having advertised infringing products. In light of this, it is difficult to say how Transcontinental could prove the absence of any potential for advertising injury coverage.*

*Id.* at 884.

In *Foundation for Blood Research v. St. Paul Fire & Marine Ins. Co.*, 1999 Me. 87, 730 A.2d 175, 179 (1999), the court found claims for inducement of patent infringement covered under variant policy language offered through St. Paul Fire & Marine

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

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

Published By  
DAVID A. GAUNTLETT . . . . . Editor  
CHRIS MODIG . . Admin. & Mktg. Manager  
TELEPHONE . . . . . (949) 553-1010

Insurance Co. The court rejected St. Paul's argument that belittlement was a narrow common law tort which could not encompass any claims like those potentially asserted in an inducement lawsuit, because its policy included language covering both the "personal injury" and "advertising injury" offense of "making known to any person or organization, written or spoken material that belittles the products, work or completed work of others."

Courts are likewise divided on whether the offense of "infringement of title" may include "interference with ownership rights" as a form of title infringement. To date, the majority of courts to address this issue have found that this is not a permissible construction.<sup>1</sup> However, courts so finding do not explain why the rules requiring construction of ambiguous policy language against the insurer are not implicated by the two variant definitions for that offense which they admit are viable – "improper use of another's name or designation on advertisement" or "the name of a

literary or artistic work."<sup>2</sup>

The Federal Circuit recently conceded that the predecessor offense of "piracy" encompassed patent infringement claims.<sup>3</sup> The *Everett* court found the successor offense of "misappropriation of advertising ideas" ambiguous and presumptively broad enough to encompass "offer for sale" patent infringement claims where damages were sought in the underlying action solely based on Everett's advertising for "corrective advertising." ISO, the drafter of the policy language in question, announced that there was "no change in scope" between the old and new policy language which interprets the "misappropriation of advertising ideas" offense to encompass claims for patent infringement.<sup>4</sup> This was also arguably the case in *Mez* where the insured was alleged to have induced others to infringe by advertising its services as a contractor. Such conduct was inconsistent with a patent owner's right to "exclude others" from "offering for sale" products created by use of its protected process.<sup>5</sup>

## B. Trademark Infringement

The majority of courts have found that trademark infringement claims may fall fairly within the above-referenced offenses. Typical of the analysis employed by these courts is the decision in *Bay Electric* wherein Judge Kent concluded, "Misappropriation of advertising ideas or style of doing business' encompasses claims for trademark and trade dress infringement." In reaching this conclusion, the court determined that a wholesale copying of all of a company's products is not essential to fall within the term "style of doing business" within the above offense.

## C. Trade Secret Misappropriation

Affirming a trial court ruling but on narrower grounds in *Frog, Switch*,<sup>6</sup> the Third Circuit (applying Pennsylvania law) found there was no causal nexus between the theft of trade secrets and the insured's advertising activities sufficient to fall within advertising injury coverage. The court prefaced its analysis by the note that "the definition of 'advertising injury' in standard business insurance policies has troubled and in some cases confounded courts for years."

The courts suggest that it would make a difference if the basis for liability was advertising activity, i.e. advertising conduct, such as duplication of that which another party claimed as its protected intellectual property rights. Indeed, it sketched a series of scenarios that would fall within potential coverage. Thus the court observed, "ESCO alleged not that Frog copied its

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<sup>1</sup>*Maxconn, Inc. v. Truck Ins. Exchange*, 74 Cal. App. 4th 1267, 88 Cal. Rptr. 2d 750 (1999), modified rehearing denied, 75 Cal. App. 4th 1037a (1999), rev. denied, 1999 Cal. LEXIS 841 (Dec. 1, 1999); *U.S. Test, Inc. v. NDE Environmental Corp. and United Coastal Insurance Co.*, 196 F.3d 1376 (Fed. Cir. 1999), reh'g denied, 1999 U.S. App. LEXIS 34475 (Dec. 17, 1999); *United National Insurance Co. v. SST Fitness Corporation*, 182 F.3d 447 (6th Cir. Ohio 1999); *Mez Industries, Inc. v. Pacific National Insurance Company*, 76 Cal.App. 4th 856, 90 Cal. Rptr. 2d 721 (Cal. Ct. App. 1999), *Petition for Review denied* 2000 Cal. LEXIS 2099 (Cal. Mar. 22, 2000); but see *Homedics, Inc. v. Valley Forge Ins. Company*, No. SA CV 99-928 DOC (ANx), 1999 U.S. Dist. LEXIS 17317, 53 U.S.P.Q.2d (BNA) 1155 (C.D. Cal. Oct. 29, 1999) (unpublished order).

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<sup>2</sup>*Maxconn*, 74 Cal.App.4th at 1379 and 1381.

<sup>3</sup>*U.S. Test, Inc. v. NDE Environmental Corp.*, 196 F.3d 1376 (Fed. Cir. 1999), reh'g denied, 1999 U.S. App. LEXIS 34475 (Dec. 17, 1999).

<sup>4</sup>*Bay Electric Supply, Inc. v. The Travelers Lloyd's Ins. Co.*, 61 F. Supp. 2d 611, 617 (S.D. Tex. 1999).

<sup>5</sup>*Id.* at 1381. The *Mez* court never reached this issue because it ruled that patent inducement claims involve inherently harmful conduct within the meaning of California Insurance Code § 533 and thus precluded a defense as well as indemnity. No other jurisdiction has found patent inducement claims preclude coverage on public policy grounds.

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<sup>6</sup>*The Frog, Switch & Mfg. Co. v. The Travelers Ins. Co.*, 193 F.3d 742, 744 (3d Cir. 1999)

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style of doing business – a plan for interacting with consumers and getting their business – but that Frog copied a particular product line that might be attractive to consumers.” *Id.* at 749-750.

## I. Insurance Coverage for e-Commerce Risks

Some Commercial General Liability (CGL) insurers are starting to exclude Internet-related risks from the “personal injury” and “advertising injury” coverage within their policies. E-commerce exposures—which can include intellectual property theft, copyright and trademark infringement, libel and slander—may be covered under traditional “advertising injury” policies but for these exclusions. These exclusions are prospective. This means that a claim which arose and is continuing up to and until the time of exclusion would clearly fall within the scope of the policy.

Insurers will argue that the typical exclusion in their advertising and personal injury coverage for a policyholder who is “in the business of broadcasting, televising, publishing, advertising” may bar coverage for such claims. However, such an interpretation flies in the face of the reasonable expectations of an insured who simply uses e-mail as another bases for pursuing a coverage claim. Any company which creates a web site regardless of its core operations could in some sense be deemed to be in the advertising business. This certainly assists policyholders in establishing an “advertising injury” nexus to their operations, but provides insurers an argument that perhaps the exclusion applies to bar coverage.

A recent decision clarifies that this exclusion will not bar coverage for the

typical manufacturer, distributor, or supplier which uses the Internet as an advertisement or order-procurement medium. In *American Employers Ins. Co. v. Delorme Publishing Co., Inc.*, 39 F. Supp. 2d 64 (D. Me 1999) the court expressly addressed the impact of this exclusion in the standard form policy on the ability of a company which published products on the web to avoid the exclusion. The court found that Delorme was in fact barred by the exclusion. The court’s analysis, however, is instructive and suggests that the typical company availing itself of e-mail and Internet linkage as an adjunct to its advertising activities is not in danger. It concluded, “[I]n this context to be ‘in the business’ of one of the four listed areas plainly means to be more than merely engaged in part and clearly means to be at least primarily engaged in that activity. . . .” *Id.* at 82.

A number of new e-commerce policies have arrived on the market that cover a host of risks incident to use of the Internet for commercial purposes. Most risk managers would view these products as a “difference-in-conditions” coverage. It makes up for the limitations under the CGL policy which has now arisen as the insurers have refined and limited its scope. The exposure of companies who use the Internet as a vehicle for promoting their goods, products and services may differ from that of companies who limit their operations to traditional forms of marketing and advertising. Nevertheless, the exposure is no different from that faced by a retailer who relies heavily on catalogues to generate sales. These include:

- AIG Patent Infringement Indemnity Insurance, underwritten by American International Specialty Insurance Company.
- IPISC Patent Defense

Reimbursement Policy, underwritten by Intellectual Property Insurance Services Corporation.

- Lloyd’s of London Patent Infringement Pursuit Coverage, available through Litigation Risk Management.
- Marsh & McClellan’s “NetSecure,” covering both first and third party losses, underwritten by a consortium including AIG, Lloyd’s, Zurich and Chubb.
- Insuretrust.com, an Atlanta-based program manager for specialty e-businesses, offers electronic information, errors and omissions liability policies for e-business and is underwritten by Philadelphia-based Legion Indemnity Co., a unit of Mutual Risk Management Ltd.
- St. Paul Fire and Marine Ins. Co. offers media liability coverage with both primary and excess arrangements.
- Reliance National Insurance Co.’s specialty-based e-commerce coverage.
- American International Group’s Internet-related products and services.
- Safety “Net Internet Liability Policy from Chubb Group of Insurance Companies.
- ZC Specialty Insurance Company’s E-Risk Protection Policy from Zurich Reinsurance.
- Information Technology Professional Liability Policy from SteadFast Insurance Brokerage Co.
- “WISP” Website Breach Security Losses Policy, available from J.S. Wurzler Underwriting Managers

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To date, insurers suffer from a lack of actuarial data to determine both the frequency and severity of Internet-related losses to help them gauge premium levels. Nevertheless, many are willing to negotiate appropriate coverage for individual companies following a careful review of their operations.

## II. Conclusion

This is a dynamic time for policyholders facing a plethora of Information Age risks. Parties who are responsible for assessing the potential for risk transfer of the costs of litigation to a company's insurers need to be especially vigilant in pursuing new forms of coverage and exploring all prior coverages that could respond to such litigation risks. As the cases referenced above reveal, it is incumbent upon all parties charged with the responsibility of evaluating coverage to take their proper roles to engage in the appropriate analytic exercise and offer meaningful and sustainable interpretations of coverage that will promote predictability in this key coverage area.

## RECENT AND UPCOMING PUBLICATIONS AND SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

David A. Gauntlett is the author of *Insurance Coverage for Intellectual Property Assets*, which was recently published by Aspen Law & Business. The first supplement for the book is scheduled for release in April 2000. Both the book and the supplement are available from the Publisher on a thirty (30) day free approval. The book is \$160.00 plus 8.5% shipping and handling when full payment is enclosed with the order. Call 1-800-638-8437.

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David A. Gauntlett will be one of the guest speakers on August 24, 2000 at the 5<sup>TH</sup> ANNUAL INSURANCE LAW INSTITUTE in San Antonio, Texas, sponsored by The University of Texas School of Law and The Insurance Law Section of the State Bar of Texas. He will report on policyholder strategies for maximizing insurance coverage.

## SPECIAL PROJECTS

David A. Gauntlett is the host of a new Radio Show entitled, "*It Is What It Is.*" It addresses a number of issues such as:

- Protecting IP Rights Through Insurance Coverage
- Understanding IP Rights and Their Impact on Stockholder Value in the Information Age
- The Role of Insurance Coverage in Addressing the Risks of Antitrust Litigation.

This show airs each Tuesday at 8:00 a.m.-9:00 a.m. on KFNX 1100 AM out of Phoenix, AZ and at 11:00 a.m.-12:00 noon on WALE 990 AM out of Providence, RI. Shows will be rebroadcast on our web site at [www.gauntlettlaw.com](http://www.gauntlettlaw.com).

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For more information, contact our Marketing Coordinator at

(949) 553-1010 x 208

E-mail:

[marketing@gauntlettlaw.com](mailto:marketing@gauntlettlaw.com)

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