

# THE INSURANCE COVERAGE/IP COUNSELOR

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## “DAMAGES RECOVERABLE AGAINST INSURERS WHO REFUSE TO PAY ALL ATTORNEYS’ FEES INCURRED IN RESPONDING TO POTENTIALLY COVERED INTELLECTUAL PROPERTY LITIGATION”

### I. INTRODUCTION

As litigation has ensued over policyholders’ rights to obtain reimbursement of attorneys’ fees in a range of intellectual property, antitrust and cyberspace torts, courts analyzing “offense” based “advertising injury” / “personal injury” coverage have recognized that a defense may be owed for a number of such claims. Many courts have so found even without reaching the issue of an insurer’s obligation to settle or indemnify the policyholder for a damages award. Obtaining full reimbursement for all attorneys’ fees incurred from inception of the defense effort, however, runs contrary to the insurer’s desire to limit

#### *Gauntlett & Associates*

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

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expenditures under its policy. Especially where the policyholder can select its own counsel at the insurer’s expense due to a conflict of interest posed by the character of the relief sought thereunder, disputes inevitably arise over reimbursement of such fees and costs. This article will address strategies to secure full reimbursement of such fees and costs.

### II. CHOICE OF FORUM, CHOICE OF LAW, KEY CRITERIA IN DETERMINING WHAT LAW WILL APPLY TO COVERAGE DISPUTES

Intellectual property counsel seeking to obtain reimbursement of attorneys’ fees and costs expended in coverage actions must first confront the most basic question before they can determine what rules may apply to this dispute – what states coverage law will apply. The answer to this question is far from simple. Indeed, what law applies may often be result determinative. While policyholder counsel may assume that the applicable law will be that which will best enhance its recovery, the

determination as to what law applies will typically require selection of a forum in which to adjudicate a dispute. Thus, a precipitous letter responding to the insurer’s request for information and including coverage analysis depending on the law of a particular state may weaken the policyholder’s subsequent argument that law other than that initially referred to should apply in this dispute.

What choices exist? Many. They include the policyholder’s principal place of business or place of incorporation. The same with respect to a key subsidiary who is sued along with it and whose conduct is at issue in the underlying action. The insurer’s place of incorporation or principal place of business where it issued the pertinent policy. The location of the insurance broker who may have acted as an

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intermediary, and the location of the conduct allegedly giving rise to damages in the underlying action. Faced with such a range of choices, assessing which jurisdiction's law should apply out of those potentially available will require analysis of a range of issues.

Further, the costs of a challenge to the selected forum must also be evaluated. Inevitably, a calculus ensues whose polar elements are the forum most likely to be unchallenged and the forum which will apply law most likely to support the broadest recovery, will be selected. Particularly difficult are conflicts arising where the possibility of securing a defense is better in one jurisdiction, i.e., California, but the potential for damages there is less, i.e., Civil Code § 2860 panel fees are available rather than "reasonable attorneys' fees" as in most other jurisdictions. Because the first comprehensive coverage analysis must properly consider these elements, early involvement of coverage counsel in significant litigation is desirable.

### **III. ONCE A FORUM IS SELECTED, WHAT LAW COULD APPLY**

In a majority of jurisdictions nationally, the law with regard to analysis of offense-based coverage for a number of intellectual property claims is relatively undeveloped. As a consequence, a conflict can readily be envisioned between the law of forum jurisdiction and that of another competing location. In such a scenario, the law of the forum controls without the need to resort to the particular conflict of law rules within the jurisdiction selected. Recent case law finding that there is no conflict means there will be no choice of forum analysis. Indeed, the smaller the forum state, the less likely it will have developed enough case law to give rise

to significant conflicts of law.

### **IV. ASSUMING A JURISDICTION IS SELECTED, THE APPLICABLE LAW PROPERLY EVALUATED, HOW CAN POLICYHOLDERS MAXIMIZE RECOVERY OF ATTORNEYS' FEES**

Under California law, Civil Code § 2860(c) requires arbitration of any dispute over the fees to be paid to an individual or firm. There is, however, no requirement that a dispute between the insurer and the insured concerning the duty to provide independent counsel of the first instance is to be resolved in the same manner. Further, the insurer's obligation to provide independent counsel is subject to certain restrictions. Independent counsel must meet minimum qualifications, and the insurer is only required to pay "reasonable" fees.

An insurer will seek to enforce the rates that they pay panel counsel typically retained by them to defend an insured. Where such counsel have expertise in a particular area of practice, such as intellectual property law, in the community in which that action arose, they may be able to use the rate paid as a benchmark under California's Civil Code § 2860, but not necessarily as a standard rate where they must pay "reasonable" attorneys' fees. Where the rate paid is less than that demanded by independent counsel, they may be required to pay the "reasonable" fees of independent counsel unless they can show that this rate is far higher than that which prevails in the relevant community.

Thus, where a California insured is defending its interest in a Texas lawsuit and counsel is employed in Texas for defense of same as well as

California counsel, both sets of attorneys may properly be subject to a reasonableness standard where Texas law governs the coverage dispute. An action filed in a Texas court may properly decide that Texas coverage law applies to such a dispute. Generally, a reasonable rate corresponds to the prevailing rates in the relevant community. The pertinent rates may be the rates charged by attorneys in the jurisdiction where the attorneys actually practice. Courts have also found that reference to the report of economic survey by the American Intellectual Property Law Association ("AIPLA") may set an appropriate standard for evaluating the reasonableness of attorneys' fees incurred in a particular jurisdiction.

What happens where an insurer agrees to defend, but pays fees only equivalent to those which it contends it would pay counsel it selects in the jurisdiction where the claim is pending, even funding a settlement of the case, but then declares that its duties have been satisfied. The simple answer is that in most jurisdictions the duty owed by the insurer is a complete duty to defend the entirety of the lawsuit immediately and fully so long as the insured can establish that the reasonable fees were higher than those it argues it would have paid its selected counsel. It is entitled to pursue the claim for differential against the insurer. Where any recovery is realized, then the insurer would have failed to provide the full obligations under the policy and in a number of jurisdictions will be entitled to recovery of the attorneys' fees it incurred in such a pursuit.

Another issue is what rate of prejudgment interest should accrue on the unpaid attorneys' fees. When do they accrue – from date of invoice? What about when the invoice by its own terms requests payment (i.e., 30 days from receipt)? Or should interest only

accrue from the date of payment or when a lawsuit is filed to enforce such claims? Each rule can find some support in different jurisdictions, and the rate of interest may be as little as a floating market rate in Illinois or 12% compounded annuity in Massachusetts. Clearly, this element must be factored into the analysis in choosing the preferred forum to pursue coverage issues.

## V. THE MAJORITY OF STATES PERMIT RECOVERY OF POLICYHOLDERS ATTORNEYS' FEES

Under the typical "American Rule," attorneys' fees are not recoverable in a contract dispute absent an express provision providing for same. Nevertheless, some legislatures have recognized that insurance disputes are different because the "disparity of bargaining power between and insurance company and its policyholders makes the insurance contract substantially different from other commercial contracts."

The insurer's duty to provide a timely defense is "litigation insurance." Providing benefits of this litigation insurance promptly and completely to litigation assures that the court protects the insureds peace of mind and security. Otherwise, a policyholder would be required to get the benefit of the litigation insurance it procured. Defense fees delayed or defense fees denied in this context. Indeed, the right to such recovery is enshrined in a number of statutory provisions.

In the context of third party liability insurance, it makes good sense that an insurer who improperly refuses to defend the policyholder should be forced to pay the attorneys' fees and costs the policyholder incurred in establishing the proper interpretation of

the policy. An insurance company who wrongfully denies a defense should bear the consequences of that action and reimbursement of the policyholder for its attorneys' fees and costs in a declaratory judgment action makes good sense. Although some courts have only awarded attorneys' fees where the carrier engaged in bad faith fraud or forms of vexatious litigation, the better view is that this approach is improper and puts too heavy a burden on the insured.

For all these reasons a number of jurisdictions expressly permit recovery of attorneys' fees to a successful litigant in a declaratory relief action.<sup>1</sup> A number of jurisdictions, recently joined by California, have also approved recovery of in-house corporate counsel's fees when an insurance coverage case is successful.

## VI. MINNESOTA LAW WHICH SUPPORTS FINDING A CONTRACTUAL BASIS FOR A DEFENSE WHERE CERTAIN "SUPPLEMENTARY PAYMENT" PROVISIONS ARE PRESENT MAY BE EXPORTABLE TO OTHER STATES

In *Church Mut. Ins. Co. v. Redeemer Lutheran Church*, No. C0-97-2002, 1997 WL 878651 (Minn. App. Apr. 28, 1998) a Minnesota Court of Appeals reiterated a proposition solidly established under Minnesota law. It followed *Security Mut. Casualty*

*Co. v. Luthi*, 303 Minn. 161, 165, 226 N.W.2d 878, 881 (1975) (There, the court construed a supplementary payments clause that provided "the [insurance] company shall - - ". . . pay all expenses incurred by the Company for investigation, adjustment and defense, and reimburse the Insured for all reasonable expenses, other than loss of earnings, incurred at the Company's request." The court construed "expenses incurred at the Company's request" as including attorneys' fees and held that under the clause, the insured was entitled to recover attorneys' fees incurred in defending a declaratory judgment action to determine coverage. *Id.* at 169-171.

Under this Minnesota precedent, where recovery of attorneys' fees is supported by the language of the Supplementary Payments clause, the simple question is whether they were incurred at the Company's request. Where similar contract provisions exist in standard form CGL policies, the same entitlement to recovery may rise for claims against insurers "analyzing coverage issues at their request." See *Insured's Right to Recover Attorneys' Fees Incurred in Declaratory Judgment Action to Determine Existence of Coverage Under Liability Policy*, Jane Massey Draper B.C.L. 87 ALR 3d. 429

## VII. CONCLUSION

Assuring recovery of attorneys' fees incurred at full rate in complex business litigation including intellectual property, antitrust and cyberspace disputes requires thorough knowledge of the basis for liability under offense-based coverage. It also requires an understanding of what law could properly apply to the coverage dispute. Supplement are available from the Publisher on a thirty (30) day free

Any attempt to shortcut a careful choice of forum analysis process may jeopardize the policyholder's ability to

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<sup>1</sup>These jurisdictions include: Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Hawaii, Idaho, Kansas, Maryland, Massachusetts, Minnesota, Nebraska, New Hampshire, New Jersey, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Texas, West Virginia, Washington, and Wisconsin.

enforce the rights it may have under its policy. In many jurisdictions, the successful policyholder will also be entitled to recover its fees incurred in pursuing such a dispute and thereby effectuate complete recovery to the insured. In those forums that do not agree with this proposition, solid precedent from Minnesota interpreting the Supplementary Payment provisions may yield the same favorable result. Forceful assertion by policyholders of their rights will force insurers to recognize that the costs of resisting proper requests that they fill their policy obligations is ultimately more costly than performance.

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### SUCCESSFUL G&A CASES

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*Fossil, Inc. v. Fireman's Fund Ins. Co.*, No. C99-5023 MHP, (USDC, N.D. CA July 12, 2000) (trade dress infringement insurance coverage)

*Anthem Electronics, Inc. v. Pacific Employer's Ins. Co.*, No. C 97-20296JW, 2001 U.S. Dist. LEXIS 332 (N.D. CA January 11, 2001) ("loss of use of tangible property that is not physically injured");

*Lexmark International v. Transportation Ins. Co. and American Motorist Ins. Co.*, No. 99 CH 3525 (Cir.

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Ct of Cook County, Ill. January 19, 2001) (trade secret misappropriation insurance coverage)

*Concept Enterprises, Inc., Coustic, Inc. v. Hartford Ins. Co.*, No. CV 00-07267 (C.D. CA February 26, 2001) (trade dress infringement insurance coverage where insurer improperly sought to pay only fees allocated to such claims "in a mixed action")

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### PUBLICATIONS BY DAVID A. GAUNTLETT

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David A. Gauntlett is the author of *Insurance Coverage for Intellectual Property Assets*, which is published by Aspen Law & Business. The first supplement for the book was released in April 2000. Both the book and the 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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### ARTICLES ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY BY DAVID A. GAUNTLETT

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*Tort Claims and Insurance in Cyberspace: Is Your Company Covered?* will appear in the American Corporate Counsel Association Docket ("ACCA") in May, 2001

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

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### UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

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David A. Gauntlett has been asked to act as Vice Chair for a new Insurance Committee within the Intellectual Property Owners Association ("IPO") committee structure. More information about the committee and scheduled events will be provided in upcoming issues of this Newsletter.

*ABA IPL Spring CLE Meeting* - April 4-5, 2001 - International Trade Center, Washington, D.C.

*American Conference Institute's Third National Coverage Issues in Complex Insurance Claims Conference* - May 3-4, 2001 - The Marriott Marquis, New York, N.Y.

*Intermediaries and Reinsurance Underwriters Association (IRU) - Claims Workshop* - May 6-8, 2001 - Amelia Island, FL

*ABA IPL Summer Conference* - June 27- July 1, 2001 - Seattle Sheraton Hotel - Seattle, WA

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