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THE INSURANCE COVERAGE/IP COUNSELOR

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"INSURANCE COVERAGE FOR THE NEW MILLENNIUM: IS YOUR COMPANY COVERED FOR CYBERSPACE RISKS?"

I. INTRODUCTION

Cyberspace risks arise from claims for defamation, invasion of privacy, and related torts and from intellectual property ("IP") claims, including copyright, trademark, trade secret, and patent infringement. Other less common risks include: computer crimes and breach of security; indecency and obscenity; advertising errors; programming and design errors; harassment and discrimination; contractual liability; and legal and regulatory uncertainty. Complicating these risks is the international character of Internet use, which results in various jurisdictions applying differing standards to the right to advertise and to the scope of commercial speech. New, emerging technologies also may aggravate exposure.

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.

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II. "ADVERTISING INJURY" COVERAGE UNDER COMMERCIAL GENERAL LIABILITY POLICIES EXISTS FOR INTELLECTUAL PROPERTY LAWSUITS THAT ARISE IN CONNECTION WITH THE USE OF THE INTERNET FOR ONLINE ACTIVITIES

A. Insurance Coverage For Online Trademark Infringement

A series of recent decisions have interpreted the "advertising injury" offense "infringement of title and slogan" to provide a defense against unfair competition and trademark/trade name claims. Most courts have found that the new 1986 offenses cover trademark infringement. But some courts, exercising questionable logic, do not agree. *See Am. States Ins. Co. v. Hayes Specialties, Inc.*, 1998 WL 1740968, at *3 (Mich. Cir. Ct. 1998) ("The analysis and reasoning of the Sixth Circuit is [sic] not only unpersuasive and flawed but demonstrates a lamentable lack of understanding and grasp of the law of trademark/trade dress, and ultimately lead [sic] to an unduly narrow and somewhat bizarre and tortured application of Michigan insurance law.").

As yet, there has not been any significant litigation regarding coverage for trademark infringement under the 1998 ISO language. The fact that the 1998 form expressly refers to trade dress infringement and not trademark infringement may precipitate coverage disputes.

B. Insurance Coverage For Online Copyright Infringement

An Oregon judge ruled that

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infringement allegations based on the distribution of electronic image libraries, composed in part of materials from Playboy magazine, were sufficient to meet the causal nexus test between the insured's advertising and its liability for copyright infringement. *See State Farm Fire & Cas. Co. v. Maxey*, No. 9209-06687 (Circuit Court Order, Sept. 22, 1993). The alleged infringements included distribution both by computer diskette and through modem transmissions. The court found the sale and distribution system to be "a classic example of advertising." *Id.* at *4. Other courts, however, have reached different results on similar facts. *See, e.g., Delta Computer Corp. v. U.S. Fire Ins. Co.*, 1999 U.S. App. LEXIS 31585 (5th Cir. Dec. 2, 1999).

C. Insurance Coverage For Online Patent Infringement

To date, CGL policyholders have had little success in persuading courts to find coverage for any form of patent infringement, including that based on an offer for sale (with one notable exception in the Northern District of California), and no success under the "infringement of title" coverage. *Compare Everett Assoc., Inc. v. Transcontinental Ins. Co.*, 57 F. Supp. 2d 874 (N.D. Cal. 1999) (analyzing "misappropriation" offenses), *with U.S. Test, Inc. v. NDE Envir. Corp.*, 196 F.3d 1376 (Fed. Cir. 1999) (applying Louisiana law) (analyzing "infringement of title" offense). They have fared significantly better where the predecessor offense of piracy was at issue. *See Union Ins. Co. v. Land & Sky, Inc.*, 247 Neb. 696, 529 N.W. 2d 773 (Neb. 1995).

D. Insurance Coverage For Online Invasions of Privacy

Most successful coverage cases analyzing privacy claims under CGL policies have focused on the "personal injury," rather than the "advertising injury," offense. The former does not require the privacy invasion to bear a causal nexus to the insured's advertisements; the latter does. As long as the privacy invasion involves an oral or written publication and arises out of the policyholder's business activities, it will fall within the 1986 ISO form's personal injury coverage.

Some variant versions of the ISO policy form include express exclusions for intentional or dishonest acts. These exclusions may narrow the scope of what otherwise would be extremely broad coverage for privacy invasions. For example, a business owner's installation of a videotape camera in the women's restroom at a marina fell within the policy's personal injury coverage "arising out of . . . a publication . . . in violation of an individual's right of privacy," but he ran afoul of the policy's dishonesty exclusion, which prohibited loss due to "any act of a dishonest character." *See Commercial Union Assurance Co. v. Oak Park Marina, Inc.*, 198 F.3d 55, 59 (2d Cir. 1999). In cyberspace, intrusive conduct may be more subtle but nonetheless perpetrated with an express commercial, rather than prurient, interest.

E. Insurance Coverage For Online "Defamation"/ "Disparagement" Exposure

Again, alleged defamation and disparagement based on conduct not involving website promotional activities may more readily trigger personal injury coverage. Thus, a Pennsylvania federal district court ruled last year that allegations that a cardiothoracic surgical group engaged in a slander campaign against a physician in an effort to destroy his professional reputation and competing practice and thus monopolize the coronary graft surgical market triggered a defense. *See CGU v. Travelers Prop. Cas.*, 121 F. Supp. 2d 819, 824 (E.D. Pa. 2000). Although this case did not directly arise out of Internet activity, the coverage issues posed by commercially motivated smear campaigns, which can be readily waged in e-mail communications and through chat rooms, are analogous to the ones that the court confronted.

III. OTHER POTENTIAL COVERAGES UNDER CGL POLICIES

A. Traditional policies

1. Commercial General Liability Insurance

A typical commercial general liability ("CGL") policy provides coverage for (1) "bodily injury" or "property damage" caused by an "occurrence" and (2) "advertising injury" or "personal injury" caused by an "offense," such as libel or a violation of privacy rights. Property damage is usually defined as physical injury to tangible property, which includes the loss of that property. Advertising injury usually refers to injury arising out of an offense that occurred in the course of the insured's advertising of goods, products or services. Key advertising injury offenses within the most widely available version of this policy include "misappropriation of advertising ideas or style of doing business" and "infringement of copyright, title, or slogan." Insurers often rely on CGL policy exclusions for "advertisers, broadcasters, or publishers," the "knowledge of [the advertising's] falsity," and "first publication," to bar

coverage. Although many courts have found these common exclusions to be inapplicable to intellectual property torts, the scope of the latter exclusion is unsettled. *See Arnette Optic Illusions, Inc. v. ITT Hartford Group*, 43 F. Supp. 2d 1088, 1094, 1096-1097 (C.D. Cal. 1998).

B. Other Policy Forms That Present Coverage Opportunities

1. The Limitations of CGL Policies

ISO has significantly curtailed its CGL "personal and advertising" injury coverage in the 2001 version of its policy being submitted nationally for regulatory approval this year. Despite the absence of any reduction in premium, it limits intellectual property coverage. To wit: "Only your advertisement of copyright, trade dress or slogan" is covered. *See* LI-GL-2001-001 at p. 9. International Internet exposure for covered offenses is extended to all offenses "that take place through the Internet or similar electronic means of communication." LI-GL-2001-001 at p. 11. No coverage is provided to website designers or Internet access providers. LI-GL-2001-001 at p. 9.

CGL policies were not designed to address Internet risks and may respond poorly in that context. Instead of counting on your company's CGL policy for protection, you should give serious consideration to supplementing this traditional coverage with express cyberspace coverage. Cyberspace policies may better meet your company's business needs.

2. Cyberspace and Multimedia Risks: Cyberspace Coverage

These multimedia policies cover two areas of third-party liability that may arise on the Internet: (1) libel, slander, and defamation claims, and (2) infringement of intellectual property rights. They generally do not provide violence and hacker coverage or E&O coverage. They fill the gap created by CGL policy exclusions for publishing and broadcasting and media services. Although you can expect pertinent exclusions and other endorsements to exclude coverage available in a given factual scenario – typically for patent, trade secret, and antitrust claims – you will find the scope of the insuring grant in these policies a good place to start negotiating desired coverage (see sidebar for a list of cyberspace coverage vendors).

Vendors for "Cyberspace" Coverage

INSUREtrust.com
Multimedia/Cyberspace/E-Business Insurance Policies
www.insuretrust.com

Steadfast Insurance Brokerage Co.*
Information Technology Professional Liability
www.steadfast.com.au

Marsh
"CyberLiability Plus Insurance Policy"
www.marshmac.com

St. Paul
Cyber-Tech+ Liability Policy
www.usfg.com/wwwstpaul/static/index.htm

Reliance National Insurance Cos.*
Specialty-based e-commerce coverage and
www.reliancenational.com/mpl

3. Internet Security, Crime, Kidnap, and Ransom Policies: Net Secure Coverage

Internet security policies cover lost website and advertising revenue due to unauthorized entry, viruses, or employee error; theft of credit data; first- and third-party virus cleanup; and some intellectual property claims. For example, Marsh's net secure policy addresses both first- and third-party losses and is underwritten by a consortium of insurers.

Vendors for "Net Secure" Coverage

AIG - American International Specialty Lines Insurance Co.
Internet Security Liability Policy (ISL)
www.accessaig.com

Media/Professional Insurance Agency, Inc.
Cyber Liability Plus™ Insurance Policy
www.mediaprof.com

Chubb Insurance Co.
Safety'Net Internet Liability Policy
www.chubb.com

Zurich Reinsurance (parent company)
ZC Specialty Ins. Company - E- Risk
www.zurichre.com/zrna/

J. S. Wurzler Underwriting Managers
"WISP"-Website Breach Security Losses
www.jswum.com

4. Intellectual Property: Intellectual Property Coverage

Intellectual property coverage protects against the loss of proprietary information or software through deliberate or inadvertent misappropriation. Some carriers also offer expanded intellectual property coverage for companies doing business on the worldwide web. Policy forms cover both offensive prosecution as well as defensive litigation expenses.

Coverage of the latter type can be particularly important to companies that have a significant value tied up in their IP assets, especially those that lack the resources to aggressively pursue infringers. Pursuit insurance can eliminate this risk and has funded two cases that reached the U.S. Supreme

Court.

Vendors for Intellectual Property Insurance Coverage

A. Offensive Policies:

Hartford Financial Services Group, Inc.
www.thehartford.com

B. Defensive Policies:

ACE
www.ace-it.com

AIG - American International Specialty Lines Insurance Co.
www.accessaig.com

Chubb Atlantic Indemnity Ltd.
www.chubbatlantic.bm

Marsh
www.marshmac.com

Swiss Re
www.swissre.com

C. Offensive and Defensive Policies:

CNA
www.cna.com

IPISC
www.ipisc.com

Litigation Risk Management
www.lrm.com

IV. FACTORS TO CONSIDER IN PROCURING AND USING INSURANCE

A. Checklist of Factors to Address in Procuring Policies

When deciding which cyberspace or net secure policy to procure to supplement your company's coverage portfolio, keep the following points in mind:

1. Avoid policies that insurers can cancel for any reason.

2. Make sure that the policy covers sublicensees, subsidiaries, affiliates, joint venturers, subcontractors, and distributors.

3. Avoid policies that automatically cancel coverage in the event of a merger or acquisition.

4. Procure policies with worldwide territorial coverage.

5. Obtain a policy with no security screening as a prerequisite for coverage.

6. Avoid policies with a breach of contract exclusion.

7. Obtain insurance policies with limits high enough to address the legal fees and/or settlement exposure that the referenced risks warrant.

8. Make sure the definition of a claim encompasses as broad a set of factual scenarios as possible.

9. Make sure the underwriting requirements are reasonable and may be properly addressed by personnel within your company in a timely, cost-effective manner.

10. Procure coverage for all risks that your company wishes to insure as part of its portfolio.

11. Procure appropriate coverage in light of your company's stage of growth – consider first obtaining express intellectual property defense coverage, either through a broad CGL policy with endorsements or an express intellectual property defense package. Procure cyberspace, and net secure and if finances permit D&O policies to supplement CGL coverage, and delay E&O professional liability coverage until a more mature phase of growth.

12. Be cautious of risk management recommendations that your company accept a significant self-insured retention or co-payment obligation. The most important benefit that liability coverage provides to your company is a first-dollar defense.

B. Creation of an Insurance Coverage Protocol to Use In Assessing Whether Claims Will Trigger Coverage

Many companies fail to realize the value of insurance coverage they have procured because they have no system in place to assess when litigation triggers their rights to defense or indemnity. One solution to this problem is to create an effective Protocol that addresses these issues. Once created, the Protocol functions as an expert system. It can be accessed vis-à-vis customized software that systematically assess whether a new claim should be reported, and if so when, to whom, and what facts should be addressed to secure coverage. The Protocol should be as comprehensive as the risks addressed and company resources warrant and be updated as frequently as necessary to track developing law that impacts the policy language at issue.

V. CONCLUSION

This is a dynamic time for policyholders facing a plethora of Information Age risks. Development of customized Protocol in responding to risks posed by litigation can allow companies to avoid the loss of pre-tender fees and integrate insurance reimbursement into their oversight of litigation activities.

Savvy corporate counsel will assure that the potential litigation exposure of their company governs the choice of its insurance policies. Many risks may not trigger net secure and cyberspace policies. But the significant exposure

posed by cyberspace perils calls for having proactive, offense-based coverage in place before it is needed.

CURRENT COVERAGE CASES

Gauntlett & Associates represented the successful policyholders in the *Lexmark* and *Concept Enterprises* actions.

Lexmark Int'l, Inc. v. Transportation Ins. Co.; American Motorists Ins. Co., No. 99-CH 0003525, Circuit Court of Cook County, Ill., Chancery Div. (Jan. 19, 2001) (On January 19, 2001, Judge Foreman, of the Circuit Court of Cook County, Illinois, Chancery Division, found that a duty to defend was owed to Lexmark in an action brought against it by BDT Products, Inc. At issue were claims for trade secret misappropriation, including fact allegations suggestive of disparagement and unfair competition. No express cause of action was alleged under these labels. There was no use of the express terms "disparagement" or "unfair competition" in the pleadings.

BDT complained that Lexmark attempted to market it newest printer engine in a manner that confused OEM purchasers as to its source of origin. The court rejected the carrier's argument that the gravamen of the case was simply about misappropriation of BDT technology and could not include the manner and mechanism in which that technology was promoted to the Lexmark customer base. Of key interest to the court were the following allegations from the underlying complaint: "Lexmark product announcements" were "in language almost identical to BDT's promotional literature" which trumpeted Lexmark's "Industry Leading Paper Handling," and Lexmark's ability to "support the widest variety of media including challenging labels, signage and card stock." This case is presently on appeal.)

Concept Enterprises, Inc. v. Hartford Ins. Co. of the Midwest, No. CV 00-7267 NM (JWJx), 2001 U.S. Dist. LEXIS 6901 (C.D. Cal. May 22, 2001) (In what is believed to be the first decision of its kind nationally, Judge Nora M. Manella ruled that Hartford's demand that its insured allocate its defense fees incurred between covered trade dress and uncovered patent infringement claims was a breach of the duty of good faith and fair dealing, justifying a finding of bad faith as a matter of law. Under California law, Hartford therefore had to pay all reasonable attorneys' fees incurred by coverage counsel in proving that Hartford's duty to defend extended to the complete lawsuit pursuant to *Brandt v. Superior Court*, 37 Cal. 3d 813, 817 (1985).

Gauntlett & Associates recovered $751,500 out of $810,000 total fees and prejudgment interest incurred in the underlying and coverage action, pursuant to a non-confidential settlement.

QSP, Inc. v. Aetna Casualty & Surety Co., Nos. SC16269, SC16270, 2001 Conn. LEXIS 181 (Conn. May 31, 2001) (Justice Sullivan, speaking for a unanimous court and applying Connecticut law, found that no duty to defend arose for claims in an underlying class action antitrust lawsuit filed in federal court.

At issue were the Bishop plaintiffs' claims "that they were deprived of substantial magazine fund-raising revenues that they otherwise would have received if there were competition in the market." *Id.* at *6.

The court found no defense arose because "the *Bishop* plaintiffs were not the parties about whom the defamatory statements allegedly had been made by QSP and Reader's Digest, nor had the *Bishop* plaintiffs suffered any harm to their reputation from the alleged defamation." *Id.* at *23. The court intimated that had the action been brought by QSP's competitors, a different result would attend.

The court's analysis flowed from its questionable assumption that each of the offenses are "torts" and that the elements to state liability under each of these "torts" must be asserted in order for there to be a defense obligation.

Hugo Boss Fashions, Inc. v. Federal Ins. Co., Nos. 00-7826(CON), 00-7884(XAP), 00-7824(L), 2001 U.S. App. LEXIS 12080, 2001 WL 636929, ___ F.3d ___ (2d Cir. June 8, 2001) (The court, applying New York law, affirmed a jury award of $500,000 for defense costs associated with the BMC action, finding it reasonable even though the

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total fees incurred were $1,723,819.64, of which $12,000 at most were expended in defense of a non-insured party, HB Germany, and $200,000 for funds expended in hammering out the settlement with BMC. The court found no indemnity appropriate for the $2,000,000 paid in settlement, which sums arguably included expansion of Hugo Boss's rights under a concurrent use agreement with BMC.

Interpreting the "trademarked slogan" exception to an exclusion for claims of trademark infringement, the court found that the "Boss" label on Hugo Boss clothing was not a slogan since it was either a "housemark" such as "Ford" or a "product mark" such as "Mustang," rather than a phrase like "Just Do It," which would qualify as a slogan.

The court cited *Blau Plumbing, Inc. v. S.O.S. Fix-It, Inc.*, 781 F.2d 604, 609 (7th Cir. 1986) as authority for its view that the policy language only applied to a trademarked "slogan" together with a trademarked "combination of words and symbols, an ornamental feature, [or] a distinctive shape" as "something . . . intended to remind the consumer of the brand."

As the law was unsettled as to this issue when the claim was tendered, however, a right to a defense nonetheless arose. This followed because "there are situations in which a legal uncertainty as to insurance coverage gives rise to (an at least temporary) duty to defend." *Id.* at *39.)

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. The first supplement for the book was released in April 2000. Another was issued in April 2001; a further one is in process. Both the book and the supplement 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

Tort Claims and Insurance in Cyberspace: Is Your Company Covered? American Corporate Counsel Association Docket ("ACCA"), Vol. 19, No. 5 (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

Intellectual Property Cases Under "Advertising Injury"/"Personal Injury" Coverage and its Implications for e-Commerce, New Matter, Vol. 25, No. 3/4 (Fall 2001)

UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

David A. Gauntlett will host a special luncheon CLE seminar entitled *"Coverage for IP and Antitrust under the 'Advertising Injury' Clause of Standard CGL ISO Policies,"* on July 30, 2001 at Finnegan, Henderson, Farabow, Garrett & Dunner, LLP in Washington, D.C.

ABA IPL Summer Conference - June 27 - July 1, 2001 - Seattle Sheraton Hotel - Seattle, WA. David A. Gauntlett is attending in his continuing role as chair of the IP Section 654 Insurance Coverage Committee.

6th Annual Insurance Law Institute - Sept. 5-7, 2001, Austin, Texas (David A. Gauntlett is a scheduled speaker)

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.