

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

NEWSLETTER

Volume 6, Issue 4: Summer 2002

Insurance Coverage Implications of Settling Intellectual Property Disputes: Pitfalls and Opportunities

I. THE BUSINESS PROBLEM

In the complex world of high-stakes intellectual property and antitrust coverage litigation, the precise language used in the settlement of these disputes has insurance coverage implications. An insurer which owes its policyholder a defense has a duty to settle claims brought against its policyholder.

Intellectual property attorneys may fail to recognize the importance of drafting the settlement agreement in a manner that ensures its client will receive the maximum benefit from its



insurance. The following settlement agreement provisions may raise coverage problems:

- Inclusion of a license for ongoing conduct;
- Reference to defendant's rights to affirmative claims for attorneys' fees against the plaintiff and characterizing the settlement as in lieu of same;
- The failure to allocate a portion of the settlement related to past damages as opposed to future business benefits where ongoing use of licensed goods, products or services is envisioned.

II. LEGAL ANALYSIS

A. Settlements Which Confer Business Rights on Alleged Infringers Through License Provisions May Require Allocation Where a Business Benefit is

Conferred on the Settling Party

Settlements should recite that monies paid are for past damages. If a prospective license fee is negotiated, and ongoing use of products or

GAUNTLETT & ASSOCIATES THE POLICYHOLDER ADVOCATE

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

Specific services offered include:

1. IP insurance coverage litigation
2. IP litigation
3. Expert witness on ins. coverage issues, including fee disputes
4. Counsel to IP case-in-chief counsel for ins. coverage, including:
 - Choice of forum, and
 - Negotiation
5. Consultant to corporations regarding what type of policies to purchase to protect against IP litigation
6. Representation in arbitrations and mediations
7. Legal malpractice defense - as expert and percipient witness
8. Ins. IP issues appellate practice

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

DAVID A. GAUNTLETT Editor
NAJWA TARZI Asst. Editor
TELEPHONE (949) 553-1010
E-MAIL marketing@gauntlettlaw.com

In This Issue

INSURANCE COVERAGE IMPLICATIONS OF SETTLING INTELLECTUAL PROPERTY DISPUTES: PITFALLS AND OPPORTUNITIES Page 1

THE "KNOWLEDGE OF FALSITY" EXCLUSION SHOULD HAVE NO APPLICATION TO INTELLECTUAL PROPERTY CLAIMS Page 3

PUBLICATIONS BY DAVID A. GAUNTLETT Page 4

UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY .. Page 4

services covered by the license will occur, some allocation of settlement payments to that business benefit should be made. Absent a conferral of business benefits to the insured, a non-defending insurer or an insurer who refuses to fund a reasonable settlement may be liable for the full amount of a settlement even if it includes uncovered claims.¹

In *Zurich Ins. Co. v. Killer Music, Inc.*, 998 F.2d 674, 679 (9th Cir. 1993) the court stated, “We recognize that the settlement agreement represents, in part, an exchange of cash consideration for the rights to Pfeifer’s songs, not simply compensation for damages from copyright infringement.” As a result, on remand, the court required the separation of the award into the “compensation” for rights to songs and the damages from copyright infringement. Critically, the policyholder acknowledged the viability of the underlying plaintiff’s copyright by seeking to license the right to play songs subject to copyright protection.

In *Platinum Technology, Inc. v. Federal Ins. Co.*, 282 F.3d 927 (7th Cir. (Ill.) 2002), the court found that the license components of a technology transfer in association with a settlement were a benefit that accrued to the insured which was chargeable to the insurer. The court ruled that Platinum purchased the

“Platinum” trademark, worth \$4M in the settlement/assignment agreement, and that this \$4M cash payment was not made as part of a reasonable settlement agreement to relieve Platinum of its liability from trademark infringement.²

B. Settlements That Reflect Affirmative Claims for Damages Against Underlying Plaintiffs May Unnecessarily Vest Insurers with Subrogation Rights That Preclude the Insured’s Full Settlement Reimbursement

In *TIG Ins. Co. v. Nobel Learning Communities, Inc.*, No. 01-4708, ___ F. Supp. 2d ___, 2002 U.S. Dist. LEXIS 10870, at *40-41 (E.D. Pa. June 18, 2002), the court found that fees incurred in prosecution of counterclaims against the underlying plaintiff as well as those expended in defending the copyright infringement claims were compensable.³

²*Everett Associates, Inc. v. Transcontinental Ins. Co.*, 159 F. Supp. 2d 1196, 1210 n.8 (N.D. Cal. 2001) (“[T]he insurer is not responsible for voluntary, prospective aspects of the settlement.”). See *TIG Ins. Co. v. Nobel Learning Communities, Inc.*, No. 01-4708, ___ F. Supp. 2d ___, 2002 U.S. Dist. LEXIS 10870, at *38 (E.D. Pa. June 18, 2002) (“[A]lthough the settlement agreement in the Florida action undoubtedly obligated Nobel to pay \$185,000, the extent to which this sum reflects damages flowing from the covered counterclaim is unclear. A hearing will be necessary to determine whether the settlement was in good faith and the allocation reasonable.”).

³It reasoned, at *41, “The court agrees with and follows [*Safeguard Scientifics, Inc. v. Liberty Mutual Ins. Co.*, 766 F. Supp. 324 (E.D. Pa. 1991), *rev’d in part on other grounds*, 961 F.2d 209 (3d Cir. 1992) (table)]. Although prior to the filing of the

Critically, however, once compelled to pay all defense fees including those related to prosecution, the recitals in the settlement agreement provided a pathway to the insurers to recover such fees. The settlement agreement recited that the \$175,000 was paid to Nobel

“to compensate them for a portion of their legal fees incurred in connection with the prosecution of its claims . . . in connection with the Litigation.” Because the court . . . determined that TIG is liable for the prosecution of the affirmative claims as of October 20, 2001, TIG is entitled to the setoff to the extent of \$175,000 against Nobel’s post-counterclaim fees, costs and expenses.⁴

The court therefore found that there was a right by the carrier to offset this portion of the sum from the settlement agreement against their defense obligation to avoid “double recovery” to the insured.

III. THE PRACTICE SOLUTION

The practice points are threefold:

First, where affirmative benefits are obtained in a settlement and confirmed by way of a license, allocation of the lowest amount justifiable to the rights transferred by

counterclaim TIG had no duty to defend, once copyright infringement was alleged against Nobel in the Florida action, Nobel’s affirmative claims became critical to and “inextricably intertwined” with the defense of the copyright infringement claim. As the prosecution of the affirmative claims was essential to the defense against the counterclaim, it was logically encompassed by TIG’s duty to defend Nobel.”

⁴*Id.* at *42-43.

¹*United States Fire Ins. Co. v. Green Bay Packaging, Inc.*, 66 F. Supp. 2d 987, 999 (E.D. Wis. 1999) (“Where a claim consists of a variety of acts, some of which are covered and others that are not, it is well settled that resulting liability falls within the terms of the insurance policy unless the uncovered risk is the sole cause of damages.”).

license may be advisable.

Second, where a paid-up license through the terms of a settlement agreement is negotiated, and no new rights are obtained by the defendant, the full sum should be recoverable. Recitals in the settlement agreement should clarify that the license was agreed upon to avoid continuing litigation expense and uncertainty, not because defendant attributed any independent economic value from its extension.

Third, where a counterclaim is asserted and a settlement ensues, the agreement should not reference the value of those claims that were surrendered as part of the case's resolution.

THE "KNOWLEDGE OF FALSITY" EXCLUSION SHOULD HAVE NO APPLICATION TO IP CLAIMS

IV. THE "KNOWLEDGE OF FALSITY" EXCLUSION

1986 ISO POLICY

This insurance does not apply to:

- (1) *advertising injury:*
.....
- (5) *arising out of oral or written publication of material if done by or at the direction of the insured with knowledge of its falsity*
.....⁵

⁵The predecessor version of the policy explicitly limited this exclusion to claims of libel, slander, and invasion of privacy:

1976 ISO POLICY

This insurance does not apply:

This provision excludes "oral or written publication of material whose first publication took place before the policy period." Courts have split on whether the first publication exclusion applies to all advertising injuries or only to libel, slander, and invasion of privacy. This issue arises because the predicate qualifying phrase in the definition of the policy's "advertising injury" offenses for "oral or written publication of material" does not modify the offenses for "misappropriation of advertising ideas or style of doing business" or "infringement of copyright, title or slogan." The latter offenses typically encompass a range of intellectual property torts.

V. CASE LAW FINDING THAT "KNOWLEDGE OF FALSITY" EXCLUSION DOES NOT APPLY

In *Adolfo House v. Travelers Property and Casualty Ins. Co.*, 165 F. Supp. 2d 1332, 1342 (S.D. Fla. 2001) the court, noting the existence of some contrary outcome, held that the knowledge of falsity exclusion only applies to libel, slander, and invasion of privacy. It stated:

Even if the exclusion were broadly interpreted to apply to trade dress or trademark infringement claims, this would not render it applicable here as an absolute coverage bar. Despite the fact that some of the

To personal injury or advertising injury arising out of libel or slander or the publication or utterance of defamatory or disparaging material concerning any person's or organization's goods, products or services, or in violation of any individual's right of privacy, made by or at the direction of the insured with knowledge of the falsity thereof. . . .

underlying suits' allegations are intentional in nature, the suit also asserted non-intentional grounds for relief. In such circumstances where the complaint's allegations leave open the possibility that Adolfo House might be liable for unintentional acts of trade dress infringement, it may be said that the complaint contains allegations which "fairly and potentially bring the case" within the policy coverage, thus requiring the insurer to defend the entire claim.

In *Walter L. Maddox, III v. St. Paul Fire & Marine Ins. Co.*, 179 F. Supp. 2d 527 (W.D. Pa. 2001),⁶ the court found that the language of the first publication exclusion is ambiguous because it is reasonably susceptible to more than one interpretation. The alternative reasonable interpretation – requiring the prior publication to cause the same injury as the later publication – is suggested both by the context of the language and the way others have

⁶See also *Arnette Optic Illusions, Inc. v. ITT Hartford Group, Inc.*, 43 F. Supp. 2d 1088, 1092 (C.D. Cal. 1998) (The first publication exclusion does not apply because language is ambiguous as to whether it applies to all advertising injuries or only to libel, slander, and invasion of privacy, which offenses are preceded by the "oral or written publication of material" policy language.); *Interface, Inc. v. Standard Fire Ins. Co.*, No. 1:99-CV-1485-MHS, 2000 U.S. Dist. LEXIS 14019, at *13 (N.D. Ga. Aug. 10, 2000) ("Knowledge of falsity, as a layman would read it, has nothing to do with copyright infringement. Nor is it an element of a claim for copyright infringement. . . . Whether Interface knowingly manufactured infringing carpets or publications displaying those carpets does not make the carpets or publications 'false.' This exclusion appears more relevant to coverage for claims of libel or slander.").

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

interpreted it.⁷

VI. 1998 ISO POLICY LANGUAGE CONTAINS A NEW EXCLUSION THAT IS SIMILAR IN CHARACTER TO THE "KNOWLEDGE OF FALSITY" EXCLUSION BUT IS MORE RESTRICTIVE

This insurance does not apply to:

a. "Personal and advertising injury"

(1) *Caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict "personal and advertising injury."*

In *TIG Ins. Co. v. Nobel Learning Communities, Inc.*, No. 01-4708, 2002 U.S. Dist. LEXIS 10870 (E.D. Pa. June 18, 2002), the court found it unnecessary to address the "knowledge of falsity" exclusion and instead focused on the more restrictive exclusion referenced above. It stated, "TIG argues that the relevant injury alleged against Nobel in the counterclaim is willful copyright infringement and that such is subject to the policy exclusion of 'injury which is caused by or at the direction

of the insured with the knowledge that the act would violate the rights of another and cause personal and advertising injury.'" *Id.* at *20-21. The court rejected that the above-referenced 1998 exclusionary language applied because it found that the intentional aspects of a willful copyright infringement claim were not the only basis for liability since innocent copyright infringement was implicated as an element for recovery.

PUBLICATIONS BY DAVID A. GAUNTLETT

David A. Gauntlett is the author of *Insurance Coverage of Intellectual Property Assets*, which is published by Aspen Law & Business. Both the book and the supplements 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.

UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

2002 Midwest Intellectual Property Institute, Minneapolis, MN - Sept. 20, 2002 - David A. Gauntlett will be the guest speaker on Insurance Coverage for IP claims.

FIRM MEMBERS

PRINCIPAL

David A. Gauntlett

ASSOCIATES

James A. Lowe
Eric Robert Little
Lonnie L. Kocontes
Joseph D. Bussone
Mark A. Hooper
Raymond E. Brown
Najwa Tarzi
Dave Collins
Maha J. Kasim

LAW CLERKS

Thomas J. Bayard

MARKETING COORDINATOR

John S. Keffalas

Gauntlett & Associates' **The Policyholder Advocate/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 request. G&A values its relationship with referring firms and will not take any actions inconsistent with that firm's wishes respecting a client.

For more information, contact our Marketing Coordinator, John S. Keffalas, at (949) 553-1010 x 208

E-mail: marketing@gauntlettlaw.com

©2002 Gauntlett & Associates

All rights reserved.

⁷In its discussion of the "prior publication" exception not applying to trademark violations, but only to libel, slander, or invasion of privacy injuries, the court cites to "David A. Gauntlett, *Insurance Coverage of Intellectual Property Assets* § 3.03 (Aspen Publishers, Inc. 2000) (explaining that exception should only apply to torts and not other types of advertising injury)"