

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

NEWSLETTER

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RECENT COVERAGE VICTORY BY GAUNTLETT & ASSOCIATES

The Cincinnati Ins. Co. v. Zen Design Group, Ltd., 329 F.3d 546 (6th Cir. (Mich.) 2003)

This case opens a chink in the hard armor of the Sixth Circuit, which to date has found no coverage for trademark infringement lawsuits.

The insured was sued by a competitor who alleged that the insured infringed on its trademark, a handheld LED lighting device, by advertising "The Wearable Light." The district court ruled in favor of the



insured, holding that it could not conclude that the competitor's allegations were not covered under the "infringement of slogan" portion of the policy. The court of appeal affirmed.

The court examined a Zen advertisement attached to the underlying complaint in analyzing potential coverage:

From [Zen's] advertisement, "SAPPHIRE" appears to be the name of the product, while "The Wearable Light" can easily be construed as a "catchword or catch phrase" used by the manufacturer to promote its product. See RANDOMHOUSE UNABRIDGED DICTIONARY 1800 (2d ed. 1993). Relying on other common definitions of slogan, "The Wearable Light," as used in the ASP advertisement also can be considered "[a] brief attention-getting phrase used in advertising or promotion."

Palmer v. Truck Ins. Exch., 21 Cal. 4th 1109, 1120, 988 P.2d 568, 90 Cal. Rptr. 2d 647 (1999).

Id. at 556.

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

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 - *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*
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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 KARZAI Asst. Editor
TELEPHONE (949) 553-1010
EMAIL marketing@gauntlettlaw.com

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WHAT ARE FACTS FOR PURPOSES OF COVERAGE ANALYSIS?

I. CASES ADDRESSING “FUZZY FACT” SCENARIOS WHERE THE QUESTIONS ASKED BY THE POLICY ARE NOT DIRECTLY ANSWERED BY THE COMPLAINT REQUIRE FACT DEVELOPMENT BEYOND THE PLEADINGS TO CLARIFY WHETHER THE SCOPE OF ALLEGATIONS WILL TRIGGER A DEFENSE

In seeking to structure pleadings that either fall inside or outside of coverage, it must be remembered that it is facts, not labels of causes of action, that trigger a defense. *Cincinnati Ins. Co. v. Eastern Atlantic Ins. Co.*, 260 F.3d 742 (7th Cir. (Ill.) 2001).

Where the facts pled, however, are insufficient to determine if coverage exists, various methods must be pursued to clarify the extent of potential coverage. Discovery may be used in the underlying action to elucidate the basis for the claims asserted in ways that help answer questions asked by the policy. It is critical that discovery occur as part of the defense effort and not be characterized as a direct question to the plaintiff about whether its claims trigger insurance since it is facts that precipitate coverage, not the legal conclusions of the plaintiff about whether that may or may not be the case. See *Shower Spa v. ITT Hartford Ins. Group*, No. G028329, 2002 Cal.

App. Unpub. LEXIS 7493 (Cal. (4th App. Dist.) Aug. 7, 2002)

In a recent decision, *Fireman’s Fund Ins. Co. v. Bradley Corp.*, 660 N.W.2d 666 (Wis. 2003), the Wisconsin Supreme Court reversed the Court of Appeals’ ruling but affirmed the trial court in finding that the insured was entitled to a defense. At issue were claims for unfair competition as well as trade secret misappropriation which encapsulated a factually viable claim for trade dress infringement. The court reasoned:

We disagree with the Insurance Company. It is not dispositive that the specific words “trademark” and “trade dress” are not included in the complaint or that neither the complaint nor Bradley identifies a single distinguishable, non-functional feature of the mixing valve system that could be the subject of a trade dress claim. Allegations in a complaint are to be liberally construed when ascertaining whether a duty to defend exists and a reviewing court is obliged to make reasonable inferences based on the complaint’s language.

Id. at 677-78.

In *Bradley*, the key inference was that a potential claim for trade dress infringement was viable even though no labeled cause of action for same was asserted. The *Bradley* court found it significant that Count VII of the complaint alleged relief under Section 43 of the Lanham Act, which the court found was a statutory section permitting recovery for trade dress infringement. Critically, the

complaint alleged that the wrongful acts included misappropriation of “Trade Secrets, technologies and designs.” The insurer’s reading of the complaint gave no significance to the separate reference to designs and did not draw appropriate inferences.

As the court remarked:

Lawler alleges that Bradley’s use of its protected designs has led to “a false designation of origin” and a “false description or representation,” and “falsely designates the origin of Lawler’s thermostatic mixing valve technology as originating from or being connected with Bradley [which] amounts to using a false description or representation in commerce.”

Id. at 677.

The Court of Appeals’ more literal and ungenerous reading of the complaint is typical of that followed by a number of courts which have found no potential “advertising injury” coverage absent specific fact allegations which delineate with particularity all the elements of a claim against the insured that would clarify why coverage arose. The practical impact of this narrow approach by a number of courts in addressing “advertising injury” coverage is to ensure that only guilty tortfeasors ultimately obtain both defense and indemnity benefits. That is because the specific conduct which will establish liability will also clarify why coverage arises.

Where true facts exist to establish liability in a way triggering coverage, a defense will become more

evident. The insurers often argue that where the tortfeasor's acts are intentional and committed with an intent to harm, public policy should preclude any defense, much less indemnity. The insurer's natural construction of the policy tends to render coverage illusory since there is insufficient factual specificity to trigger a defense where the tortfeasor is not guilty, and if guilty its conduct is deemed to possess a form of scienter which is incompatible with the extension of insurance coverage. Most courts, however, have found that "advertising injury" coverage is not vitiated by mere allegations of intentional conduct. *See Villa Enterprises Management Ltd. v. Federal Ins. Co.*, No. MRS-L-1131-01, 2002 N.J. Super. LEXIS 540, at *28 (N.J. Super. Law Div. Morris Cty. Oct. 11, 2002); *Northern Virginia Funeral Choices, Inc. v. Erie Ins. Co.*, Chancery No. 163598, 2003 Va. Cir. LEXIS 59, at *12 (Va. Cir. Ct. Fairfax Cty. Mar. 21, 2003).

II. FRIVOLOUS, FALSE AND GROUNDLESS CLAIMS ENTITLE THE INSURED TO A DEFENSE

Intellectual property counsel may encounter difficulties in proving a defense for claims asserted against them which are false, frivolous or groundless. Nevertheless, Commercial General Liability policies either explicitly or by implication require a defense of such claims. *Horace Mann Ins. Co. v. Barbara B., et al.*, 4 Cal. 4th 1076, 1086 (1993).

The difficulty, however, is that where the facts asserted in the complaint are unclear vis-à-vis the issues raised by the policy, an insured

cannot supplement that record by reference to facts it knows to be true. An insured cannot clarify the factual basis for the claims in a manner that triggers a defense where there are no supporting facts consonant with the theory asserted against the insured.

III. THE CLAIMS ASSERTED IN A SUIT ARE THEMSELVES "FACTS" IN EVALUATING POTENTIAL COVERAGE

There are two distinct sources for drawing inferences favorable to coverage in a pleading: First, actual fact allegations which can clarify answers to policy questions. While facts, not labels, are determinative in establishing a defense, the claim for relief can necessarily clarify what the elements of recovery would be and, viewing the facts asserted in light of such claims for relief, proper inferences can be drawn to establish why defense rights accrue. In *Bradley Corp.*, the court noted, "[A] duty to defend is based upon the nature of the claim and not on the merits of the claim." *Id.* at 674.

Second, the actual articulated theories of recovery. The court gave meaning to that statement when the court reasoned that Count VII, entitled "Federal Unfair Competition," alleging violation of Section 43 of the federal Lanham Act (15 U.S.C. § 1125), permitted relief for trade dress infringement even though no fact allegations of same were specifically asserted. The allegations allege misappropriation of "Trade Secrets, technologies and designs relating to thermostatic mixing valves" and the use thereof in connection with the accused products. The court inferred that the word

"designs" referred to something apart from trade secrets and misappropriated technology and possibly reached distinguishing nonfunctional items in the mixing valve systems despite the fact that neither the complaint nor the insured ever identified a single distinguishing nonfunctional feature of the mixing valve system that could possibly be the subject of a trade dress claim. *Id.* at 677.

Insurer attacks on the alleged pleadings as limited to functional patent infringement claims were dismissed as not inconsistent with a trade dress claim phrased as an alternative count. The *Bradley Corp.* court also found that allegations of theft of patented functional designs were not inconsistent with proof that the valves sold also included a misappropriated distinctive nonfunctional design. It noted critically that:

Pleading rules permit plaintiffs to plead inconsistent theories for relief. Thus it is not essential that all allegations be construed harmoniously.

Id. at 678.

IV. THE TEXAS EXPERIENCE

In Texas, courts will determine whether a duty to defend exists by applying the "eight corners" rule. Under this approach, the duty to defend is determined by comparing the "four corners" of the complaint with the "four corners" of the insurance policy.

Where the allegations of the complaint are ambiguous in neither

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clearly establishing or negating potential coverage, the court may look beyond the pleadings and policy language, particularly where the applicability of an exclusion is pertinent. A number of Texas cases have therefore held that the insurer or insured may supplement the “four corners” of the petition by introducing extrinsic evidence to determine if a duty to defend exists.

V. CONCLUSION

The practice points for IP litigators are three-fold:

First, where the character of the asserted claims does not answer questions raised by the insurance policy one way or the other, care should be taken to clarify the nature of fact allegations asserted in the pleadings and to answer the following questions: What was the insured’s advertising? Was an advertising idea allegedly used by the insured? Is liability sought to be attached in such a way that the advertising conduct of the insured would independently create liability under the claims asserted?

Second, discovery should be used to clarify the pertinent role that advertising creates in establishing liability under the claims asserted so as to establish damages as well as relief under the articulated claims.

Third, where the case is settled, care should be taken to clarify fact assertions at the time of settlement to answer the above questions in a way that would implicate coverage.

PUBLICATIONS BY DAVID A. GAUNTLETT

David A. Gauntlett is the author of *Insurance Coverage of Intellectual Property Assets* published by Aspen Law & Business. 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/ARTICLES ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY

August 7-12, 2003 - ABA Annual Meeting - San Francisco, CA

September 14-16, 2003 - Intellectual Property Owners Association Annual Meeting - Chicago, IL (David A. Gauntlett is the Vice-Chair of the Insurance Committee)

September 26, 2003 - Licensing Executives Society - Salt Lake City, UT - David A. Gauntlett Speaking re Obtaining IP Insurance

David A. Gauntlett is on the Editorial Board of IRMI’s CGL Reporter and Summarizes Insurance Coverage Case Law

David A. Gauntlett Also Authors a Monthly Article on Insurance Coverage Issues for the Licensing Journal

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For more information, contact our Marketing Coordinator, John S. Keffalas, at (949) 553-1010 x 208
Email: marketing@gauntlettlaw.com

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