

# THE POLICYHOLDER ADVOCATE/IP COUNSELOR

## NEWSLETTER

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### TEN MOST COMMON MISTAKES CORPORATIONS MAKE RE INSURANCE CLAIMS FOR INTELLECTUAL PROPERTY INFRINGEMENT AND ANTITRUST

#### 1. COMPANIES DO NOT TENDER INSURANCE CLAIMS FOR INTELLECTUAL PROPERTY OR ANTITRUST. THESE ARE THE MOST UNDER-TENDERED CLAIMS IN AMERICA

Unless a policyholder knows the claim is not covered and can definitively opine why, it is typically in its interest to promptly give notice of a claim. This is for **five** reasons:

**First**, policy provisions require it.

**Second**, where insurers learn of lawsuits that are not reported, they may claim that subsequent policy applications are inaccurate for failing to disclose same.

**Third**, cancellation for mere claim reporting may be bad faith in many jurisdictions.

**Fourth**, the mere reporting of the claim is not a loss, and may never be a loss, unless the insurer is required to pay sums owed to the insured under the policy.

**Fifth**, if insurance is never used, there is little point in having it in place.

If notice can be established, the benefits to pursuit of claims that the insurer was apprized of can be significant. A number of states have written contract statutes of limitations of significant length: **Alaska, California, Rhode Island, Texas** and **Vermont** (four years); **Florida, Kansas** and **Idaho** (five years); **Wisconsin, Washington, Utah, Pennsylvania, Oregon, New York, New Jersey, Nevada, New Mexico, Minnesota, Michigan, Massachusetts, Maine, Arizona, Alabama** and **Hawaii** (six years); **Iowa, Illinois, Louisiana** and **Wyoming** (ten years). **Indiana**, at 20 years, holds the record, with **Kentucky** a close second at 15 years.

#### 2. COMPANIES TENDER CLAIMS FOR INTELLECTUAL PROPERTY AND ANTITRUST TOO LATE. BECAUSE OF STATE INSURANCE LAW REGARDING PREJUDICE, CLAIMS MAY BE DENIED IN THEIR ENTIRETY

As policyholder insurance coverage counsel, we have had occasions where we have had to impart bad news to clients that forfeited recovery of pre-tender fees because of the "voluntary payments" provision in their Commercial General Liability policies. This was true even though there was a clear defense duty under the policy. See *Ivan Insua v. Scottsdale Ins. Co.*, 104 Cal. App. 4th 737, 743 (2002) ("[The voluntary payment provision] typically bars 'reimbursement for pre-tender expenses based on the reasoning that until the defense is tendered . . . there is no duty to defend.'"). In some jurisdictions, such as Illinois, Georgia and New York, where a draconian late notice rule applies, the consequence of a mere month's delay in notice may result not only in the loss of pre-tender fees, but of any coverage at all.

Nevertheless, not all policies contain “voluntary payments” provisions, and variant policy provisions available in umbrella policies can give rise to coverage. *See Powerine Oil Co., Inc. v. Superior Court of Los Angeles County*, 128 Cal. App. 4th 827 (2002) (addressing “Ultimate Net Loss” definition of “damages and expenses” which provided coverage for environmental cleanup expenses not available in standard form primary policy).

### **3. COMPANIES RELY ON INSURANCE BROKER’S ANALYSIS OF COMPLEX INSURANCE POLICY LANGUAGE REGARDING INTELLECTUAL PROPERTY AND ANTITRUST CLAIMS. FURTHER, INSURANCE BROKERS GIVE PERFUNCTORY VERBAL ANALYSIS OF THESE COMPLICATED CLAIMS**

The client’s insurance broker cannot render legal opinions. Even if the broker handles claims activities as well as marketing insurance products, the broker will rarely be knowledgeable about court opinions analyzing coverage. The net effect is that many policyholders may misperceive their prospects for obtaining coverage and by their non-tender eliminate any potential coverage that might otherwise arise.

### **4. COMPANIES DO NOT READ THEIR INSURANCE POLICY LANGUAGE THOROUGHLY**

Notice to a broker may not be notice to an insurer or, more critically, to all the insurers who need to receive notice based on when the first alleged wrongful act occurred. We have represented policyholders whose corporate counsel, before we were retained, sent notice to the broker, which their D&O insurer claimed was the policyholder’s agent for receipt of claims. Those insurers pointed out that the policy reflected that notice must go directly to the insurer’s designated agent for service of process at a location reflected in the policy. Fortunately, the D&O carrier had received direct notice of the claim in connection with its renewal of coverage. Absent that fact the deficient notice only to the broker but not the insurer could have barred any coverage under that policy.

### **5. COMPANIES DO NOT KEEP ALL OF THEIR OLD INSURANCE POLICIES**

Intellectual property, as well as antitrust, cases often do not state with particularity the date when the first alleged wrongful acts occurred that created liability. They may include general allegations such as “on or before x date,” “within the last several years,” or “at a time within the applicable statute of limitations for the claim of x.” In such circumstances, both brokers and policyholders are ill-equipped to assess how many policies will be triggered or what layers will be implicated for occurrence-based coverage.

While discovery propounded in the underlying action or careful attention to additional facts that come to light in pleadings may answer these questions, direct communications to the claimant’s counsel may elucidate these issues, even without the need for formal discovery. Once these facts are ascertained, the appropriate policies to be implicated can be identified. A recent California Supreme Court case suggests that the identification of the policy’s coverage can be assessed by constructive evidence of its existence sufficient to permit coverage. *See Dart Indus., Inc. v. Commercial Union Ins. Co.*, 28 Cal. 4th 1059, 1069-1070, 124 Cal. Rptr. 2d 142, 151-52 (2002).

What happens where a policyholder cannot locate earlier insurance policies? One recourse is to hire archeological specialists who seek to produce policies through investigatory techniques honed over years of practical experience. Insurance Archeology Group, [www.iagltd.com](http://www.iagltd.com), (“IAG”) is such a company, as is Risk International, [www.riskinternational.com](http://www.riskinternational.com) (“RI”). Other practical techniques include:

- Search of home office and off-site storage facilities, as well as broker records.
- Review of accounting and banking records referencing the purchase of insurance, specifically the policy number, premium and name of carrier for whom the policy was purchased.

- Consulting proof of insurance records in connection with lease, real estate, goods transportation and employee bonding requirements.
- Tax records and bookkeeping records.
- References to prior claims and/or coverage litigation.
- Direct application to the state insurance commission for certificate of facts or information about policies. *See California Insurance Code §§ 12950-12955.*
- Conferences with executives in charge of the insurance function at the time the alleged bad acts occurred.

If none of the above suffices, then review of industry groups and carriers likely to be used by companies in the line of business of the insured can suggest carriers to whom notice can be forwarded, who may have records of the insured and may acknowledge a policy's existence.

## 6. THE LEGAL AND RISK MANAGEMENT DEPARTMENTS OF MANY COMPANIES HAVE INCONSISTENT GOALS AND DO NOT COMMUNICATE IN PROTECTING THEIR OWN TERRITORY AND BUDGETS, WHICH OFTEN ADVERSELY IMPACTS THE OVERALL CORPORATE MISSION FINANCIALLY

In a "hard market" many brokers and risk managers suggest that policyholders would be better off not giving notice to their insurers of claims, even if they are potentially covered, so as to avoid higher renewal costs. Electing to not provide notice is problematic for **five** distinct reasons.

**First**, cash flow recognized from defense fee reimbursement in such cases can be significant.

**Second**, insurance brokers risk exposure for errors & omissions when they do not report claims which may be potentially covered of which they are aware. *See Broker Exposure to Intellectual Property and Antitrust Lawsuits* by David A. Gauntlett, [www.gauntlettlaw.com](http://www.gauntlettlaw.com), **CGL Reporter Spring 2002 (14) pp. 1400-1-1400-8.**

**Third**, neither brokers nor risk managers **may** have evaluated the correct insurance program at issue since it is often difficult to discern when the first alleged wrongful conduct occurred which might trigger liability.

**Fourth**, most jurisdictions follow the rule that a narrowing of insurance coverage, not brought to the insured's attention, may not be effective. Thus, pre-wrongful acts inception policies must also be reviewed.

**Fifth**, business litigation exposure is but one of the liability risks to be assessed upon renewal. Anecdotal evidence reveals that premium adjustments rarely occur in connection with this claims activity. Broker advice to the contrary is suspect in light of broker conflicts of interest. *See Friday, October 15, 2004 Wall Street Journal Article "Spitzer Charges Bid Rigging in Insurance."*

## 7. COMPANIES OFTEN ACCEPT UNREASONABLY LOW INSURANCE COMPANY REIMBURSEMENT RATES FOR INSURANCE COMPANY "PAID FOR" ATTORNEYS, SUCH AS THROUGH PANEL COUNSEL, WITHOUT EVEN CHALLENGING THE INSURANCE COMPANY REGARDING THE REASONABLENESS OF SUCH FEES

The question policyholders need to ask is how they can 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” 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.

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? Or where an insurer funds 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. In such forums, 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 this pursuit.

## **8. COMPANIES DO NOT OPTIMIZE THE CHANCES OF FINDING THE MOST FAVORABLE FORUM AND “CHOICE OF LAW” FOR THEIR UNIQUE SITUATION**

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 state’s 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 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.

## **9. COMPANIES OFTEN DISMISS COUNTS IN A LAWSUIT EARLY ON TO NARROW THE SCOPE OF THE LITIGATION. HOWEVER, THE COUNTS THAT ARE DISMISSED MAY BE THE VERY ONES THAT WILL TRIGGER INSURANCE POLICY COVERAGE**

Defense counsel should not eliminate coverage by seeking to dismiss potentially covered claims. Thus in *Winklevoss Consultants, Inc. v. Federal Insurance Co.*, 11 F. Supp. 2d 995, 998-999 (N.D. Ill. 1998), the insured made

false statements to steer customers away from Lynchval's product. Winklevoss' promotional materials falsely advertised capabilities of its software, drew adverse comparisons to Lynchval's software, and made false comparative statements about the speed of its software. Such claims satisfied the layman's definition of "disparagement." Nevertheless, dismissal of underlying action's Count for common law product disparagement did not rid the complaint of all allegations which may fit within the covered offense of "disparagement." Distinctly labeled causes of action for "false advertising" that relied, in part, upon disparaging statements triggered a defense duty.

Additionally, litigants can eliminate or create coverage for the party sued. *See Severin Montres, Ltd. v. Yidah Watch Co., et al.*, USDC, C.D. Cal., No. 97-6985 KMW (MANx) (Lyon & Lyon's initially filed complaint triggered defense rights for the parties sued. Following costly litigation, Gucci gave its counsel permission to amend its complaint as follows: "That plaintiffs have such other and further relief as the court may deem just and equitable (except monetary damages, which are forever waived)." Following amendment, Yidah Watch Co.'s insurer promptly withdrew its defense.).

## **10. COMPANIES OFTEN DO NOT HAVE A FORMAL WRITTEN, WELL-COMMUNICATED INSURANCE CLAIM PROTOCOL AND USE AD HOC PROCEDURES, OFTEN "AFTER THE FACT." EVEN THE AD HOC PROCEDURES ARE NOT USED CONSISTENTLY. THE EXPRESSION "I'LL CHECK IT OUT IF I HAVE THE TIME" IS OFTEN HEARD WITH RESPECT TO INSURANCE CLAIMS**

This is a dynamic time for policyholders facing a plethora of information age risks. Development of a customized protocol to respond 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. 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 using customized software that systematically assesses 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.

Protocols should be in place to alert insureds when they are susceptible to penetration so that they can properly alert carriers. Indeed, some carriers may require, by policy language, notice when 50% of the amount of the SIR is expended. They may also need assistance of coverage counsel to determine how many policies are implicated and how far back. ■

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### **PUBLICATIONS BY DAVID A. GAUNTLETT**

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David A. Gauntlett is the author of *Insurance Coverage of Intellectual Property Assets* published by Aspen Law & Business. The book and supplements are available for \$160.00 plus tax where applicable; shipping and handling are free when full payment is enclosed with the order. To order, call Aspen Law & Business at 1-800-638-8437.

## UPCOMING SEMINARS ON INSURANCE COVERAGE AND INTELLECTUAL PROPERTY WHERE DAVID A. GAUNTLETT IS SPEAKING OR ATTENDING

- *September 11-13, 2005* - IPO Annual Meeting - Seattle, Washington
- *September 25-30, 2005* - IBA Annual Meeting - Prague, Czech Republic
- *October 20-23, 2005* - CILS, Center For International Legal Studies, Boston, Mass. - David A. Gauntlett is a featured speaker. His presentation is entitled: Funding the Defense As Well As Pursuit of Internet/E-Commerce Litigation: Insurance For U.S. and International Companies
- *February 16-18, 2005* - ABA Section on Insurance Coverage Litigation Meeting - Marina Del Rey, California
- *April 23-27, 2005* - RIMS ANNUAL CONFERENCE - Honolulu, Hawaii - David A. Gauntlett is a featured speaker. His presentation is entitled: Bringing the Insurer to the Table in Intellectual Property Litigation.

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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.*

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