

THE POLICYHOLDER ADVOCATE/IP COUNSELOR

NEWSLETTER

Volume 11, Issue 1: Winter 2007

G&A OBTAINS 100% REIMBURSEMENT OF DEFENSE FEES IN ANTITRUST LAWSUIT FOR A FORTUNE 100 COMPANY

Gauntlett & Associates obtained a recommended order from a Special Master in December 2006 finding that ACE Property & Casualty Insurance Co. (ACE) owes defense expense reimbursement to a Fortune 100 company in the amount of nearly \$25 million. Our client won after a long jury trial in 1999, paying high defense costs. The federal judge referred to a Special Master the determination of “what expenses ‘would be conducted against liability by a reasonable insured under the circumstances.’ ”

The Special Master found that ACE failed to meet its burden of proving that any of the expenses were unreasonable or unnecessary. The Special Master’s report is now being considered by the District Court along with consideration of the award of prejudgment interest that now totals over \$20 million. ACE thus faces a potential judgment of over \$45 million.

THE DUTY OF DEFENSE REQUIRES COURTS TO LOOK BEYOND THE MERITS IN ASSESSING THE TRUE SCOPE OF “POTENTIALITY”

I. INTRODUCTION

What one judge may categorize as “speculation,” another judge may find falls within the scope of “potentiality.” Potentiality requires a focus on any set of facts consistent with the claims pled that would not trigger exclusion but would still have the coverage provisions implicated. It matters not if the allegations are frivolous, groundless or false or would bar coverage if proven as alleged. The dividing line depends upon what facts may be reviewed in evaluating whether a defense is due.

Depending upon the forum, this may include the facts alleged in the current complaint, the four corners rule (the law in Florida and Texas); facts known to the insurer (the law in Illinois and New York); or facts available to the insurer, implicating a duty to investigate (the law in California and Massachusetts) (where facts “knowable” to the insurer are pertinent).

II. IN ASSESSING POTENTIAL COVERAGE IN “FACTS AVAILABLE” FORUMS, THE FOCUS IS ON THE PERTINENT FACTS THAT EVIDENCE HOW LIABILITY WILL ATTACH IN THE UNDERLYING ACTION

A. A Claimant’s Poor Draftsman Skills Cannot Avoid a Finding of Potential Coverage

An insurer is excused from defending only where “the basis for claiming potential liability under the policy is . . . tenuous and farfetched.” *Giddings v. Industrial Indem. Co.*, 169 Cal. Rptr. 278, 282 (Ct. App. 1980). Insurers who

urge a narrow construction of the potentiality doctrine misapprehend its import in light of this case law as a number of courts have found.

Nelson v. West Am. Ins. Co., No. B143838, 2004 WL 1302500, at *11 (Cal. Ct. App. June 14, 2004) (“As in *El-Com Hardware, Inc. v. Fireman’s Fund Ins. Co.*, *supra*, 92 Cal.App.4th at pages 217-219, 111 Cal.Rptr.2d 670, Murray’s cross-complaint depicts a set of facts that verges on a claim for defamation. Again, as in *El-Com Hardware*, the additional facts needed to fill the gap in the cross-complaint are found in Weinblatt’s files, which indicate that Nelson had made disparaging remarks about Murray to third parties.”); *Pension Trust Fund v. Federal Ins. Co.*, 307 F.3d 944, 951-52 (9th Cir. (Cal.) 2002) (“California courts have repeatedly found that remote facts buried within causes of action that may potentially give rise to coverage are sufficient to invoke the defense duty.”).

B. The Reasonable Inferences Arising from the Pleadings and Other Extrinsic Evidence Available to the Insurer Trigger a Defense

An insurer’s defense obligation can be established not only by the pleaded fact allegations, but also by the inferences which emanate from those allegations, and those inferences need not be in evidence. *Anthem Electronics, Inc. v. Pacific Employers Ins. Co.*, 302 F.3d 1049, 1058 (9th Cir. (Cal.) 2002).

C. A Factual Dispute about the Potential for Coverage Does Not Create a Disputed Issue of Fact Requiring That It Compels the Insurer to Defend

“If the parties dispute whether the insured’s alleged misconduct is potentially within the policy coverage and if the evidence submitted does not permit the court to eliminate either party’s view, . . . ‘the duty to defend is then established’” *American Cyanamid Co. v. American Home Assur. Co.*, 35 Cal. Rptr. 2d 920, 923 (Ct. App. 1994).

D. Courts Must Not Look to the Merits of the Underlying Action in Analyzing the Potential For Coverage

In reviewing precedent, coverage counsel should be aware that federal district courts have experienced great difficulty in applying the potentiality doctrine. They often look to the merits of a claim, employing a 12(b)(6) standard rather than the broader “any possibility” test requisites in analyzing the duty to defend. Courts are required to look beyond the complaint to determine its scope. Indeed, the number of reversals in *de novo* coverage cases, dealing with opaque “offense” based coverage, is startlingly high.

Curtis-Universal, Inc. v. Sheboygan Emerg. Med. Servs., Inc., 43 F.3d 1119 (7th Cir. (Wis.) 1994); *Lockwood Int’l, B.V. v. Volm Bag Co., Inc.*, 273 F.3d 741 (7th Cir. 2001); *Pension Trust Fund v. Federal Ins. Co.*, 307 F.3d 944 (9th Cir. (Cal.) 2002); *Aurafin-OroAmerica, LLC v. Federal Ins. Co.*, No. 04-56681, 2006 WL 1880088 (9th Cir. (Cal.) June 26, 2006).

III. DIFFERENT FORUMS HAVE DIFFERENT RULES ON WHAT FACTS ARE RELEVANT TO COVERAGE ANALYSIS

The range of options covers the spectrum:

(1) facts set forth in the pleadings alone (Florida, Texas and Virginia)

Lazzara Oil Co. v. Columbia Casualty Co., 683 F. Supp. 777 (M.D. Fla. 1988), *aff’d without opinion*, 868 F.2d 1274 (11th Cir. 1989) (Following the “four corners” or “eight corners” doctrine, the court declined to look beyond the face of the pleadings to determine if the conduct alleged was part and parcel of other unarticulated conduct by the policyholder that could readily have been found to be covered as advertising activities.);

Providence Washington Ins. Co. v. A & A Coating, Inc., 30 S.W.3d 554, 555-56 (Tex. App. 2000) (“An insurer’s duty to defend is determined by the ‘eight corners rule,’ which limits review to the four corners of the insurance policy and the four corners of the plaintiff’s petition. The insurer’s duty to defend is not affected by facts learned before, during, or after the suit. The duty to defend is determined independent of the parties’ knowledge of the true facts.” (citations omitted));

Brenner v. Lawyers Title Ins. Corp., 397 S.E.2d 100, 102 (Va. 1990) (“The obligation to defend arises whenever the complaint against the insured alleges facts and circumstances, some of which, if proved, would fall within the risk covered by the policy.”).

(2) facts known to the insurer (Illinois, New York)

L.J. Dodd Constr., Inc. v. Federated Mut. Ins. Co., 848 N.E.2d 656, 658 (Ill. App. Ct. 2006) (“[W]e may consider ‘true but unpleaded facts’ that are known to the insurer and that, when coupled with the allegations of the complaint, give rise to a duty to defend.”);

Fitzpatrick v. American Honda Motor Co., Inc., 78 N.Y.2d 61, 66-68 (1991) (“[W]here the insurer is attempting to shield itself from the responsibility to defend despite its actual knowledge that the lawsuit involves a covered event, wooden application of the ‘four corners of the complaint’ rule would render the duty to defend narrower than the duty to indemnify – clearly an unacceptable result. . . . [T]he sounder approach is to require the insurer to provide a defense when it has actual knowledge of facts establishing a reasonable possibility of coverage. . . . The conclusion we reach here flows naturally from the fact that the duty to defend derives, in the first instance, not from the complaint drafted by a third party, but rather from the insurer’s own contract with the insured.” (citation omitted)).

(3) facts knowable to the insurer (Massachusetts, Minnesota)

Transamerica Ins. Co. v. KMS Patriots, L.P., 752 N.E.2d 777, 781-82 (Mass. App. Ct. 2001) (“[T]he defendants also claim that Palla’s answer to a KMS interrogatory in her action triggered coverage under the CGLE. . . . Because there was nothing in the record to demonstrate that Transamerica was aware of the existence of Palla’s answer to the interrogatory and its contents, we reject the defendants’ argument that the answer to this interrogatory triggered a duty to defend.”);

Westfield Ins. Co. v. Kroiss, 694 N.W.2d 102, 106 (Minn. Ct. App. 2005) (“[A] duty to defend is determined by comparing the complaint with the policy language. However, if the insurer has knowledge of facts outside the complaint, it can use these to determine coverage.” (citation omitted)).

(4) facts available to the insurer (California)

Mariscal v. Old Republic Life Ins. Co., 50 Cal. Rptr. 2d 224, 225 (Ct. App. 1996) (“If [an insurance company] seeks to discover only the evidence that defeats the claim it holds its own interest above that of its insured.”). The greater the insurer’s duty to investigate, the easier it is to establish a defense.

IV. WHY COURTS ARE ABANDONING THE “COMPLAINT ALLEGATIONS” RULE IN FAVOR OF THE “FACTS AVAILABLE” TEST

Aside from specific exclusions, there are more general reasons for not applying the four corners doctrine.

First, courts have found it inappropriate to apply the four corners rule when pleadings need only provide notice of the claim asserted.

Alabama – *Perkins v. Hartford Ins. Group*, 932 F.2d 1392, 1395 (11th Cir. 1991); **Arkansas** – *Home Indem. Co. v. City of Marianna*, 727 S.W.2d 375, 379 (Ark. 1987); **Iowa** – *First Newton Nat’l Bank v. General Cas. Co.*, 426 N.W.2d 618, 623 (Iowa 1988); **Missouri** – *Farm Bureau Town & Country Ins. Co. v. Turnbo*, 740 S.W.2d 232, 234 (Mo. Ct. App. 1987); **Nevada** – *Grand Hotel Gift Shop v. Granite*

State Ins. Co., 839 P.2d 599 (Nev. 1992); **Ohio** – *Riverside Ins. Co. v. Wiland*, 474 N.E.2d 371, 374 (Ohio Ct. App. 1984); **Utah** – *Deseret Fed. Sav. & Loan Ass'n v. United States Fidelity & Guar. Co.*, 714 P.2d 1143, 1147 (Utah 1986).

Second, a growing group of jurisdictions apply the “late discovered facts” rule under which a separate duty to defend arises if evidence triggering the duty arises following the initial pleadings.

Siligato v. Welch, 607 F. Supp. 743, 746 (D. Conn. 1985); *Grissom v. Commercial Union Ins. Co.*, 610 So. 2d 1299, 1306-07 (Fla. Dist. Ct. App. 1992), *rev. denied*, 621 So. 2d 1065 (Fla. 1993); *Phoenix Phase I Assocs. v. Ginsberg, Guren & Merritt*, 500 N.E.2d 365, 367 (Ohio Ct. App. 1985).

Third, an insurer’s duty to defend exists when the allegations in the action against the policyholder are so vague, ambiguous, or incomplete that potential coverage arises.

Arizona – *Aetna Cas. & Sur. Co. v. Dannenfeldt*, 778 F. Supp. 484, 499 (D. Ariz. 1991); **Georgia** – *State Farm Mut. Auto Ins. Co. v. Keene*, 142 S.E.2d 90, 91 (Ga. Ct. App. 1965); **Oregon** – *Cooper v. Commonwealth Land Title Ins. Co.*, 699 P.2d 1128, 1129 (Or. Ct. App. 1985), *review denied*, 704 P.2d 513 (Or. 1985); **South Dakota** – *North Star Mut. Ins. Co. v. Kneen*, 484 N.W.2d 908, 912 (S.D. 1992); **Washington** – *E-Z Loader Boat Trailers, Inc. v. Travelers Indem. Co.*, 726 P.2d 439, 444 (Wash. 1986).

Fourth, the insurer must look to the factual allegations of the complaint, as well as to the title of the counts in the complaint, to determine whether the alleged injuries are covered by insurance.

Illinois – *Tews Funeral Home, Inc. v. Ohio Cas. Ins. Co.*, 832 F.2d 1037, 1042 (7th Cir. 1987) (applying Illinois law); **New Jersey** – *Ethicon, Inc. v. Aetna Cas. & Sur. Co.*, 737 F. Supp. 1320, 1327-29 (S.D.N.Y. 1990), *dismissed*, 805 F. Supp. 203 (S.D.N.Y. 1992), *aff'd without opinion*, 993 F.2d 1532 (2d Cir. 1993) (applying New Jersey law); **New York** – *Federal Ins. Co. v. Cablevision Sys. Dev. Co.*, 637 F. Supp. 1568, 1571-72 (E.D.N.Y. 1986), *summary judgment granted*, 662 F. Supp. 1537 (E.D.N.Y. 1987), *aff'd*, 836 F.2d 54 (2d Cir. 1987); **California** – *CNA Cas. v. Seaboard Sur. Co.*, 222 Cal. Rptr. 276, 279 (Ct. App. 1986).

Fifth, and finally, if coverage depends on the existence or nonexistence of undetermined facts outside the complaint, the insurer has a duty to defend claims against its policyholder unless and until the claims are narrowed to a claim outside the policy’s coverage.

Colorado – *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991); **Hawaii** – *Commerce & Indus. Ins. Co. v. Bank of Hawaii*, 832 P.2d 733, 736 (Haw. 1992), *recons. den.*, 834 P.2d 1315 (Haw. 1992); **New York** – *Allstate Ins. Co. v. Zuk*, 574 N.E.2d 1035 (N.Y. 1991); **Pennsylvania** – *Germantown Ins. Co. v. Martin*, 595 A.2d 1172, 1174 (Pa. Super. Ct. 1991), *appeal denied*, 612 A.2d 985 (Pa. 1992).

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 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

- **March 1-3, 2007** - *Insurance Coverage Litigation Committee* - Tucson, Arizona - Attending Conference/Speaking Engagement
- **March 27-28, 2007** - *Intellectual Property Owners Directors and Officers Meeting* - Washington, D.C. - Attending Conference
- **April 29-May 3, 2007** - *RIMS Annual Conference* - New Orleans, Louisiana - Attending Conference/Speaking Engagement
- **May 17-20, 2007** - *TIPS Section Spring Meeting* - Newport Beach, California - Attending Conference
- **June 14-15, 2007** - *Intellectual Property Conference* - San Francisco, California - Attending Conference/Speaking

FIRM MEMBERS

PRINCIPAL

David A. Gauntlett

ASSOCIATES

James A. Lowe	Andrew M. Sussman
Eric Robert Little	George K. Rosenstock
M. Catherine Reid	Najwa Tarzi Karzai
Joseph S. McMillen	Stephanie Rothberg

DIRECTOR OF BUSINESS DEVELOPMENT

Richard A. Beserra

NEWSLETTER FACTS

The Policyholder Advocate/IP Counselor is published quarterly. The Articles appearing in **The Policyholder Advocate/IP Counselor** do not constitute legal advice or opinions. Such advice and opinion are provided by the firm only upon request.

For more information, contact our Director of Business Development, Richard A. Beserra, at (949) 553-1010 x 208

Email: marketing@gauntlettlaw.com to be added to our newsletter circulation list, or to be removed from that list.

GAUNTLETT & ASSOCIATES – THE POLICYHOLDER ADVOCATE

Gauntlett & Associates specializes in policyholder insurance coverage and litigation re copyright, antitrust, patent, trademark, trade secret, business and general coverage disputes. Including:

1. INSURANCE COVERAGE LITIGATION FOCUSING ON IP AND ANTITRUST CLAIMS
2. IP LITIGATION
3. EXPERT WITNESS ON INSURANCE COVERAGE ISSUES, INCLUDING FEE DISPUTES
4. COUNSEL TO IP CASE-IN-CHIEF COUNSEL FOR INSURANCE 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

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

©2007 Gauntlett & Associates – All rights reserved