The Coverage Inkwell

Emerging Coverage Issues in Intellectual Property, Privacy, and Cyber Liability

White and Williams LLP

Joshua A. Mooney
mooneyj@whiteandwilliams.com

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SOME SWEET CASES: THE UNAUTHORIZED USE EXCLUSION & RELIANCE UPON A COURT DECISION OF NO COVERAGE

It's the day after Valentine's Day, which means that chocolates are now half-priced at your local neighborhood pharmacy chain. Now, I won't start quoting Forrest Gump to you (or Mrs. Gump, to be more precise), but I do love those little boxes of chocolates. That candy can pack a lot of flavor in small, little bites. The same can be said of two recent decisions issued by the Ninth Circuit and the Northern District of California. They are short and sweet, and both pack some bite. One with regard to application of the Unauthorized Use exclusion; the other on defense costs owed when a trial court's decision for no coverage is reversed.

In *CollegeSource, Inc. v. Travelers Indem. Co. of CT*, 2013 WL 492462 (9th Cir. Feb. 6, 2013), a cyber case involving domain names, the Ninth Circuit affirmed the trial court's holding that the underlying action against CollegeSource fell within the Unauthorized Use exclusion in the Travelers insurance policy. The underlying complaint alleged that CollegeSource had used the underlying plaintiff's domain name in its own domain name in a way likely to cause confusion in the marketplace. *Id.* at *1. The Ninth Circuit concluded that the "only reasonable reading" of the complaint "is that it claims injury from an activity that (1) is 'similar to' the unauthorized use of another's name or product in one's domain name, and (2) would mislead customers." *Id.* Seems pretty straightforward.

To circumvent the exclusion, however, CollegeSource argued that Travelers's removal of a trademark infringement exclusion from the policy showed an intent to provide coverage for domain name infringement where the domain name also was a trademark. In other words, although the Unauthorized Use exclusion barred coverage, it really didn't because the parties did not mean it to exclude coverage for trademarks. *Id.* The Ninth Circuit rejected this argument flatly:

> Because the language of the Unauthorized Use exclusion is unambiguous, we do not consider drafting history or other extrinsic sources to determine the parties' intent.

Id. This may seem a small point, but its significance should not be overlooked. If underwriting chooses to remove an exclusion in a policy, it should not have to worry about eviscerating those exclusions that remain based on some theory of "intent." If the lawsuit falls within the language of an exclusion, the exclusion bars coverage. No sweet surprises.

National Union Fire Ins. Co. of Pittsburgh, PA v. Seagate Tech., Inc., 2013 WL 308875 (N.D. Cal. Jan. 25, 2013) involves defense costs when a trial court's decision that no coverage exists is reversed on appeal. There, the insured was sued in 2000; in 2004, its insurers commenced a coverage action to determine whether they had a duty to defend. After six years of "motions, appeals, and proceedings after remand," the district court ruled that the insurers had a duty to defend from November 1, 2000, until July 18, 2007. At that point, National Union decided it would rely on the district court's entry of judgment and it stopped paying for Seagate's defense. Meanwhile, the parties cross-appealed again. *Id.* at *1.

In 2012, the Ninth Circuit reversed the trial court's decision, concluding that the district court had erred in its decision that National Union's duty to defend had terminated in 2007. As a result, National Union suddenly found itself five years late on payments for Seagate's legal defense. *Id.*

Seagate delivered to National Union invoices for its legal bills from 2007 to 2012 and also demanded prejudgment interest. National Union paid only part of the legal bills (*i.e.,* reasonable rates pursuant to Cal. Civil Code § 2860) and paid prejudgment interest on the reduced amount. *Id.* Seagate objected, contending that the Ninth Circuit's decision converted National Union's decision to stop funding the defense into a breach of the insurance contract; therefore, National Union could not rely on Cal. Civil Code § 2860. *Id.* This was no small matter. At oral argument, "counsel represented that the delta between the fees paid and the fees allegedly due is in excess of *20 million dollars*." (Italics mine.)

The district court rejected Seagate's argument, holding that "general principles compel the conclusion that [National Union] did not act wrongfully when it chose to rely on the district court's final judgment":

> In the ordinary case, the duty to defend terminates upon a judicial determination that the insured does not have a potentially-covered claim. *Montrose Chem. Corp. v. Super. Ct.*, 6 Cal. 4th 287, 301, 24 Cal. Rptr. 2d 467, 861 P.2d 1153 (1993). The decision granting summary judgment became such a judicial determination when judgment was entered under Rule 54(b) (Dkt. No. 324). The entry of judgment created a final order with *res judicata* effect. *Cont'l Airlines, Inc. v. Goodyear Tire & Rubber Co.,* 819 F.2d 1519. 1525 (9th Cir. 1987). It is a "basic proposition that all orders and judgments of courts must be complied with promptly. If a [defendant] believes that order is incorrect the remedy is to appeal, but, absent a stay, he must comply promptly with the order pending appeal." *Maness v. Meyers*, 419 U.S. 449, 458, 95 S. Ct. 584, 42 L.E.2d 572 (1975).

Id. at *2.

Seagate appealed, but did not seek a stay of the adverse district court ruling at issue. Therefore, as a result, National Union "was entitled to the benefit of the (erroneous) ruling that there was no longer a duty to defend." *Id.* The court further explained that "[t]o hold that [National Union] was committing a breach of contract all along would convert a final judgment under Rule 54(b) into a provisional one and directly conflict with the principle that absent a stay, a party must comply with a judgment pending appeal." *Id.* In other words, a holding that there was no coverage really meant that there was no coverage.

As a result, National Union was permitted to rely upon on Cal. Civil Code § 2860 to reduce the defense costs owed to Seagate.

> …an insurer who wrongfully denies coverage may not rely on section 2860 after the fact, once it has agreed to—or been found obligated to—provide a defense [citations omitted].
>
> Again, the key word is "wrongfully." [National Union] did not wrongfully deny coverage after 2007; now that its contractual obligations have been reinstated, it has elected to pay and it may accordingly take advantage of Section 2860.

Id., *5.

The court also added this little tidbit:

> During the pendency of the appeals, Seagate should have been aware that it was retaining expensive counsel at a risk to itself. If Seagate had wanted to change this calculus, it should have made a motion for stay pending appeal.

Id.

What do these cases mean? Both have their own, distinct flavor. In *CollegeSource*, an insured cannot circumvent an unambiguous exclusion by arguing that the removal of another exclusion demonstrated an intent that certain remaining exclusions also should not apply. In *Seagate*, an insurer should be entitled to rely upon a district court decision that there is no coverage. Note, however, that the *Seagate* Court's decision becomes distinguishable if the insured, upon losing at the trial level, obtains a stay of the court's order pending the appeal. Both cases rest on simple, straightforward principles. Yet, both pack a lot of flavor.

Questions are welcome.

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Joshua A. Mooney | Counsel
1650 Market Street | One Liberty Place, Suite 1800 | Philadelphia, PA 19103-7395
Direct 215.864.6345 | Fax 215.399.9613
mooneyj@whiteandwilliams.com | whiteandwilliams.com
Assistant: Dana Genovese | 215.864-6331