

The Coverage Inkwell

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



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STRIKING OUT WITH THE INTELLECTUAL PROPERTY EXCLUSION EXCEPTION

For baseball fans, July is a sobering month. It's the time when, for most teams, preseason fantasies can be put to bed and cold reality sets in: there will be no October baseball. I am starting to get that feeling, though I've promised myself that I am going to remain upbeat despite my team's apparent fate. I will still enjoy the hot dogs and peanuts, and the hot afternoons as I watch my favorite players swing and miss more times than not. I will debate game day stats with my son, and I will stand with my daughter after the 7th inning and sing with her "...one, two, three strikes you're out at the old ballgame." What does this have to do with insurance? Nothing, really, except that I thought of the ending to that song when reading the recent decision, *Basalite Concrete Prods., LLC v. National Union Fire Ins. Co. of Pittsburgh, PA*, 2013 WL 2156582 (E.D. Cal. May 17, 2013). In that case, the insureds took not three, but four, swings at the exception to the intellectual property exclusion and struck out.

Most CGL policies have an exclusion for intellectual property claims. The exclusion states in effect that the policy does not cover "personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights, but it carves out an exception for infringement in the insured's advertisement of copyright, trade dress or slogan. (Some versions of the exclusion also carve out claims for use of another's advertising idea in the insured's advertisement.) In *Basalite*, the insureds tried to obtain coverage within the former carve out and failed.

In that case, the insureds, who were in the business of manufacturing and distributing "hardscape products, including structural blocks, interlocking paving stones, wall systems, and retaining walls, as well as ornamental and garden products," had been sued by Keystone Retaining Wall Systems (Keystone) for patent and trademark infringement. *Id.* at *1. The underlying action alleged that the insureds "improperly used Keystone's trademarks and patents after breaching licensing agreements which granted plaintiffs 'the right and license to utilize the Know-How, Molds, Patent Rights, and Trademarks to manufacture, market and sell the Products'." *Id.* at *2. The underlying action brought claims for breach of contract, trademark infringement, patent infringement, and violation of the Lanham

Act. *Id.* The insurers denied coverage for the claim. The insureds settled the action for \$1.5 million and incurred \$1 million in defense costs. *Id.* at *3. They thereafter commenced coverage litigation.

The insurance policies at issue provided coverage for “personal and advertising injury,” which was defined in part as injury arising out of: “oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services”; “the use of another's advertising idea in your advertisement”; and/or “infringing upon another's copyright, trade dress, or slogan in your advertisement.” *Id.* at *1.

The policies also had two relevant exclusions. The first exclusion precluded coverage for personal and advertising injury “arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights”; however, the exclusion did not apply “to infringement, in [the insured's] advertisement, of copyright, trade dress or slogan.” *Id.* The second exclusion precluded coverage for personal or advertising injury “arising out of breach of contract”; however, the exclusion did not apply to “an implied contract to use another's advertising idea in [the insured's] advertisement.” *Id.* at *2.

The *Basalite* court began its analysis by summarily holding that the exclusions barred coverage for the underlying action. The court stated:

These patent, trademark, and breach of contract claims in the Keystone pleadings are excluded from coverage under the Policies. Therefore, no duty to defend arose from the causes of actions alleged in the Keystone Matter.

Id. at *4 (internal citation omitted).

However, noting that “factual allegations in the underlying complaint may trigger an insurer's duty to defend, even if the underlying ‘technical legal causes of action’ do not reveal a potential for coverage,” the court investigated whether the underlying action alleged facts that fell within the carve out exception to the IP exclusion. Specifically, the court examined whether the underlying action alleged “potential claims for slogan infringement, trade dress infringement, and disparagement in [the insureds'] advertising,” as the insureds contended. *Id.* The court held that the underlying action did not.

The court first rejected the idea that theft of marketing strategies constitutes advertising injury. *Id.* at *5. This holding is not surprising, as the argument has been rejected routinely by other courts. More unusual was the court's holding that mere infringement of a trademark also does not allege advertising injury. The court explained:

“[A]dvertising injury” must have a *causal connection* with the insured's advertising activities before there can be coverage.” *Bank of the West v. Superior Court*, 10 Cal. Rptr. 2d 538 (Cal. 1992). “In other words, any of the policy's enumerated advertising injuries must be caused by [the insureds']

advertising in order to satisfy Bank of the West's nexus requirement." *Simply Fresh Fruit, Inc. v. Cont. In. Co.*, 94 F.3d 1219, 1221 (9th Cir.1996).

Even when a complaint uses the word "advertising" in framing a trademark cause of action, "references to the term 'advertisement' *do not transform trademark infringement allegations into advertising injuries.*" [Citation omitted.]

Id. at *4-5 (emphasis added).

In the case before it, the court held that there was no alleged advertising injury because the alleged injuries were caused by the misappropriation of trademarks, *not* by the advertising itself. Simply put, use of the trademark in an advertisement was not enough. There had to be more:

Nor is a single allegation that unauthorized use of the Trademarks is commercial advertising that misrepresents the nature, characteristics, qualities, or origin of the Trademarks In the Keystone pleadings, the harm ... is allegedly caused by misappropriation of the [trademarks and patents], not by the advertising itself.

Id. at *5 (internal quotation marks omitted).

The court also rejected the insureds' contention that the underlying action alleged slogan and trade dress infringement, or disparagement.

For the slogan argument, the insureds argued that (1) the infringed trademarks were slogans and (2) the Keystone trademark "Retaining Excellence" was a slogan. *Id.* at *6. The court rejected the argument on two grounds. First, noting the legal definition for a slogan as a "brief attention-getting phrase used in advertising or promotion or a phrase used repeatedly, as in promotion," the court stated that trade names and service marks do not constitute slogans. Second, although "Retaining Excellence" could be a slogan, nowhere did Keystone allege that the trademark had been infringed. Therefore, the underlying action did not allege infringement of a slogan in the insureds' advertisement:

Plaintiffs provide no legal support for their assertion that "the term 'trade name' and/or 'service marks' are commonly understood to appear and be included within 'trade dress' and/or 'slogan.'" Plaintiffs' argument is further undermined by the fact that Keystone specifically listed the trademarks allegedly infringed, but nowhere mentions the phrase "Retaining Excellence" and does not include factual allegations as to how the phrase was used in advertising. . . . Here, however, neither "Retaining Excellence" or any other potential slogan appears in the Keystone complaint.

Id. at *6.

The court also rejected the insureds' argument that the underlying action's Lanham Act claims stated a potential claim for trade dress infringement. Trademarks are not trade dress:

Trade dress refers generally to the total image, design, and appearance of a product and may include features such as size, shape, color, color combinations, texture or graphics.

* * *

The Keystone pleadings, however, do not include any factual allegations regarding a product's "total image, design, or appearance," nor do they include any factual allegations concerning a product's non-functionality. [Citation omitted.] Keystone's claims under [the Lanham Act] repeatedly allege violation due to plaintiffs' "use of the *Trademarks*," not trade dress.

Id. at *7 (emphasis in original).

Finally, the court rejected the insureds' argument that the underlying action alleged a potential disparagement claim, holding that mere "passing off" goods does not constitute disparagement of the quality of such goods to implicate coverage. Again, there had to be more:

When an underlying complaint for infringement of a design patent "only allege[s] that [the plaintiff] imitated its product, thereby infringing its patent," "it does not follow that ... it is, therefore, disparaging it. In point of fact, it's quite the opposite—as has been oft said: imitation is the highest form of flattery.

* * *

Here ... the allegations in Keystone's underlying complaint are that plaintiffs "passed off" Keystone's products as plaintiffs' own after breaching the licensing agreement, "not that [plaintiffs] made a false or injurious statement about the quality" of Keystone's products. Thus, the underlying Keystone pleadings did not state a potential claim for disparagement.

Id. at *8 (internal citations omitted).

What does this case mean? The determinations rendered by the *Basalite* court in of themselves are not necessarily extraordinary. What makes *Basalite* unusual, however, is that the issues were examined all together and rejected *in seriatim*. Furthermore, there are few decisions analyzing these coverage issues in the context of the intellectual property exclusion's carve out. For this reason alone, *Basalite* may garner some additional attention. Whether courts will follow this decision's lead, or distinguish it, time will tell.

Questions are welcome.

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