

The Coverage Inkwell

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



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A LEAVE IT TO BEAVER LESSON: PAYING ROYALTIES IS NOT LOSS FROM A WRONGFUL ACT

My kids have never watched *Leave It To Beaver*. Eddie Haskell means nothing to them. Instead, they've grown up consuming shows like *iCarly*, *Good Luck Charlie*, and *Dog with a Blawg*. (Don't ask me about the last one—I still don't get it.) Although meaningless to my kids, for me, *Leave It To Beaver* remains an iconic classic, like the bright-orange shag carpet in my grandmother's family room, which I sat on while spending many weekday mornings watching the show. I remember the morals from many of episodes. Like, don't play catch with your father's autographed baseball! (Although, my father never had one.) In some ways, in my neighborhood, *Leave It To Beaver* and other like shows served as an introduction into pop philosophy, later to be replaced by the lyrics of Dylan and The Beatles, The Smiths and REM.

Recently (and albeit indirectly), the show taught another lesson—actually, two age-old lessons—when actor Ken Osmond (aka Eddie Haskell) brought a class action lawsuit against the Screen Actors Guild (SAG) over SAG's failure to pay royalties collected and owed from overseas broadcasting of syndicated programming. The lessons: (1) a loss is not something the insured owed in the first place, and (2) an insured cannot use an award of attorney's fees to bootstrap coverage. The case is *Screen Actors Guild, Inc. v. Federal Ins. Co.*, 2013 WL 3525273 (C.D. Cal. July 11, 2013). Although not a cyber liability or IP case, the lessons of the case are universal. In addition, I've seen some insureds try to shoehorn royalty-based disputes into cyber/media liability coverage. For these reasons, the case merited attention here.

In *SAG*, actor Ken Osmond brought an action against SAG alleging that since 1996, "SAG had been collecting monies due actors from various foreign countries," which it then failed to distribute. *Id.* at *2. The complaint alleged that SAG had "intentionally collected and took possession of" the funds and held the funds for an 'unreasonably long period of time,' and that he and the plaintiff class were entitled to possession of their share of the foreign levy funds." *Id.* The complaint sought restitution, compensatory and punitive damages, an accounting, a constructive trust, costs, attorneys' fees, prejudgment interest, and injunctive relief. *Id.* It alleged four causes of action: conversion, unjust enrichment, accounting, and violation of Cal. Bus. & Prof. Code § 1700, *et seq.* *Id.* at *1.

SAG sought coverage from its insurer under a Directors and Officers Liability and Entity Liability Policy, which provided coverage for Loss which the Organization becomes legally obligated to pay on account of

a Claim for a Wrongful Act. *Id.* at *1. The insurer defended under a reservation of rights. The Policy defined Loss in part as “the amount that any Insured becomes legally obligated to pay on account of any covered Claim, including but not limited to ... (ii) judgments; (iii) settlements; ... [and] (vi) Defense Costs.” *Id.* at *2. The policy defined Wrongful Act in part as:

(a) any error, misstatement, misleading statement, act, omission, neglect, breach of duty, Personal Injury Wrongful Act or Publisher Wrongful Act committed, attempted, or allegedly committed or attempted by an Insured Person in his or her Insured Capacity or, for purposes of coverage under Insuring Clause 3, by the Organization;

(b) any other matter claimed against an Insured Person solely by reason of his or her serving in an Insured Capacity; or

(c) any Outside Capacity Wrongful Act.

Id.

The Osmond class action settled under which SAG agreed to use best efforts to allocate 90% of the collected funds to the class members, minus a 10% administrative fee to cover the cost of the distribution. *Id.* at *3. The court approved the settlement and awarded Osmond an enhancement payment of \$15,000 and class counsel fees and costs in the amount of \$315,000, for a total amount of \$330,000. *Id.* SAG sought indemnification from its insurer for this amount. The insurer refused. *Id.* In the subsequent coverage litigation, the California federal court agreed that coverage did not exist.

The essential fact of the coverage dispute was that SAG had conceded its pre-existing obligation to distribute the collected funds to the class members. SAG stated that it did not dispute its obligation to distribute the money, it only hadn't because it had lacked the resources and technological ability to do so (i.e., “there was no computer system in place for doing it”). *Id.* at *6-7. Because SAG had a preexisting obligation to distribute the funds, the court concluded that the Osmond complaint did not (and could not) allege loss from a wrongful act. Explaining this principle with a moral instruction that even Ward Cleaver would admire, the court stated that:

California courts have also held, “[e]ven in the absence of an express exclusion, ... a claim alleging breach of contract is not covered under a professional liability policy because there is no ‘wrongful act’ and no ‘loss’ since the insured is simply being required to pay an amount it agreed to pay.” [Citation omitted.] This policy makes sense when considered in practical terms: if a contracting party fails to pay amounts due under a lawful contract and is sued for that failure to pay, it cannot then obtain a windfall by having its payments covered by an insurance policy covering only “wrongful acts.”

Id. at *6 (emphasis in original); see also *Health Net, Inc. v. RLI Ins. CO.*, 206 Cal. App. 4th 232, 253 (2012) (“In short, performance of a contractual obligation ... is a debt the [insured] voluntarily accepted. It is not a loss resulting from a wrongful act within the meaning of the policy.”).

The court further concluded that because there was no loss from a wrongful act, the enhanced award given to Osmond and the attorneys' fees also could not constitute loss from a wrongful Act. The court explained that "if the entire action alleges no covered wrongful act under the policy, coverage cannot be bootstrapped based solely on a claim for attorney's fees." *Id.* at *7. Therefore, there was no coverage:

In this case, SAG's own coverage position and assertions lead to but one result, which is that, insofar as SAG is and was, prior to the Osmond Action, obligated to account for and distribute the foreign levy funds to the plaintiff class, SAG fails to establish that the \$330,000 Award arises from a "covered" Claim under the Policy. As such, the Court finds that SAG's first cause of action for breach of contract fails as a matter of law and Federal owes no duty to indemnify SAG for the \$330,000 award.

Id. at *7.

What does this case mean? This case highlights two fundamental principles sometimes overlooked when an insured seeks coverage: (1) giving over what is not yours to begin with is not a loss; and (2) having to pay attorneys' fees as a result also is *not* a loss. Questions are welcome.

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