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TECHNOLOGY RISKS AND LIABILITIES: ARE YOU COVERED?

Robert M. (Randy) Roach, Jr.*
Daniel L. McKay**

INTRODUCTION

GIVEN rapid transformations in the American and global economies and the continuing shift to a service and information-based economy dependent on technology, future insurance coverage battles between policyholders and their insurers are likely to focus increasingly on new types of first-party losses and complex third-party liability issues.¹ As policyholders seek to exploit new business opportunities in cyberspace, both domestically and abroad, and as insurance carriers also explore potential new markets, policyholders and their counsel²

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1. This article focuses primarily on business and technology risks facing U.S. policyholders in their domestic operations. As U.S. firms expand overseas and engage in joint ventures, cross-licensing agreements, and other business with foreign companies and competitors, these firms inevitably will become involved in a greater number of disputes between foreign companies and licensees concerning intellectual property issues. If a litigation matter arises with a foreign competitor, forum, venue selection, and choice-of-law issues will be significant in resolving such litigation. *See, e.g.,* ICT Pharm., Inc. v. Boehringer Ingelheim Pharm., Inc., 147 F.Supp.2d 268 (D. Del. 2001) (patent infringement suit against allegedly affiliated German corporations dismissed for lack of personal jurisdiction because there was no “substantial connection” between German corporations’ activities and Delaware). *See also In re* Application of Ishihara Chem. Co., Ltd., 251 F.3d 120 (2nd Cir. 2001) (case of first impression involving the issue of whether 28 U.S.C. § 1782 may be used by a Japanese company to obtain discovery from a U.S. corporation for use in patent invalidity proceeding in Japan where the U.S. corporation was a party to the Japanese proceeding and where the discovery could not be obtained under Japanese law). Therefore, U.S. policyholders should ensure that their insurance portfolio covers events occurring outside the United States. Furthermore, U.S. policyholders should also ensure that in the event coverage litigation ensues, the insurance carrier will agree to be served in the U.S. and will agree to resolve the coverage dispute in a U.S. forum applying U.S. law.

2. This article does not address ethical duties of counsel that may arise in the course of representing intellectual property clients with potential insurance coverage issues. However, practitioners should be aware of potential liabilities for failing to properly investigate and accurately determine whether or not insurance coverage may apply to claims being asserted against an intellectual property client. *See generally* Lisa A. Dolak, *As If You Didn’t Have Enough to Worry About: Current Ethics Issues for Intellectual Property Practitioners*, 82 J. PAT. & TRADEMARK OFF. SOC’Y 235, 259 (Apr. 2000) (discussing cases involving the question of whether or not an attorney “has a duty to inquire into the

should carefully analyze strategies of using insurance to hedge against foreseeable and unforeseeable business risks, such as the loss of computer data or corruption of storage networks, infringement of intellectual property rights, the risk of attacks on computer networks, and the potential theft of trade secrets.³ Insurers should also investigate economically viable means of spreading new and emerging risks across a diverse spectrum of business policyholders and also reinsuring such risks where appropriate.

This article identifies significant potential risks and liabilities facing policyholders and analyzes whether or not insurance policies may provide coverage for the claim at issue or a defense to the policyholder in the event litigation is commenced against the policyholder. Section I identifies general business risks and liabilities associated with conducting business based on intellectual property, including potential liability exposure to patent, copyright, service mark, trademark, unfair competition, Lanham Act, trade dress, tortious interference of contract, and anti-trust claims. Section II identifies business risks arising out of potential exposure to invasion of privacy, libel, slander, and defamation claims. Section III identifies risks of incurring economic losses due to loss or corruption of computer data, network downtime, business interruptions, and similar potential issues. Section IV identifies risks of loss of intellectual property rights and trade secrets.

The foregoing sections primarily address five general and distinct types of risk facing policyholders in the new millennium: (1) the risk of being

existence, nature and scope of insurance policies previously procured by the client, and to determine whether any such policy provides the client with any entitlement in relation to the claim being litigated.”). Intellectual property law firms representing multiple technology clients may inadvertently be exposed to conflict of interest issues following *successful* litigation many years after the litigation has concluded. *See, e.g., Berkeley Ltd. P’ship v. Arnold, White & Durkee*, 118 F.Supp.2d 668, 671 (D. Md. 2000) (“The present suit was filed *thirteen years* after AW & D began representing plaintiff and Intel. The statute of limitations in this case is three years. Defendant began their representation of plaintiff in 1984, and their representation of Intel in late 1984. Plaintiff’s claim against IBM was settled in 1988. Plaintiff argues that their claim did not begin to accrue until June 1996 when Donald Jefferson and Arnold Berkeley allegedly had a conversation reminiscing over the old days. Jefferson was telling Berkeley that he thought they should have gotten more out of IBM as a result of their 1988 settlement. Jefferson expressed the opinion that had AW & D not represented Intel, more of BLP’s claims would have remained in the complaint against IBM. Berkeley allegedly got agitated because this was the first time he had heard that AW & D represented Intel. As a result of the conversation, plaintiff filed suit against AW & D in 1997.”) (emphasis added).

3. As the scope of the article is limited to insurance coverage issues, broader issues concerning the Internet’s impact on society have not been discussed. *See generally* Keith Aoki, *Considering Multiple and Overlapping Sovereignties: Liberalism, Libertarianism, National Sovereignty, “Global” Intellectual Property, and the Internet*, 5 *IND. J. GLOBAL LEGAL STUD.* 443 (1998). The trend toward “globalization” in business, fostered by advances in communications, may lead to important changes in international law. *See* Dan L. Burk, *Trademark Doctrines for Global Electronic Commerce*, 49 *S.C. L. REV.* 695 (1998) (suggesting changes in trademark law to adapt to new forms of global electronic commerce); *see also* Paul Edward Geller, *From Patchwork to Network: Strategies for International Intellectual Property in Flux*, 31 *VAND. J. TRANSNAT’L L.* 553 (1998) (analyzing the shift from national to international intellectual property laws in the emerging global e-commerce marketplace).

sued by a competitor, e.g., the risk of defending a significant intellectual property (IP) liability suit;⁴ (2) the risk of potential liability to business consumers and individuals arising out of invasion of privacy, defamation, libel, slander and similar claims; (3) the risk of incurring economic losses due to first and third-party claims based on alleged loss or destruction of data, inability to access data, network downtime, and similar types of claims based on economic losses and destruction or corruption of computer data; (4) the risk of loss of intellectual property rights and/or trade secrets as a result of the wrongful acts of third parties and/or employees; and (5) the risk of losing existing and prospective business relations because of the improper actions of competitors.⁵ Most of the reported insurance coverage cases focus on whether or not coverage exists under the policyholder's comprehensive general liability ("CGL") policy and more

4. This article discusses the following types of IP liability lawsuits: (1) patent infringement cases, both contributory and inducing; (2) trademark infringement cases; (3) service mark infringement cases; (4) trade dress infringement cases; (5) misappropriation of trade secrets cases; and (6) Lanham Act cases. For other commentators' views on emerging coverage cases in this area, see David A. Gauntlett, *Patents and Insurance: Who Will Pay for Reimbursement?*, 4 B. U. J. SCI. & TECH. L. 6 (1998) (concluding that "counsel representing clients in patent infringement lawsuits should promptly tender these claims to insurers, who are 'at risk' from and after the date when an insured asserts a claim for damages. Insurers will more than likely deny a defense based on pertinent case law. Nevertheless, such denials may be ill-considered and do not specifically address the factual elements necessary to prove the pertinent patent claims. Careful analysis of the claims, in light of applicable law and the character of the proof required in the underlying patent infringement lawsuit, may support the basis of the insured's claim against the insurer. The rewards available to a persistent policyholder in pursuit of such claims can be significant." See also Lisa A. Small, *Offensive and Defensive Insurance Coverage for Patent Infringement Litigation: Who Will Pay?*, 16 CARDOZO ARTS & ENT. L.J. 707 (1998) (discussing patent infringement actions brought by a two-person company, Celeritas Technologies Ltd., against Rockwell International Corp. and AT&T, demonstrating the great burden small companies face in defending their patent rights against larger competitors. Ms. Small concludes that "because the high-tech industry continues to grow in importance to the United States, the economy, insurers, businesses, and courts must make a strong cooperative effort to put an end to this industry's suffering. In recognizing that patents are the lifeblood of this industry, adequate insurance coverage must be made widely available in order to ensure patent security to all interested parties."). See also David Syrowik, *Insurance Coverage for Software-Related Patent and Other Intellectual Property Disputes*, 75 MICH. BUS. L.J. 502 (1996) and Jason A. Reyes, *CGL Insurance Coverage for Patent Infringement*, 2 B.U. J. SCI. & TECH. L. 14 (1996).

5. The risks facing policyholders involved in technology enterprises are very difficult to accurately assess and quantify. One of the significant problems in pricing insurance to protect a policyholder's intellectual property is the difficulty of accurately assessing the risks to that "property." As noted by David N. Schachter in the Denver Business Journal, "IP liability insurance is scarce because, unlike other areas of potential liability, it has proven extremely difficult to apply the insurance model to the types of losses that arise from the misuse or infringement of intellectual property rights. There are two reasons for this. First, while it may be relatively easy to predict the types of losses that can befall something tangible like a building or a supply of inventory, it is far more complex trying to predict the types of perils that can arise from the misuse of an intangible asset like intellectual property. Thus, statistical accuracy suffers." Schachter also notes that the expected magnitude of loss is also very difficult to assess: "[E]ven if the risks can be identified, it's also difficult to estimate the magnitude of losses that can occur. As a result, only a few types of policies insure against liability for intellectual property claims, and those that do are sometimes of little benefit." David N. Schachter, *Intellectual Property Insurance in Short Supply*, Denver Bus. J., Nov. 26, 1999, at 39A, available at 1999 WL 24308375.

particularly, under Coverage “B” of that policy which insures against personal and advertising injuries.⁶ As technology and the law evolve, policyholders, their counsel, and their carriers will face new and complex issues concerning whether or not new risks and/or theories of liability trigger the duty to defend, the effect of inserting exclusions in prior policies to “clarify” the policy’s coverage, whether or not new IP policies have been triggered, as well as other similar issues.

Section V analyzes select insurance cases and key concepts in determining whether or not a claim that has resulted in litigation may be covered by the policyholder’s insurance portfolio. This section analyzes strategies available to a policyholder facing an intellectual property loss or claim, the duties and obligations of an insurance carrier to investigate and defend that claim after receiving notice of the claim, and the policyholder’s ability to recoup its own investigation costs. Moreover, this section also includes an analysis of the policyholder’s options when facing a denial of coverage or a reservation of rights letter, including entering into a standstill agreement with the insurance carrier or filing a declaratory judgment action against the carrier. Included in that discussion is a synopsis of Texas’s duty-to-defend jurisprudence and the eight-corners rule, as well as standing issues and potential issues concerning the cooperation clause in the event the policyholder elects to file a declaratory judgment action.

I. GENERAL BUSINESS RISKS ARISING OUT OF OPERATIONS THAT ARE BASED PRIMARILY UPON INTELLECTUAL PROPERTY

Businesses that are primarily involved in the creation, dissemination, distribution, production, and protection of intellectual property face unique business risks and potential liabilities.⁷ This section analyzes potential risks posed by business competitors arising out of potential liability for patent, copyright, service mark, trademark, unfair competition, Lanham Act, trade dress, and anti-trust claims.⁸

6. For an excellent synopsis of the history and evolution of the CGL policy, see Kenneth S. Abraham, *The Rise and Fall of Commercial Liability Insurance*, 87 VA. L. REV. 85 (2001).

7. See, e.g., *Westport Ins. Corp. v. MP3.com*, No. 01-CV-1899, S.D.N.Y. (complaint filed to avoid providing reimbursement to MP3.com for legal settlements made by MP3.com after U.S. Judge Jed S. Rakoff of the Southern District of New York found that MP3.com willfully infringed the copyrights of Universal Music Group and would be required to pay \$25,000.00 for each CD copied to its database—which later resulted in a settlement of \$53.4 million). See also 6 MEALEY’S EMERGING INSURANCE DISPUTES 6 (Mar. 20, 2001).

8. This article focuses on conflicts that have arisen or that may potentially arise between domestic competitors. However, as U.S. firms expand overseas, conflicts between U.S. companies and international companies will become more prevalent. Furthermore, as developing countries seek access to new technology, disputes may arise concerning the price to be paid for such access and the purpose for which the technologies may be used. See Eveyln Su, *The Winners and the Losers: The Agreement on Trade-Related Aspects of Intellectual Property Rights and Its Effects on Developing Countries*, 23 Hous. J. INT’L L.

Companies are increasingly using their intellectual property rights, technology, and the Internet to reach new markets, gain a competitive advantage in existing markets, safeguard their existing market position, and maximize their revenues and net income. Uncertainties concerning the scope of patents have led to significant litigation, as well as disruptions in leading industries such as the semi-conductor and the pharmaceutical industries. Companies may use their intellectual property to attempt to distinguish their goods and services from those of the competition and to gain market share from the competition. Companies may also attempt to extend existing patents to new uses. Other companies may use their intellectual property rights as a revenue source by aggressively prosecuting infringers.⁹ Policyholders conducting business operations in the finan-

169, 170-71 (2000) (“The competitiveness of firms in developed countries is largely determined by the ability to develop, commercialize, and, most importantly, to capture the economic benefits from technological innovations. In recent years, these industries have experienced an increase in the number of infringement cases regarding protected corporate technology. These industries have pushed for the strengthening of global protection on intellectual property rights because violations of protected intellectual property rights cost manufacturers and companies billions of dollars in lost revenue each year. For instance, the value of pirated goods in China was \$2.3 billion in 1996 and \$2.8 billion in 1997. Governments have not only strengthened their own national laws protecting intellectual property rights, but they have also entered into international agreements in an attempt to create an international system of protection for intellectual property rights. In 1994, as part of the Uruguay Round of negotiations and agreements, the Trade-Related Aspects of Intellectual Property Rights (‘TRIPs Agreement’) was adopted in Marrakesh, Morocco. This comprehensive law governing the global protection of intellectual property rights provides the protection that industries and developed countries have been seeking. However, the TRIPs Agreement simultaneously narrows the developing countries’ access to technology, discouraging the rapid diffusion of new technology needed for economic growth.”).

9. In a recent article by Carolyn Whelan in *Fortune* magazine, the author noted that “[i]n fact, a number of older, established tech firms have strategically opted to patent everything in sight, using a massive cache of protected material as both a revenue stream and a truncheon against the competition. For example, Texas Instruments (“TI”) has guarded its stockpile of 10,000 patents as if it were Fort Knox. If a smaller company goes to market with an integrated circuit that’s even remotely close to that of TI’s, the veteran chipmaker—with its behemoth legal budget—can scare off this smaller company by threatening an expensive lawsuit. Consequently, this leads smaller companies to settle out of court, or strike some kind of licensing or royalty deal, simply to stay in business. Moreover, TI generates a whopping 20% of its profits through royalties. Likewise, mighty Intel, in its latest courtroom battle, unleashed its legal arsenal on competitor Broadcom, which the chip giant says infringed on five of its patents (and a few trade secrets to boot). Intel has a war chest of 3,000-plus patents, while Broadcom . . . has a mere eight. That’s right, eight.” Carolyn Whelan, *Are Patents Really A Virtue? Big Tech Firms May Flaunt Them. But the Truth is, Often the Best Science is Kept Under Wraps*, *FORTUNE*, Oct. 16, 2000, available at 2000 WL 24218467. Ms. Whelan also points out that to take a different approach some companies have elected not to file patent applications because of the uncertainties that may arise concerning the scope of the patent and because valuable information is required to be disclosed in the public domain as part of the patent process, thus providing the competition with a road map of the company’s best technology. *Id.*

cial services,¹⁰ professional services,¹¹ pharmaceutical sales,¹² Internet,¹³ software,¹⁴ hardware, and the retail sectors of the economy should be especially wary of the prospect that their business activities might infringe upon the intellectual property rights of their competitors.¹⁵

10. Potential liability for financial services firms may arise out of unauthorized access to client accounts, theft of account information, attacks on computer systems, unauthorized transactions, "identity theft," i.e., stealing someone's identity and using that identity to create credit lines and false account information, and other illegal and improper conduct.

11. Several prominent companies have attempted to market professional services over the Internet. For example, drkoop.com provides medical advice. Likewise, many law firms and accounting firms advertise over the Internet and may also provide legal or business advice over the Internet or via e-mail. But providing professional advice over the Internet to strangers via e-mail inquiries raises a host of liability issues.

12. Given the high number of prescription drugs that are expected to come off patent in the next five years and the need to maintain revenues, a tremendous number of patent lawsuits are expected to be filed by drug makers seeking to maximize their royalty revenues. According to William Nixon, President of the Generic Pharmaceutical Association, "whenever a brand-name drug is supposed to come off patent, there is a lawsuit. Then there is the mysterious appearance of all these new patents." Theresa Agovino, *Prilosec is Just the Start: Drug Companies Fight to Hang On To Lucrative Patents*, THE NEWS & OBSERVER, Raleigh, North Carolina, May 15, 2001, at D3, available at 2001 WL 3465081. According to a UBS Warburg report, more than \$30 billion in brand sales—about a third of prescription medicines in the United States—are slated to come off patent between 2000 and 2005. Their report concludes that new drugs under development are not sufficient to replace lost sales due to patent expiration. *Id.*

13. After the U.S. Court of Appeals for the Federal Circuit ruled that business methods could be patented, the P.T.O. was deluged with patent applications. In perhaps the most widely known case, Amazon.com sued Barnesandnoble.com, alleging that Barnesandnoble.com infringed on its "one-click ordering patent." Anne Eisenberg, *Copyright, Legal Issues in Stars for Celestial Jukebox*, CHICAGO TRIBUNE, December 27, 1999, at 6, available at 1999 WL 31274616. The court's ruling surprised many patent law practitioners because it was thought that business methods were not subject to patents: "For 100 years, courts had held that business methods themselves could not be patented, said Barry Rein, a partner at Pennie & Edmonds, but the 1998 ruling ran counter to that idea. Many Internet companies promptly started filing patents for their methods, and some of them then sued other companies for infringement." *Id.*

14. For example, Jupiter Media Metrix, Inc. recently sued competitors claiming that they infringed software used to track visitors to websites. Ellen McCarthy, *Media Metrix Targets Rivals in Patent-Infringement Suits*, WASH. POST, Mar. 29, 2001, at E05, available at 2001 WL 17616522. According to the Washington Post, "The company announced yesterday that it has settled a patent-infringement case against PC Data Inc. of Reston—a deal that will essentially force the smaller player out of business. Media Metrix then promptly filed similar lawsuits in federal court against two other rivals, NetRatings Inc. of Silicon Valley and NetValue SA of Paris." *Id.*

15. See also Claire Horn, *Patently Unfair*, THE NEWS & OBSERVER, Raleigh, North Carolina, Feb. 19, 2001, at D1, available at 2001 WL 3453057 ("Considering the thousands of patents that IBM can assert across diverse technologies—the company was issued more than 2,800 last year alone—the scale is always in our favor," Rosenthal says. Patent portfolios and cross-licensing practices are the new monopolies in the new economy, and a source of growing concern to many creators of software and e-commerce systems. If you can't pay cross-licensing fees, you won't get to play. If you land, even inadvertently, on another's intellectual property, go straight to your lawyer's office and prepare to be sued."). Some commentators believe that the "use of patent litigation for pure profit and competitive advantage is fundamentally wrong." Michael Paul Chu, Note, *An Antitrust Solution to the New Wave of Predatory Patent Infringement Litigation*, 33 WM. & MARY L. REV. 1341, 1342 (1992) ("Although legitimate patent owners have exclusive rights to make, use, or sell their patents, the question arises whether the corporate use of patent litigation for pure profit and competitive advantage is fundamentally wrong.").

Intellectual property rights, including patents on business methods, and the creation of recognized web sites may enable a policyholder to distinguish their goods and services from their competition in a unique or meaningful manner and may force their competitors out of business. Given the uncertainty created by mass patent filings and the increased emphasis on the use of intellectual property to create meaningful barriers to competition, policyholders operating a high technology enterprise or conducting business operations on the net or in cyber-space should evaluate their potential exposure to the following risks and develop an appropriate insurance portfolio¹⁶ to protect their businesses from potentially crippling losses or litigation for the following risks:

1. That a competitor will claim that the policyholder has infringed its patents, trademarks, service marks, trade dress, or copyrights;¹⁷
2. That a competitor will claim that the policyholder has engaged in unfair competition or has violated anti-trust statutes;¹⁸
3. That a competitor will claim that the policyholder has misappropriated trade secrets;¹⁹
4. That a competitor or former employer will claim that the policyholder has committed defamation, slander, or libel;²⁰
5. That a competitor will claim that the policyholder has engaged in tortious interference of business contracts;²¹ and

16. Because specialized insurance policies providing insurance for patent infringement and other claims have only recently become available, there are very few cases to guide policyholders on the coverage afforded by such policies. In addition, because ISO's 1998 modifications and clarifications to the "standard" CGL policy have only recently been approved by state regulatory agencies, policyholders face some uncertainty regarding the meaning of the changes to the "advertising injury" section of the CGL policy, under which most of the cases cited in this article have been decided. Given the changes made to this section of the policy, it is foreseeable that many coverage issues may arise. For example, A-Frame Pools, Inc., a pool manufacturer, recently filed a lawsuit against a competitor, Concord Pools Ltd., complaining that the competitor's website, www.aframepools.com, which automatically diverted Internet browsers to the competitor's website, infringed the plaintiff's trademarked name. As further explained in Section V below, evaluating whether or not the duty to defend or the duty to indemnify are triggered raises several questions: (1) does a domain name constitute an "advertisement"?; (2) does the registration of a domain name constitute "advertising activity"?; (3) are damages measured by the plaintiff's lost sales as a result of the alleged trademark infringement or by the plaintiff's lost sales and the competitor's gain in sales, or some other metric? The CGL Policy is available at ISO website at <http://www.iso.com>.

17. See, e.g., *Franklin v. Fugro McClelland, Inc.*, 16 F. Supp.2d 732, 735 (S.D.Tex.1997).

18. See, e.g., *Scottsdale Ins. Co. v. Travis*, 2001 WL 569300 (Tex. App.—Dallas 2001, no pet. h.) (competitor accused of tortious interference of contract because of the alleged misuse of proprietary client information).

19. See, e.g., *3V, Inc. v. JTS Enter., Inc.*, 40 S.W.3d 533 (Tex. App.—Houston [14th Dist.] 2000, no pet. h.).

20. See, e.g., *Bio-Medical Applications of Texas v. Dionicio Manuel Alvarez, M.D.*, 2000 WL 1368048 (Tex. App.—El Paso 2000) (suit against former employee involving the breach of covenants not to solicit employees, compete, disclose trade secrets, unfair competition claims, Lanham Act violations, tortious interference of contract claims, business disparagement claims, and requests for permanent injunctions).

21. *Gaia Tech. Inc. v. Recycled Prod. Corp.*, 175 F.3d 365, 368-69 (5th Cir. 1999) ("Gaia filed the present lawsuit on October 20, 1993, alleging that the defendants' use of the Turner-Entek intellectual property amounted to federal patent and trademark infringement and various Texas law torts. The individual defendants in this appeal were affiliated

6. That the policyholder will become involved in litigation concerning claims that a new employee has violated a covenant not to compete.²²

Businesses that are particularly dependent on their patent portfolio face enormous risks if their patents are challenged and ultimately invalidated or found to have a narrower scope than previously anticipated.²³ Likewise, businesses that are not based on technology or the Internet also face significant potential liabilities arising out of their use of technology, email, or the Internet. For example, a number of lawsuits have been filed by discharged workers alleging that their employer violated their right to privacy by reading their mail.²⁴

with Retex at the time of the alleged conduct. Turner was initially a defendant in this case, but he settled with Gaia before trial. As for the other corporate defendants, Retek was Retex's parent company, and Progressive was involved with Retek's efforts to raise money for its operations. *Id.* at 368, n.1. The jury verdict found the corporate defendants liable for all of Gaia's federal infringement claims, awarding damages totaling \$3,972,500. It also found the corporate defendants liable for three state law claims, awarding damages of \$125,000 for unfair competition, none for misappropriation of trade secrets, and \$4,350,000 for tortious interference with prospective contractual relations.")

22. *NCH Corp. v. Share Corp.*, 757 F.2d 1540 (5th Cir. 1985).

23. See, e.g., Nicholas Varchaver, *A Hot Stock's Dirty Secret: Remember When Chip Company Rambus Was the Talk of CNBC? Now It's Been Laid Low – By H's Own Duplicity and Greed*, *FORTUNE*, July 9, 2001, at 106, available at 2001 WL 2173007. Rambus obtained licensing agreements from Hitachi and Samsung to license SDRAM technology. Other companies, however, refused to pay Rambus licensing fees. Thus, Rambus ultimately lost. *Id.*

24. See, e.g., Donald W. Schroeder, *The Information Superhighway: Avoiding Workplace Nightmares*, 45 B. Bus. J. 8, 23 (Mar.-Apr. 2001) ("The widespread use of electronic communications in the workplace has led to an increase in discrimination and harassment lawsuits."). Schroeder writes that "[a] federal court in Pennsylvania dismissed a lawsuit in which an employee claimed he was discharged because his employer wrongfully intercepted his e-mail messages. Michael Smyth, Regional Operations Manager for the Pillsbury Company, received an e-mail at home from his supervisor. Smyth failed to show the best of judgment in his responses, which contain references to sales management and threats to 'kill the back-stabbing bastards.' Smyth also referred to a planned company party as the 'Jim Jones Kool-Aid affair.' After intercepting the messages, Pillsbury decided to terminate Smyth for transmitting what it deemed to be inappropriate and unprofessional messages over the company's e-mail system. Smyth then sued for invasion of privacy. The court decided that Smith did not have a claim against Pillsbury, holding that there could be no reasonable expectation of privacy in e-mail communications voluntarily made over the company e-mail system. Additionally, the court would not consider Pillsbury's interception of Smith's e-mail communications to be a substantially and highly offensive invasion of his privacy. Moreover, the court reasoned that Pillsbury's interest in preventing inappropriate and unprofessional activity over its e-mail system would outweigh Smyth's privacy interest. At the same time, a Massachusetts state court refused to dismiss an invasion of privacy claim where the president of the company allegedly reviewed his employees' e-mail messages. In *Restuccia v. Burk Technology, Inc.*, 1996 WL 1329386 (Mass. Super. Ct. 1996), the corporation did not have an electronic communication policy against using the e-mail system for personal messages. Moreover, the corporation never informed its employees that their e-mail messages were saved onto backup computer files and that supervisors had access to these communications. Following his review of certain e-mail messages between two employees, Laurie Restuccia and Neil LoRe, the president purportedly terminated them based upon their excessive use of the e-mail system. Under Massachusetts law, 'a person shall have a right against unreasonable, substantial or serious interference with his privacy.' MASS. GEN. L. Ch. 214 § 16. Finding a genuine material issue as to whether plaintiffs had a reasonable expectation of privacy in their e-mail messages, the court declined to grant summary judgment for the company. At trial, however, the jury granted a defense

II. GENERAL RISKS OF LIABILITY ARISING OUT OF INVASION OF PRIVACY, SLANDER, LIBEL, AND DEFAMATION CLAIMS

Policyholders also face a wide array of potential invasion of privacy, slander, libel, and defamation claims from businesses and individuals. Individual consumers may also seek to recover damages caused by the improper practices of third parties, e.g., recovery for damages caused by third parties "stealing" the identity of the consumer and making unauthorized purchases using the stolen identity.²⁵ In addition, policyholders may face suits arising out of consumer complaints regarding lack of access to computer networks or network downtime. Consequently, there is no

verdict, finding insufficient evidence to support the plaintiffs' privacy claim." Schroeder, at 9 & 23. According to Schroeder, in another case in Massachusetts, "two African-American employees sued Morgan Stanley for allegedly denying them promotions following complaints relating to a racist e-mail distributed throughout the company's e-mail system." *Owens v. Morgan Stanley & Co.*, 1997 WL 403454 (S.D.N.Y. 1997). Plaintiffs alleged that distribution of the racist e-mail constituted a hostile work environment. Dismissing plaintiffs' harassment claim, the court reasoned that a single offensive e-mail could not form the basis for a claim of hostile work environment. . . . To avoid litigation, an employer should establish a detailed electronic communications policy to minimize an employee's reasonable expectation of privacy. The following principles should form the basis of the employer's policy: electronic communications, including e-mail, voice-mail, and the contents of the employee's computer should be strictly identified as the property of the employer. Use of this property by the employee must be strictly limited to the employer's business. The employer must clearly reserve the right to monitor and access these communications, including the contents of any business computer for any legitimate business reason. The employer should specify the purpose of the employer monitoring and identify the extent of any monitoring of employees' communications, including e-mail, voice-mail, computer files and Internet use. The employee should also offer voluntary consent to electronic and telephonic monitoring. Employees should also be aware that the use of passwords or codes may be overridden by the employer for legitimate business reasons and that all passwords and codes should be disclosed to the employer to facilitate this access. The employer should reserve the right to inspect e-mail files at any time to ensure the system is not abused by employees." Schroeder, at 23-24. We have not found a similar Texas case involving allegations by employees of employer misuse of internal communications systems. In general, under Texas law, a claim for "intrusion upon the plaintiff's seclusion, solitude and into his private affairs "requires that there be an intentional intrusion, upon the solitude or seclusion of another, or his private affairs or concerns that is highly offensive to a reasonable person. *Gill v. Snow*, 644 S.W.2d 222, 224 (Tex. Civ. App.—Fort Worth 1982, no writ). See also RESTATEMENT (SECOND) OF TORTS, § 652B (1977). This type of invasion of privacy is generally associated with either a physical invasion of a person's property or by eavesdropping on another's conversation with the aid of wiretaps, microphones or spying. *Gonzales v. Southwestern Bell Tel. Co.*, 555 S.W.2d 219 (Tex. Civ. App.—Corpus Christi 1977, no writ). See also RESTATEMENT (SECOND) OF TORTS, § 652B, cmts. b, c, and d (1977). The plaintiffs in this case allege this form of invasion of privacy stemming from the publication of the list of employees who were sent "letters of concern."

25. The use of the Internet to commit fraud is becoming more prevalent. See John C. Anderson and Michael L. Closen, *Document Authentication in Electronic Commerce: The Misleading Notary Public Analog for the Digital Signature Certification Authority*, 17 J. MARSHALL J. COMPUTER & INFO. L. 833, n.29 (Spring 1999 Symposium) ("Reports of Internet fraud tripled between 1996 and 1997. David Hayes, *Internet Fraud: Oh, What A Tangled Web! The Number of Complaints About Computer Crooks Is Rising Sharply*, YORK DAILY REC., Mar. 2, 1998, at D6, available at 1998 WL 6211361. Last year, companies spent roughly \$6.3 billion on computer network security systems, a figure that is expected to double by 2000. See L.A. Lorek, *Security the Focus for Businesses as Internet Crime Increases*, FT. WORTH STAR-TELEGRAM, Oct. 20, 1997, at 23, available at 1997 WL 11913906.").

way to list or foresee the multitude of risks that a policyholder may face in conducting its business operations. Some of the more significant risks and potential liabilities that may occur include the following:

1. The policyholder's software will corrupt the consumer's data;²⁶
2. The policyholder's hardware will fail;²⁷
3. The policyholder's software may not perform as expected or as warranted;²⁸
4. The policyholder's network may not be accessible by consumers;²⁹
5. The policyholder's hardware or software will contain glitches or need to be recalled;³⁰
6. The policyholder may not be able to deliver goods as promised to the consumers by set schedules;
7. The policyholder's data relating to consumers will be hacked, and then inadvertently released, disclosed, lost, or corrupted;³¹
8. The policyholder's hardware will become infected by computer viruses or that software developed to prevent viruses will fail;³² and

26. *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp.2d 942 (E.D.Tex. 2000) (multi-billion dollar consumer class action settlement involving claims of data loss and data corruption).

27. *Comptech Int'l, Inc. v. Milam Commerce Park, Ltd.*, 753 So.2d 1219, 1226 (Fla. 1999) (damage to tenant's computers constituted damage to "other property" within the meaning of the applicable insurance policy) ("With this understanding of the use of the term 'other property,' we agree that the trial and district courts erred in finding the computers which were damaged during the warehouse renovations were not "'other property.'").

28. For example, Intel has faced numerous suits alleging defects in its math co-processors. See *Shaw, supra* note 26, at 990. "For example, Intel has been repeatedly sued in class action suits alleging defective computer designs, including its famous 1994 debacle with its Pentium computer chip, which had a flaw affecting certain mathematical calculations."

29. For example, spamming or an unexpected spike in the numbers of e-mails sent on a computer network may cause an ISP system to crash, thus preventing consumers from accessing that network. See Michael S. Yang, *E-Commerce: Reshaping the Landscape of Consumer Privacy*, 33 Md. B.J. 12, 16 (July/August 2000) ("If enough messages are sent, the computer networks carrying the messages may even crash, thus costing consumers usage time and damaging the reputation of service providers. Because service providers are private entities, they have prevailed against First Amendment challenges to their denial of access to senders of unsolicited bulk e-mails.").

30. See, e.g., *Taylor Inv. Corp. v. Weil*, 2001 WL 391559, *2 (D. Minn. 2001) ("Shortly after CMAC installed StarBuilder at Taylor, Taylor began discovering serious defects in the software that made it entirely unusable. The record reflects that numerous other Geac customers, including other customers of CMAC, were having similar problems with StarBuilder. On March 5, 1996, Geac issued a memorandum to its sales force describing various flaws in the software that customers had discovered.").

31. For example, banks providing online access to client information may be at risk if that confidential information is inadvertently released or hacked. See Edward L. Raymond, Jr., Annotation, *Bank's Liability, Under State Law, For Disclosing Financial Information Concerning Depositor or Customer*, 81 A.L.R.4th 377 (1990); see also *Peoples Bank of Virgin Is. v. Figueroa*, 559 F.2d 914, 917 (3d Cir. 1977) (unauthorized disclosure by bank of customer's financial information would "breach[] duties of confidentiality and privacy.").

32. See *The Impact of Computer Viruses and other Forms of Computer Sabotage and Exploitation on Computer Information Systems and Networks: Hearing Before the Subcommittee on Technology and the Law of the Committee on the Judiciary*, 101st Cong. (1989).

9. The policyholder's technology systems will fail to prevent attacks on the consumers' computer systems.³³

III. SIGNIFICANT RISKS OF POTENTIAL LIABILITIES ARISING OUT OF NETWORK UNAVAILABILITY, SYSTEM FAILURES, COMPUTER CRASHES, COMPUTER VIRUSES, AND SIMILAR EVENTS

Policyholders face significant potential liabilities arising out of damage claims related to system crashes, network downtime, and loss or corruption of data.³⁴ In general, policyholders should safeguard their intellectual and physical assets, to the extent economically feasible, against the following types of business risks:

1. The policyholder's software or hardware will fail and the policyholder's systems will crash;
2. The policyholder's systems will be hacked;
3. The policyholder's data will be lost, corrupted, or stolen;
4. The policyholder's website will fail, causing significant loss of revenues;
5. The policyholder's intellectual property will be misappropriated; and
6. The policyholder's systems will be damaged by computer viruses.

IV. RISK OF LOSS OF INTELLECTUAL PROPERTY RIGHTS AND TRADE SECRETS

Valuable intellectual property rights can be infringed upon, misappropriated, or stolen in many different ways. Successful products or designs

33. See, e.g., Eugene M. Katz & Theodore F. Claypoole, *Willy Sutton is on the Internet: Bank Security Strategy in a Shared Risk Environment*, 5 N.C. BANKING INST. 167 (2001) ("Financial institutions are required to file a Suspicious Activity Report ("SAR") when encountering a known or suspected violation of law or a suspicious transaction relating to a money laundering activity in violation of the Bank Secrecy Act. The SAR procedures now include 'computer intrusion' as a type of reportable 'suspicious activity.' 'Computer intrusion' is defined in the instructions to the SAR form as 'gaining access to a computer system of a financial institution to: (a) [R]emove, steal, procure or otherwise affect funds of the institution or the institution's customers; (b) [R]emove, steal, procure or otherwise affect critical information of the institution including customer account information; or (c) [D]amage, disable or otherwise affect critical systems of the institution. For purposes of this reporting requirement, computer intrusion does not mean attempted intrusions of websites or other non-critical information systems of the institution that provide no access to institution or customer financial or other critical information.'"). Software and hardware providers that are working with banks and brokerage firms to provide their customers with access to their accounts online obviously face tremendous potential liability in the event safety systems are compromised.

34. For example, consumers may claim that the policyholder's products corrupted data stored on the consumer's servers. See, e.g., *Shaw, supra* note 26, at 942. According to the Plaintiffs' Second Amended Class Action Petition, the defendants floppy-diskette controllers or ("FDCs"), "fail[ed] to detect the error, resulting in the storage of corrupt data or the destruction of data without the user's knowledge." A class action settlement of \$2.1 billion, along with attorney's fees of \$147.5 million, was approved by the Hon. Thad Heartfield in the *Toshiba* case. Sofia Adroque, *News and Departments Keeping Up with Class Actions*, 38 Hous. Law. 52, 52-53 (2000).

may be copied and sold in gray markets or overseas. Businesses may attempt to reverse engineer protected products to save money or use the well-recognized slogans of others in their marketing plans. Current or former employees may improperly misappropriate valuable trade secrets or other proprietary information.

In general, business policyholders face the following types of risks in defending their intellectual property portfolio:

1. That competitors will infringe the policyholder's valid intellectual property rights;
2. That competitors will copy the policyholder's products and distribute them in foreign, counterfeit, or gray markets;
3. That competitors will distribute the policyholder's products without obtaining a distributorship agreement from the policyholder;
4. That competitors will pass off the policyholder's goods or products as the competitor's;
5. That competitors will incorporate aspects of the policyholder's design into products manufactured or distributed by the competitor;
6. That competitors will improperly divert business traffic on the Internet to the competitor's website;
7. That competitors will claim that the policyholder should be required to enter into a licensing agreement because the policyholder has allegedly infringed on protected aspects of the competitor's goods or services;
8. That competitors will hire the policyholder's employees or agents and obtain information concerning the policyholder's trade secrets and business operations; and
9. That competitors will engage in industrial espionage and steal computer data, designs, product information, client lists, and other proprietary information.

V. INSURANCE COVERAGE ISSUES ARISING OUT OF INTELLECTUAL PROPERTY LITIGATION OR THE THREAT OF LITIGATION

The risks of conducting business operations in the highly competitive technology industry are significant and vary widely. Companies should carefully evaluate their operations and consult with a risk assessment specialist to determine whether or not economically feasible hedges are available to minimize or transfer the risks identified above to third parties. Companies should attempt to minimize their risks by developing an in-house risk management program that would potentially include the following: (1) regular, periodic reviews of the company's insurance program; (2) market intelligence evaluations to determine whether or not competitors are likely to infringe on the company's proprietary technology; and (3) legal reviews of the company's existing intellectual property portfolio to determine whether additional patent, trademark, or service

mark applications should be filed.³⁵ This section covers policyholders' potential responses to first-party and third-party claims that may be covered by insurance policies or indemnity agreements.

A. CRITICAL INITIAL DECISIONS CONFRONTING POLICYHOLDERS
FACED WITH AN INTELLECTUAL PROPERTY CLAIM

In the event a first-party or third-party claim occurs, the policyholder should notify the insurance carrier or indemnitor as soon as possible.³⁶ The policyholder should also request a copy of all insurance policies that might provide coverage for the claim. Moreover, the policyholder should be wary of memoranda prepared by employees relating to the claim of expert reports or internal communications concerning the investigations of the claim are within the scope of discovery, and not subject to work product protection. The policyholder should also carefully consider the process of tendering the claim to the insurance company and communicating with insurance carriers. Policyholders should be aware that insurance companies might claim that they relied on statements made by the policyholder or the policyholder's employees in deciding whether or not to defend the policyholder. If the policyholder's statements are later determined to be inaccurate or incorrect, the insurance carrier might seek to recoup its pre-tender investigation costs and defense costs.³⁷ In any

35. Given the expected growth of e-commerce and the continued increasing reliance on technology, there is likely to be a substantial increase in the number of intellectual property disputes in the near future. According to commentator Robert Paul Norman, "[e]-commerce is growing at a simply phenomenal pace. Previously, it was estimated that e-commerce would total \$1.4 trillion by the year 2003. It is now virtually certain that e-commerce will far surpass that estimate. Data 'traffic' on the 'Net' alone is growing exponentially, somewhere between 200-600% per year. Tens of millions of people log on to the Internet every day. Net traffic *doubles* every 100 days. Amazingly, PC's are becoming a thing of the past in this new economy. In their place, hundreds of millions of hand held Internet 'appliances' (such as cell phones and Palm Pilots) will be used to access the Internet. This exponential growth of the Internet is resulting in additional exposure for users of the 'Net.' Insurance carriers believe that e-commerce will be the 'single biggest insurance risk of the 21st century.' REUTERS ENG. NEWS SERV. (May 9, 2000); J. COM. ABSTRACTS 12 (2000). For instance, the so-called Love Bug e-mail virus caused an estimated \$15 billion in damages. Many insurance carriers have already gone on record as saying that Love Bug losses are not covered under traditional insurance products. As a result, many carriers have begun to produce new insurance policies, which are directed specifically at the types of risks that exist in cyber space." *Virtual Insurance: Is Your Old Policy From InvisibleINC.COM? If So, What Cyber Policy Adequately Covers Your Risks?*, ABA's Tort and Insurance Law Practice Group Seminar Presentation, March 20-24, 2001.

36. If there is a potential indemnification claim, the policyholder should review the language of the indemnity closely. The indemnity provision may or may not address critical issues such as the responsibility for payment of investigation and defense costs, the forum in which the claim will be resolved, the law that will apply to the resolution of the claim, and other similar issues.

37. The legal counsel for the policyholder should also monitor interpretations of policy language and adoptions of changes to policy language issued by the Department of Insurance. Other commentators have noted that the Texas Supreme Court has shown an increasing willingness to examine the opinions of administrative law bodies in determining the scope of insurance coverage. See Hon. Rose Spector & Mary Keller, *High Court and Insurance Commission Perspectives on Bad Faith and Other Issues*, TEXAS INSURANCE LAW SYMPOSIA (1999) ("While the Court still adhered to its long tradition of interpreting poli-

event, consultation with an experienced lawyer is essential to ensure that the policyholder presents the insurance claim in the best possible manner.

B. THE INSURER'S DUTY TO DEFEND THE POLICYHOLDER

Because defending and prosecuting intellectual property claims involves tremendous legal costs and uncertainties, policyholders and insurers need to carefully assess their respective positions on the duty to defend. Following the service of suit on a policyholder, these critical questions should generally be addressed as soon as possible: (1) whether the suit should be tendered to the insurance carrier; (2) whether the carrier should accept coverage and agree to defend the policyholder, deny coverage and refuse to defend, or defend under a "reservation of rights"; (3) whether the policyholder should accept a limited form of defense offered by the carrier in a reservation of rights letter or expend its own funds defending the suit and seeking reimbursement later; (4) whether the carrier should file a declaratory judgment action to determine its defense and indemnity obligations; and (5) whether the policyholder can require the carrier to prosecute a counterclaim. These are complex, significant issues for both policyholders and carriers. Policyholders should also take all appropriate steps to ensure that they recover their "pre-tender" defense costs, including the costs of investigation. In order to understand the strategies that are available to both policyholders that are facing a lawsuit which alleges intellectual property liabilities and the strategies that are available to the insurer in response, it is first necessary to understand when the duty to defend is triggered under the "eight corners"³⁸ rule and the relatively few exceptions to that rule.³⁹

cies under general rules of contracts, three of the opinions made reference to the regulatory oversight of the Department and one relied, to some degree, on an official order of the Department and its finding with respect to the effects on rates. This recognition of the Department began last term with the Court's opinions in *Liberty Mut. v. Garrison* and *Balandran v. Safeco*. In *Balandran*, the Court detailed the Department's adoption of the Texas Standard Homeowner's Policy—Form "B", including the intention of the Department that any changes to the policy 'not in any manner restrict coverages currently available to the insured.' This opinion was in sharp contrast to the 1995 decision in *Nat'l Union v. CBI Indus.*, in which the Court refused to consider the circumstances surrounding the Department's adoption of the policy in question. In *Garrison*, the Court specifically recognized the Department's 'unquestionable' expertise in the insurance trade and referred to the Department's rules in interpreting the Insurance Code. The Court's opinions this term and last signal a possible reconciliation of insurance law with other areas of administrative law. Instead of viewing insurance policies as pure contracts, the Court may be adopting a more modern view that insurance policies, often promulgated or approved by the Department, are more in the nature of administrative rules where guidance from the administrative agency would be useful and maybe even necessary." Mr. Roach was counsel of record in the *CBI* case.

38. The "eight corners" rule is also known as the "complaint allegation" rule.

39. See generally Lee H. Shidlofsky, *The Duty to Defend: An Analysis of the Eight Corners Rule*, 9TH ANNUAL ULTIMATE INSURANCE LAW SEMINAR, STATE BAR OF TEXAS (2000). Mr. Shidlofsky is an associate with Cook, Roach & Lawless in Austin, Texas.

1. *When Is the Duty to Defend “Triggered” Under Texas’s “Eight Corners” or “Complaint Allegation” Rule?*⁴⁰

The classic formulation of Texas’s “eight corners rule” or “complaint allegation rule” was provided by the Texas Supreme Court in *Heyden Newport Chemical Corp. v. Southern General Insurance Co.*:

We think that in determining the duty of a liability insurance company to defend a lawsuit the allegations of the complainant should be considered in the light of the policy provisions without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the true facts to be, or without reference to a legal determination thereof.⁴¹

Courts will not look beyond the “eight corners” of the petition nor the “four corners” of the insurance policy to determine whether or not the insurer owes a duty to defend.⁴²

During their review of the petition, Texas courts initially focused on whether or not the allegations made in the petition “were sufficient to state a cause of action against [the policyholder] coming within the terms of the policy.”⁴³ The duty to defend was triggered when the factual allegations stated a cause of action that could result in a judgment of liability that would be covered by the insurance policy. However, Texas courts now focus on the factual allegations made in the petition, rather than focusing on a cause of action test. If the factual allegations state a claim that may be covered by the insurance policy, then the court will find a duty to defend.⁴⁴ Moving away from a cause of action test shifts the focus away from the legal allegations made in the petition to the facts that caused the alleged injuries, thus making it much less likely that an allegation of negligence, for example, would trigger the duty to defend.

Under the eight corners rule, Texas courts also generally construe complaint allegations liberally in favor of coverage. As stated in the *Heyden Newport* case, “[w]hile we have said above that the court is limited to

40. This article focuses primarily on Texas cases and current Texas jurisprudence concerning the duty to defend. For a summary of the jurisprudence of other states on the duty to defend, see generally David A. Gauntlett, *INSURANCE COVERAGE OF INTELLECTUAL PROPERTY ASSETS*.

41. 387 S.W.2d 22, 24 (Tex. 1965).

42. As explained by commentators Michael Sean Quinn and Pamela D. Nielson, “The rule is quite simple. If a petition alleges facts which would, if proved, require the insurer to make payments on behalf of the insured, then the insurer has a duty to defend. The truth of the allegations [in the petition] does not matter in the slightest. Under the Eight Corners Rule, courts are not to ‘read facts into the pleadings.’ Furthermore, courts should not look ‘outside the pleadings, or imagine factual scenarios which might trigger coverage.’” Michael Sean Quinn & Pamela D. Nielson, *Insurance Law*, 51 SMU L. REV. 1131, 1167 (1998) (footnotes omitted).

43. *Maryland Cas. Co. v. Moritz*, 138 S.W.2d 1095, 1097-98 (Tex. Civ. App.—Austin 1940, writ ref’d); see also *Heyden Newport*, *supra* note 42, at 26.

44. See *Nat’l Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997) (“It is not the cause of action alleged that determines coverage but the facts giving rise to the alleged actionable conduct.”) (citing *Adamo v. State Farm Lloyds Co.*, 853 S.W.2d 673, 676 (Tex. App.—Houston [14th Dist.] 1993, writ denied).

consideration of the allegations and the insurance policy in determining an insurer's duty to defend, we wish to point out that in considering such allegations[,] a liberal interpretation of their meaning should be indulged."⁴⁵ Currently, there are few legal precedents concerning how broadly allegations should be read in favor of coverage. However, in *Farmers Texas County Mutual Ins. Co. v. Griffin*,⁴⁶ the court held that although factual allegations will be construed liberally in favor of coverage, the construction of the allegations must be reasonable. Moreover, the court states that "Farmers is not required to defend Royal for another reason: Griffin's petition does not allege that his injuries resulted from an auto accident. . . . To read Griffin's petition as alleging an 'auto accident' would strain that term beyond any reasonable meaning."⁴⁷

If, after applying a liberal pro-coverage interpretation to the allegations, there is no doubt that the policy would not cover the factual allegations pled, the court will not find a duty to defend. But courts disagree as to when there is enough doubt to warrant a finding that the insurance carrier has a duty to defend. For example, in *Merchants*, after liberally interpreting the allegations in the plaintiff's petition, the Texas Supreme Court overruled the Beaumont Court of Appeals' opinion that the allegations made by the plaintiff triggered the duty to defend. The court held that "[b]ecause the facts alleged in the pleadings do not suggest even a remote causal relationship between the truck's operation and Gonzalez's injury, they do not create that degree of doubt which compels resolution of the issue for the insured."⁴⁸ Consequently, future decisions will likely focus on whether the facts alleged by the plaintiff create a "degree of doubt" that is sufficient to trigger the duty to defend.

Recently, the Texas Supreme Court has clarified that under the eight corners rule, an insurer has no duty to conduct an investigation into the merits of a claim when evaluating whether or not to defend the claim.⁴⁹ Furthermore, there are obvious advantages and disadvantages of the eight corners rule. The primary advantage is that the rule is simple to apply. But the disadvantages include creating an incentive to file groundless pleadings that trigger coverage in order to force a settlement. First,

45. *Heyden Newport*, *supra* note 42, at 26; *see also Merchants*, *supra* note 45, at 141. "When applying the eight corners rule, we give the allegations in the petition a liberal interpretation").

46. 955 S.W.2d 81 (Tex. 1997).

47. *Id.* at 83.

48. *Merchants*, *supra* note 45, at 142. Under the court's analysis, the policyholder would be required to show that the injuries sustained by the plaintiff resulted from the use of the policyholder's truck. Although the policyholder was using the truck at the time of the incident, the injuries were caused by the policyholder's allegedly negligent discharge of a firearm. However, there was no link between the use of the truck and the discharge of the firearm.

49. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 829 (Tex. 1997) ("[U]nder the 'complaint allegation rule' an insurer is entitled to rely solely on the factual allegations contained in the petition in conjunction with the terms of the policy to determine whether it has a duty to defend. The duty to defend is not affected by facts ascertained before suit, developed in the process of litigation, or by the ultimate outcome of the suit.") (citing *Am. Alliance Ins. Co. v. Frito-Lay*, 788 S.W.2d 152, 154 (Tex. App.—Dallas 1990, writ dismissed)).

while the basic parameters of the rule are well known, there will always be some uncertainty as to whether the factual allegations create a sufficient degree of doubt to trigger the duty to defend. Second, the existence of liability insurance coverage may provide an incentive to target companies that otherwise would not be sued. Finally, the eight corners rule provides an incentive to abuse the judicial process by requiring insurers to defend cases as leverage for a settlement for an amount the insurer expects to be incurred in defense costs.⁵⁰

2. *Analysis of the Duty to Defend or Indemnity in Intellectual Property Cases in Texas*

There are few legal precedents in Texas to guide courts, policyholders, and insurers concerning whether or not factual allegations made by the plaintiff during intellectual property litigation can trigger the insured's duty to defend under the eight corners rule. Each of the Texas cases involves an "advertising injury"-type of claim under Coverage "B" of the standard CGL policy.⁵¹ Based on these cases, it is critical that a policyholder show: (1) that the "advertising injury" arose out of and was "causally related" to the policyholder's "advertising activities"; and (2) that the advertising offense first occurred during the time the policy was in effect.⁵²

Each case has been decided on one of the following five grounds: (a) the underlying petition did not contain a factual allegation connecting the plaintiff's alleged damages to the policyholder's "advertising activities"; (b) the conduct resulting in the alleged damages occurred prior to the inception of the policy; (c) coverage was precluded for public policy reasons under the "loss in progress" or "known loss" doctrine; (d) coverage was precluded because the plaintiff sought equitable relief rather than

50. Some commentators have suggested that the complaint-allegation rule increases the probability that a lawsuit will be filed against a company with insurance and that the plaintiff's counsel must use the duty to defend to gain leverage in tort cases. For example, Susan Randall has written that "the rules increase the likelihood that an insured will be sued. Because the complaint measures an insurer's duty, plaintiff's counsel can manipulate the pleadings to trigger the defense obligation, even in cases which are clearly not covered under the policy. As a result, the existence of liability insurance drives tort litigation; a defendant whose insurer can be involved in litigation is a more attractive target and more likely to be sued than a defendant whose insurer cannot be involved. Second, although individual insureds may benefit economically by receiving an insurer-provided defense, the complaint rule works to the economic detriment of insureds as a class by raising insurance costs. It raises costs in at least two ways: (1) by increasing the incidence of lawsuits; and (2) by requiring a defense in cases not covered by the applicable policies. Moreover, defense costs represent a significant expense for insurers, and these costs are passed onto insurance consumers. Finally, the complaint rule increases the possibility of conflicts of interest in insurance defense since an insurer must defend even where it believes there is no coverage under the policy. Consequently, an insurer has a duty to defend until it can confine the case to a non-covered claim. This formulation is a recipe for conflicts of interest. The insurer's primary concern is demonstrating non-coverage; the insured's interest lies in avoiding liability, or at least limiting it to a covered claim." Susan Randall, *Redefining the Insurer's Duty to Defend*, 2 CONN. INS. L.J. 221, 222-23 (1997).

51. See, e.g., *Indust. Molding*, *infra*, note 58; *Bradley's Elec.*, *infra* note 56.

52. See *id.*

damages; and (e) the activity alleged to have caused the plaintiff's damages was not "advertising" within the meaning of the CGL policy.

The courts' narrow approaches in resolving each case leave many of the critical questions facing policyholders and insurers unanswered, including the following: (1) when may an insurer recoup defense costs; (2) when may a court properly consider extrinsic evidence in determining whether the insurer owes a duty to defend; (3) when are the facts of the underlying case sufficiently developed to permit the insurer to file a declaratory judgment action; (4) when, if ever, is the duty to defend triggered by facts alleged in a suit that are not contained in the plaintiff's petition; (5) what *res judicata* or collateral estoppel effect, if any, does a declaratory judgment in a subsequent coverage action have when the plaintiff amends its pleadings to allege a claim that would trigger the duty to defend; (6) should an insurer be required to defend when the insurer knows or is aware of facts related to the underlying litigation that would require the insurer to defend the action; and (7) when may a policyholder recover the costs incurred in defending itself against a declaratory judgment action brought by its insurer.

Because of the narrow focus in resolving these coverage cases, courts likewise have not addressed broader cost and efficiency issues, such as: (1) is there a feasible, better, and less costly alternative to litigation to resolve duty to defend issues, such as arbitration or non-binding mediation; (2) is there an alternative to the eight corners rule that would allow insurers and policyholders to better evaluate their respective positions to avoid high cost and uncertainty.

a. The Linkage Between the Allegations in the Petition and the Policyholder's Advertising Activities

In many jurisdictions, courts have held that there is no duty to defend the policyholder in the absence of a "causal connection" between the policyholder's advertising activities and the alleged damages sustained by the plaintiff.⁵³ Insurance policies generally provide coverage for an "advertising injury" which is "caused by an offense committed in the course of advertising [your] goods, products, or services."⁵⁴ Moreover, the definition of "advertising injury" contains a second nexus requirement as well. In order for coverage to exist, the "injury" must arise out of one of these four types of offenses: (1) oral or written publication of material that libels or slanders another person or organization or that disparages another person or organization's goods, products, or services; (2) oral or written publication of material that violates another person's right of privacy; (3) misappropriation of advertising ideas or style of doing business; and (4) infringement of copyright, title, or slogan.

53. *See, e.g.*, *QSP, Inc. v. Aetna Cas. and Sur. Co.*, 773 A.2d 906 (Conn. 2001).

54. *Id.* at 921.

In *Bradleys' Electric*,⁵⁵ the court held that there was no duty to defend the policyholder against a counterclaim alleging patent infringement and contributory patent infringement. The court applied the eight corners rule and found no duty to defend because the plaintiff's petition did not contain any factual allegations that the policyholder's advertising activities caused the patent infringement to occur.⁵⁶

In *Industrial Molding Corp. v. American Mfrs. Mut. Ins. Co.*,⁵⁷ the court examined whether a CGL policy provided coverage for trade dress infringement claims brought under section 43(a) of the Lanham Act.⁵⁸ The plaintiff claimed that the policyholder introduced a "prototype Christmas tree stand product for vertical positioning of a tree during February 1996 at the Amer-Christmas Show in New Orleans."⁵⁹ The plaintiff also claimed that the policyholder sold and marketed Christmas tree stands, which infringed on the plaintiff's trade dress in a Swivel Straight stand. The plaintiff's argument was that the policyholder was attempting to avoid design, development, marketing, and advertising costs by copying the plaintiff's stand and had misappropriated the plaintiff's trade dress in its product. The policyholder brought suit against its insurer and sought a declaratory judgment that the insurer had a duty to defend, as well as damages for breach of contract, DTPA violations, unfair insurance practices, and bad faith. In ruling on cross motions for summary judgment, the court held in favor of the policyholder that coverage existed under the advertising injury section of the CGL policy for the plaintiff's claims because there was "no doubt that the complaint accused IMC of engaging in unlawful advertising activity . . . [and therefore] IMC has successfully shown that the allegations in the underlying complaint aver an

55. *Cigna Lloyds Ins. Co. v. Bradleys' Elec.*, 33 S.W.3d 102 (Tex. Civ. App.—Corpus Christi 2000, pet. denied).

56. In addition to the court's holding, several other aspects of the case are significant. First, despite the absence of any factual allegations linking the plaintiff's damages to the policyholder's advertising activities, the policyholder's primary insurance carrier initially agreed to provide a defense, subject to a reservation of rights. The carrier's decision reflects the uncertainty that exists in Texas regarding the application of the eight corners rule and the penalties that follow from mistakenly denying the policyholder a defense. Second, the primary insurer subsequently withdrew its defense and demanded to be reimbursed for the costs incurred in providing the defense. The court was not required to address the issue of whether or not the insurer was entitled to be reimbursed for the defense costs incurred. Third, the court was not required to address issues regarding the res judicata or collateral estoppel effect of the declaratory judgment. For example, if the plaintiff in the underlying suit amended its petition, following the entry of the declaratory judgment, to allege that the policyholder's advertising activities caused the plaintiff's damages, presumably under the eight corners rule, the insurer would be obligated to assume the policyholder's defense, notwithstanding the earlier entry of the declaratory judgment. *Id.* at 105.

57. 17 F. Supp.2d. 633 (N.D. Tex. 1998), *vacated*, *Indus. Molding Corp. v. Am. Mfrs. Mut. Ins. Co.*, 22 F. Supp.2d. 569 (N.D. Tex. 1998) (the parties settled their claims after the district court entered its Order granting Plaintiff's Motion for Summary Judgment and denying Defendant's Motion for Summary Judgment. The Order vacating the Court's September 16, 1998 Order was made "pursuant to this settlement." The plaintiff "neither oppose[d] nor agree[d] with" the Defendant's Motion to Vacate Order).

58. 15 U.S.C. § 1125(a) (1996).

59. *Indus. Molding*, *supra* note 57, at 640, n.1.

'advertising injury.'"⁶⁰

In reaching its holding, the court applied the three-part test applied in *Sentex Systems, Inc. v. Hartford Accident & Indemnity Co.*⁶¹: (1) whether or not the allegations in the underlying complaint raised a "potential" for liability under one of the covered offenses stated in the policy; (2) whether or not the insured engaged in an "advertising activity" during the policy period when the alleged "advertising injury" occurred; and (3) whether or not the insured's advertising activities were causally related to the underlying lawsuit's trade dress infringement claims.

In addressing whether or not the first prong of the *Sentex* test had been met, the court concluded that trade dress infringement was a covered offense under the policy. The court cited a majority of cases holding that the phrase "style of doing business," taken in its ordinary and popular sense, embraced "trade dress."⁶²

Moreover, the court found that the second prong of *Sentex* was also met because the insured's marketing activities constituted advertising under the policy. Noting that the policy did not define "advertising," the court applied the following broad definition of "advertisement" from Black's Law Dictionary, which was based on a Texas case: "[n]otice given in a manner designed to attract public attention."⁶³

Finally, the court held that the third prong of the test was met because the insured's advertising activities were "causally related" to the trade dress infringement allegations made in the underlying action.⁶⁴ "Not only was misappropriation of trade dress alleged in the underlying complaint, the required nexus between the advertising activities and damages alleged by County Line also proved the necessary causal nexus."⁶⁵ Would the case have turned out differently under the ISO's revisions? Probably not, especially given that the 1998 revisions specifically cover the infringement of another's "trade dress."⁶⁶

60. *Id.* at 639-640.

61. 882 F. Supp. 930, 936 (C.D. Cal. 1995).

62. *Id.* at 942-43. The court rejected *Advance Watch Co. v. Kemper Nat'l Ins. Co.*, 99 F. 3d 795 (6th Cir. 1996), which refused to find that "misappropriation of advertising ideas or style of doing business" included trademark or trade dress infringement, under Michigan law. *Id.* at 796.

63. BLACK'S LAW DICTIONARY 54 (6th ed. 1990) (citing *Edwards v. Lubbock Co.*, 33 S.W.2d 482, 484 (Tex. Civ. App.—Amarillo 1930, no writ)).

64. 882 F. Supp. 930.

65. *Indust. Molding*, *supra* note 57, at 639.

66. However, the new definition of "advertisement" contained in the insurance policy differs from the Black's Law definition. The new definition refers to "a notice" that is "broadcast or published in the general or specific market segments about your goods, products, or services . . ." whereas the Black's Law definition refers to "notice given" to the public. Under the district court's view, the product itself arguably constitutes "notice given" to the public whereas under the new definition it is possible that "a notice" separate and apart from the product must be given and that the product itself may not constitute an "advertisement."

b. Coverage Precluded by the “Known Loss” or “Loss in Progress” Doctrine

Several courts have held that coverage is precluded because the policyholder was aware of the loss prior to the occurrence at issue. In *Franklin v. Fugro-McClelland (Southwest), Inc.*,⁶⁷ (six insurers brought suit against two policyholders seeking a declaratory judgment that the insurers had no duty to defend or indemnify in connection with a lawsuit pending against the policyholders. However, the court’s decision was based on its application of the “known loss” and “loss in progress” doctrines.⁶⁸

In the underlying litigation, the plaintiffs alleged that the defendants infringed the plaintiffs’ patents, misappropriated trade secrets, committed fraud, breached fiduciary duties, tortiously interfered with existing and prospective contractual relationships, and committed other similar wrongful actions.⁶⁹ The plaintiffs contended that an employee of Fugro’s viewed the operations and equipment of the plaintiffs under an obligation of confidence.⁷⁰ Thereafter, Fugro allegedly solicited one of the plaintiffs to perform soil sampling work for Fugro using a machine patented to one of the plaintiffs and licensed to the other plaintiff.⁷¹ During the performance of the work, two Fugro employees were allowed to observe the work but were advised that the equipment was patented and that the work methods were confidential and were not to be used or disclosed to others.⁷² Thereafter, one of the defendants allegedly solicited technical information from the defendants regarding marketing, scheduling, and billing.⁷³ The information solicited was provided based on the belief that Fugro intended to hire the plaintiffs to complete additional work.⁷⁴ Plaintiffs allegedly learned later that Fugro had constructed a soil sampling machine that would allow Fugro to perform the work itself.⁷⁵ Fugro was informed that the construction and use of the machine violated an existing patent and the plaintiffs demanded that Fugro cease the infringing activities and cease misappropriating plaintiffs’ trade secret information.⁷⁶ Consequently, Fugro allegedly informed the plaintiffs that it would no longer use the machine.⁷⁷ However, the plaintiffs claimed that Fugro continued to use the machine and constructed additional infringing machines.⁷⁸

The court found that the claims were not covered by the advertising injury section of the policyholder’s CGL policy because “the alleged in-

67. 16 F. Supp.2d 732 (S.D. Tex. 1997).

68. *See id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. 16 F. Supp. 2d 732.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

jury began before the effective date of the insurance policy.”⁷⁹ The court relied heavily on *Two Pesos, Inc. v. Gulf Ins. Co.*,⁸⁰ which held that trade dress infringement claims were not covered because the wrongful activities began before the purchase of the insurance coverage.⁸¹ Again, as in the *Bradleys’ Electric* case, because the court found that the patent infringement occurred prior to the inception of the policy, the court was not required to tackle the issue of whether or not patent infringement claims would be covered by the insured’s CGL policy.

The insurers advanced several other arguments against coverage. However, because the court accepted the insurers’ contention that the “loss in progress” or “continuing loss” doctrine applied, the court did not address the other non-coverage theories advanced. Prior to taking up the “continuing loss” doctrine, the court first addressed the defendants’ claim that the declaratory judgment action was not ripe for adjudication because liability had not been determined in the underlying litigation. The court rejected the defendants’ argument in a footnote, finding that the case “can be decided as a matter of law, without further factual development in the underlying litigation.”⁸² Consequently, although the court found that the ripeness standard had been met in this case, the question of whether or not a declaratory judgment is ripe for adjudication will vary with each technology case depending on the facts and circumstances of the claims made in the underlying litigation.⁸³

79. *Id.* at 734.

80. 901 S.W.2d 495, 502 (Tex. App.—Houston [14th Dist.] 1995, no writ.).

81. *See id.* It should be noted that the ISO’s 1998 revisions include a new exclusion of coverage for an advertising injury “caused by or at the direction of the insured with the knowledge that the act would violate the rights of another or would inflict ‘personal or advertising injury.’” This new exclusion appears to be intended to reinforce the doctrines of “fortuity,” “known loss,” and “loss in progress.”

82. *Franklin*, 16 F. Supp.2d at 735, n.3.

83. Several potential issues may arise in future cases in which the policyholder asserts that the insurer’s declaratory judgment action is premature. *See generally* Ellen S. Pryor, *Mapping the Changing Boundaries of the Duty to Defend in Texas*, 31 TEX. TECH L. REV. 869, 889-890 (2000). For example, what if the policyholders in *Franklin* contested the plaintiffs’ claims in the underlying litigation and specifically asserted that they did not infringe any of the intellectual property rights of the plaintiffs at any time? Is the duty to defend defeated merely based on the plaintiffs’ allegation of facts that the insureds’ claims are untrue? Isn’t a declaratory judgment action inappropriate until the contested facts are judicially resolved? What if the facts in dispute do not relate to the judgment being sought in the underlying action? Is it appropriate for the insurance company to essentially intervene in the resolution of the underlying case by filing a declaratory judgment action to resolve the facts that are not essential to the judgment in the underlying litigation? How is a court supposed to resolve such issues given the likely probability that the insurance policy is silent on the question of whether or not either party may file a declaratory judgment to resolve defense issues in the underlying litigation? No Texas courts have addressed these issues with respect to a technology claim, but such issues could produce a mass of future litigation given the *Two Pesos* and *Franklin* decisions, which potentially present insurers with an incentive to file a declaratory judgment action to resolve the duty to defend and duty to indemnify by claiming that the policyholder knew that a loss would occur prior to purchasing the insurance policy. Broader questions of risk assessment and risk allocation also may arise. Did the policyholder bargain for a defense that would not be provided until the insurer resolved factual questions that were not relevant to the adjudication of underlying litigation? Who should pay for the costs of adjudicating the declaratory judg-

In *Two Pesos, Inc. v. Gulf Ins. Co.*,⁸⁴ the court of appeals found that there was no coverage because the alleged offense occurred prior to the policy's inception date. The court recognized that trademark infringement is a "continuous wrong, and as such gives rise to a claim for relief as long as the infringement persists."⁸⁵ However, the court appeared to deny coverage for two reasons: (1) because the claim "constitute[d] a known loss or loss in progress" that would be barred under the fortuity doctrine; and (2) because "affording coverage to Two Pesos would violate public policy by allowing protection for a known loss and permitting an insured to benefit from its wrongdoing."⁸⁶

Finally, in *Essex Ins. Co. v. Redtail Prod., Inc.*,⁸⁷ the court addressed the question of whether or not an insurer should be required to defend or indemnify the policyholder against federal trademark claims. The court granted the insurer's motion for summary judgment on two grounds: (1) the policy did not apply to offenses committed before the beginning of the policy period; and (2) the fortuity doctrine precluded coverage because of the facts and circumstances of the case.⁸⁸ In reaching its decision, the court focused primarily on a letter from the plaintiff in the underlying action dated September 27, 1996, which "complained about Redtail's marketing practices and alleged that Redtail's use of OMC's marks violated its trademark rights."⁸⁹ Because this letter was dated prior to the inception of the policy, the court ruled there was no coverage.⁹⁰

c. Cases That Do Not Seek Damages

In *Feed Store, Inc. v. Reliance Ins. Co.*,⁹¹ the court addressed the issue of whether or not the advertising injury section of the CGL policy required Reliance to reimburse the policyholder for its defense costs. The Feed Store was sued by Dairy Queen, which claimed that The Feed Store infringed upon Dairy Queen's registered service mark "Texas Country" by using the phrase "Texas Country Cookin" in its business.⁹² Judge Mahon granted summary judgment in favor of The Feed Store that Dairy

ment brought by the insurer on the duty to defend? Is the insurer entitled to reimbursement for defense costs, if any, incurred in investigating and defending the claims made against the insured in the event the insurer prevails in its declaratory judgment action? What if the plaintiffs in the underlying action amend their complaint to remove factual allegations implicating the "known loss" doctrine? Are factual allegations in a superceded complaint ever admissible in a declaratory judgment action brought by the insurer to escape the duty to defend?

84. See *supra* note 81.

85. *Id.* at 500.

86. *Id.* at 502.

87. 1998 WL 812394 (N.D. Tex. Nov. 12, 1998).

88. See *id.*

89. *Id.* at *1.

90. See *id.* at *3.

91. 774 S.W.2d 73 (Tex. App.—Houston [14th Dist.] 1989, writ denied).

92. See *id.*

Queen take nothing on its claims.⁹³ The Feed Store then filed suit to recover its defense costs incurred in obtaining the take nothing judgment.⁹⁴

Reliance Insurance sought summary judgment on two grounds: (1) that Dairy Queen's suit "sought injunctive relief only, rather than damages, and . . ." therefore the allegations in the complaint did not trigger a duty to defend; and (2) that the phrase "Texas Country" is not a slogan and is therefore an exclusion in the advertising injury section of the policy, thus barring coverage.⁹⁵ The court affirmed summary judgment after reviewing Dairy Queen's complaint and concluded that there was no allegation where Dairy Queen was seeking to recover damages.⁹⁶ But the court expressly declined to rule on the issue of whether or not "Texas Country" constituted a slogan because of the "complexities of trademark law."⁹⁷

d. Cases Involving Intentional Acts

In *ABC Distributing, Inc. v. Lumbermens Mut. Ins. Co.*,⁹⁸ the court affirmed the district court's decision to grant the insurers' motion for summary judgment. In the underlying action, ABC was sued by Lighting Systems, Inc. in a seven-count complaint alleging trademark infringement and other related causes of action. Because the "overall scheme" alleged by Lighting Systems was "clearly intentional," the court determined that the complaint fell within the intentional act exception to the policy and that there was no duty to defend.⁹⁹

e. Cases Involving Trade Dress Issues

In *Bay Electric Supply, Inc. v. Travelers Lloyds Ins. Co.*,¹⁰⁰ Bay Electric and FAE, Inc. filed a declaratory judgment and a breach of contract lawsuit against Travelers. The underlying action arose out of claims made against Bay Electric and FAE by a competitor, American Circuit Breaker Corporation ("ACB"). "ACB alleged that Bay and FAE [had] violated federal and state law[s] prohibiting trademark and trade dress infringement, trademark dilution, and unfair competition."¹⁰¹ Moreover, "[t]he allegations were based upon the sale by Bay and FAE of circuit breakers bearing trademarks and configurations allegedly identified with and owned by ACB."¹⁰² Travelers denied coverage on January 16, 1998.¹⁰³ Thereafter on March 25, 1998, counsel for Bay Electric and FAE requested reconsideration of travelers' decision, but again Travelers denied

93. *Id.*

94. *Id.*

95. *Id.* at 74.

96. *See id.* at 73.

97. *Id.* at 75.

98. 646 F.2d 207 (5th Cir. 1981).

99. *Id.* at 209.

100. 61 F.Supp.2d 611 (S.D. Tex. 1999).

101. *Id.* at 614.

102. *Id.*

103. *Id.*

coverage. Subsequently, FAE and Bay Electric settled the underlying lawsuit.¹⁰⁴

In the coverage action, the court looked to *Industrial Molding* for guidance on the issue of whether or not “claims of trademark and trade dress infringement constitute an “advertising injury” under Texas law.”¹⁰⁵ The district court agreed with *Industrial Molding* that trademark and trade dress infringement are covered “advertising injury” claims.¹⁰⁶ In reaching its holding, the court also relied on the three-part *Sentex* test discussed in section (a) above.¹⁰⁷

With respect to the first prong of *Sentex*, the court agreed with Bay Electric and FAE’s contention “that the physical appearance of a product—the ornamental features which serve to identify its source and distinguish it from similar products—can reasonably be construed as either an ‘advertising idea’ or ‘style of doing business.’”¹⁰⁸ It may be significant in future cases that a definition of “advertisement” has been added to the CGL policy. Consequently, the court’s emphasis may shift from the physical appearance of the product to the contents of the advertisement. Furthermore, the ISO revisions delete coverage for misappropriation of the “style of doing business.”¹⁰⁹ In addition, coverage for the “misappropriation of advertising ideas” has been transformed into “the use of another’s advertising ideas in your ‘advertisement.’”¹¹⁰ But if the product itself is not an advertisement, cases such as *Bay Electric* may be resolved in a different manner.

The district court also relied on the following history of the “advertising injury” coverage to reach its holding:

Until 1986, the standard ISO CGL form included “unfair competition” as a covered class of advertising injuries, and explicitly excluded injuries resulting from trademark, service mark, and trade name infringement. In 1986, [the] ISO revised the standard form: unfair competition was eliminated in favor of misappropriation of advertising ideas and style of doing business, and the trademark, service mark, and trade name exclusion was eliminated. *Thus, a policyholder over time could reasonably infer that claims related to trade dress would not be excluded from a CGL policy, based upon the 1986 revision of the standard form.*¹¹¹

The court also squarely rejected Travelers’s contention “that only a wholesale copying of *all* of a company’s products falls within the scope of

104. *Id.*

105. *Id.* at 615.

106. *Id.*

107. *Id.*; see *Sentex*, *supra* note 62.

108. *Id.* at 615-16.

109. *See id.* at 617. The ISO revisions can be found at <http://www.iso.com>.

110. *See id.*

111. *Bay Elec.*, *supra* note 101, at 617 (emphasis added). Moreover, a policyholder should continue to have a reasonable expectation that claims related to trade dress will not be excluded under the ISO’s revisions because the revisions include coverage for infringement of another’s “trade dress” in the policyholder’s “advertisement.”

[the term 'style of doing business'].¹¹² According to the court, "[s]uch categories would be wholly artificial and impossible to apply in a consistent fashion from case to case, and the Court declines Travelers' invitation to do so."¹¹³ The court states further that "[a]n examination of the underlying [c]omplaint in the instant action, in which it is unclear what portion of ACB's products and ideas Bay [Electric] and FAE copied, demonstrates the difficulty that a court would constantly encounter in trying to ascertain from a complaint the precise extent of the alleged infringement."¹¹⁴

f. Cases Concerning the Meaning of the Term "Advertising"

ANR Production Co. v. American Guarantee & Liability Ins. Co.,¹¹⁵ involved the issue of whether or not a policyholder's statement regarding the ownership of a "debottlenecking" process installed in ANR's natural gas plant constituted "advertising." The trial court granted summary judgment in favor of the insurance company and the court of appeals affirmed, holding that the policyholder's statements were not advertising.¹¹⁶ "To accept ANR's definition of advertising would mean that any time parties negotiated any kind of contract, there would be a potential for coverage under advertising injury for representations or omissions made during the negotiations."¹¹⁷

It will be interesting to see if coverage issues arise concerning whether or not different types of oral representations regarding a policyholder's goods, products or services made for the purpose of attracting customers or supporters, count as "advertisements" under the new definition. Would a statement by a policyholder to a prospective client that the policyholder owned a "debottlenecking" process made for the purpose of obtaining work, count as an "advertisement?" Would a similar statement made in a trade publication constitute an "advertisement?"

*Atlantic Lloyd's Ins. Co. of Texas v. Susman Godfrey, L.L.P.*¹¹⁸ involved the issue of whether a law firm's solicitation letter containing statements about a doctor's "sloppy, callous, unacceptable, impersonal, and indifferent" work and "outrageous" conduct fell within the definition of "advertising injury."¹¹⁹ Although the case does not involve a cyberspace claim, it highlights the importance of the new "advertisement" definition. Would a solicitation letter sent to one prospective client constitute "a notice that is broadcast or published in the general public or specific market segments about your goods, product or services for the purpose of

112. *Id.* at 617 (emphasis added).

113. *Id.* at 618.

114. *Id.*

115. 981 S.W.2d 889 (Tex. App.—Houston [1st Dist.] 1998, no writ).

116. *See id.*

117. *Id.* at 892.

118. 982 S.W.2d 472 (Tex. App.—Dallas 1998, no writ).

119. *See id.* at 475.

attracting customers or supporters?" Does one person constitute a specific market segment?

3. *Coverage Issues Raised in Intellectual Property Cases Outside of Texas*

a. Patent Infringement Claims

i. *Cases Finding No Coverage for Patent Infringement*

According to commentators, the majority of courts have ruled that patent infringement claims are not covered under the "advertising injury" section of the policy.¹²⁰ Moreover, several cases have found that there is no duty to defend or indemnify the policyholder against patent infringement claims. For example, in an unpublished opinion, the Delaware Superior Court ruled that "advertising injury" coverage does not extend to coverage for patent infringement actions.¹²¹ The Court determined that the policyholder's allegedly infringing actions did not "[arise] out of" or [occur] "in the course of" its advertising activities as required by the policies.¹²²

In a second unpublished opinion, *Doskocil, Inc. v. Fireman's Fund Ins. Co.*,¹²³ the court ruled that the "advertising injury" provision of a Travelers' policy was not triggered because the patent infringement action made "no mention whatsoever of advertising activity" on the part of [the policyholder].¹²⁴ Applying Texas law, the California court refused to consider the policyholder's "ample extrinsic evidence" under the eight-corners rule.¹²⁵ When extrinsic evidence may be introduced under the

120. Bruce Telles, *Insurance Coverage for Intellectual Property Torts in Cyberspace*, MEALEY'S EMERGING INS. DISP., July 3, 1997, at <http://www.newsletteronline.com/mealeys/search.htm> ("Policyholders have frequently, and almost always unsuccessfully, attempted to obtain coverage for suits alleging that they have infringed a third party's patents. Courts have generally rejected these efforts, with a majority of the courts holding that patent infringement is not an enumerated offense.")

121. *ABB Flakt, Inc. v. Nat'l Fire Ins. Co.*, No. 94-C-11024, 1998 WL 437137 (Del. Super. Ct. June 10, 1998).

122. *See id.* at 9. In the underlying case, Joy Technologies, Inc., one of Flakt's competitors developed a flue gas desulfurization (FGD) system covered by a patent. Joy sued Flakt in 1989 for direct, inducing, and contributory patent infringement. A jury found in Joy's favor on all three counts, finding that Flakt directly infringed, contributed to the infringement, and induced infringement of the patent. Joy subsequently filed a second suit alleging Flakt adopted certain contracts from Combustion Engineering, Inc. and committed acts identical for which Flakt was found liable in the first suit. Flakt sought a defense and indemnity from its insurance carriers, which denied coverage, and subsequently Flakt filed a declaratory judgment action. The court entered summary judgment for the insurance carriers, finding that patent infringement did not fall within the enumerated offenses in the policies and that there was no causal connection between the patent infringement and the policyholder's advertising activities. The court also determined that "misappropriation" refers to the common law tort and not to conduct prohibited by statute and thus did not encompass patent infringement. This case was later affirmed by the Delaware Supreme Court, which agreed that the infringement for which the insured sought coverage did not arise out of or occur in the course of the insured's advertising activities.

123. 1999 WL 430755 (N.D. Cal. 1999).

124. *Id.* at 3.

125. *Id.*

eight corners rule is a question that has not been fully resolved by the Texas courts.¹²⁶

Similarly, in *Clark Mfg. v. Northfield Ins. Co.*,¹²⁷ the court rejected coverage claims for patent infringement and inducement to infringe a patent and ruled that the claims made against the policyholder did not arise out of the insured's advertising activities, but rather out of the insured's alleged misappropriation and use of its trade secrets to manufacture and sell components patented by a competitor. Likewise, in *Julian v. Liberty Mutual Ins. Co.*,¹²⁸ the court found that the policyholder had no reasonable expectation of patent infringement coverage because the policy language restricted coverage to advertising injuries.¹²⁹ Additionally, the court found that the plaintiffs had failed to establish that the alleged offense arose from their advertising activities.¹³⁰

ii. Cases Finding Coverage for Patent Infringement Claims

Everett Associates, Inc. v. Transcontinental Ins. Co.,¹³¹ held that the phrase "misappropriation of advertising ideas or style of doing business" is ambiguous and could reasonably be construed by the policyholder to cover patent infringement claims.¹³² In addition, the court found there was a sufficient nexus between the policyholder's advertisement and the patent infringement claims asserted by Clark to establish a causal connection and to require the carrier to defend the action.¹³³ According to the court,

Plaintiffs argue that the addition of the "offers to sell" language in Section 271 [of the Patent Act], along with claims against Everett in the *Clark* action based upon Everett's advertising of the allegedly

126. The court also determined that the continuing tort of patent infringement is not covered if the tortious activity begins before the inception of the policy, essentially following the reasoning of *Two Pesos*. See *supra* note 81. Moreover, the court held that "there was no offense during the policy period since [the policyholder] began making and selling its allegedly infringing products before June 30, 1997." *Doskocil, supra* note 124, at 3.

127. 187 F.3d 646 (9th Cir. 1999) (unpublished opinion).

128. 682 A.2d 611 (Conn. App. 1996).

129. *Id.*

130. *Id.* Several courts have addressed the issue of whether or not advertising, selling or marketing activities infringe patent rights. See, e.g., *Nat'l Union Fire Ins. Co. v. Siliconix, Inc.*, 726 F. Supp. 264, 270 (N.D. Cal. 1989); *Intex Plastic Sales Co. v. United Nat'l Ins. Co.*, 23 F.3d 254, 256 (9th Cir. 1994) ("infringement does not occur in the course of the insured's advertising activities"); *Iolab Corp. v. Seaboard Sur. Co.*, 15 F.3d 1500, 1507 (1994) (it is necessary to show that advertising caused the patent infringement, rather than the liability; moreover, it is also necessary to show that the loss was caused by advertising, rather than by the infringement of a patent); *New Hampshire Ins. Co. v. Chaides Constr. Co., Inc.* 847 F. Supp. 1452, 1457 (N.D. Cal. 1994) ("The acts of making, selling, or using [a patented invention] simply do not arise out of the insured's advertising activities. Selling is not equivalent to advertising."); *Aetna Cas. & Sur. Co. v. Water Cloud Bed Co., Inc.*, Cal. Rptr. 2d 442, 446 (1993) (In patent infringement cases, [t]he patentee is not injured because a product incorporating its invention is advertised; rather, he is injured because the infringer, without consent, used or sold a product utilizing a protected invention").

131. 57 F. Supp. 2d 874 (N.D. Cal. 1999).

132. *Id.* at 881.

133. *Id.*

infringing products, create a sufficient causal connection between the patent infringement and the advertising injury to invoke Defendant Transcontinental's duty to defend. In addition, the "offers to sell" language creates an objectively reasonable expectation on the part of the insured that the insured could be prosecuted for advertising injury in a claim for patent infringement. Transcontinental hotly disputes these contentions. However, for two reasons, this Court must agree with Plaintiffs. First, the cases cited by Transcontinental which determine [that] there is no duty to defend patent infringement claims indicate that the very reason those courts found no duty was because the Patent Act did not, at that time, include the "offer to sell" provision that it now contains. Second, the court in the underlying *Clark* action, based upon the new language in the Patent Act, entertained the plaintiff's claims for patent infringement based on *Everett's advertising activity*. This alone is enough to demonstrate the required causal connection between Everett's advertising activities and the patent infringement claim. In addition, it indicates that the insured could have an objectively reasonable expectation that it could be prosecuted for advertising injury in a claim for patent infringement.¹³⁴

The court also rejected Transcontinental's argument that coverage is barred by the policy's "first publication" exclusion, noting that Transcontinental did not conduct an investigation before denying coverage and was not aware of the possible application of the exclusion at the time the suit was tendered for defense.¹³⁵

In *Foundation for Blood Research v. St. Paul Marine & Fire Ins. Co.*,¹³⁶ the Supreme Judicial Court of Maine held that a general commercial insurer had a duty to defend a policyholder in an action alleging that the policyholder induced patent infringement. The policy provided coverage for advertising injury and personal injury that included coverage for injuries resulting from belittling the products of others.¹³⁷ The court provided an example of an insured belittling the validity of a plaintiff's patent to third parties and the third parties' attempt to infringe the plaintiff's patent as a potentially covered claim. In doing so, the court refused to limit the meaning of "belittle" to the archaic tort of belittlement.¹³⁸

Likewise, the court in *Elan Pharmaceutical Research Corp. v. Employers Ins. of Wausau*,¹³⁹ held that an insurer was obligated to defend its policyholder in a suit alleging that the policyholder infringed a drug patent by selling a competing version of a drug patented by Pfizer. The panel found that the insured's dissemination of the information about its competing drug in trade journals and at presentations brought its conduct within the advertising activity requirement and that a causal connection

134. *Id.* at 881-82 (emphasis in original).

135. *See id.* at 884-85.

136. 730 A.2d 175 (Me. 1999).

137. *See id.* at 179-80.

138. *See id.*

139. 144 F.3d 1372 (11th Cir. 1998).

existed between such advertising activity and the harm allegedly suffered by Pfizer.¹⁴⁰ According to the court,

In 1992, when Pfizer filed its complaint, it was an open question of federal patent law whether the subsequent dissemination of clinical studies and information developed for the purpose of obtaining FDA approval for a drug or medical device deprived a defendant of the protections of section 271(e)(1) and therefore gave rise to an action of section 271(a). Under such a theory of liability, the dissemination of the data in a company's advertising would give rise to an action for patent infringement, because the dissemination would retroactively deprive the protected use of the patented drug to collect the data of its exemption. Construed this way, Pfizer's lawsuit provided the necessary causal connection between the alleged patent infringement and Elan's advertising activities, because . . . until that activity took place, the clinical studies at issue would have been exempt.¹⁴¹

But in *Union Ins. Co. v. Land & Sky, Inc.*,¹⁴² the court found an ambiguity in the insurance policy at issue because the excess policy included an express exclusion of patent infringement coverage, but the underlying policy did not.¹⁴³ According to the court,

However, we note that the court in *Atlantic Mutual Ins. Co.* did not have to consider the additional evidence of an ambiguity present in this case—the express exclusion of patent infringement coverage in the excess policy. The fact that Union determined it necessary to exclude patent infringement in the excess policy would indicate a belief on Union's part that patent infringement was included in the primary policy. We find that this inconsistency in the two policies create an ambiguity regarding the meaning of the term 'piracy.' Thus, we find that the term 'piracy' is ambiguous and is capable of at least two definitions. Because the term is susceptible to two reasonable interpretations, one encompassing patent infringement and the other one not, we construe the term 'piracy' in favor of the insured. . . .¹⁴⁴

iii. *Views of Commentators Concerning Coverage for Patent Infringement claims.*

Commentators are divided on the issue of whether or not there is advertising injury coverage for patent infringement claims under the 1985 coverage form. David A. Gauntlett, a policyholder advocate, contends that patent infringement may fall within advertising injury coverage.¹⁴⁵ Gauntlett's analysis is based on coverage for "piracy" that was eliminated by ISO's 1985 revisions. Moreover, Gauntlett has since taken the position that the phrase "misappropriation of advertising ideas or style of do-

140. *See id.*

141. *Id.* at 1379-80 (footnotes omitted).

142. 529 N.W.2d 773 (Neb. 1995).

143. *See id.*

144. *Id.* at 777.

145. *See* David Gauntlett, *The Case for "Advertising Injury" Coverage of Intellectual Property Litigation*, A.B.A. INTELL. PROP. L. SEC. (Aug. 2, 1998).

ing business” contained in the post-1985 policy, but deleted by the 1998 revisions, is subject to a number of reasonable definitions, “some of which encompass patent infringement claims.”¹⁴⁶

George B. Hall, an insurance company advocate, strongly disagrees that patent infringement claims of any nature are covered.¹⁴⁷ Hall agrees with the reasoning set forth in *Gencor Industries, Inc. v. Wausau Underwriters Insurance Co.*,¹⁴⁸ which states that “[i]t is nonsense to suppose that if the parties had intended the insurance policy in question to cover patent infringement claims, the policy would explicitly cover infringements of ‘copyright, title or slogan,’ but then include patent infringement, *sub silentio*, in a different provision, by reference to [an] ‘unauthorized taking of . . . [the] style of doing business.’”¹⁴⁹

b. Coverage Issues in Cases Raising Copyright, Trademark, And Service Mark Claims

1. Cases Finding Coverage

Courts are divided on the question of whether or not advertising injury coverage extends to cover claims of infringement of copyrights, trademarks, and service marks. In *Advance Watch v. Kemper National Ins. Co.*,¹⁵⁰ the court held that coverage for “misappropriation of advertising ideas or style of doing business” extended only to the common law tort of misappropriation and did not extend to rights subject to “statutory systems protecting intellectual property: copyright, patent, trademark/deception as to origin.”¹⁵¹ However, the court in *Lebas Fashion Imports v. ITT Hartford Ins. Group*,¹⁵² reached the opposite conclusion, finding the coverage ambiguous and holding that trade dress and trademark infringement claims were potentially covered.¹⁵³

In addition, the Idaho Supreme Court in *Doron Precision Systems, Inc. v. United States Fidelity & Guaranty Co.*,¹⁵⁴ found a duty to defend on the part of United States Fidelity & Guarantee (USF&G) in a copyright ac-

146. See David Gauntlett, *Exposing Duplicity of Insurer Analysis of ‘Advertising Injury’ Offenses*, MEALEY’S EMERGING INS. DISP., at <http://www.newsletteronline.com/mealeys/search.htm>.

147. See George Hall, *A Logical Approach to Advertising Injury Coverage*, MEALEY’S EMERGING INS. DISP. (June 3, 1999), at <http://www.newsletteronline.com/mealeys/search.htm>.

148. 857 F. Supp. 1560 (M.D. Fla. 1994).

149. *Id.* at 1564.

150. 99 F.3d 795 (6th Cir. 1996).

151. *Id.* at 802 (quoting *U.S. Gulf Assoc. v. Data-Max, Inc.* 749 F.2d 1028, 1035 (3d Cir. 1984)).

152. 50 Cal. App. 4th 548 (1996).

153. See *id.*; see also *Zurich Ins. Co. v. Keller Music, Inc.*, 998 F.2d 674 (9th Cir. 1993). Furthermore, in *Federal Ins. Co. v. Microsoft Corp.*, WL 371416 (W.D. Wash. April 14, 1993), order vacated by 1994 WL 510102, Microsoft obtained a defense of Apple’s suit against it for copyright infringement based on Microsoft’s Windows platform on the basis of allegations that Microsoft had infringed Apple’s copyright by marketing, distributing, and licensing Windows. See *id.*

154. 963 P.2d 363 (Idaho 1998).

tion. The court rejected USF & G's argument that the advertising injury provision did not cover copyright infringement unless the advertising itself constituted copyright infringement.¹⁵⁵ According to the court,

Doron's complaint alleged that Denison violated Doron's copyrights regarding certain films and computer programs by copying such material, by placing the material on the market, by selling or giving away such material, and by showing and displaying such material. Although the allegations do not directly state that the copyright infringement occurred in the course of advertising, these allegations in the complaint, when read broadly, reveal a potential for liability under the insurance policy. Specifically, the allegations that Denison showed and displayed the copyrighted materials, and placed the materials "on the market," gave rise to the potential that Denison's copyright infringement activities were related to or connected with advertising. Where there is doubt as to whether the complaint sufficiently alleged advertising injury, USF & G must defend regardless of its potential defenses.¹⁵⁶

Finally, in *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA Co.*,¹⁵⁷ the court held that gray market figurines with genuine U.S. trademarks that had different color patterns but were virtually identical in all other respects, were materially different for purposes of trademark infringement analysis.¹⁵⁸

2. Viewpoints of Commentators Concerning Trade Dress Trademark, Copyright, or Service Mark Infringement Claims

Commentators and courts in other jurisdictions are divided on the issue of whether or not advertising injury coverage exists for trademark, copyright, or service mark infringement claims under the 1985 advertising injury coverage. Hall believes such claims are not covered, citing an attachment to a January 6, 1998 ISO circular, which states:

Infringement[s] of trademark[s] w[ere] never intended to be covered under Personal and Advertising Injury Liability Coverage, and deleting the term 'title' [from the infringement of copyright, title, or slogan offense] clarifies that original intent. The phrase 'infringement of copyright' is intended to encompass publication titles such as title of song, title of book, etc.¹⁵⁹

One of the ISO's implicit goals in revising the coverage may have been to eliminate coverage for trademark infringement. Laurence Monin has

155. *See id.* at 365.

156. *Id.* at 366.

157. 112 F.3d 1296 (5th Cir. 1997).

158. Mr. Roach served as co-counsel to the policyholder in the *Martin's Herend* litigation. *See also* Arifs Haq, *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA Company: Gray Market Goods; Reason Makes a Run for the Border*, 23 N.C.J. INT'L L. & COM. REG. 381, 391 (1998); *Societedes Produits Nestle S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633, 641 (1st Cir. 1992) (stating that a material difference is presumed to exist where the consumer would likely consider such a difference relevant to the decision of whether or not to purchase the product).

159. Hall, *supra* note 148.

concluded that “[a]lthough coverage for ‘trademark infringement’ may now be more clearly not covered, undoubtedly insureds in many future cases will seek to find a ‘copyright, trade dress or slogan’ hook.”¹⁶⁰

With regard to copyright infringement, commentators note that while the insured’s advertising activities must still proximately cause the injuries sustained by the copyright holder, the courts have accepted a “relatively slim connection” at least for purposes of requiring a defense.¹⁶¹

c. Cases Outside of Texas Regarding Unfair Competition Claims

In *Western States Ins. Co., v. Wisconsin Wholesale Tire, Inc.*,¹⁶² the court found that a complaint filed against an insured accused of unfair competition through misappropriation of customer lists did not trigger defense or indemnity obligations under the personal injury or advertising injury sections of the policy.

Furthermore, the court concluded there was an insufficient nexus between the allegations of business disparagement and unfair competition and the policyholder’s “advertising activities.” According to the court,

Wisconsin Tire . . . relies on paragraph (c), asserting that MITA accused it of “piracy” and “unfair competition.” This is a sensible characterization of MITA’s complaint—but of course the “advertising injury” clause does not cover *all* piracy and unfair competition. It insures only those incidents of piracy and unfair competition that arise out of Wisconsin Tire’s “advertising activities of [its] own goods, products or services.”¹⁶³

The court also distinguished between “advertising” and “marketing” and reasoned that if advertising were found to be equivalent to marketing “[t]hen the work of a salesman in calling up customers is ‘advertising’, an unnatural use of that word, and any effort to sell that involves one of the four listed ‘offenses’ is covered.”¹⁶⁴ The court found that such an interpretation would not be sensible and declined to “torture ordinary words until they confess to ambiguity.”¹⁶⁵

The court also relied on *Diversified Investments Corp. v. Regent Ins. Co.*,¹⁶⁶ in which the court held that even though the plaintiff’s damages in the underlying action arose out of the insured’s advertisement of bicycles that copied its rivals protected design, there was no “advertising injury” coverage because “there must be something wrongful about the advertising.”¹⁶⁷ According to the Seventh Circuit, to hold otherwise would mean that “a fairly narrow clause [would] cover almost every injury connected

160. See *id.*

161. See Martin C. Loesch & David M. Brenner, *Coverage on the Technology Frontier*, presented at the ABA’s Committee on Insurance Coverage seminar in Tucson (March 14-15, 1997).

162. 184 F.3d 699 (7th Cir. 1999).

163. *Id.* at 702.

164. *Id.*

165. *Id.*

166. 596 N.W.2d 502 (Wis. App. 1999).

167. 184 F.3d at 703.

with a business operation.”¹⁶⁸ But Justice Rovner strongly disagreed in her dissent. She concluded that the “advertising injury” provision applied, reasoning that the complaint explicitly alleged that Wisconsin Tire damaged MITA’s reputation through, among other methods, “print advertising.”¹⁶⁹

In *Comsat Corp. v. St. Paul Mercury Ins. Co.*,¹⁷⁰ Senior Judge Alsop ruled that “St. Paul owed Comsat a duty to defend for claims of commercial disparagement under its express personal injury coverage for making known . . . material that belittles products.”¹⁷¹ The court found that factual claims within the pleadings required the carrier to defend, even though no express cause of actions were plead for commercial disparagement or trade libel.¹⁷²

In *A-Mark Financial Corp. v. CIGNA Property & Casualty Co.*,¹⁷³ the court found there was not a duty to defend an insured against claims of unfair competition made under the Idaho Consumer Protection Act. The cases cited above arose under the 1985 coverage that provided protection for “misappropriation of advertising ideas or style of doing business.” But this coverage was eliminated by ISO’s 1998 revisions and subsequently replaced with two types of coverage for: (1) misappropriation of advertising ideas; and (2) coverage for trade dress infringement occurring in the insured’s advertisement.¹⁷⁴

3. *The Impact of ISO’s 1998 Revisions to “Advertising Injury” Coverage on the Duty to Defend*

Policyholders and insurance carriers also should consider the coverage impact, if any, of significant changes to the “advertising injury” section of the CGL Policy by ISO. Under the most recent CGL policy approved in Texas, “advertising injury” is generally defined as an injury “caused by an offense committed in the course of advertising your goods, products or services,¹⁷⁵ but only if the offense was committed in the ‘coverage territory’ during the policy period.”¹⁷⁶ “Advertising injury” is generally defined under Section V of the typical CGL policy as

Injury arising out of one or more of the following offenses:

168. *Id.*

169. *See id.* at 704 (Rovner, J., dissenting).

170. D. Minn. Civil Action No. 97-2236 (Mar. 6, 1998).

171. *Id.*

172. *Id.*

173. 40 Cal. Rptr. 2d 808 (Cal. Ct. App. 1995).

174. *See Copart, Inc. v. Travelers Ins. Co.*, 2001 WL 327747, at 1 (9th Cir. 2001) (“Travelers argues that there was no duty to defend the Woltz action because Copart was not sued for copyright infringement committed ‘in the course of’ its advertising. Although the Woltz complaint did not specifically articulate an advertising claim, the copyright infringement that it did allege could encompass copies of the program interface which Copart left with potential customers as a demonstration of its services”).

175. The CGL Policy can be found at the ISO website <http://www.iso.com>.

176. *See id.*

- (1) Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services;
- (2) Oral or written publication of material that violates a person's right of privacy;
- (3) Misappropriation of advertising ideas or style of doing business; or
- (4) Infringement of copyright, title or slogan.¹⁷⁷

Section 2 of Coverage "B" generally provides that the insurance does not apply to "advertising injury:"

- (1) Arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity;
- (2) Arising out of an oral or written publication of material whose first publication took place before the beginning of the policy period;
- (3) Arising out of the willful violation of a penal statute or ordinance committed by or with the consent of the insured;
- (4) For which the insured has assumed liability in a contract or agreement. This exclusion does not apply to liability for damages that the insured would have in the absence of the contract or agreement;
- (5) Arising out of breach of contract, other than misappropriation of advertising ideas under an implied contract;
- (6) Arising out of the failure of goods, products or services to conform with advertised quality or performance;
- (7) Arising out of the wrong description of the price of goods, products or services; and
- (8) Arising out of an offense committed by an insured whose business is advertising, broadcasting, publishing or telecasting.¹⁷⁸

ISO proposed revisions to the advertising injury coverage in 1998, and those revisions have been adopted by every state, except Texas and Louisiana.¹⁷⁹ Moreover, ISO's "Notice to Policyholders" clarifies that the revisions are not intended to narrow the scope of coverage:

[T]he changes in the Personal and Advertising injury in these coverage forms result in broadening the coverage in certain respects and may, in certain states, result in a decrease in [coverage in] other respects. The impact of the changes in the revision [is] very difficult to quantify and may differ in different states. Taken as a whole, the revised Personal Injury and Advertising Injury Coverage [are] at least equal to, if not broader than, that which the current coverage

177. *See id.*

178. *See id.*

179. Lawrence O. Monin provides an excellent discussion of the ISO's revisions in his article entitled "*ISO Advertising and Personal Injury 1998 Revisions: Major Surgery or Just a Band-Aid Fix?*," published in MEALEY'S EMERGING INS. DISP. (Aug. 19, 1999). Monin concludes that while the revisions are "positive ones, and, in particular, help restore the prior 'advertising injury' coverage . . . to its apparent original intent," "time will likely demonstrate that the 1998 revisions are just one more band-aid attempt to fix a fundamentally flawed coverage."

provides.¹⁸⁰

A comprehensive discussion of all of the ISO's revisions is beyond the scope of this article.¹⁸¹ However, two significant changes to the form should be noted:

First, the ISO has included, for the first time, a definition of "advertisement," which is defined as "a notice that is broadcast or published in the general public or specific market segments about your goods, products, or services for the purpose of attracting customers or supporters."¹⁸² This definition may eliminate confusion in the courts regarding whether or not advertising is equivalent to marketing and whether or not statements by sales persons constitute advertising. In other words, the intent of defining the term "advertisement" appears to be to restrict coverage.

Second, coverage for "misappropriation of advertising ideas or style of doing business" has been eliminated and replaced with two coverages, one for "[the] use of another's advertising ideas in your 'advertisement'", and the other for infringing upon another's "trade dress" in "your 'advertisement.'"¹⁸³ "Trade dress" is not defined and may be construed broadly. For example, in *Two Pesos*, the jury was instructed that "[t]rade dress' is the total image of the business. Taco Cabana's trade dress may include the shape and general appearance of the exterior of the restaurant, the identifying sign, the interior kitchen floor plan, the decor, the menu, the equipment used to serve food, the servers' uniforms and other features reflecting on the total image of the restaurant."¹⁸⁴ Monin notes that the ISO has described trade dress as the "totality of elements in which a product or service is packaged or presented."¹⁸⁵

4. *New IP Liability Coverages*

Policyholders may also face significant coverage under specialized insurance policies being offered to cover IP-type claims. Such specialized intellectual property policies are being offered that may provide insurance coverage to defend or indemnify against techno tort claims. For example, patent infringement liability policies are being sold that provide a defense to both damages and injunctive actions for covered patent infringement and may insure the cost of asserting counterclaims. To be covered, the policyholder may be required to conduct an infringement search and obtain an opinion of non-infringement from a patent attorney before the inception of the policy or before the first use, manufacture, or distribution of the infringing product. Moreover, intellectual property infringement abatement policies are also now being offered that indemnify policyholders for their legal fees and costs in suing to stop alleged in-

180. ISO, *supra* note 175.

181. For more information, see generally Lawrence Monin, ISO Advertising, *supra* note 175.

182. ISO, *supra* note 175.

183. See *id.*

184. *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 764 n.1 (1992).

185. See *supra* note 175.

fringement of covered property. In addition, coverage also may be available for intellectual property liabilities outside of the advertising injury context.

a. Potential E&O Coverage

Unlike CGL policies, error and omissions policies (“E&O”) are not based on standardized ISO forms; thus very little standardization of forms exists. Assuming that the insured’s activities qualify as “insured services,” the policy may respond to claims that the insured committed an error or omission in the course of its activities. Some E&O carriers also include coverage for errors or omissions that result in intellectual property litigation, including copyright litigation. But there are very few reported cases in this area involving E&O coverage claims.

Technology Errors and Omissions coverage, according to Loesch and Brenner, also may be available to respond to claims for consequential damages that result from error, omission, negligence, or breach of warranty where there is no bodily injury or property damage.¹⁸⁶ Under such coverage, losses must be caused by a “manufacturing or performance error.”¹⁸⁷ Such errors are defined as errors or omissions in the “design, manufacturing, labeling, packaging, distribution or instructions for use of” the policyholder’s work or manufactured product.¹⁸⁸ As Loesch and Brenner note, “most technology errors and omissions polic[ies] exclude personal injury and bodily injury claims. Losses based on physical injury to tangible property will not be covered; they fall under the CGL rubric . . . intellectual property violations are also not covered.”¹⁸⁹ Furthermore, “the world of electronic coding of information on disk drives, floppies, and computer tape poses a substantial challenge to [the] old concepts of ‘tangible’ and ‘intangible’ property.¹⁹⁰ As matters [currently] stand, courts have been hostile to coverage for pure data loss, but receptive to any situation which ties the data to damage to [the] hardware in some way.”¹⁹¹

b. Media Liability Policies

These policies are generally designed to protect publishers, broadcasters, advertisers, and advertising agencies. Generally, these policies do not provide coverage for errors or omissions in the course of the insured’s business. However, endorsements may be added that would provide coverage for errors or omissions contained in the insured’s published content. Moreover, coverage may also be provided for covered perils that

186. Loesch & Brenner, *supra* note 161.

187. *See id.*

188. *See id.*

189. *See id.*

190. *See id.*

191. *See id.*

occur in the process of disseminating information via a company's website, home page, or through the publication of online information.

c. D&O Policies

Coverage may exist for directors and officers ("D&O") if the company is sued for allegedly violating a copyright or trade secret by posting materials on the Internet.¹⁹² Coverage issues may also arise if directors or officers allegedly overstate revenue to be derived from patented products or approve business decisions that allegedly infringe on a competitor's intellectual property portfolio.

d. Intellectual Property Policies

"Offensive" and "defensive" intellectual property policies have been developed to protect the intellectual property rights of the insured.¹⁹³ Typically, "infringement abatement" policies cover 75-80% of the costs of prosecuting an action to abate the infringement of the insured's intellectual property and is designed to protect insureds who otherwise would not have the financial capacity to bring such a suit to a conclusion. These policies may also provide coverage in the event a counterclaim is asserted against the insured.

Section I(A)(2) states that "the alleged INFRINGING acts complained of must first begin during the policy period."¹⁹⁴ This raises the issue of whether or not allegations of infringement would trigger coverage absent a specific allegation that the alleged infringing acts occurred during the policy period. Moreover, section I(B)(3) provides that coverage will be afforded for the "LITIGATION EXPENSES incurred in defending any declaratory judgment actions seeking to have an INSURED INTELLECTUAL PROPERTY declared invalid, but only if one more of the parties seeking invalidity can also be charged with INFRINGEMENT of the INSURED INTELLECTUAL PROPERTY sought to mean validated." Likewise, this raises several issues. First, how does a court determine whether or not one or more of the parties seeking invalidity of the policyholder's intellectual property "can be charged" with infringement of that intellectual property? Is the policyholder's subjective view that the plaintiff is infringing the policyholder's intellectual property conclusive on this issue? Does the charge have to relate to the intellectual property at issue in the lawsuit between the policyholder and the plaintiff or is it sufficient for the charge to relate to the other intellectual property held by the policyholder?

Several new policies have been issued by various entities. For example, American International Specialty Insurance Company underwrites an

192. *Fight Against Coercive Tactics Network, Inc. v. Coregis Ins. Co.*, 926 F. Supp. 1426 (D. Colo. 1996).

193. It should be noted that "offensive" or "infringement abatement" policies have not been approved and may not be sold in New York.

194. The following material can be found at ISO, *supra* note 175.

AIG patent infringement indemnity insurance policy. Intellectual Property Insurance Services Corporation underwrites a patent defense reimbursement policy. Litigation Risk Management markets a Lloyd's of London patent infringement pursuit coverage policy. Marsh & McClellan market a "net secure" policy covering first and third-party losses that was underwritten by a consortium of insurance companies including AIG, Lloyd's, Zurich and Chubb. Insure Trust.com, an Atlanta-based program manager for specialty E-business, offers electronic information and errors and omissions liability policies for E-businesses, and is underwritten by Philadelphia-based Legion Indemnity Company, a unit of Mutual Risk Management, Ltd. St. Paul Fire & Marine Insurance Company offers a media liability coverage policy with primary and excess limits. Reliance National Insurance Company markets specialty-based E-commerce coverage. AIG offers Internet related products and services. The Chubb Group of Insurance Companies offers a "safety net Internet liability policy." Zurich Reinsurance offers an E-risk protection policy. Steadfast Insurance Brokerage Company markets an information technology professional liability policy. Finally, J.S. Wurzler Underwriting Managers sells a "wisp" website breach security losses policy.¹⁹⁵

To date, there are very few reported cases concerning the scope of coverage provided by the new patent infringement abatement insurance policies offered by the market. In *Plug-in Storage Systems v. Homestead Ins. Co.*,¹⁹⁶ the court addressed the insured's claim that its insurer's claims were time barred. The patent infringement abatement policy apparently contained an arbitration clause and the insurance company filed a demand for arbitration against the policyholder "claiming that it was entitled to repayment of the litigation fees and costs paid on behalf of Plug-in pursuant to the policies. Specifically, Homestead claimed that Plug-in's misrepresentations rendered the policy contract void."¹⁹⁷ The court agreed with the insurer's contention that its claims against the policyholder required a determination of the party's respective contractual duties and obligations under the insurance policy, and rejected the policyholder's assertion that the insurer's claims were barred by the three year statute of limitations on tort claims under Connecticut law.¹⁹⁸ According to the court, "[t]he instant case concerns the plaintiff's compliance with [the] terms of contracting for insurance coverage. Accordingly, contract law governs this action, and the defendant is not precluded from demanding arbitration by the statute of limitations for tort."¹⁹⁹

195. *See id.*

196. 81 F. Supp.2d 371 (D. Conn. 1999).

197. *Id.* at 372.

198. *Id.* at 373.

199. *Id.*

e. Excess and Umbrella Policies

A company with substantial liability exposure through its online activities should consider purchasing an excess or umbrella policy that provides significant additional insurance protection. Such coverage would provide insurance above the policyholder's primary limits and is generally a relatively inexpensive means of increasing the limits of one's insurance coverage significantly.

f. First-Party Coverage

Insurance coverage is now being offered to cover lost data and network downtime. For example, INSUREtrust.com provides "Internet/Network Computer Liability Coverage" for coverage of claims arising out of a "Network Computer Act," such as intrusion into a network or a "Multimedia Act," or a claim for copyright and trademark infringement occurring in the course of "Network Computer Activity."²⁰⁰ "Digital Asset Protection" provides first-party coverage, which is applicable to: (1) "Networked Computer Theft," such as loss of "money" or "securities"; (2) damage to networked assets (such as "corruption" of proprietary data due to "unauthorized access" or "computer virus"); or (3) loss of "business income" and "additional expense" from business disruption due to a "denial of service attack," "unauthorized access," or "computer virus."²⁰¹ Likewise, "Network Extortion and Ransom" provides first-party coverage applicable to: (1) the wrongful takeover of a system; (2) the alteration of passwords or security schemes causing loss of control of computer system; (3) expenses resulting from extortion threats, including negotiators, public relations consultants, loan interest, and fees to decrypt or replace electronic data; and (4) rewards.²⁰² "Public Key Infrastructure (PKI) Policies" include "Network Computer Liability Policies," "Digital Certificate Warranty Liability Policies," and "Digital Certificate Management Liability Policies."²⁰³

5. *Coverage for Losses Due to Network Downtime, Corruption or Loss of Data, Hackers, and Other Types of Losses*

Under Coverage "A" of the standard CGL policy, coverage is available for "property damage," generally defined as "[p]hysical injury to tangible property, including all resulting loss of use of that property" as well as "[the] loss of use of tangible property that is not physically injured."²⁰⁴ However, it is an open question under Texas law whether or not the loss of computer data would constitute "property damage" under a CGL policy. A second unresolved issue is whether or not the temporary inability to use computer data would qualify as "loss of use." The Minnesota State

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

204. ISO, *supra* note 175.

Court of Appeals has held that a computer tape, together with the information contained on the tape, constitutes tangible property for insurance coverage purposes under a CGL policy.²⁰⁵ However, the same court, later held that the data contained or stored on a computer tape is not tangible property.²⁰⁶

Another important unresolved issue is whether or not software constitutes a "product" for purposes of CGL policies that exclude liabilities resulting from "your work" or "your product". For purposes of the Uniform Commercial Code (U.C.C.), software has been found to be both a service and a good. Software is a service when it is custom designed and installed for a unique use. But software is a good if it has been mass-produced and distributed widely.²⁰⁷

In *Seagate Technologies, Inc. v. St. Paul Fire & Marine Ins. Co.*,²⁰⁸ the court held that an umbrella liability insurer need not defend the maker of allegedly defective computer parts because there was no covered "physical injury."²⁰⁹ The plaintiff in the underlying action sought damages for the failure of the insured's disk drive to perform as promised, but there was no suggestion in the plaintiff's complaint that any damage resulted to any other component from the alleged defects in the disk drives.²¹⁰ According to the court, "[a]s a general matter, the risk of replacing or repairing a defective product is considered a commercial risk which is not passed on to a liability insurer. . . . This rule is designed to prevent liability insurance from serving as a warranty or a guarantee of an insured's product."²¹¹ Moreover, the court concluded that it "must follow the rule . . . that 'physical incorporation of a defective product into another does not constitute property damage unless there is physical harm to the whole.'"²¹²

6. *Insurance Coverage Cases Relating to the Recovery of Y2K Compliance Costs*

Xerox, GTE, and Unisys and other policyholders have filed lawsuits against their respective insurance carriers seeking to recover their past and future Y2K compliance costs.²¹³

The policyholders contend their Y2K compliance costs are covered under the "sue and labor" clauses of their respective property policies.²¹⁴

205. *Retail Sys., Inc. v. CNA Ins. Co.*, 469 N.W.2d 735, 738 (Minn. App. 1991).

206. *See St. Paul Fire & Marine Ins. Co. v. Nat'l Computer Sys., Inc.*, 490 N.W.2d 626 (Minn. Ct. App. 1992).

207. *See RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985); *see also Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670 (3rd Cir. 1991).

208. 11 F. Supp.2d 1150 (N.D. Cal. 1998).

209. *Id.* at 1153.

210. *Id.* at 1152.

211. *Id.* at 1155.

212. *Id.*

213. *See MEALEY'S EMERGING INS. DISP.* (Aug. 5, 1999) (regarding the Xerox and GTE suits), and *MEALEY'S EMERGING INS. DISP.* (August 19, 1999) (regarding the Unisys suit).

214. *See id.*

These clauses generally provide as follows:

[I]n case of actual or imminent loss or damage by a peril insured against, it shall without prejudice to this insurance, be lawful and necessary for the insured to . . . sue, labor, and travel, in and about the defense, the safeguard, and the recovery of the property or any part of the property insured.²¹⁵

The policies generally require the carriers to “contribute to the expenses so incurred according to the rate and quantity of the sum herein insured.”²¹⁶

GTE expects to spend \$400 million in year 2000 compliance costs, according to documents filed with the S.E.C.²¹⁷ Xerox expects to spend \$183 million in 1999 on Y2K costs.²¹⁸ On July 15, 1999 a consortium of thirty three property/casualty insurers and reinsurers held a round table conference in Washington D.C. in reaction to the actions brought by GTE, Xerox, and Unisys.²¹⁹ The insurers raised three arguments against such claims: (1) “remediation expenses are different from the types of expenses that sue and labor clauses are intended to cover”; (2) the expenses were not incurred for the primary purpose of benefiting the insurer but rather to meet industry standards, protect their company’s reputation, and maintain their market share; and (3) allowing such claims would allegedly “transfer the ordinary business costs of remediating non-compliant software to insurers and ultimately affect the reserves that insurers maintain to protect all policyholders.”²²⁰ The insurance coverage battle concerning reimbursement of Y2K compliance costs have not been resolved as of this writing.

7. *Potential Coverage For Defamatory/Libelous Statements in Cyber-Space*

Coverage “B” provides coverage for damages the policyholder becomes legally obligated to pay because of “personal injury.”²²¹ “Personal injury” is defined to mean “injury, other than ‘bodily injury’,” arising out of one or more of the following offenses:

- a. False arrest, detention or imprisonment;
- b. Malicious prosecution;
- c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling, or premises that a person occupies by or on behalf of its owner, landlord, or lessor;

215. *See id.*

216. *See id.*

217. *See id.*

218. *See id.*

219. *See id.*

220. *See Insurers’ Y2K Roundtable Sees No Coverage Under ‘Sue and Labor’ Clauses*, MEALEY’S EMERGING INS. DISP. (Aug. 5, 1999). The complaints filed in the Unisys, GTE, and Xerox actions are available at <http://www.2000law.com>.

221. ISO, *supra* note 175.

- d. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services; or
- e. Oral or written publication²²²

An untested question in Texas is whether or not online service providers should be classified as publishers, distributors, or common carriers for purposes of assigning liability for defamatory statements transmitted by users of their services. In *Cubby, Inc. v. CompuServe, Inc.*,²²³ the court held CompuServe to the standard of a distributor.²²⁴ The plaintiff sought to hold CompuServe, a comprehensive service provider, liable for defamatory statements contained in a newsletter that CompuServe made available on its electronic journalism forum.²²⁵ An outside publisher was responsible for supplying the newsletter to an independent company, Cameron Communications, Inc., which decided to upload the newsletter and include it in the forum.²²⁶ CompuServe did not review the contents of the newsletter before it was made available to the subscribers.²²⁷

The court found that CompuServe exercised virtually no editorial control of the content of statements transmitted by its system and therefore classified it as a distributor.²²⁸ The court noted that “[w]hile CompuServe may decline to carry a given publication altogether, in reality, once it does decide to carry a publication, it will have little or no editorial control over that publication’s contents.”²²⁹ Accordingly, CompuServe could not be held liable for the defamatory statements contained in the newsletter unless the plaintiff could show that it knew or should have known of the statement’s defamatory nature.²³⁰

In contrast, the court in *Stratton Oakmont, Inc. v. Prodigy Services Co.*,²³¹ classified Prodigy, a comprehensive service provider similar to CompuServe, as a publisher for purposes of liability for defamatory statements posted by users on Prodigy’s “Money Talk” bulletin board. Moreover, the court found that Prodigy held itself out as exercising editorial control over its network and thus did exert editorial control akin to a newspaper publisher or a television network.²³² In addition, the court also focused on the following indicia of Prodigy’s editorial control: (1) it issued content guidelines that directed users to refrain from posting “insulting” messages or messages that “harass other members or are deemed to be in bad taste or grossly repugnant to community standards”; (2) it used software designed automatically to screen all postings for offensive

222. *See id.*

223. 776 F. Supp. 135 (S.D.N.Y. 1991).

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. *Id.*

229. *Id.* at 140.

230. *Id.* at 142.

231. 1995 WL 323710 (N.Y. Sup. Ct. May 24, 1995).

232. *Id.*

language; (3) it instituted “board leaders” to monitor its bulletin boards; and (4) it enabled board leaders to delete undesirable messages by using “an emergency delete function.”²³³ Thus, because Prodigy had taken steps to sensor the material it transmitted, the court treated it as a publisher.²³⁴

In response to the online service providers’ concerns raised by the *Stratton Oakmont* case, Congress included in the Telecommunications Act of 1996²³⁵ a provision protecting “good samaritan” blocking and screening of offensive material.²³⁶ According to the Act, “no provider or publisher of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.”²³⁷ Furthermore, “no provider or user of an interactive computer service shall be held liable on account of—[. . .] any action voluntarily taken in good faith to restrict access to or availability of material that the provider or users considers to be obscene, lewd, lascivious, filthy, excessively violent, harassing, or otherwise objectionable, whether or not such material is constitutionally protected. . . .”²³⁸

As pointed out by Martin C. Loesch and David M. Brenner,²³⁹ the exception of liability created by the Telecommunications Act is a narrow one and leaves open the question of whether or not OSP’s who exercise control over the content of messages posted to a bulletin board may still be held to the standard of publishers where the editorial control is not undertaken for the purpose of restricting online access to obscenity and other “objectionable material,” but for other purposes, such as insuring topicality.²⁴⁰ Accordingly, commentators have for the most part argued against treating online service providers or bulletin board operators as publishers.²⁴¹ Rather, they have suggested that a plaintiff should be required to demonstrate that the provider or operator knew of the material’s defamatory character before imposing liability.²⁴²

8. Recovery of “Pre-tender” Investigation Costs

In *Copart, Inc. v. Travelers Indemnity Co. of Illinois*,²⁴³ the court awarded the policyholder prejudgment interest on its defense costs beginning on the date the policyholder first incurred the payment obligations.²⁴⁴ According to the court,

233. *Id.* at *3.

234. *See id.*

235. 47 U.S.C. sec. 541.

236. *See id.*

237. *See id.*

238. *See id.*

239. *See supra* note 162.

240. *Id.*

241. *Id.*

242. *See id.*; see also Loftus E. Becker, Jr., *The Liability of Computer Bulletin Board Operators for Defamation Posted by Others*, 22 CONN. L. REV. 203, 220-230 (1989).

243. 1999 WL 977948 (N.D. Cal. Oct. 22, 1999), *aff’d*, 2001 WL 327747 (9th Cir. Apr. 3, 2001).

244. *Id.*

Copart [was] entitled to prejudgment interest on the expenses it incurred in defending a copyright action that Travelers was obligated to defend. Interest began to accrue on the date Copart incurred its obligations (i.e., the billing dates). The court has reviewed the alternative methods by which the plaintiff has calculated this interest and finds [the most reasonable method to be the calculation] that takes into account the parties' compromise regarding actual damages.²⁴⁵

Moreover, the court distinguished between prejudgment interest awarded in a coverage case from prejudgment interest awarded in a damages case by stating that : "the court further finds that the focus of this lawsuit has been coverage, not [the] extent of damages."²⁴⁶ *Esgro Central, Inc. v. General Insurance Co.*²⁴⁷ involved the alleged breach of insurance contracts which insured stores damaged during the 1965 Watts Riots in Los Angeles.²⁴⁸ Prejudgment interest was proper on damages awarded under a fire insurance policy because the essential dispute was one of *coverage* and the computation of the amount was a question of law (the value of the property destroyed).²⁴⁹ However, the court denied prejudgment interest on the judgment entered based on a policy of business interruption insurance.²⁵⁰ The issue in that cause of action was the *extent* of the property owner's damage for losses admittedly covered.²⁵¹ But the dispute in this case is more analogous to the fire insurance claim in *Esgro*.

CONCLUSION

This article discusses only a few of the many untested insurance coverage questions in a complex and evolving area of the law. The Internet, e-commerce, and technology are developing and changing at a rapid pace. New insurance policies are being offered and being developed to enable participants in the information economy to manage the inherent risks that are present in a world of conflicting intellectual property rights and changing economic systems. While traditional policies are being revised in significant ways, the standard insurance policies were not designed to address common IP risks of liability and often do not provide clear answers to critical questions, such as: (1) whether or not a competitor's claims for trademark or trade dress infringement are covered; (2) whether or not a policyholder is entitled to be reimbursed for its reasonable costs of preparing for Y2K events; (3) whether or not advertisements or marketing of products that allegedly infringe upon a competitor's products are activities that trigger a duty to defend a CGL policy; (4) whether or not the loss of computer data constitutes a tangible injury to property; and (5) whether or not network downtime or computer crashes

245. *Id.* at *3.

246. *Id.*

247. 20 Cal. App. 3d 1054 (1971).

248. *Id.*

249. *Id.* at 1060.

250. *Id.*

251. *Id.* at 1062-63.

and damages following from such events are covered by liability or first-party insurance policies. Given the complexities of such insurance coverage issues to a developing area of insurance law, policyholders and insurance carriers will need to proceed with an abundance of caution and foresight.