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PERSPECTIVE

Overcoming intellectual property exclusions in insurance policies

By Peter S. Selvin

A key challenge for policyholders seeking coverage under commercial general liability, directors and officers, and other insurance policies is the presence of the so-called “intellectual property exclusion.” In a typical formulation, this provision excludes from coverage claims “based upon or arising out of any actual or alleged infringement, contributory infringement, misappropriation or theft of any intellectual property rights by the insured, including, but not limited to patent, copyright or trademark, service mark, trade dress, trade dress, trade secret, or trade slogan.”

While this exclusion is seemingly broad, policyholders have several arguments to overcome it.

At the threshold, it is often the case that intellectual property claims are cojoined with common law claims in a single action. In this context, insurers will typically argue that because such cojoined common law claims “arise out of” or “are based upon” the underlying intellectual property claim, the IP exclusion bars coverage with respect to the entire action.

This is not necessarily the case. In the first place, many courts have held that while the phrase “arising out of” may be given a broad interpretation where it appears in provisions granting coverage, the phrase is narrowly construed where it appears in exclusionary clauses. *See, e.g., Tower Ins. Co. of N.Y. v. Capurro Enters. Inc.*, C 11-03806 (N.D. Cal. Apr. 2, 2012) (rejecting argument that “arising out of” is always construed broadly, even in exclusionary clauses, and noting that the “broad coverage-narrow exclusion principle is well illustrated with respect to the phrase ‘arising out of’”); *MyChoice Software, LLC v. Travelers Cas. Ins. Co. of Am.*, 19-56030 (9th Cir. 2020); *Hartford Fire Ins. Co. v. Vita Craft Corporation*, 911 F.Supp.2d 1164, 1180 (D. Kan. 2012).

This principle has been illustrated in several cases. For example, in *MyChoice Software*, the plaintiff sued Trusted Tech Team, Inc. for intellectual

property theft. Trusted Tech responded with a cross-complaint against MyChoice which evidently did not contain any intellectual property claims.

The trial court, giving a broad interpretation to the phrase “arising out of” in the exclusion, determined that coverage was barred “based on the

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allegations that MyChoice, as the insured under the policy, asserted against Trusted Tech.” The 9th U.S. Circuit Court of Appeals reversed, holding that it was “reasonable for an insured under the policy to interpret the exclusionary provision as applying only to allegations asserted against it in the absence of explicit language stating otherwise.”

Align Technology, Inc. v. Federal Ins. Co., 673 F.Supp.2d 957 (N.D. Cal. 2009), illustrates the same point. In that case Align sued a competitor, OrthoClear, for intellectual property theft, including a claim for trade secret misappropriation. OrthoClear then filed a cross-complaint against Align in which it alleged 17 causes of action, including statutory and common law unfair competition, libel and defamation. Align tendered OrthoClear’s cross complaint to its CGL carrier (Federal), which denied coverage for the claim.

In denying coverage for the claim, Federal explained that “part of the allegations and damages sought [by OrthoClear] related to the alleged misappropriation of confidential and/or trade secret rights held by Align as well as unfair competition or similar practices.” In other words, Federal characterized all of Align’s allegedly actionable statements as having been “made in an attempt to protect its intellectual property from OrthoClear.” From this dubious premise, Federal argued that all of Align’s allegedly defamatory statements were

“related” to the Align’s underlying intellectual property rights and hence were excluded by the IP exclusion.

The district court rejected this argument: “[A]ccepting Federal’s argument would allow it to cobble together the most favorable allegations from both parties and disregard the rest. Such

an approach defies the public policy of strictly construing exclusionary clauses. At best, the conflicting allegations might create a factual issue as to whether injury from each statement was related to an alleged intellectual property dispute. Since a factual dispute does not completely eliminate the possibility of coverage, it does relieve Federal of its duty to defend.” *See also Curtis-Universal, Inc. v. Sheboygan Emergency Medical Services, Inc.*, 43 F.3d 1119, 1122 (7th Cir. 1994) (an insurer cannot avoid its duties of defense and indemnification by reference to the core or dominant character of the plaintiff’s allegations; instead, the insurer must defend if any conduct alleged in the complaint falls within the insurance policy, even if those allegations are only a “subordinate aspect” of the complaint); *Vita Craft*, 911 F.Supp.2d at 1180 (coverage found because single claim of defamation, even though it was asserted as part of complaint for violation of intellectual property rights, was not directly tied to intellectual property rights); *Woodspring Hotels, LLC v. National Union Fire Insurance Co. of Pittsburgh, PA*, N17C-09-274 EMD CCLD (Del. Super. Court 2018) (“An insurer cannot avoid a duty to defend unless every allegation in a complaint falls into an exception under the policy”).

Another approach may come into play where the plaintiff characterizes

the information or material allegedly misappropriated by the defendant as “confidential information and/or a trade secret.” This scenario arose in *MedAssets, Inc. v. Federal Ins. Co.*, 705 F.Supp.2d 1368 (N.D. Ga. 2010), which involved coverage under a D&O policy. There, two plaintiffs sued a subsidiary of MedAssets for allegedly accessing the plaintiffs’ confidential pricing information. Importantly, while some paragraphs of the plaintiffs’ complaint characterized plaintiffs’ pricing information as a “trade secret,” other paragraphs characterized that information as “confidential information.” Determining that there was coverage notwithstanding the presence of an IP exclusion, the court noted that the distinction between a “trade secret” and “confidential information” was pivotal in finding coverage under the policy. This is in part because information can be confidential yet not rise to the level of being a trade secret. *See also TDS Healthcare Sys. Corp. v. Humana*, 880 F.Supp. 1572, 1584-85 (N. D. Ga. 1995). And although plaintiff’s characterization of its pricing information as a “trade secret” was incorporated into each count in the complaint, the court held that “the drafting style of the Plaintiff should not govern the question of coverage of the Defendant.”

The takeaway is that IP exclusions, while seemingly broad and expansive, can be successfully overcome by policyholders seeking coverage in cases where intellectual property rights may be involved. ■

Peter S. Selvin is a partner at *Ervin Cohen & Jessup LLP*. You can reach him at pselvin@ecjlaw.com.

