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"Buried Treasure" - Securing Reimbursement for Monies Expended in Past Intellectual Property Lawsuits

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Companies looking for extra money in these tough economic times may have an answer from the past. The vast majority of insurer denial letters for intellectual property lawsuits lack merit. Therefore, companies who have litigated intellectual property cases and expended significant monies in defense and settlement may be overlooking ready sources of cash through pursuit of coverage claims.

Five Reasons Why Insurer Denials of Intellectual Property Claims May Not Be Well Taken

First, insurers rarely consider all the potential bases for coverage factually implicated by the underlying lawsuits they address. The distinctions necessary to identify pertinent policy provisions may not be possessed by the personnel charged with conducting that analysis.

Second, insurer's distinctly narrow fact constructions of allegations leads to consistent under-assessment of potential coverage for fact-based claims under "offense" based coverage for "categories of wrongdoing" which often proceed under a bewildering variety of labeled causes of action.

Third, the insurer's ability to appreciate a potential for coverage requires an ongoing and "neutral assessment" of developments in coverage case law. Mechanisms to communicate this developing law to the claims handling personnel charged with evaluating coverage for such claims are often ineffective and inconsistent with the insurer's institutional perspective on how coverage should be evaluated.

Fourth, further, when case law, favorable to policyholders arises, it is not disseminated with appropriate instruction to caution claims to personnel to its significance.

Fifth, claims personnel may be the victim of a collective "willful blindness" to case developments that are antithetical to coverage perspectives developed while protecting insurer interests.

Intellectual Property Lawsuits Are Expensive

It is not uncommon, pursuant to AIPLA surveys for companies to expend $500,000 to $1,000,000 for defense of trademark and copyright infringement lawsuits. More than five times that sum may be expended for patent infringement lawsuits. Where insurer denial letters assert erroneous grounds for denial, a distinct opportunity for pursuit of coverage arises.

Ascertaining Whether Buried Treasure Exists Requires a Five-Part Analysis

These issues include:

1. Did the company give notice to the insurers on risk as of the date of the first alleged "wrongful act" as well as all subsequent carriers and those at higher levels who may have a duty to pay any settlement reached.

2. If not, was the insurer on constructive notice of the lawsuit and/or settlement.

3. Has the statute of limitations run on their complaint.

4. Are facts beyond the complaint available to clarify potential coverage where the law applicable permits reference to such evidence.

5. Were the insurer or insurers notified of any settlement prior to its consummation where the insurer agreed to defend under a reservation of rights.

Notice

Notice is the key element in finding "buried treasure." Without notice, there is no right to insurance coverage as it is a prerequisite to accessing policy benefits in every case. Notice should be promptly provided. The rule is "tender early, tender often." Fears that notice may raise insurance premiums are ill-founded, inconsistent with the advice given by thoughtful brokers who know the insurance marketplace.

In the majority of jurisdictions, the "prejudice rule" applies. This means that unless an insurer can show the alleged late notice caused it prejudice, it must provide full policy benefits to its insured. Indeed, the Texas Supreme court made clear several years ago in a seminal decision that late notice applied to advertising injury/personal injury coverage claims, clarifying Texas law on this point. Nevertheless, late notice can still be a problem in some forums.

In Illinois, late notice is a condition precedent to coverage. Until the recent statutory change, New York made notice a condition precedent to procure coverage. In changing that rule, the New York legislature observed several years ago in changing the Draconian New York "late notice" rule is "a trap for the unwary." In Florida, a prejudice standard applies, but the insured has the burden of proof.

Constructive Notice

If notice was provided, "buried treasure" pursuit may be available whether or not a denial letter was received so long as an insurer cannot claim it never learned of the suit. Constructive notice may be established by facts coming to the insurer's attention from other policy renewals, communications by insurers through brokers to the insured, as well as public information provided to the insurer in connection with other policy applications.

Constructive notice can arise where there is evidence in public filings, such as 10Q and 10K statements discussing litigation which are then provided to insurers in connection with the renewal of policies. Policy renewal for D&O or E&O policies frequently require an answer to the following: "Are you involved presently or expected to be involved in the future with any form of litigation?" Answers to this question brought to a CGL/umbrella insurer's attention may put it on constructive notice of the litigation. No formal tender need be made in such a circumstance.

The "No Harm, No Foul" Exception To Late Notice Challenges

A "voluntary payments" prohibition may not apply where an insurer would have denied a defense no matter when notice was provided on other grounds. Where an insurer denies a defense based on grounds other than notice, a frequent issue in intellectual property insurance coverage dispute, a number of jurisdictions have embraced the "no harm, no foul" rule. That principle addresses the problem that an insurer would have failed to defend even if receiving timely notice because the grounds for denial were far greater than merely lack of notice. These can include the failure of potential coverage because of the lack of fact allegations triggering it, applicable exclusions the insurer contends applies, the failure to meet other conditions and the like.

Statute of Limitations May Not Delimit The Scope of Recoverable Claims

The statute of limitation varies in many of the states. A state like Indiana is 20 years. Kentucky and Ohio is 15 years. Wyoming, Iowa, Illinois and Louisiana, 10 years. Montana is 8 years. But most of the states have either a 5 year statute of limitation or a 4-year statute of limitation. And some have as short as three years. Where your company is headquartered in states with a shorter statute of limitation (four years is typical) the statute may be tolled while the lawsuit is ongoing in the majority of forums until the litigation is resolved through appeal. Thus, there may be more time to pursue coverage claims than is readily appreciated in many cases.

Pre-Judgment Interest May Be Recoverable

Prejudgment interest typically runs from the date of invoice of attorneys' fees to an insured or date of settlement (although from jurisdictions make the sum recoverable dependent on the date of payment of a settlement). The majority of forums permit recovery of prejudgment interest in a range from 8 to 12%. Oklahoma permits 15%. Under certain circumstances, Texas permits 18%.

Where an insurer's failure to pay a defense or settlement benefit is at issue then recovery of prejudgment interest can greatly enhance the value of the recovered fees. Indeed, one of the most salient investments businesses can make is to pay attorneys' fees. The return on those fees exceeds market interest rates in a number of jurisdictions.

Pertinent Policy Periods to Evaluate For Potential Coverage

Insurer obligations to defend include claims based on false, frivolous or fraudulent allegations. The merits of the underlying action are of no moment to insurance coverage analysis. In those jurisdictions that look only to the allegations of the complaint (some 20 in the United States), which include Texas and Illinois, as well as Florida, the four corners rule is followed. Under this "complaint allegations" rule it is not important whether the wrongful conduct alleged actually occurred. The allegations control in compelling a defense duty.

Typically, CGL/umbrella coverage is "occurrence," not "claims made" based. The question is when the wrongful act occurred. It is not uncommon to look to a date as far back in time as 20 to 25 years ago when the alleged wrongful conduct allegedly occurred. In circumstances where fraudulent concealment is alleged the statute of limitations may be circumvented. Thus, the copyright statute of limitations is three years but its inception date is often difficult to fix.

Answering Questions Raised By the Policy That the Complaint Does Not Answer

In one case (an antitrust suit) an outside law firm, after providing notice and receiving a denial, did not advise an insurer when the complaint was amended to add a labeled claim for defamation the carrier would have been compelled to defend. As no notice was ever provided of the defamation claim, no policy benefits were ever obtained.

A jurisdiction that will permit facts beyond pleadings to be brought to an insured's attention applies two different rules. One, facts must be "known to the insurer" or two, "available to the insurer." In other jurisdictions, only facts known to the insurer may be evaluated. The better practice is to insure that the facts known standard is met in every jurisdiction.

To do so, active interaction between coverage counsel and defense counsel is key. Without an opportunity to not only inform the insurer of what facts have developed, but to ask questions germane to insurance coverage, in the underlying case, opportunities for coverage may be lost unnecessarily. It is critical that settlement communications be orchestrated with the assistance of coverage counsel to best secure reimbursement for such payments.

Conclusion

For companies seeking funding for ongoing litigation, a ready source of capital may be pursuit of coverage claims following past denials of insurers in previously pending suits. Critically, insurance coverage litigation requires a matter of months, not years, since discovery is rarely necessary. *See* ©David A. Gauntlett, *Insurance 101 — Insight for Young Lawyers — No Discovery Is Appropriate in Addressing Coverage for Intellectual Property Disputes*, Coverage, July/Aug. 2009.

Statutes of limitation rarely bar pursuit of coverage action since they are tolled during litigation. Indeed, choice of forum in coverage suits is a valuable tool that policyholders can use to obtain favorable coverage results. Obtaining the most favorable prejudgment interest on monies paid in defense fees and/or settlement can also significantly enhance the recovery available to insureds.

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