**New York's Declaratory Judgment Insurance Trap**
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The young IP litigator in the big New York firm licked his chops. One of his firm’s best clients, also a New York-based business, had, as part of its routine market monitoring, noticed an up-tick in knockoffs of a major new product, earmuffs in the shape of the distinctive noggin of a popular cartoon character. The product was protected by a whole suite of intellectual property registrations: A copyright on the character, a pending design patent, and a registered trademark. Together with counsel and local law enforcement, the client had succeeded, in a low-key, low-impact way, in seizing or otherwise cutting off distribution of the infringing merchandise. So far, so good.

But word had leaked back through "channels" that a major out-of-state manufacturer of the infringing goods was angling for a fight. He believed the copyright was lapsed, the design patent would be rejected, the trademark registration was invalid -- something for everything. He stood to make a lot of money on the knockoffs; the genuine item sold at specialty stores for $14.95, but cost only $1.45 to manufacture. There was a lot of room for "competition." The question was, when would the judicial challenge come? And where?

At lunch with in-house counsel -- an experienced transactional attorney with a background in licensing -- the young litigator expressed his concerns: "What if they sue for declaratory judgment in their home state? Its 800 miles from here. We’ll be at a huge strategic and economic disadvantage. Not to mention the ‘friendly’ reception they’ll get from local judges."

"Do you think they’d bring this in state court?" asked the in-house lawyer. She knew enough about that prospect to shudder, causing her to withdraw her fingers from the base of her cold glass of mineral water.

"They might," answered the litigator, buttering his roll. "That would give them their best shot at a friendly jurist. But because of all the federal questions, we wouldn’t even have to plead diversity to get automatically removed to federal court."

The in-house lawyer breathed a sigh of relief.

"Still," said the gunslinger, "it does seem a little crazy to wait for them to choose their time and place.

"That’s what has me thinking," he continued, wiping the corner of his mouth with the cloth napkin on his lap. "Why don’t we bring the declaratory judgment action ourselves? We file here in New York, where most of the judges are experienced at intellectual property cases. We gain all the tactical advantages of the home ‘court’ and the friendliness of New York law to IP stakeholders. And we take our sweet time drafting the complaint and the motion papers."

"Sounds a little expensive," said the corporate lawyer. "After all, we might not get sued at all."

"That's the beauty of it," responded the litigator. "The only way standing pat saves you money is if he never sues. Chances are good that he will, though -- there's just too much money to be made. But he hasn't made it yet. By moving pre-emptively, seizing the high ground and moving all our guns into place, he'll wake up one morning with a summons on his reception desk and he'll sue for peace. His margins are so low, I don't even see how he could finance a sustained defense. In the long run you'll save a ton. And the board will, of course, praise your foresight. Tofu square?"

Three years, 19 depositions, six experts, two summary judgment motions, and a 136-page pre-trial memorandum later, it wasn't bread that the in-house lawyer wanted to break with her aggressive outside litigator. Why hadn't he told her about the insurance policy?

The coverage is called "advertising injury." It is a typical covered injury in most commercial general liability insurance policies -- the basic insurance policy that any substantial business buys. Typically, "advertising injury" is defined in such policies as a loss "arising solely out of one or more of the following offences committed in the course of advertising your goods," including "infringement of copyrighted advertising materials or infringement of trademarked or service marked titles or slogans." An infringer with such a policy may be a very dangerous defendant.

In our story, no insurance company would have financed a declaratory judgment action by the manufacturer of the knockoff goods. But once the manufacturer was sued, the insurer had little choice but to defend. It is a cardinal rule of insurance law that the duty to defend under a liability policy is broader than the duty to indemnify. This breadth of duty applies both to the (1) merits of the claim, and the (2) cost of the defense as well.

At this point a brief explanation is in order, using New York law by way of example, because it is typical, though not the last word on the subject (see below). By the "merits," I mean that it does not matter whether the claim against the covered party is ultimately found to be meritorious. It also does not matter whether there are other claims in the complaint, of which the covered claim -- here, the trademark claim -- is only one small part. The insurer has to defend the whole case. Frontier Insulation Contractors, Inc. v. Merchants Mutual Insurance Co., 667 N.Y.S.2d 982, 984-5 (N.Y. 1997).

Furthermore, to avoid its duty to defend, an insurer must show "as a matter of law that there is no possible factual or legal basis on which [the insurer] might eventually be held to be obligated to indemnify [the insured] under any provision of the insurance policy." Servidone Constr. Co. v. Security Ins. Co., 488 N.Y.S.2d 139 (N.Y. 1985). If there is anything within the "four corners" of the complaint that raises the possibility of coverage, the insurer must defend. Fitzpatrick v. American Honda Motor Co., 571 N.Y.S.2d 672, 674 (N.Y. 1991).

As to cost, the duty to defend simply has no limitation on cost, which is why insurance companies often find it worthwhile to settle cases at, or even above, a policy's coverage limits. It may cost more to litigate than to simply pay the maximum claim.

Does advertising injury cover typical trademark infringement claims? Yes, it does, at least in some jurisdictions. As a general principle, under New York law, "[T]he use of a trademark on goods implies or constitutes 'advertising' in 'the ordinary meaning of the term,' and that 'it is not possible to allege a claim for trademark, service mark or trade name infringement without the infringing mark being used to identify the goods or services to the public. This use qualifies as advertising under the definition [of the policy].'" So said the court in a recent high-water mark for advertising injury claims, Hugo Boss Fashions, Inc. v. Federal Ins. Co., 1999 U.S. Dist. LEXIS 17016 (S.D.N.Y. 1999), at *11. Accord, Energex Sys. Corp. v. Fireman's Fund Ins. Co., 1997 U.S. Dist. LEXIS 8894 (S.D.N.Y. 1997), at *8-9.

In Hugo Boss, which addresses the policyholder's coverage claim against a recalcitrant insurer, the trademark claim was embedded in a contractual dispute involving the terms of a licensing agreement. Among the insurer's defenses were that coverage was excluded by the policy, which stated that it did not cover advertising injury "arising out of breach of contract." The insurer also cited a limitation excluding claims involving "trademark or service mark or certification mark or collective mark or trade name other than trademarked or service marked titles or slogans."

The court rejected both proffered exclusions (among others). First, it relied on the well-established jurisprudence that strictly construes limitations in insurance policies against a denial of coverage. The Southern District cited the Second Circuit in Village Of Sylvan Beach v. Travelers Indem. Co., 55 F.3d 114 (2nd Cir. 1995), which restated the rule that, "To negate coverage by virtue of an exclusion, an insurer must establish that the exclusion is stated in clear and unmistakable language, is subject to no other reasonable interpretation, and applies in the particular case." Id. at 115-116.

Applying this principle, the court rejected the insurer's defenses. The "breach of contract" exclusion, reasoned the court, did not apply, because the trademark claims stand on their own – though their factual genesis may have been contractual, the trademark rights asserted by the markholder themselves were not created by contract. Id. at *8 -*9. To say that the Southern District succeeded in reading the exclusion narrowly in Hugo Boss is an understatement.

Similarly, the District Court rejected the argument that the claims in the case only applied to trademarks and trade names "other than trademarked . . . titles or slogans" as set forth in the exclusion. The insurer claimed, understandably, that the mark at issue, "Boss," was simply the policyholder's trademarked name, and could not qualify as a "title or a slogan." The court's rejection of this exclusion was a marketing executive's dream, and deserves to be quoted in full:

While a closer question than Federal's contention with respect to the breach of contract exclusion, I cannot conclude as a matter of law that "Boss" falls outside the definition of "title" or "slogan." Although I agree with Federal that "Boss" can hardly be characterized as a title, I find that "Boss" in this context may qualify as a slogan. . . . English dictionaries generally define "slogan" as a word or combination of words that acts as an attention-getting device. The word "Boss" appears to do just that, . . . "Boss" does suggest something about the nature or quality of BMC's products. Indeed, unlike other tradenames such as Nike, McDonald's, or Ford, the word "Boss" itself conveys a meaning that the emblazoned products are of first-rate quality and that the wearer is "above the rest" or "in control." Thus, although BMC uses the word "Boss" to identify its products in the marketplace, it also attempts to distinguish these products by conveying -- and successfully so, in my opinion -- a sense of power, style and quality. Id. at *10-11.

Yes, under New York law, it appears that just about any trademark infringement claim is covered "advertising injury." On the other hand, under Michigan law, it may not be. See, Advance Watch Company, Ltd. v. Kemper National Ins. Co., 99 F.3d 795 (6th Cir. 1996). In our story, we made it easy: The client, the covered event, and let's even stipulate to the place of contracting, were in New York. Application of the appropriate law to an insurance coverage dispute is an entire topic unto itself – and far beyond our subject here.

In any event, counsel would be well-advised not to bet on choice of law when deciding whether or not to file for a declaratory judgment. Such a decision requires a lot of research on the law and more information about the adversary's policy (and the facts surrounding its making) than is typically available.

The real moral of the story, of course, is that when it comes to declaratory judgments, the question is not merely whose ox is being gored, but who is doing the goring. An infringer with a limited budget can become a mighty mad ox indeed if it can call on its business insurance to defend it in a declaratory judgment action it could never have afforded to bring itself. Sometimes, it seems, the right thing to do really is nothing at all. The alternative could spoil your appetite.