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## Coverage for Unfair Competition Torts under General Liability Policies: Will the "Intellectual Property" Tail Wag the Coverage Dog?

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# COVERAGE FOR UNFAIR COMPETITION TORTS UNDER GENERAL LIABILITY POLICIES: WILL THE “INTELLECTUAL PROPERTY” TAIL WAG THE COVERAGE DOG?

*Francis J. Mootz III\**

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## INTRODUCTION

An efficient insurance market presumably follows a standard chronology in response to the emergence of new risks. In the first stage, courts begin to stretch policy language to adapt coverage to unforeseen circumstances, in accordance with the principle that carriers should bear the burden of ambiguous policy language, and informed by the desire to respect the reasonable expectations of the parties. Responding to the unexpected expansion of policy language, the next stage sees underwriters revising policy language to preclude similar judicial interpretations,

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generally by excluding the unanticipated risks from coverage in relatively unambiguous language. Finally, if the new risk is substantial enough and can effectively be underwritten, carriers will develop new coverage or stand-alone policies to accept a transfer of these risks from businesses. When following this developmental logic, the insurance market effectively works to identify emerging liabilities that present substantial exposure, and then segregates these risks with distinct underwriting and loss prevention services that facilitate the efficient and economical provision of insurance coverage.

The rapid emergence during the past ten years of Employment-Related Practices Liability Insurance in the form of an endorsement or as a stand-alone policy provides a good example of this chronology.<sup>1</sup> In response to the tremendous increase in employment-related liabilities over the past thirty years, employers began seeking coverage under traditional liability products with some success. As insurance carriers moved quickly to exclude these risks from coverage, a new and highly competitive market for this form of coverage rapidly developed. Adjustments in the insurance market are not always so smooth, however, as is amply demonstrated in the protracted and ongoing debacle regarding insurance coverage for pollution-related liabilities.<sup>2</sup> Courts continue to attempt to find coverage, while the extremely broad exclusions operate to confound the reasonable expectations of the insureds in many ways beyond the limited question of pollution liabilities.

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1. See generally Symposium, *Insurance Coverage of Employment Disputes*, 18 W. NEW ENG. L. REV. 1 (1996); Symposium, *Employment Practices Liability Insurance and the Changing American Workplace*, 21 W. NEW ENG. L. REV. 245 (1999). This story is not yet complete, however, as the fierce competition for this new market may lead too many insurers to undercharge for this coverage, posing the potential for problems in the future. See, e.g., Francis J. Mootz III, *Insuring Employer Liability for Hostile Work Environment Claims: How Changes in Discrimination Law May Affect the Growing Market for Employment-Related Practices Liability Insurance*, 21 W. NEW ENG. L. REV. 369, 370-72 (1999).

2. It would be beyond tedious to attempt to catalogue the vast literature on the pollution exclusion. For an interesting argument that the pollution exclusion debacle has played a large role in the degradation of the CGL by limiting "the insurability of important forms of business liability," see Kenneth S. Abraham, *The Rise and Fall of Commercial Liability Insurance*, 87 VA. L. REV. 85, 86 (2001) [hereinafter Abraham, *Rise and Fall*]. For a particularly incisive analysis of one moment in this doctrinal train wreck, see Jeffrey W. Stempel, *Unreason in Action: A Case Study of the Wrong Approach to Construing the Liability Insurance Pollution Exclusion*, 50 FLA. L. REV. 463 (1998). For a broader account, see KENNETH S. ABRAHAM, ENVIRONMENTAL LIABILITY INSURANCE LAW (1991).

Contributions to this Symposium discuss the evolution of insurance coverage of intellectual property liabilities in the context of an emerging cyber-economy, with a focus on the changing coverage under the Advertising Injury part of the CGL form. This focus appears to exemplify the standard progress of an efficient insurance market: as insureds began seeking coverage for the growing list of intellectual property liabilities arising out of e-commerce activities, insurers responded by excluding most coverage for these liabilities under the CGL form, while almost simultaneously developing distinct products for this coverage.<sup>3</sup> However, I will argue that this story is more complex than it first appears.

The high-exposure, high-profile question of coverage for traditional intellectual property liabilities (including copyright infringement, patent infringement, trademark infringement, etc.) has garnered nearly all of the attention surrounding the scope of the Advertising Injury coverage. In contrast, the more mundane and common business tort liabilities for unfair competition (including breach of agency duties, breach of fiduciary duties, and misappropriation of trade secrets) have apparently been forgotten. CGL underwriters have developed exclusions that should be effective in precluding coverage for many intellectual property liabilities and business tort liabilities, but the market so far has developed new grants of coverage only for intellectual property liabilities. For example, the 1998 CGL form makes it clear that copyright infringement is a covered offense under the Personal and Advertising Injury coverage, and policies designed for e-commerce liabilities or media business liabilities may provide coverage for a range of intellectual property liabilities that have now been excluded from the CGL.<sup>4</sup>

This development is potentially disastrous for a number of insureds. Many small companies, particularly start-up companies created by former employees of a more established enterprise, face a substantial threat if they

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3. Robert H. Jerry, II & Michele L. Mekel, *Cybercoverage for Cyber-Risks: An Overview of Insurers' Responses to the Perils of E-Commerce*, 8 CONN. INS. L.J. 7, 17-23, 26-28 (2001).

4. *Id.* See also Douglas R. Richmond, *A Practical Look At E-Commerce And Liability Insurance*, 8 CONN. INS. L.J. 87, 94-96 (2001); James R. Warnot, Jr. & Daniel C. Glazer, *Insurance Coverage for Intellectual Property and Cyberspace Liability*, 652 PLI/LIT 407, 426 (2001) (describing the emergence of new policies and endorsements that "appear to provide more extensive coverage for trademark and copyright protection than did the CGL," but which do not explicitly cover trade secret or unfair competition liabilities); Bruce Telles, *Insurance Coverage for Intellectual Property Torts*, 602 PLI/LIT 629, 656-59 (1999) (describing specialty policies that specifically cover traditional intellectual property liabilities but do not expressly cover trade secret or unfair competition liabilities).

are sued for business torts relating to the formation and marketing of their new enterprise. These businesses almost certainly will purchase the basic CGL coverage, but they are unlikely to consider purchasing a specialized insurance product for unfair competition business torts, even if this product is developed in the future. Because every business entity is potentially subject to these liabilities, even if specialty coverages for internet businesses or media businesses begin to offer coverage for unfair competition business torts, these products simply will not reach the relevant market. Consequently, as the insurance industry focuses on adapting to the proliferation of intellectual property claims in our e-commerce and media-saturated world, many businesses may find that they are without coverage for some of the basic risks of doing business.

Kenneth Abraham recently noted that what “was once broad general liability insurance has now become much narrower general liability insurance . . . The full logic of narrowing suggests that eventually all particular liabilities would be excluded from coverage under CGL policies and would have to be the subject of special purpose coverage.”<sup>5</sup> The problem, according to Abraham, is that specialized endorsements and policies are themselves subject to narrowing over time, the end result being that significant gaps remain in the CGL policy’s coverage of traditional business liabilities. It may be that revision of general liability policy forms will have precisely the effect that Abraham fears on the coverage of standard business tort liabilities, much to the surprise of insureds. I am not arguing that business entities have some kind of natural right to insurance coverage for these liabilities. Rather, I am suggesting that the emergence of a significant e-commerce business environment is driving carriers to expand their exclusions. These expanded exclusions may have the practical effect of rendering common business tort risks uninsurable. Moreover, although the insurance industry has already developed new products to address e-commerce liabilities, coverage of standard business tort liabilities appears to be forgotten. In short, important “commercial general liability coverage” may be disappearing inadvertently, and without notice.

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5. Abraham, *Rise and Fall*, *supra* note 2, at 105-06.

### I. DEFINING THE RISK: UNFAIR COMPETITION AND RELATED BUSINESS TORTS.

American law is quite forgiving of vigorous competition. As one might expect, as a general matter it is tortious to interfere improperly with another's prospective business advantage, but the pursuit of one's own business interests is generally not considered "improper" under tort law.<sup>6</sup> However, common law and statutory protection of trade secrets provide important examples of limitations on competition between businesses.<sup>7</sup> These laws protect the interest of a business entity in "information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others."<sup>8</sup> The nature of the wrong is not the misappropriation of another's property, but rather a wrongful acquisition of another's secret business information in a manner that exhibits bad faith and, in many cases, the abuse of a confidential relationship.<sup>9</sup> Consequently, these claims do not fit the standard model of "intellectual property" liabilities.

Businesses often seek to protect trade secrets regarding their production processes, marketing strategies, customer lists, and customer information. Regardless of any protections afforded to this information as intellectual property, the law acknowledges that the company has a legitimate interest in preventing others from improperly acquiring and using confidential and valuable information for their own gain. The typical scenario involves former employees breaking away to form their own competing company, or an employee's migration to a competitor. Often, a company will sue not only their competitor but will also sue the former employees individually for breaching their duties of loyalty and confidentiality as found in the law of agency or fiduciary duty.<sup>10</sup>

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6. See RESTATEMENT (SECOND) OF TORTS § 768(1) (1979). However, competition provides no justification for interfering with another party's enforceable contract. *Id.* at § 768(2).

7. See, e.g., UNIF. TRADE SECRETS ACT § 768 (amended 1985), 14 U.L.A. 433 (1990) (forty-one states and the District of Columbia have adopted this Uniform Act or have similar statutory provisions); RESTATEMENT (THIRD) OF UNFAIR COMPETITION §§ 39-45 (1995) (restating common law protections for trade secrets).

8. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 (1995).

9. *Id.* at cmt. a.

10. For a good model of this typical case, see *Scottsdale Insurance Co. v. Travis*, No. 05-99-01831, 2001 WL 569300 (Tex. App. May 29, 2001). The former employee allegedly

Business tort litigation against a new competitor serves the dual purpose of not only protecting trade secrets but also creating an immediate obstacle to building the business. Consider, for example, the scenario of several highly placed individuals who decide to resign their employment and form a competing firm. If the employees are well-counseled, they will only prepare to compete while they are still employed, so as not to breach their duties of loyalty and confidentiality. Upon their resignation, they generally are free to compete energetically with their former employer. If their former employer feels wronged, however, the employer may assert a variety of claims against the new enterprise and seek an injunction as well as damages. The former employer could allege that jointly resigning was tortious in itself because it was designed to cripple the enterprise,<sup>11</sup> but more likely it would allege that the former employees have misappropriated trade secrets and are planning to use them, or otherwise are engaging in unfair competition. When faced with an aggressive litigation campaign to thwart their new business, the former employees may find that sufficient resources to mount a defense against the (potentially unwarranted) claims are critical. It is at this juncture that the new business will turn to its general liability policy and seek a defense of the action and, potentially, coverage of monetary damages or settlements.

What the former employees will now find, however, is disheartening. The transition from the 1973 Insurance Services Office's ("ISO") Broad Form Endorsement to the 1986 CGL form, and now to the 1998 CGL form, has successively made the prospects for coverage much less likely.<sup>12</sup> This development appears to have been matched by corresponding changes in manuscripted general liability policies. Although a few courts had begun to recognize that a business entity could obtain a defense against such claims,

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schemed to set up a competitor by recruiting his employer's employees and customers, making false accusations and spreading ill-will among his employer's customers, and using his knowledge of customer lists and secrets to steal business for himself and his new business. He was sued for tortious interference with contract, misappropriation of trade secrets, breach of fiduciary duty, and conversion. The insurance coverage issues were not reached in this case, however, because the alleged offenses took place prior to the commencement of the policy period.

11. *See generally*, Feddeman & Co. v. Langan Assocs., 530 S.E.2d 668 (Va. 2000); ABC Trans Nat'l Transp., Inc. v. Aeronautics Forwarders, Inc., 413 N.E.2d 1299 (Ill. App. Ct. 1980); Duane Jones Co. v. Burke, 117 N.E.2d 237 (N.Y. 1954); Republic Sys. & Programming, Inc. v. Computer Assistance, Inc., 440 F.2d 996, 996 (2d Cir. 1971) (Medina, J., dissenting).

12. For a succinct description of these changes in the policy language, see Warnot & Glazer, *supra* note 4, at 412-14.

depending on how the complaint was pleaded, the adoption of the 1998 form has narrowed the advertising injury coverage to such an extent that this claim is now far more difficult to establish. The reaction of the insurance markets to the increase in high-exposure intellectual property claims therefore threatens to leave business insureds without any defense or coverage obligations for these typical business torts.

## II. THE EMERGENCE OF ADVERTISING INJURY COVERAGE IN GENERAL LIABILITY POLICIES: THE MOVE TO FIND COVERAGE FOR UNFAIR COMPETITION BUSINESS TORTS

The 1973 ISO CGL form included coverage for Advertising Injury as part of a Broad Form Endorsement. Advertising Injury was designated as an "offense" rather than an "occurrence," and so it was not limited only to covering negligent behavior. Advertising Injury was defined, in relevant part, as: "injury arising out of an offense committed during the policy period occurring in the course of the named insured's advertising activities, if such injury arises out of . . . piracy, [or] unfair competition."<sup>13</sup>

This grant of coverage clearly establishes potential coverage for a business tort suit alleging unfair competition that occurs in the course of "advertising activities," which remain undefined in the policy. Several exclusions might apply to such a case, including an exclusion for an offense that constitutes "the wilful violation of a penal statute or ordinance committed by or with the knowledge or consent of the insured," and the exclusion of "any injury arising out of any act committed by the insured with actual malice."<sup>14</sup> As a general matter, though, these exclusions would not apply and the insured would have a plausible claim that the duty to defend was triggered by the typical allegations in a complaint for misappropriation of trade secrets and unfair competition.<sup>15</sup>

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13. INS. SERVS. OFFICE, INC., BROAD FORM COMPREHENSIVE GENERAL LIABILITY ENDORSEMENT GL 04 04 05 81, at 2 (1985), *quoted in* Jerry & Mekel, *supra* note 3, app. at 31-32 [hereinafter ISO, BROAD FORM]. See *Nat'l. Union Fire Ins. Co. v. Siliconix, Inc.*, 729 F. Supp. 77, 78 (N.D. Cal. 1989) (quoting the ISO policy definition). For an example of a similarly worded grant of coverage for advertising injury in a non-ISO policy, see *International Insurance Co. v. St. Paul Fire & Marine Insurance Co.*, Nos. 86-4438, 86-7011, 1988 WL 113360, at \*5 n.7 (E.D. Pa. Oct. 24, 1988). In *Liberty Life Insurance Co. v. Commercial Union Insurance Co.*, 857 F.2d 945, 948-49 (4th Cir. 1988), the court compared various versions of this grant of coverage in primary, excess and umbrella policies.

14. ISO, BROAD FORM, *supra* note 13, at 2.

15. See *John Deere Ins. Co. v. Shamrock Indus., Inc.*, 696 F. Supp. 434, 441 (D. Minn. 1988) (holding the allegations that the insured intended to destroy the plaintiff's business



There are not many cases interpreting the application of this coverage language to business torts such as unfair competition and misappropriation of trade secrets.<sup>16</sup> This might be explained by the fact that insurers did not challenge such claims and considered them covered, or by the relative infrequency of such claims during the relevant time period. Nevertheless, the scarce case law indicates that there were strong coverage arguments available to insureds under this policy language.<sup>17</sup>

In *Liberty Life Insurance Co. v. Commercial Union Insurance Co.*,<sup>18</sup> the insured was sued for allegedly enticing employees away from the plaintiff, inducing them to disparage the plaintiff, and wrongfully appropriating the plaintiff's customer lists and other trade secrets. The court found that *Liberty's* Advertising Injury coverage in two of the relevant policies was not conditioned on an "occurrence," and so allegations that the insured intended to destroy the plaintiff's business could still potentially trigger coverage.<sup>19</sup> As to the policy that appeared to limit coverage for Advertising Injury to "occurrences," the court remanded the matter for further consideration, noting that to allow the carrier "to escape coverage at this stage of the proceeding under its definition of occurrence would make much or all of the advertising liability coverage illusory."<sup>20</sup> The court acknowledged the insurer's claim that the alleged behavior did not arise in connection with the insured's "advertising activities," and directed the district court to consider this issue on remand. The court did note that an ambiguity in the definition should be construed

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did not trigger the actual malice exclusion).

16. There are a number of cases in which insureds unsuccessfully attempted to obtain coverage under this provision for suits alleging violations of the antitrust laws. *See, e.g., Lazzara Oil Co. v. Columbia Cas. Co.*, 683 F. Supp. 777 (M.D. Fla. 1988).

17. Although not raised in the cases that involved unfair competition business torts, one potential problem for insureds would be the meaning of the undefined phrase "unfair competition." Some courts construed this clause narrowly, while others followed the traditional rule of construing ambiguities against the insurer and read the clause broadly. *Compare* QSP, Inc. v. The Aetna Cas. & Sur. Co., 256 Conn. 343, 371, 773 A.2d 906, 924-25 (2001) and *Pine Top Ins. Co. v. Pub. Util. Dist. No. 1 of Chelan County*, 676 F. Supp. 212 (E.D. Wash. 1987) (interpreting "unfair competition" narrowly to mean liability for passing off one's goods as the goods of another) with *Liberty Mut. Ins. Co. v. Consol. Capital Equities Corp.*, Nos. 87-15007, 87-15008, 1989 WL 68652 (9th Cir. June 19, 1989) (interpreting "unfair competition" broadly to include injuring a competitor).

18. 857 F.2d 945 (4th Cir. 1988).

19. *Id.* at 950.

20. *Id.* at 951. Because the enumerated causes of action covered by the policy included intentional wrongdoing, limiting coverage only to "occurrences" was deceptive (or, at a minimum, extremely poor drafting).

against the carrier, especially in the context of determining whether there was a duty to defend.<sup>21</sup>

In similar fashion, the opinion in *John Deere Insurance Co. v. Shamrock Industries, Inc.*<sup>22</sup> reveals the potential for obtaining coverage of business torts under the 1973 definition of "Advertising Injury." An employee developed an improved machine and then resigned to create a new corporation with the plaintiff's competitor in order to solicit the plaintiff's customers. The plaintiff sued, alleging, *inter alia*, that the insured had disclosed its trade secrets by disseminating its business practices and design improvements in letters sent to a potential customer. Relying on the maxim *contra proferentem*, the court held that sending letters to a single customer could potentially constitute "advertising activity," and that the complaint arguably alleged injuries arising out of that activity.<sup>23</sup>

### III. THE FIRST CUT: ADVERTISING INJURY AS A STANDARD (BUT SHRINKING) COVERAGE UNDER GENERAL LIABILITY POLICIES

In 1986, the ISO approved a new CGL form that included Advertising Injury in Part B of the standard coverage rather than offering it as part of a Broad Form Endorsement. Although the ISO provided the standard explanation that the changes in coverage language were intended to clarify rather than to change the coverage afforded, the changes proved to be significant.<sup>24</sup> Under the new language, the CGL provided coverage for "advertising injury caused by an offense committed in the course of advertising your goods, products or services."<sup>25</sup> Advertising injury was defined as several enumerated offenses, with the two most relevant definitions for purposes of unfair competition business torts being: "(a) Oral or written publication of material that slanders or libels a person or

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21. *Id.* at 950. Of course, the court then politely added that it was not expressing an opinion on the matter that it was remanding to the district court. It seems safe to conclude, however, that this policy language would require some causal nexus between advertising activities and "unfair competition." See *Pac. Group v. First State Ins. Co.*, 70 F.3d 524, 527-28 (9th Cir. 1995).

22. 696 F. Supp. 434 (D. Minn. 1988).

23. *Id.* at 440.

24. Jerry & Mekel, *supra* note 3, at n.54 and accompanying text (quoting Lawrence O. Monin, ISO Advertising and Personal Injury 1998 Revisions: Major Surgery or Just Band-Aid Fix?, 4 MEALEY'S EMERGING INS. DISP. 24 (Aug. 19, 1999)).

25. INS. SERVS. OFFICE, INC., COMMERCIAL GENERAL LIABILITY - OCCURRENCE COVERAGE FORM CG 00 01 10 93, at 4 (1992), *quoted in* Jerry & Mekel, *supra* note 3, app. at 32-34 [hereinafter ISO, OCCURRENCE FORM].

organization or disparages a person's or organization's goods, products or services," and "(c) Misappropriation of advertising ideas or style of doing business."<sup>26</sup>

The effect of these policy changes are obvious and palpable. First, the activities giving rise to liability must now be committed "in the course of advertising" rather than "in the course of . . . advertising activities." This change suggests the need for a much closer causal link between the insured's advertisements and the alleged injury. Whereas advertising activities could encompass actions beyond advertising proper, the requirement of "in the course of advertising" appears to make clear that the offense must be caused by the advertisement itself. Moreover, the previous specific inclusion of "unfair competition" as a covered offense is replaced by less pertinent coverage for defamation and the curiously worded offense of misappropriation of "advertising ideas or style of doing business."

Despite this reduction in the scope of coverage, several courts found that the duty to defend business tort liabilities arising out of claims of unfair competition was triggered because of the potential for coverage. In the leading case, *Sentex Systems, Inc. v. Hartford Accident & Indemnity Co.*,<sup>27</sup> the Ninth Circuit interpreted California law to find that the "advertising injury" coverage potentially was triggered by a suit against a former employee alleging that he breached a non-compete agreement by misappropriating trade secrets (customer lists, marketing techniques, and other inside and confidential information) to solicit the plaintiff's clients. The court held that the undefined term "advertising ideas" included such proprietary information because of the breadth of the word "ideas." The core reasoning of the case is as follows:

In this day and age, advertising cannot be limited to written sales materials, and the concept of marketing includes a wide variety of direct and indirect advertising strategies. It is significant that [the plaintiff's] claims for misappropriation of trade secrets related to marketing and sales and not to secrets relating to the manufacture and production of security systems.<sup>28</sup>

Because the claimed injuries flowed from the marketing activities of the defendant-insured, the court concluded that these activities triggered the duty to defend under the "advertising injury" coverage.

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26. *Id.* at 9.

27. 93 F.3d 578 (9th Cir. 1996).

28. *Id.* at 580.

Recently, the same analysis was applied by a New Jersey court in a case involving the misappropriation of sales and marketing trade secrets. In *Tradesoft Technologies, Inc. v. Franklin Mutual Insurance Co.*,<sup>29</sup> the court cited *Sentex* and concluded that the duty to defend could be triggered when the insured is sued for misappropriating trade secrets relating to sales and marketing information.<sup>30</sup> But the *Tradesoft* case is more important for revealing the degree to which potential coverage for business torts was restricted under the new policy language. The court emphasized that the duty to defend was triggered only if the trade secrets allegedly misappropriated by the insured related to advertising and marketing activities in order to satisfy the causation requirement of the insuring provision.

With respect to [the plaintiff's] claim of misappropriation of trade secrets, we note first that the federal courts have distinguished between trade secrets related to manufacturing and production and those related to marketing and sales, holding that the appropriation of manufacturing and production trade secrets does not meet the required causal nexus since the injury is the misappropriation and not the advertising by which the misappropriation was revealed.<sup>31</sup>

Thus, we think it plain that the import of the advertising injury coverage was to afford protection to the insured for offenses committed while undertaking advertising activities that caused specifically defined injuries. It was not reasonably intended by either party to this insurance contract nor reasonably understood by them to offer liability coverage for the entire gamut of business torts simply because after commission of the basic tortious conduct there was a sale or offer to sell.<sup>32</sup>

This reasoning acknowledges the shift in the 1986 policy definition of "Advertising Injury" to provide coverage only for those injuries sustained as a result of offenses "committed in the course of advertising your goods, products and services."<sup>33</sup>

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29. 746 A.2d 1078 (N.J. App. Div. 2000).

30. *Id.* at 1087.

31. *Id.*

32. *Id.*

33. ISO, OCCURRENCE FORM, *supra* note 25, at 4.

Numerous other courts similarly have reasoned that there is a potential for coverage sufficient to trigger the duty to defend only when the injury is caused by the insured's advertising and not by the fact that the insured has misappropriated trade secrets to develop products and services that later are advertised for sale. For example, a District Court in California distinguished *Sentex* in a case involving an employee who allegedly misappropriated confidential proprietary information before joining a competing wholesale insurance broker, since the injury flowed from the misappropriation of proprietary information that permitted the former employee to solicit clients, rather than from the misappropriation of marketing contacts and strategies in themselves.<sup>34</sup> Similarly, a District Court in Illinois applying California law recently emphasized the limited scope of the *Sentex* holding by explaining that the mere appropriation of a customer list is not a "misappropriation of an advertising idea," unless the proprietary information involves a marketing technique or manner of advertising.<sup>35</sup> Writing for the Seventh Circuit, Judge Easterbrook affirmed this rationale and went so far as to suggest that there was no basis in California law for the federal court's analysis in *Sentex* and other cases.<sup>36</sup> These restrictive readings of the causal nexus between the alleged injuries and the insured's advertising under the new policy language are typical.<sup>37</sup>

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34. *Monarch E & S Ins. Servs., Inc. v. State Farm Fire & Cas. Co.*, 38 F. Supp. 2d 841, 846 (C.D. Cal. 1999).

35. *Zurich Ins. Co. v. Sunclipse, Inc.*, 85 F. Supp. 2d 842, 854 (N.D. Ill. 2000) (applying California law and distinguishing *Sentex*), *aff'd* 241 F.3d 605 (7th Cir. 2001).

36. *Zurich Ins. Co. v. Amcor Sunclipse N. Am.*, 241 F.3d 605, 608 (7th Cir. 2001).

37. *See generally* *Assoc. Aviation Underwriters, Inc. v. Vegas Jet LLC*, 106 F. Supp. 2d 1051, 1056 (D. Nev. 2000) (citing to the "overwhelming weight of jurisdictions."); *Peerless Lighting Corp. v. Am. Motorists Ins. Co.*, 98 Cal. Rptr. 2d 753, 763-64 (Cal. Ct. App. 2000); *Pierce Cos., Inc. v. Wausau Underwriters Ins. Co.*, No. CV-97-00315-AHS, 1999 WL 1011862, at \*2 (9th Cir. Nov. 5, 1999); *Frog, Switch & Mfg. Co., Inc. v. Travelers Ins. Co.*, 193 F.3d 742, 746-48 (3d Cir. 1999); *Arnette Optic Illusions, Inc. v. ITT Hartford Group, Inc.*, 43 F. Supp. 2d 1088, 1101 (C.D. Cal. 1998), *disagreed with on other grounds in* *Maxtech Holding, Inc. v. Fed. Ins. Co.*, No. 98-56729, 1999 U.S. App. LEXIS 37330 (9th Cir. Oct. 8, 1999); *Henges Mfg., LLC v. Amerisure Ins. Co.*, 5 S.W.3d 544, 546 (Mo. Ct. App. 1999); *Ark Telecomm., Inc. v. State Farm Fire & Cas.*, No. CV 96-0379-LGB (BQRx), 1998 WL 750910 (9th Cir. Oct. 19, 1998); *Winklevoss Consultants, Inc. v. Fed. Ins. Co.*, 991 F. Supp. 1024, 1034 n.13, 1035 (N.D. Ill. 1998); *Novell, Inc. v. FDIC*, 141 F.3d 983, 988 (10th Cir. 1998); *GAF Sales & Serv., Inc. v. Hastings Mut. Ins. Co.*, 568 N.W.2d 165, 168 (Mich. Ct. App. 1997); *Simply Fresh Fruit v. Cont'l Ins. Co.* 84 F.3d 1105, 1109 (9th Cir. 1996); *St. Paul Fire & Marine Ins. Co. v. Advanced Interventional Sys., Inc.*, 824 F. Supp. 583, 586 (E.D. Va. 1993), *aff'd*, 21 F.3d 424 (4th Cir. 1994); *Bank of the West v. Superior Court*, 833 P.2d 545, 558 (Cal. 1992).

In addition to requiring a much closer causal connection between the injury and the insured's advertising, the new policy language suggests that advertising may be a more narrow term of art by restricting the scope of coverage from "advertising activities" to "advertising". Consequently, many courts have been reluctant to broadly define "advertising," despite the prevalent maxim (*contra proferentem*) that courts should construe undefined and general terms in insurance policies in favor of the insured. For example, in a case involving allegations that two former employees misappropriated copies of customer lists and then used them to solicit business for their new employer, the Seventh Circuit flatly rejected the idea that "advertising" can be equated with any manner of "marketing."<sup>38</sup> A majority of courts have held that the term "advertising" does not encompass mere solicitation of an individual customer, but rather involves the widespread dissemination of information to the public for the purpose of monetary gain.<sup>39</sup>

Several courts have rejected this narrow reading and concluded that the undefined term "advertising" should be read broadly to include even the solicitation of a single customer.<sup>40</sup> However, this line of cases is not unqualified. Even the *Sentex* court limited its holding to the facts, stating that it didn't necessarily agree with the District Court's conclusion that unfair competition by misappropriating customer lists and marketing techniques would always trigger the policy's Advertising Injury coverage.<sup>41</sup>

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38. *W. States Ins. Co. v. Wis. Wholesale Tire, Inc.*, 184 F.3d 699, 702 (7th Cir. 1999).

39. *See, e.g., Delta Pride Catfish, Inc. v. Home Ins. Co.*, 697 So. 2d 400, 404 (Miss. 1997) ("Most jurisdictions hold that advertising means 'widespread promotional activities directed to the public at large.'"). For examples of cases in which the misappropriation of trade secrets clearly was used in "advertising," see *Aselco, Inc. v. Hartford Insurance Group*, 21 P.3d 1011, 1018-19 (Kan. Ct. App. 2001) (finding the potential for coverage as to allegations that the insured misappropriated customer and supply lists, copied the plaintiff's line card and substituted its own letterhead, and then distributed the line card to potential customers as a catalog), and *Ross v. Briggs & Morgan*, 520 N.W.2d 432, 435 (Minn. Ct. App. 1994), *rev'd on other grounds*, 540 N.W.2d 843 (Minn. 1995) (holding that a mass mailing of 8,000 solicitation letters to plaintiff's patients that implied that the insured's office was a new office of the plaintiff's business triggered potential coverage for an "advertising injury").

40. *John Deere Ins. Co. v. Shamrock Indus., Inc.*, 696 F. Supp. 434, 439-40 (D. Minn. 1988), *aff'd*, 929 F.2d 413 (8th Cir. 1991) (holding that "advertising encompasses any form of solicitation, presumably including solicitation of one person"); *Sentex Sys., Inc. v. Hartford Accident & Indem. Co.*, 93 F.3d 578, 580 (9th Cir. 1996) ("In this day and age, advertising cannot be limited to written sales materials, and the concept of marketing includes a wide variety of direct and indirect advertising strategies.").

41. *Sentex*, 93 F.3d at 581.

Even under the California rule that interprets advertising broadly, the definition is constrained in other ways. In a recent case applying California law, the District Court acknowledged California's liberal interpretation of the undefined term "advertising" to include even one-on-one solicitations in certain situations, but emphasized that this liberal reading was constrained by the requirement of a strong causal connection between the injury alleged and the insured's advertisement.<sup>42</sup>

Several courts have adopted a middle approach that construes the term "advertising" in context and does not define the term as requiring either dissemination to the general public or merely the solicitation of a single customer. In *Solers, Inc. v. Hartford Casualty Insurance Co.*,<sup>43</sup> the court held that "advertising" was not ambiguous, and that it did not include submitting bidding materials to individual customers for the purpose of soliciting contracts. However, in response to the insured's argument that many businesses have very focused marketing strategies that would not fit with the definition of "advertising" as dissemination to the general public, the court agreed in dicta that "advertising" could involve targeted solicitations in certain contexts.<sup>44</sup> Nevertheless, even under these cases, the court is very closely examining the allegations to determine whether the insured's harmful activities are in fact advertising, and therefore trigger potential coverage.

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42. *Zurich Ins. Co. v. Sunclipse, Inc.*, 85 F. Supp. 2d 842, 856 (N.D. Ill. 2000), (citing *Microtec Research, Inc. v. Nationwide Mut. Ins. Co.*, 40 F.3d 968, 971 (9th Cir. 1994)). The *Zurich* court agreed with a California court's reasoning that "because it had adopted a broad definition of 'advertising,' a more remote causal connection would, if taken to the extreme, 'lead to the conclusion that any harmful act, if it were advertised in some way, would fall under the grant of coverage merely because it was advertised.'" *Sunclipse*, 85 F. Supp. 2d at 856 (quoting *Bank of the West*, 833 P.2d at 559). See also *GAF*, 568 N.W.2d at 168.

43. 146 F. Supp. 2d 785, 792-93 (E.D. Va. 2001).

44. *Id.* at 795.

However, even for companies with small markets, the Court must examine advertising in the context of the overall universe of customers to whom an advertising communication may be addressed. . . . [w]here a promotional communication is addressed to a small audience, but that audience nonetheless comprises all or a significant number of the promoter's client base, the advertising activity requirement is met.

*Id.* (citing *NH Ins. Co. v. Foxfire, Inc.*, 820 F. Supp. 489, 494 (N.D. Cal. 1993)); see also *Tri-State Ins. Co. v. B & L Prods., Inc.*, 964 S.W.2d 402 (Ark. Ct. App. 1998) (holding that because the term "advertising" is ambiguous it could encompass the distribution of information to a select group for the purpose of soliciting business).

Finally, the 1986 CGL form contains exclusions that could be relevant to the coverage issue. Most pertinent is the exclusion of advertising injury that arises out of “[b]reach of contract, other than misappropriation of advertising ideas under an implied contract.”<sup>45</sup> Because companies often require employees to sign confidentiality agreements and/or covenants not to compete, many suits for unfair competition torts also allege breach of contract. These contract claims would not be covered under the policy in light of the exclusion.<sup>46</sup> More importantly, though, one could argue that all of the causes of action in such a case would “arise out of” the breach of the insured’s contractual obligations. As a general matter, courts should construe this exclusionary language more narrowly than the same language used in a coverage provision.<sup>47</sup> Nevertheless, in certain circumstances, an insured may find that all of the causes of action asserted “arise out of” the insured’s breach of contractual obligations, and therefore would be excluded from coverage even if the barriers in the insuring agreement are overcome.

In summary, the 1986 CGL narrowed the potential arguments for coverage of business torts involving claims of unfair competition. Courts responded by finding that these types of claims trigger the potential for coverage only in certain, sharply circumscribed contexts. However, the situation has gone from bad to worse from the perspective of insureds with the widespread introduction of new coverage language in the ISO’s 1998 CGL form.

#### IV. THE END OF THE LINE? THE CONTINUED CUTBACK IN ADVERTISING INJURY COVERAGE

The ISO again significantly revised the Advertising Injury coverage in its 1998 CGL form, despite the claim that again it was only clarifying coverage.<sup>48</sup> The magnitude of the changes are signaled by the fact that

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45. ISO, OCCURRENCE, *supra* note 25, at 4.

46. *Tradesoft Tech. Inc. v. Franklin Mut. Ins. Co., Inc.*, 746 A.2d 1078, 1086 (N.J. Super. Ct. App. Div. 2000) (holding that although neither party raised the exclusion, it precluded coverage for injuries arising out of breach of a confidentiality agreement); *see Ross v. Briggs & Morgan*, 520 N.W.2d 432 (Minn. Ct. App. 1994), *rev’d on other grounds*, 540 N.W.2d 843 (Minn. 1995).

47. *Cf. Assurance Co. of Am. v. J.P. Structures, Inc.*, 132 F.3d 32, Nos. 95-2384, 96-1010, 96-1027, 1997 U.S. App. LEXIS 34565, at \*15 (6th Cir. Dec. 3, 1997) (*per curiam*) (holding that the breach of a franchise agreement was too remote from the independent harm of trademark infringement, and therefore deeming the exclusion inapplicable).

48. *See John Deere Ins. Co. v. Shamrock Indus., Inc.*, 696 F. Supp. 434, 440 (D. Minn.



Advertising Injury is no longer a separate coverage, but instead is a component of a combined "Personal and Advertising Injury" coverage. The significant coverage issues under the 1986 CGL form relating to coverage of unfair competition business torts are likely to become moot as the 1998 CGL form begins to define the relevant coverage. Although as yet there are only a few cases interpreting the 1998 changes, and no cases specifically addressing the coverage issues raised in this article, the changes in the policy language speak for themselves.

The new form provides that the insurance applies to "Personal and Advertising Injury caused by an offense arising out of your business."<sup>49</sup> At first glance, this appears to be a rather broad grant of coverage, but the details of the coverage are now found solely in the definitions. "Personal and Advertising Injury" is defined as "injury . . . arising out of one or more of the following offenses: . . . (f) The use of another's advertising idea in your advertisement."<sup>50</sup> This revised policy language clearly effects significant changes in the coverage and should put to rest the disputes surrounding the degree of causal connection between the offense and the insured's advertisements necessary to trigger coverage. The insured is covered only when it is sued for injuring another party by using that party's advertising idea in its own advertisement. Unlike the original inclusion of "unfair competition," or the more recent "misappropriation of advertising ideas or style of doing business," the current language limits coverage only to the injury that is caused by an advertisement that uses another's advertising idea.

Moreover, the CGL now defines "Advertisement" as "a notice that is broadcast or published to the general public or specific market segments about your goods, products or services, for the purpose of attracting customers or supporters."<sup>51</sup> This language is clearly designed to preclude judicial interpretations of "advertisement" to mean any manner of marketing, although the language about "specific market segments" would appear to invite courts to continue to develop a middle approach that contextually defines advertisement in a manner that could include relatively focused customer solicitation.

The significance of these changes is unmistakable. The typical scenario involving a start-up company that is sued for misappropriation of

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1988).

49. INS. SERS. OFFICE, INC., COMMERCIAL GENERAL LIABILITY COVERAGE FORM CG 00 01 07 98, at 5 (1997), *quoted in* Jerry & Mekel, *supra* note 3, app. at 34-36.

50. *Id.* at 12.

51. *Id.* at 10.

trade secrets or other forms of unfair competition will likely trigger coverage under the new policy form only if the plaintiff alleges that it was injured by the fact that the insured used misappropriated “advertising ideas” in the insured’s own advertising. There undoubtedly will be coverage battles surrounding this language, but for the most part an insured facing litigation for unfair competition business torts will find it difficult to make a plausible case for coverage.

The effect of these changes in policy language on future coverage litigation is forecast by the District Court’s analysis of similar policy language in *Murphy v. Federal Insurance Co.*<sup>52</sup> Although the court acknowledged the generally liberal treatment of “advertising injury” coverage under California law,<sup>53</sup> it concluded that these precedents should be distinguished on the basis of differences in policy language.<sup>54</sup> As to whether personal solicitations of customers by a former employee could constitute “advertising,” the court concluded that the narrow definition of “advertising” in the policy precluded the court from creating its own definition.<sup>55</sup> On the question of the necessary causal link between advertising and the alleged injury, the court noted that the policies in the precedents affording coverage “contained language that specifically covered advertising injury arising out of the ‘misappropriation of advertising ideas or style of doing business,’” in contrast to the policy before the court that did not include this covered offense.<sup>56</sup> The court

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52. No. C-01-00430 CRB, 2001 WL 902551 (N.D. Cal. July 24, 2001). The non-ISO policy in *Murphy* defined “advertising injury as:

[I]njury, other than bodily injury or personal injury, arising solely out of one or more of the following offenses committed in the course of advertising of your goods, products or services: oral or written publication of advertising material that slanders or libels a person or organization; oral or written publication of advertising material that violates a person’s right of privacy; or infringement of copyrighted advertising materials or infringement of trademarked or service marked titles or slogans.

*Id.* at \*4. The policy defined “advertising” as “any advertisement, publicity article, broadcast or telecast.” *Id.*

Although this language is not exactly the same as the new ISO language, the close similarity suggests that this case provides the first indication how the courts will respond to the ISO language.

53. *Id.* at \*4-5.

54. *Id.* at \*5-6.

55. *Id.* at \*4.

56. *Id.* at \*5.

concluded that the omission of the broader coverage language suggested that the parties “deliberately excluded such coverage.”<sup>57</sup>

The easy response to the constriction of the Advertising Injury coverage is to suggest that insureds purchase the coverage they desire as an endorsement or separate policy. One court made just this point in the course of endorsing a narrow interpretation of the Advertising Injury coverage.<sup>58</sup> But this justification for the elimination of coverage under the CGL assumes that the coverage otherwise will be available and will be made known to the insured when it purchases its insurance program. This assumption may prove to be unfounded. With the rapid development of insurance products designed to protect intellectual property interests, the more modest (but, I suspect, more ubiquitous) liabilities for unfair competition business torts appear to have been forgotten. Sophisticated insureds are always free to negotiate for increased coverage under their general liability policy, or, more likely, secure broader coverage with a drop-down umbrella policy. However, the typical start-up business created by former employees of a litigious company will unlikely look beyond the standard insurance package, trusting that their potential liabilities will be handled by a “commercial general liability” policy. This trust now appears to be misplaced.

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57. *Id.*

58. *Solers, Inc. v. Hartford Cas. Ins. Co.*, 146 F. Supp. 2d 785, 795 n.2 (E.D. Va. 2001).

Of course, small businesses [that may not engage in the narrow meaning of advertising adopted by the court] are not limited to insurance coverage for claims based in ‘advertising injury’ for the protection of their profession. Small businesses may obtain broad coverage by purchasing several forms of insurance, including coverage for errors and omissions liability, directors and officers liability, and completed operations and products liability.

*Id.*