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Aspen Law & Business



Insurance

Michael Sean Quinn

Insurance for Cyber Liabilities

The commercial general liability insurance policy (CGL) is the foundation of virtually all business liability insurance. It contains huge gaps, however, for those involved in cyberspace business activities.

First, CGL covers only bodily injury and property damage. (To be sure, the phrase "property damage" includes not only physical injury to tangible property but also the loss of use thereof. However, information and that, which software makes possible, is often not counted as tangible property, even though it takes tangible property to produce and operate it.) Second, CGL policies often contain exclusionary language for professional services. Almost certainly, software design is a professional service.

Insurance markets are traditionally slow to react to the new and the novel. However, they are now beginning to respond to the need for malpractice liability (PML) insurance covering cyberspace-related professional activities.

Most PML contracts are "claims made" policies. What does this mean? How does it distinguish PML insurance from other liability insurance?

CGL policies insure against injuries that manifest themselves either during or after the policy period, if the causal process resulting in the injury happens, in part, during the period of insurance. It does not matter when the claim is reported, so long as it is reported by the insured near the time the insured becomes aware of the injury or damage.

Claims-made insurance works in the opposite fashion. It insures only claims made to the insurer during the insured interval (a.k.a.,

the policy period). Many policies also insure only injuries that are inflicted during the period of insurance. Thus, in a pure claims-made policy, both the injury and the claim must occur during the insured interval.

Most PML policies provide additional retroactive coverage if both sides agree, and the insured pays for it. These contracts provide liability insurance for covered claims first made during the insured interval, so long as the injury or untoward conduct occurred during a specified previous interval. This stretch is the period of time that elapses between a fixed or "retroactive date" written into the contract and the beginning of the insured interval.

Another difference between CGL and PML policies is that most CGL contracts devote the entirety of the policy limits to the payment of claims. In other words, defense expenses are in addition to policy limits. In most PML policies, defense expenses erode the limits because they are included within the policy limits. Some people call these "wasting" policies. Thus the prudent risk manager, when dealing with malpractice insurance, will consider buying more than may appear to be necessary for the payment of possible claims. The extra money is needed for defense expenses.

Like virtually all other types of insurance policies, PML insurance for cyberspace activities involves two major substantive parts: (1) the insuring agreement, which provides coverage, and (2) the exclusions, which structure the general grant of coverage.

In PML insurance for cyber activities, the key to the insuring agreement is almost always insurance for "errors, omissions, or neg-

ligent acts." This is standard language in malpractice policies. This phrase explains why malpractice insurance is frequently called "E & O" insurance. In addition to core insurance for negligence, policies frequently provide coverage for some forms of defamation, invasion of privacy, trademark and copyright infringement, malicious prosecution, and the failure of the insured to prevent persons other than the insured from gaining unauthorized access to, using, tampering with, or infecting data systems. Thus, at least some forms of cyberactivity PML insurance insure against liability for failing to prevent the infliction of computer viruses by others.

Much of cyberspace PML insurance is quite general; some of it, however, restricts the scope of coverage to explicitly specified activities. One PML policy uses a defined notion, "cyberspace activity," which is fleshed out contract by contract in the declarations that proceed the policy. Any activity within that description will be covered and any activity outside of it will not, though there will always be gray areas, of course.

PML policies are a mixed bag when it comes to defending the insured. Sometimes the insurer has neither the right nor the duty to conduct the insured's defense, but must pay reasonable and necessary attorney fees. On other occasions, the insurer has the right but not the duty to defend. When the insurer does not exercise the right, it usually must pay reasonable and necessary attorney fees. When it does exercise the right, the insurer must select counsel and run the defense. When an insurer has not only the right but the duty to defend, then PML insurance looks very much like CGL coverage when it comes to defending the insured.

Cyber business and malpractice liability policies also contain fairly standard exclusions. Among the most important are the following: intentional dishonesty (e.g., fraud); bodily injury; property damage;

punitive and multiple damages; harassment and discrimination of various sorts; patent infringement; effects upon computer hardware (unless created by the policyholder's insured negligence); electrical failures (including power interruptions, surges, brownouts, and blackouts); unauthorized introduction of viruses, etc., by the insured itself; policyholder's liability under indemnity agreements; the policyholder liability for breach of contract, warranty, or guarantee; antitrust, ERISA, and securities law violations; liability under the law governing employers and employees; and finally, pollution.

Virtually all liability policies exclude coverage for claims made by one insured against another, and many exclude coverage for administrative actions, sometimes through definition. Cyberspace activity policies are no different, although they rely on express exclusions.

Some of these exclusions result from the nature of insurance itself. In general, there must be some sort of fortuity before an untoward event is insurable. Thus, foresee-

able consequences of deliberate dishonesty are almost never insurable. Some states prohibit insuring punitive damages. Punitive damages are usually awarded when conduct is intentional, or nearly so. Insuring punitive damages bumps up against the requirement that insurance is for fortuities.

Insurance for viruses illustrates the fortuity problem very nicely. Insurance is not provided for deliberately infecting computer systems with cyber viruses. On the other hand, if someone negligently creates a system that permits someone else to infect a system, then there may be coverage for that.

Other exclusions are simply price related. For example, the cost of defending a securities case can be enormous. Many carriers delete that exclusion in return for the payment of a substantial premium. The same is true for some types of antitrust violations (though not for all). Some types of antitrust violations are by their nature deliberate and nonfortuitous. Probably this is why patent

infringement is excluded. (Besides, some insurers are marketing specialized patent infringement insurance.)

It is common for specialty policies, such as PML policies, to state that they are excess with respect to many other applicable insurance. This frequently causes difficulties. CGL policies almost always say that they apply *pro rata*. Thus, if a CGL policy has coverage for defamation and so does a malpractice policy, one policy will claim to provide *pro rata* coverage, while one will claim to be excess with respect to the other. Insurers frequently struggle over this. Usually, policies marked excess prevail, except when the other policy is excess—then they are simply both applied *pro rata*.

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Latest Legal

Edmund J. Ferdinand, III

Copyright Act Does Not Preempt Right of Publicity Claims

Recently, the US Supreme Court let stand, without comment, a ruling from the US Court of Appeals for the Ninth Circuit that permits the actors who portrayed the characters "Norm Peterson" and "Cliff Clavin" on the popular television program *Cheers* to assert right of publicity claims against *Cheers*' producer Paramount Pictures and its licensee Host International.

[See *Paramount Pictures v. Wendt*, ___ U.S. ___, 2000 U.S. LEXIS 4886 (U.S., October 2, 2000).] In so doing, the Supreme Court sided with the actors in a dispute that ultimately may limit the right of the copyright holder, Paramount, to exploit the *Cheers* characters in derivative works.

Paramount licensed Host to create a line of *Cheers* theme bars in airports. Several of the bars featured two animatronic patrons resembling the "Norm" and "Cliff" characters—one of which was

heavily set, while the other wore a US Postal Service uniform. The robots, named "Hank" and "Bob," were programmed to move and engage the customers in humorous banter.

George Wendt and John Ratzenberger, the actors who portrayed the "Norm" and "Cliff" characters on *Cheers*, sued Host in 1993, claiming that it had misappropriated their likenesses by creating robots that so closely resembled the "Norm" and "Cliff" characters in violation of, *inter alia*, their rights of publicity under California law. Paramount intervened in the lawsuit and claimed that its copyrights preempted plaintiffs' right of publicity claim.

In *Wendt v. Host International, Inc. (Wendt I)*, [35 U.S.P.Q.2d 1315 (9th Cir. 1995)] the Ninth Circuit reversed the trial court's grant of