The John Liner Review

THE QUARTERLY REVIEW OF ADVANCED RISK MANAGEMENT STRATEGIES

VOL. 23 NO. 2 SUMMER 2009

S·P 1865
www.spcpub.com

Alleged trademark counterfeiting may be covered under older or currently endorsed CGL policies.

Insurance Coverage for the Alleged Sale of Counterfeit Goods

DIANA SHAFTER GLIEDMAN AND KANISHKA AGARWALA

Trademark counterfeiting has assumed staggering proportions and is the cause of monumental loss to owners of trademarks. Retailers and other companies selling goods today typically devote substantial resources to ensuring that counterfeit goods do not creep into their supply chain. Counterfeiters quickly adapt, like bacteria to antibiotics, to anticounterfeiting measures, however, and counterfeit goods do land on store shelves and delivery trucks with disturbing frequency — often without the knowledge of the companies subsequently offering them for sale.

Trademark owners can bring suit not only against manufacturers of counterfeit goods, but also against distributors, wholesalers, and retailers, *even when said distributors did not intentionally purchase or sell counterfeit goods*. Lack of knowledge of the counterfeiting activity often is not a defense. The entities most at risk of being sued for trademark counterfeiting are large distribution and retail chain stores, which purchase and sell numerous types of goods from numerous distributors.

Insurance companies are also adroit at adapting to changing trends in coverage litigation. The ISO commercial general liability (CGL) form in use today excludes coverage for most types of intellectual property (IP) infringement. Many cases brought today, however, trigger older policies that include coverage for numerous types of intellectual property infringement. Moreover, while standard ISO CGL policies generally exclude coverage for IP-related losses, some CGL policies on company forms and umbrella policies continue to afford coverage in terms that have been traditionally offered. Finally, risk managers and corporate counsel of entities that are particularly at risk of being sued by trademark holders frequently purchase specialized manuscript policies that include (for a price) coverage for IP injuries, including lawsuits alleging the wrongful sale of counterfeit goods.

As such, risk managers and corporate counsel should not simply assume that there is no coverage available for injuries involving trademark counterfeiting. Risk professionals must look carefully at older and new policies to determine whether there may be coverage for counterfeiting. Moreover, risk managers of entities at a heightened risk of liability for counterfeiting should seek to purchase appropriate "advertising injury" coverage, either as an endorsement to the CGL policy or as part of standard coverage. Attention should also be paid to the limits or sublimits as befits the risk.

Counterfeiting Versus "Ordinary" Trademark Infringement

Trademark counterfeiting is the act of producing, offering for sale, selling, or distributing a product or service using "a spurious mark which is identical to, or substantially indistinguishable from, a registered mark."[1] It is, thus, the most egregious form of trademark infringement and differs from plain-vanilla trademark infringement claims in both genesis and remedies. In order to be successful in a claim for counterfeiting, it is essential that (a) the impugned mark be identical or substantially indistinguishable from the plaintiff's mark, and (b) that the plaintiff have registered its trademark prior to bringing suit. However, neither of these requirements is compulsory insofar as bringing a claim for trademark infringement is concerned.

Coverage for Trademark Infringement Under Advertising Injury Provisions

"A trademark serves three distinct and separate purposes: (1) It identifies a product's origin, (2) it guarantees the product's unchanged quality, and (3) it advertises the product. Injury to the trademark in any of its offices as an identifying, guaranteeing or advertising device should suffice to constitute an infringement thereof."[2] Therefore, trademark law is concerned with the protection of consumers and the investments made by trademark owners towards building goodwill in their trademarks. When such protection or goodwill is threatened and lawsuits are filed, policyholders who have been sued for distributing or selling counterfeit goods have successfully sought coverage for their defense costs and, in some cases, even indemnity.

Coverage for "Misappropriation" and "Infringement" Can Mean Coverage for Many Trademark Counterfeiting Claims

Until 1986, the standard ISO (Insurance Services Office) CGL form included "unfair competition" as a class of advertising claims that were covered. Injuries resulting from damage to trademark rights were explicitly excluded from coverage. In revisions to the standard form in 1986, however, ISO eliminated coverage for unfair competition, added coverage for misappropriation of advertising ideas and style of doing business, and eliminated the trademark exclusion. While language added to the ISO CGL form in recent years added new exclusions, some company forms and umbrella policies and manuscript policies include a 1986-type clause that reads (with minor variations):

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal injury" or "advertising injury" to which the insurance applies ... We will have the right and duty to defend any "suit" seeking those damages.
>
> The policy usually defines "advertising injury" as:
>
> Injury arising out of one or more of the following offenses:
>
> a. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services.
> b. Oral or written publication of material that

violates a person's right of privacy.

c. Misappropriation of advertising ideas or style of doing business.
d. Infringement of copyright, title or slogan.[3]

Most policies further provide:

This insurance applies to:

"Advertising injury" caused by an offense committed in the course of advertising your goods, products or services; but only if the offense was committed in the "coverage territory" during the policy period.

This broad language arguably provides coverage for trademark counterfeiting cases. Risk managers for retailers should be aware, therefore, that under certain circumstances, their CGL policies *will* cover cases of counterfeiting.

Does Trademark Counterfeiting Constitute an Advertising Injury?

Disputes over insurance coverage for trademark counterfeiting claims generally center around whether counterfeiting constitutes an "advertising injury," a "misappropriation of advertising ideas or style of doing business," or an infringement of title.

This area of law is constantly changing. Indeed, the U.S. District Court for the Northern District of California came out on both sides, within a span of seven months, on the question of whether "misappropriation" included injury to a trademark.[4] Both actions involved the same insured business, Reboans, Inc., a retailer that owned and operated gift shops in San Francisco, from which it sold brand-name merchandise to tourists. Its advertisements in tour books displayed the names of many of the product lines it carried. These names were also displayed on posters and placards in its store windows and on point-of-purchase displays in the store.

The policyholder was sued by the owners of the *Hunting World* and *Dunhill* trademarks for trademark counterfeiting. The policyholder sought coverage under its CGL policy for the defense of these actions.

In *Reboans I*, the court was concerned with the *Hunting World* trademark and held that "misappropriation of advertising ideas or style of doing business" covered only common law misappropriation and did not extend to misappropriation of trademarks.[5] It further held that the injury did not have a causal connection with the policyholder's advertising activity because "[t]he trademarks at issue ... 'advertise' *Hunting World's* products — not *Reboans'* — and the policy only covers offenses committed in the course of advertising *Reboans'* goods."[6] As such, the court concluded, the policyholder's CGL policy did not provide coverage for the underlying counterfeiting case.

The court reached an *entirely different conclusion* in *Reboans II*, which was concerned with coverage for counterfeiting of the *Dunhill* trademark. Between *Reboans I* and *Reboans II*, the California court had decided a case in which it held that "infringement of title refers to claims based on confusion of names or designations ... advertisements themselves are likely to be the source of any claim based on one business masquerading as another."[7] The *Reboans II* court, therefore, found that the insurance company owed the policyholder a duty to defend because the complaint alleged infringement of title, and the policy covered "(1) injuries suffered by Dunhill, (2) arising out of Reboans' infringement of a name or designation, (3) if the infringement was committed in the course of advertising by Reboans of goods it was offering for sale."[8]

Misappropriation: Another Basis for Obtaining Coverage

Policyholders also may be able to argue that they are entitled to a defense and indemnity for lawsuits alleging they have engaged in trademark counterfeiting by arguing that the sale of counterfeit goods constitutes a form of "misappropriation" of advertising ideas or style of doing business.

For example, in the action titled *B.H. Smith, Inc. v. Zurich Insurance Company*,[9] a policyholder was alleged to have sold counterfeit Liz Claiborne handbags. The coverage court held that such allegations are covered "under the offense of 'misappropriation of style of doing business' and is therefore an enumerated offense under the policy. Smith copied Claiborne's style of doing business because it sold handbags that were strikingly similar to Claiborne's."[10] The court also found that Claiborne's complaint alleged an injury that occurred in the course of Smith's advertising its goods because it distributed a line sheet that reflected an imitation of several of Claiborne's Canyon Road line of products.[11] In finding that the policyholder was entitled to coverage under its CGL policy, the court held:

> where a complaint alleges that the advertisement of a knock-off product results in harm from the sale of such product it would be artificial to deny coverage by constructing a distinction between the injuries arising from the manufacture and sale of infringing goods and injuries arising from the marketing of these same goods by means of display or advertisement of the goods.[12]

Likewise, in the case titled *Allou Health & Beauty Care, Inc. v. Aetna Cas. and Sur. Co.*,[13] a policyholder sought coverage under its CGL policy for an underlying litigation predicated on the policyholder allegedly selling counterfeit Nexxus hair care products. In the underlying litigation, plaintiffs alleged that the policyholders had engaged in deceptive advertising techniques intended to convince the public that counterfeit products were actually Nexxus products. The insurance company denied coverage for this claim. The court, however, held that such claims were covered, because in New York, these allegations constituted "advertising injury where they relate to the misappropriation of advertising ideas and style of doing business."[14] The court rejected the view that the misappropriation category of advertising injury was narrowly limited to common law misappropriation actions and therefore excluded the misuse of another's trademark.[15] In another case, the Supreme Court of New York, Appellate Division, held that the insurance company had a duty to defend the policyholder where the underlying complaint filed by Proctor & Gamble alleged that the policyholder had distributed counterfeit Head & Shoulders shampoo.[16]

Some courts, however, have reached different conclusions. For example, a Michigan court held that the policyholder's act of shipping a mechanical seal in its competitor's packaging with the policyholder's name affixed on the packaging to a single customer was not "advertisement" and did not result in "advertising injury."[17] The court held that under the terms of the policy, the policyholder must "publicly disseminate information about its goods and services for the purpose of attracting patronage."[18]

Exclusions: Hidden Landmines That May Preclude Coverage

Furthermore, most CGL policies contain exclusions that insurance companies may argue will preclude coverage for trademark counterfeiting, even in jurisdictions such as New York that generally find that such claims are covered. For example, in the case titled *Atlantic Mutual Insurance Co. v. Terk Technologies Corp.*,[19] the Supreme Court of New York, Appellate Division, denied coverage to a policyholder who was alleged to have sold counterfeit goods on the ground that the policy contained an exclusion stating that:

> This insurance does not apply to:
> a. 'Personal injury' or 'advertising injury'
> (1) Arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity ...

In the underlying litigation, it was alleged that the policyholder sold counterfeit CD 25 compact disk holders and used the name and logo of a well-known designer on these counterfeit goods. The counterfeit holder enjoyed very good sales, but the policyholder represented to the designer that there were very weak sales of the holder in the United States. The coverage court noted that in the underlying litigation, the court had found that the policyholder had knowingly and intentionally obtained counterfeit CD 25 holders and had "intentionally, willfully, knowingly, surreptitiously and fraudulently passed off counterfeit goods of inferior quality as [the designer's] authentic Danish-made goods." In view of these findings in the underlying litigation, the coverage court held that such acts fell within the ambit of the exclusion, and the insurance company had no duty to defend or obligation to indemnify the policyholder.

Moreover, since most typical CGL insurance policies contain exclusions relating to intentional torts or intentional acts of the insured, insurance companies may seek to deny coverage by arguing that, according to the complaint, the retailer intentionally sold or advertised counterfeit goods, and as such, coverage is excluded. This can be particularly galling for the innocent retailer who has been duped into purchasing (and selling) counterfeit goods, since virtually all complaints filed by aggrieved trademark owners allege that the retailer "knew or should have known" that it was selling counterfeit goods.

Many courts, however, have held that insurance companies must provide a defense in counterfeiting cases, "intentional acts" exclusions notwithstanding. For example, in the case of *Federated Mutual Insurance Company v. Power Lift LLC*,[20] the court held that a mere allegation of willful or intentional wrongdoing is not enough to free an insurance company from its obligation to defend.[21]

Conclusion

In today's complex global economy, retailers may be surprised and distressed to learn that counterfeit goods have made their way into the stream of commerce — and onto their shelves. And since lack of knowledge of counterfeiting activity may not be a defense, retailers may find that they are liable for significant damages to actual trademark owners, even where they had no intention of selling or marketing counterfeit goods. If this type of liability is a substantial risk, retailers should seek to include coverage for counterfeiting liability as part of their purchasing program. If faced with liabilities stemming from allegations of counterfeiting, retailers should also look to their existing CGL policies to ascertain whether defense and indemnification would be covered. As courts across the country have held, these policies may provide coverage for trademark counterfeiting.

Endnotes

1. See 15 U.S.C. § 1127.
2. Callmann, Rudolf, *The Law of Unfair Competition, Trademarks and Monopolies*, 4th ed. (London: Sweet & Maxwell, 1994): § 21.06, cited in *Lebas Fashion Imports of USA, Inc. v. ITT Hartford Insurance Group*, 50 Ca.App.4th 548, 557, 59 Cal.Rptr.2d 36, 41 (1997).
3. The current ISO CGL form combines personal and advertising injury.
4. See *American Economy Insurance Co. v. Reboans, Inc.*, 852 F.Supp. 875 (N.D.Cal. 1994) *(Reboans I)* and *American Economy Insurance Co. v. Reboans, Inc.*, 900 F.Supp. 1246 (N.D. Cal. 1994)(*Reboans II*).
5. *Reboans I* at 880–81.
6. Ibid. at 882.
7. *Reboans II* at 1251–52.
8. Ibid. at 1253–54.
9. *B.H. Smith, Inc. v. Zurich Insurance Company*, 676 N.E.2d 221, 285 Ill. App.3d 536 (1996) (applying New York law).
10. Ibid. at 223.
11. Ibid.
12. Ibid.
13. *Allou Health & Beauty Care, Inc. v. Aetna Cas. and Sur. Co.*, 269 A.D.2d 478 (N.Y. App. Div. 2000),
14. Ibid. at 479, 255.
15. Ibid. at 480, 255–56.
16. *American Manufacturers Mutual Insurance Company v. Quality King Distributors, Inc.*, 287 A.D.2d 527, 731 N.Y.S.2d 234 (2d Dept. 2001).
17. *Citizens Insurance Co. v. Pro-Seal Service Group, Inc.*, 730 N.W.2d 682, 477 Mich. 75 (Mich. 2007).
18. Ibid.
19. *Atlantic Mutual Insurance Co. v. Terk Technologies Corp.*, 309 A.D.2d 22, 763 N.Y.S.2d 56 (1st Dept. 2003)
20. *Federated Mutual Insurance Company v. Power Lift LLC*, 152 F.3d 925 (9th Cir. 1998)
21. *See also Montrose Chemical Corp. v. Superior Court*, 6 Cal. 4th 287, 300–01 (1993); *In Union Insurance Company v. The Knife Company, Inc.*, 897 F. Supp. 1213 (WD Ark. 1995) (holding that since intent is not a required element of a trademark infringement cause of action, there can be a finding of liability against the insured even if the infringement were innocent, and therefore, there is a duty to defend despite an allegation of willfulness.)

Diana Shafter Gliedman is the coordinator at Anderson Kill and Olick for this column. Gliedman is an attorney practicing in Anderson Kill's New York office and regularly represents policyholders in insurance recovery litigation and mediation. She can be reached at dgliedman@andersonkill.com.

Kanishka Agarwala, an attorney in Anderson Kill & Olick's New York office, focuses his practice on intellectual property and commercial and unfair competition litigation. He can be reached at kagarwala@andersonkill.com.

Reprinted with permission from The John Liner Review,
Volume 23, Number 2; Summer 2009.