Client Alert

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Southern District of Florida Finds CGL Policy's "Knowing Violation" and "Infringement" Exclusions Inapplicable to Advertising Injury Claims

In a decision of import to businesses facing intellectual property infringement lawsuits, the Southern District of Florida has ruled that a commercial general liability policy's "knowing violation" and "infringement" exclusions do not apply to lawsuits involving allegations of intent and knowledge in the context of advertising injury. *E.S.Y., Inc., et al. v. Scottsdale Insurance Company*, No. 15-21349 (S.D. Fla. October 14, 2015) ("*E.S.Y.*").

Background

Exist, Inc. ("Exist"), a Fort Lauderdale-based clothing manufacturer and seller, sued Miami-based clothing retailer E.S.Y., Inc. ("E.S.Y."), in the US District Court for the Southern District of Florida for injunctive relief, actual damages and treble damages stemming from various federal and state infringement allegations related to E.S.Y.'s sale of garments with hang tags and labels bearing Exist's federal- and Florida-registered "Liquid Energy Shield Mark." Specifically, Exist alleged: (1) federal copyright infringement and federal vicarious and/or contributory copyright infringement under the Copyright Act, 17 U.S.C. § 101 *et seq.*; (2) federal unfair competition, false designation of origin and federal trademark infringement under the Lanham Act, 15 U.S.C. § 1051 *et seq.*; (3) Florida statutory trademark infringement under Section 495.151, Florida Statutes; and (4) Florida common law unfair competition. In support of its claim for treble damages, Exist incorporated into each count allegations of "intentional, malicious, willful and wanton misconduct" as well as "knowing violations" of Exist's rights. The lawsuit settled before trial.

E.S.Y. sought a defense and indemnity from its general liability insurer, Scottsdale Insurance Company ("Scottsdale"), under a CGL policy that Scottsdale issued to E.S.Y. The policy provided coverage for "advertising injury," defined in part as injury arising out of "infring[ement] upon another's copyright, trade dress or slogan in your 'advertisement.' " The policy defined "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." The policy excluded coverage for " 'advertising injury' caused by or at the direction of the insured with knowledge that the act would violate the rights of another and would inflict 'personal and advertising injury' " ("Knowing Violation Exclusion") and for " 'advertising injury' arising out of the infringement of copyright, trademark, … or other intellectual property rights…" ("Infringement Exclusion"). The Infringement Exclusion featured a carve-out that provided: "this exclusion does not apply to infringement, in your 'advertisement', of copyright, trade dress or slogan." Scottsdale denied coverage based on both exclusions.

E.S.Y. commenced a declaratory judgment action against Scottsdale in Florida state court concerning the scope of the coverage provision and the exclusions. Scottsdale removed the matter to the Southern District of Florida. The parties cross-moved for summary judgment.

Holdings

The court found that Scottsdale had a duty to defend E.S.Y. in the underlying infringement action. The court found that E.S.Y. established that an alleged violation gave rise to an advertising injury as defined by the policy, by proving the existence of a causal connection between the alleged injury and the advertising activity

undertaken by the insured, and by showing that Exist sought damages for the particular advertising injuries to which the causal connections were established.

The court determined that the subject hang tags qualified as advertisements based on a fair reading of the Exist complaint and a liberal interpretation of the policy's definition of "advertisements." Accordingly, the court found that the Infringement Exclusion did not bar coverage because the policy's express carve-out precluded the application of the exclusion to infringement allegations arising from advertisements.

The court also found that the Knowing Violation Exclusion did not bar coverage. Although the Exist complaint contained factual allegations of knowing, willful and intentional acts for the benefit of treble damages, the causes of action alleged were not for intentional harms and could therefore be established without proof of knowledge or intent. Relying on the finding in *Orlando Nightclub Enterprises, Inc. v. James River Ins. Co.*, No. 6:07-cv-1121-Orl-19KRS, 2007 WL 4247875 (M.D. Fla. Nov. 30, 2007), that a court should consider both the allegations and the actual causes of action asserted in a complaint to determine the potential for a duty to defend, the court ruled that because the Exist complaint sought actual damages as well as treble damages, Scottsdale had a duty to defend the underlying action.

Implications

E.S.Y. is significant to business entities engaged in the marketing and sale of garments using decorative tags or similar dressing, as well as those facing other types of infringement lawsuits. Under the *E.S.Y.* court's analysis, when considering a duty to defend in the context of an intellectual property infringement claim, a court may look beyond the express language of the complaint to consider the actual elements of the cause of action when the complaint alleges "knowledge" that is otherwise not a requisite element of the infringement cause of action. Such a broadened analysis of the duty to defend may be necessary to ensure that a defense is provided when it is objectively warranted, rather than allowing a carrier to deny a defense based on a knowing violation exclusion, when knowledge or intentional conduct is not required for recovery of actual damages. The decision, therefore, underscores the importance of analyzing both the allegations against the policyholder as well as the substantive law on which the clams are being asserted.

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