Lawyer Insights

Ninth Circuit Narrowly Construes IP Exclusion Reaffirming Rules of Insurance Policy Construction

The case discusses principles that ensure that insureds get from their insurance policy the coverage that they reasonably expected they had purchased.

By Scott DeVries and Michael Huggins
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The My Choice Decision

On August 19, 2020, the Ninth Circuit issued its decision in My Choice Software, LLC v. Travelers Casualty Insurance Co. of America, No. 19-56030, 2020 WL 4814235, holding that longstanding rules of insurance policy construction required reversal of a district court holding denying a duty to defend. Specifically, the Court determined that the Intellectual Property Exclusion in a Travelers policy did not unambiguously preclude the possibility of coverage for a claim against the Insured, My Choice, and that Travelers accordingly had a duty to defend.

At issue was a Travelers' IP Exclusion which stated coverage would not apply to "'Personal injury' or 'advertising injury' arising out of any actual or alleged infringement or violation of any of the following rights or laws, or any other 'personal injury' or 'advertising injury' alleged in any claim or 'suit' that also alleges any such infringement or violation."

In the underlying action, My Choice sued Trusted Tech alleging that its former employees had misappropriated the company's sensitive client information and other proprietary material. In turn, Trusted Tech cross-complained against My Choice, alleging, among other things, a claim for defamation. The District Court held that the Intellectual Property exclusion looked to the entirety of the lawsuit, that the presence of any excluded allegations – whether in the complaint or the cross-complaint – would bar coverage. Accordingly, it concluded that the presence of excluded allegations in My Choice's complaint precluded coverage for the defense of Trusted Tech's otherwise covered cross-complaint.

The Ninth Circuit reversed. As it observed, it is longstanding law that an exclusionary clause must be "stated precisely and understandably, in words that are part of the working vocabulary of the average layperson."(quoting Haynes v. Farmers Ins. Exch., 32 Cal. 4th 1198, 1204 (2004)). Here, it was reasonable for My Choice to view each pleading separately and, in the absence of explicit language stating otherwise, to interpret the exclusion as applying only to allegations asserted against it.

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Nor did the Ninth Circuit accept the district court's alternative holding that the allegations against My Choice arose out of actual or alleged infringements or violations of IP rights, such that the first part of the IP exclusion provided an independent basis to bar coverage. The Court stated that applying the "arising out of" phrase in the IP Exclusion to these allegations ran counter to the principle that "insurance coverage is interpreted broadly so as to afford the greatest possible protection to the insured, [whereas] … exclusionary clauses are interpreted narrowly against the insurer." (quoting MacKinnon v. Truck Ins. Exch., 31 Cal. 4th 635, 648 (2003)). In reaching this conclusion, the Court distinguished cases where the term "arising out of" appeared in coverage grants where it would be broadly construed (e.g., Southgate Recreation & Park District v. California Ass'n for Park & Recreation Ins., 106 Cal. App. 4th 293 (2003) from cases like this one where it appeared in an exclusion and would be narrowly construed. As supportive of this distinction, it cited to Tower Ins. Co. of N.Y. v. Capurro Enters. Inc., No. C 11-03806, 2012 WL 1109998, at *9-10 (N.D. Cal. Apr. 2, 2012) (rejecting argument that "arising out of" is always construed broadly, even in exclusionary clauses, and noting that the "broad coverage-narrow exclusion principle is well illustrated with respect to the phrase 'arising out of.'"). Here, Trusted Tech's allegations against My Choice did not "unambiguously, plainly and clearly fall within the "arising out of" language of the IP Exclusion" in My Choice's policy (citing Haynes, 32 Cal. 4th at 1204) and the exclusion would not bar coverage.

Accordingly, because the IP Exclusion was determined to be ambiguous and could reasonably be construed in favor of coverage, the Ninth Circuit determined that it did not preclude a duty to defend in the underlying action.

Key Takeaways

The Ninth Circuit decision reaffirms the well-established principles of California insurance law that an exclusion must be stated precisely and understandably and that exclusions must be interpreted narrowly against the insurer. However, the decision also speaks to a broader context, which is the standard of construction that courts apply to interpreting insurance policies under California law.

California law has long held an insurance policy is ambiguous when it is susceptible of two or more reasonable constructions. Ameron Int'l Corp. v. Ins. Co. of State of Pennsylvania, 50 Cal. 4th 1370, 1378 (2010). In other words, an insured need only show that its interpretation of the policy language is a reasonable interpretation to warrant a grant of coverage under the ambiguous provision.

Further, as the California Supreme Court has explained, ambiguous terms in an insurance policy must be construed "against the insurer, who wrote the policy and is held 'responsible' for the uncertainty[,]" so as to protect the insured's reasonable expectation of coverage. Id. These principles ensure that insureds get from their insurance policy the coverage that they reasonably expected they had purchased.

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