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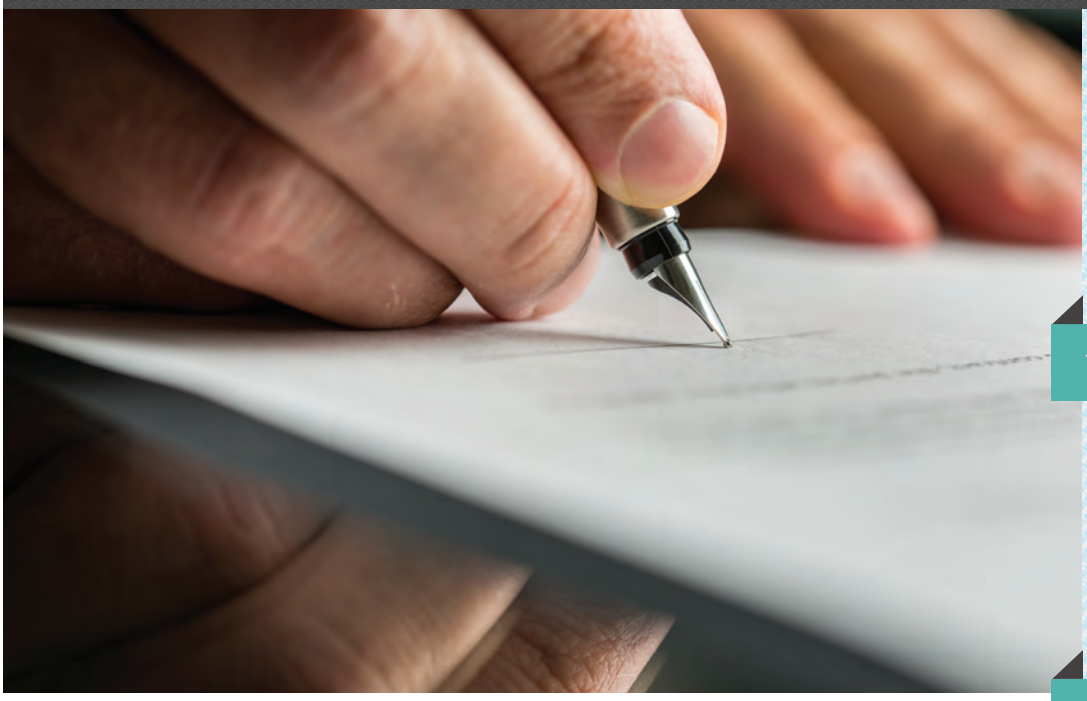

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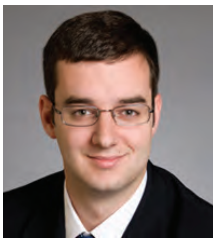
Wisconsin Federal Court Applies Prior Publication Exclusion in Copyright Infringement Case



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In *Design Basics, LLC v. Best Built, Inc.,* the court held two insurers owed no duty to defend and indemnify an insured for copyright infringement claims where the complaint alleged infringement of the designs at issue before their policy periods. The court affirmed an insurer's right to rely on extrinsic evidence of the dates when the allegedly infringing advertisements at issue began, and rejected the insured's argument that the insurers had a duty to defend based on speculation that the plaintiff may discover additional infringements triggering coverage.

In *Design Basics, LLC v. Best Built, Inc.,* Design Basics alleged that the insured contractor, Best Built, infringed on six of its copyrighted architectural plans in its advertisements and home construction activities. There was no dispute that Design Basics first used all six designs in its marketing materials in the late 1990s and first published them on its website in 2003. Two of Best Built's insurers, Secura and Acuity, intervened in the lawsuit seeking a declaratory judgment that they owed no coverage because their policies were issued after 2003.

Design Basics moved to compel documents unrelated to the designs identified in its complaint, which Best Built refused to produce, contending the discovery requests were overbroad. Best Built moved for summary judgment based on a prior release and the statute of limitations. Secura and Acuity moved for summary judgment based on the prior publication exclusion. The court granted Design Basics' motion to compel, denied Best Built's motion and granted the insurers' motions.

Addressing the insurers' motion, the court first recognized that where an insurer defends under reservation and intervenes in the underlying action, the court may consider evidence outside the four corners of the complaint in evaluating the duty to defend. The court found it was undisputed that all designs identified in the pleadings were first marketed in 1997 or 1998 and first advertised on Best Built's website in 2003. Acuity did not issue policies until 2006 and Secura did not issue policies until 2008. On this basis alone, the prior publication exclusion applied.

Design Basics and Best Built appealed to Rule 56(d), arguing that discovery may lead to additional allegations of infringement of other designs, which may or may not have been first infringed upon during the insurers' policy periods. The court noted the parties had ample opportunity to take discovery, and refused to find a duty to defend based on speculation as to what the plaintiffs would allege in the future.

Design Basics argued the insurers' continued publication of designs during the policy period constituted new publications that gave rise to distinct copyright claims, but the court found this irrelevant with respect to the prior publication exclusion. Indeed, the prior publication exclusion is specifically intended to exclude infringement starting before and continuing into the policy period.

Jim Pinderski and Michael DiSantis represented Secura Insurance, a Mutual Company, in this case.

Stick With the Greek Yogurt: Wisconsin Supreme Court Holds Wrong Ingredient in Probiotic Tablet Does Not Constitute "Property Damage"

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In *Wisconsin Pharmacal Co. LLC v. Nebraska Cultures of California, Inc.*, Nos. 2013AP613, 2013AP687, 2016 WL 785203 (Wis. March 1, 2016), the Wisconsin Supreme Court held that the incorporation of the wrong ingredient into probiotic supplement tablets that rendered the tablets useless for their contracted purpose, did not constitute "property damage" caused by an "occurrence." The Court also held that the "impaired property" exclusions in the policies otherwise applied to preclude any "property damage" liability coverage for the underlying claims, and therefore the insurers did not owe any duty to defend or indemnify the claims.

Wisconsin Pharmacal Company (Pharmacal) contracted with Nutritional Manufacturing Services LLC (NMS) to manufacture certain supplement tablets containing the probiotic bacteria Lactobacillus rhamnosus (LRA). NMS then contracted with Nebraska Cultures of California, Inc. to supply the LRA for the tablets. Nebraska Cultures in turn contracted with Jeneil Biotech, Inc. to supply the LRA to Nebraska Cultures.

Using an ingredient represented as LRA from Nebraska Cultures, NMS manufactured the supplement tablets. The manufacture of the tablets required the blending of other ingredients with the ingredient supplied by Nebraska Cultures and then compressing all the ingredients to form a tablet. Once in tablet form, the ingredients could not be separated from one another.

After the manufacturing of the tablets and shipment to a retailer, it was discovered that the ingredient provided by Nebraska Cultures was not LRA, but instead was a different bacteria species, Lactobacillus acidophilus (LA). The retailer recalled the tablet and thereafter, Pharmacal destroyed the tablets.

After NMS assigned to Pharmacal all of its causes of action against Nebraska Cultures and Jeneil, Pharmacal filed suit against Nebraska Cultures, Nebraska Cultures' general liability insurer (Evanston Insurance Company), Jeneil and Jeneil's general liability insurer (Netherlands Insurance Company). Nebraska Cultures also filed a cross-claim against Jeneil. All of the claims alleged that Nebraska Cultures incorrectly supplied LA to NMS and Pharmacal, when the parties had contracted for LRA.

After moving to stay and bifurcate the merits portion of the litigation, the insurers moved for summary judgment and argued that the claims against Nebraska Cultures and Jeneil did not allege "property damage" caused by an "occurrence."

The circuit court granted the insurers' motion for summary judgment and held that the incorporation of LA into the tablets did not constitute "property damage" caused by an "occurrence" because LA harmed only the product itself, which was an integrated system.

The court of appeals reversed, finding that the integrated system rule was not applicable. The court of appeals held that the incorporation of LA constituted "property damage" to the product (i.e., the tablets) caused by an "occurrence" and that no exclusion applied to preclude coverage.

Applying Wisconsin law to the Netherlands policy, the Wisconsin Supreme Court determined that there was no physical injury to other property or any loss of use of tangible property, as required by the policy's definition of "property damage." In finding that there was no physical injury, the Court determined that combining LA with other ingredients to form the supplement tablet constituted an integrated system. The Court determined that the complaint of injury was sustained by the integrated system itself (i.e., the tablets), and that no other property was injured. The Court rejected the argument that there was physical injury due to the blending of LA with the other ingredients into the tablets. The Court reasoned that any changes to the other ingredients were the result of the tableting process, not from the use of LA. The Court also rejected the argument that there was physical injury to any "cartons, shippers, inserts, tooling and dies" associated with the tablets, because such materials did not undergo any physical alteration as a result of the use of LA in the tablets.

In finding that there was no "loss of use," the Court held that the recalled and discarded tablets were rendered permanently worthless due to the inclusion of a wrong ingredient, which is a loss distinct from the temporary "loss of use" of property. The Court also determined that the accidental provision of the wrong ingredient did not constitute an "occurrence."

In addition, the Court determined that the "impaired property" exclusion of the Netherlands policy applied to otherwise preclude coverage, on the basis that any loss of use was due to the incorporation of Jeneil's product (i.e., LA). In finding that the "impaired property" exclusion applied, the Court held that the exception to the exclusion was inapplicable

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because there was no sudden or accidental injury to the LA, other ingredients or the tablets themselves.

Applying California law to the Evanston policy, the Court likewise held that there was no physical injury as required by the definition of "property damage" because the mere presence of the defective ingredient (i.e., LA) did not render the tablets hazardous. The Court also held that there was no "loss of use" because the tablets were rendered permanently worthless from the incorporation of LA, and that there was no "occurrence" because the provision of LA and the intentional incorporation of LA into the tablets, were deliberate actions and not an accident, as required by the policy's definition of "occurrence."

The Court likewise determined that the Evanston policy's "impaired property" exclusion applied to preclude coverage because any loss of use arose out of Nebraska Culture's failure to properly perform its contractual obligations – a loss that fell entirely within the scope of the exclusion.

Tressler Comments

In its well-reasoned analysis, the Wisconsin Supreme Court discussed the important distinction between damage caused by the incorporation of a defective product into an integrated system and damage to another product or property. This case demonstrates the importance in pinpointing the specific damage alleged in the underlying claim, and determining whether the insured's defective product is alleged to have damaged any other property, as opposed to the integrated product alone.

No Settlement, No Suit; Insured's Assumed Legal Obligation Not Imposed by Law

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In *Busch Properties, Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA.*, No. 14–3688, 2016 WL 722950 (8th Cir. 2016), the 8th U.S. Circuit Court of Appeals held that: (1) under Missouri law, the insured's legal obligation to remediate mold was not "liability imposed by law," and thus remediation expenditures were not within commercial general liability (CGL) policies' coverage; and (2) the insured's remediation expenditures were not covered under a CGL policy as a sum that the insured was "legally obligated to pay as damages for…liability assumed by the Insured under contract."

Busch Properties, Inc (Busch) sued its insurer, National Union Fire Insurance Company (National Union) after National Union denied coverage for Busch's expenditures to remediate mold in a condominium complex that it managed. National Union argued that no coverage existed because Busch was not legally obligated to make the repairs. Essentially, National Union argued that Busch contracted to manage the property, discovered mold on the property and voluntarily repaired the property without being sued. Although Busch had unit owners sign a consent form prior to remediation, National Union noted that Busch admitted no liability for the mold and was not required to proceed with the remediation if it chose not to.

The District Court agreed with National Union, stating "[w]ithout a settled claim or a settlement or judgment arising from a lawsuit, [Busch] cannot show it was 'legally obligated to pay by reason of liability imposed by.'"

Busch appealed, arguing that "coverage existed because it undertook remediation efforts based upon its existing obligations sounding in contract and tort" and "[t]he fact that these obligations were not reduced to a settlement agreement or judgment rendered them no less obligatory or enforceable." Moreover, Busch stated it had an independent contractual obligation to maintain the complex's common areas, and when Busch's employees discovered mold, Busch "was legally required to fulfill its maintenance obligations or otherwise face liability for breach." Additionally, Busch believed it assumed liability in its consent agreement with the individual unit owners.

On appeal, the 8th Circuit disagreed, holding that because Busch voluntarily entered into two contractual agreements that obligated it to maintain the complex, it had a preexisting obligation to remediate the mold, and preexisting obligations are not considered "liability imposed by law." Furthermore, the court held that Busch's policy provided coverage for an indemnification or hold harmless agreement; not a contractual agreement such as the consent agreement signed by the unit owners.

Tressler Comments

This is a good result for insurers under Missouri law; however, insurers should be aware of the dramatically different holdings among the various state jurisdictions analyzing the "liability imposed by law," and "liability assumed by the Insured under contract" policy language.

California Court Upholds Liability Policy's Remodeling Limitation and Residential Construction Exclusion

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In *Nazarian v. Colony Insurance Company*, 2016 WL 471853 (Cal. App. February 8, 2016), the California Court of Appeals held that an insurer owed no duty to defend or indemnify its insured for an underlying suit arising out of the insured's construction of claimants' residence where the policy only covered the remodeling activities.

Richard Nazarian was sued by homeowners for breach of contract, breach of express and implied warranty, and negligence. Nazarian allegedly represented himself as an experienced general contractor and agreed to build their dream home in Pacific Palisades, California within their $1.5 million budget. The homeowners alleged that Nazarian agreed to take full responsibility for the home's construction and manage the project. Nazarian allegedly failed to complete the home's construction and to properly supervise subcontractors, leaving the home otherwise defective.

Nazarian tendered the suit for defense and indemnification to its CGL carrier, Colony Insurance Company (Colony). By endorsement, the Colony policy limited coverage to "bodily injury" or "property damage" resulting from Nazarian's business as a remodeling general contractor. A second endorsement precluded coverage for "bodily injury" or "property damage" included in the "products-completed operations hazard" and arising out of or resulting from "your work" on any "residential construction."

Colony denied coverage, claiming the complaint alleged damages due to work arising out of residential construction and therefore fell outside the scope of coverage. Nazarian countered that he was simply remodeling the home and submitted a permit to support his contention that he'd been working on existing property. While the permit showed that the original driveway, a gate and a retaining wall remained, the permit confirmed that the original home, garage and pool had been demolished.

Nazarian brought suit against Colony for declaratory judgment, breach of contract and breach of the implied covenant of good faith and fair dealing, and Colony moved for summary judgment asserting that the underlying claim involved residential construction not covered under the Colony policy.

The court held that the Colony policy unambiguously covered remodeling work only and did not cover residential construction. Accordingly, since the underlying complaint alleged residential construction and not remodeling, there was no coverage under the Colony policy. The court rejected Nazarian's characterization and tendered evidence suggesting that because parts of the property remained intact it was simply remodeling the property. The court found the facts established that Nazarian was building a new home and it "exceeded anything that could be considered remodeling."

The court also rejected Nazarian's argument that it should nonetheless be covered because his business was classified in the policy declarations as a contractor "in connection with construction." The court found that accepting Nazarian's argument would render the endorsements superfluous and ignored the policy's unambiguous terms. Consequently, the court granted summary judgment in favor of Colony, finding that it owed no duty to defend or indemnify Nazarian, and further rejected his claim for breach of the implied covenant of good faith and fair dealing.

Tressler Comments

The case highlights a situation where a court will refuse to allow an insured to expand the scope of coverage beyond what is provided in the policy, enforcing unambiguous policy terms as written, including limitations on the risk insured.

Under Minnesota Law, Insurer is Entitled to Equitable Contribution From Co-Insurer Even if Co-Insurer Will Ultimately be Reimbursed by Insured

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(picture not available)

The 8th U.S. Circuit Court of Appeals affirmed the United States District Court for the District of Minnesota and found that insurer, National Union, had a duty to defend the insured and, therefore, another insurer, Continental Casualty, was entitled to equitable contribution from National Union despite the fact that National Union and the insured entered into a separate fronting arrangement whereby the insured agreed to indemnify and reimburse National Union for defense costs. *Continental Cas. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2016 WL 496999 (8th Cir. Feb. 9, 2016).

The Valspar Corporation (Valspar) bought primary general liability insurance from various insurers, including Continental Casualty Company (Continental), National Union Fire Insurance Company of Pittsburgh, PA (National Union) and others. In 2005 and 2006, benzene-related claims against Valspar triggered policies Valspar purchased from Continental, National Union and five other primary insurers. Continental defended Valspar, reserving its rights as to the contribution for defense costs from co-insurers. National Union denied it was required to contribute to defense costs because a "fronting agreement" with Valspar required Valspar to pay for its own costs.

When Continental filed a declaratory judgment action against National Union for a declaration that National Union owed a duty to defend Valspar and owed its share of defense costs, Valspar intervened. Valspar argued that requiring contribution from National Union would be, in essence, a requirement for Valspar to contribute to defense costs. National Union then filed a declaratory action seeking declaration that Valspar must indemnify National Union against any contribution Continental obtains. The District Court found that National Union had a duty to defend Valspar and a duty to contribute to defense costs and that Valspar did not have a duty to contribute to the defense costs directly. Valspar appealed. The 8th Circuit affirmed the District Court's ruling and remanded for further proceedings.

The 8th Circuit found that the insurance policies stated that National Union had a right and duty to defend Valspar and that National Union never disclaimed that duty. Other agreements between Valspar and National Union required Valspar to reimburse National Union for some defense costs, but this duty to reimburse did not relieve National Union from its obligation to defend, because an insurer's duty to defend extended beyond mere obligation to pay defense costs. Valspar argued that requiring Valspar to pay defense costs indirectly through National Union is the same as requiring Valspar to contribute to defense costs. Rejecting this argument, the 8th Circuit explained that the fact National Union ultimately may recover defense costs from Valspar does not affect a separate right by Continental to recover in equitable contribution defense costs from National Union.

In addition, the 8th Circuit rejected Valspar's argument that by seeking contribution from National Union, Continental violated its agreement with Valspar not to seek recovery for defense costs paid by Continental. The 8th Circuit explained a waiver of rights against one party is not a waiver of different rights against another, unrelated party. Further, the Eighth Circuit rejected Valspar's claim that Continental has unclean hands because it breached its duty to defend by not reimbursing approximately $15,800 Valspar paid in defense costs. Even if Continental should have paid $15,800, which was only 3% of over $560,000 in defense costs paid by Continental, this conduct did not rise to the level of a breach of its duty precluding equitable contribution against another insurer.

Tressler Comments

This case illustrates the importance of analyzing each party's obligations and relationships separately. In this case, it did not ultimately matter that the monies National Union paid as its share of defense costs would be paid by Valspar, the insured, and not National Union. Valspar's obligation to National Union was a distinct obligation, independent from National Union's separate obligation to Continental.

"But For" or Proximate Causation? That is the Question...the 3rd Circuit Answered When Interpreting an Additional Insured Endorsement

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In *Ramara, Inc. v. Westfield Insurance Co.*, No. 15-1003 (3d Cir. Feb. 17, 2016), the 3rd U.S. Circuit Court of Appeals held that, under Pennsylvania law, the additional insured need only show "but for" causation to trigger the additional insured coverage under an endorsement providing coverage for liability caused in whole or in part by the named insured's acts or omissions.

A garage owner, Ramara, Inc., contracted with a general contractor, Sentry Builders Corporation (Sentry), to perform work on its garage. Sentry subcontracted the cement and steel installation to Fortress Steel Services, Inc. (Fortress). Fortress agreed to provide additional insured coverage to the Ramara and Sentry and provided a certificate of insurance reflecting that agreement. One of Fortress' employees, Anthony Axe, was injured during construction and sued Ramara and Sentry, but not Fortress – his employer – as it was immune from legal action due to the Pennsylvania Workers' Compensation Act.

Axe's complaint alleged that he was Fortress' employee, and that Ramara, acting through its agents, servants and employees, negligently supervised the work. Ramara tendered the suit to Fortress' insurer, Westfield Insurance Co., but Westfield denied the tender because the complaint did not expressly allege that Fortress' acts or omissions caused the employee's injuries. The additional insured endorsement covered Ramara to the extent that its liability was caused in whole or in part by the acts or omissions of Fortress in its performance of ongoing operations for Ramara.

Applying Pennsylvania law, the 3rd Circuit held that, regardless of whether "but for" or proximate causation was applied, Axe's complaint "clearly [] made factual allegations that potentially would support a conclusion that [the employee's] injuries were 'caused, in whole or in part' by [the subcontractor's] acts or omissions." However, the 3rd Circuit did not limit its holding to these facts. Instead, the court waded into a "proximate cause" versus "but for" causation debate governing these endorsements. While the 3rd Circuit held that the allegations of Axe's complaint would have satisfied either causation standard, the court held that "but for" causation should apply – in part based on Pennsylvania's broad duty to defend, and in part, based on an "other insurance" endorsement that, when read in *pari materia*, with the additional insured endorsement, indicated that a "but for" showing triggered the coverage.

The 3rd Circuit didn't stop there either. It went on to address the boundaries of the four corners rule under Pennsylvania law in the additional insured context. The 3rd Circuit noted that the four corners rule does not permit insurers to make coverage determinations "with blinders on" or "bury its head in the sand and disclaim any knowledge of coverage-triggering facts." Instead, in construing the factual allegations of the underlying claim, insurers must consider the context in which the underlying claim is being made. For example, when an employee is barred from suing his or her employer, the insurer should factor that into its evaluation of the underlying claim.

Tressler Comments

This is an important case with respect to the scope of additional insured coverage under Pennsylvania law and the application of Pennsylvania's four corners duty to defend analysis. Furthermore, it is one of few federal appellate level cases that address the causation standard for triggering additional insured endorsements affording coverage for liability caused in whole or in part by the acts or omission of a subcontractor's ongoing operations. Policyholders and insurers will surely take notice.

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