

**American International Specialty Lines Insurance
Company v International Business Machines
Corporation**

2006 NY Slip Op 30270(U)

June 21, 2006

Supreme Court, New York County

Docket Number: 0600728/2005

Judge: Herman Cahn

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

HERMAN CARR

PRESENT

PART 49

Index Number : 600728/2005
AMERICAN INTERNATIONAL
vs
INTERNATIONAL BUSINESS
Sequence Number : 001
DISMISS ACTION

C

INDEX NO. _____
MOTION DATE 2/28/06
MOTION SEQ. NO. 001
MOTION CAL. NO. 1

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

FILED
JUN 26 2006

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM
DECISION IN MOTION SEQUENCE**

Dated: 6/28/06

Herman Carr
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION
Check if appropriate: DO NOT POST REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 49

-----X
AMERICAN INTERNATIONAL SPECIALTY
LINES INSURANCE COMPANY, as Subrogee
of AMERICAN CENTURY SERVICES LLC,

Plaintiff,

-against-

Index No.
600728/05

INTERNATIONAL BUSINESS MACHINES
CORPORATION,

Defendant.

-----X
Herman Cahn, J.:

Defendant International Business Machines Corporation (IBM) moves to dismiss the complaint, CPLR 3211 (a) (7). Plaintiff cross-moves to dismiss the affirmative defenses of statute of limitations and laches, CPLR 3211 (b).

In this action, plaintiff seeks to enforce the rights of American Century Services LLC's (American Century), as its subrogee, against IBM.

American Century sponsors, operates, and manages mutual funds and provides investment management services to customers. Plaintiff issued an Investment Management Insurance Policy to American Century. American Century had entered into an agreement with IBM, pursuant to which IBM sold and licensed certain software and other equipment, which American Century used in connection with its interactive, automated, telephone system, known as "DirecTalk."

Sometime after American Century began using the "DirecTalk" system, it was contacted by an inventor and patent holder, Ronald A. Katz, who asserted that the "DirecTalk" system

FILED
JUN 26 2006
COUNTY OF NEW YORK

infringed on one or more of his patents. After American Century notified IBM of the patent infringement claims, it settled the claims, paying more for a release and license. It then asserted a claim for coverage under the policy issued by plaintiff, and was paid by plaintiff. Plaintiff now seeks indemnification and recovery against IBM for the payment made and defense costs attendant to the Katz claim.

BACKGROUND

The facts alleged are as follows:

Plaintiff American International Specialty Lines Insurance Company (AISLIC) issued Investment Management Insurance Policy, number 912-41-89, having a policy term of December 20, 1998 through December 20, 2000, to American Century (Complaint, ¶ 6).

American Century is a mutual fund investment management company, which renders advisory services to its customers through its interactive automated telephone system (*id.*, ¶ 7).

IBM creates, develops, and manufactures information technologies, such as computer systems, and software for certain applications such as telecommunications, which technologies are sold or licensed by it. (*id.*, ¶ 8).

On May 21, 1998, IBM and American Century entered into a Customer Agreement, pursuant to which IBM provided American Century with its “DirecTalk” automated telephone system (*id.*, Exhibit A; Exhibit 2 to Notice of Motion). The Customer Agreement provides, in part, in section 1.6, that:

if a third party claims that a Product we provide to you infringes that party’s patent, copyright, or trade secret, we will defend you against that claim at our expense and pay all costs, damages, and attorney’s fees that a court finally awards, provided that you:

1. promptly notify us in writing of the claim; and
2. allow us to control and cooperate with us in, the defense and any related settlement negotiations.

Id. at AC 03887 and AC 03901. Section 1.6 further provides that “[t]his is our entire obligation to you regarding any claim of infringement” (id.). The Customer Agreement provided, in section 1.9 (1), that American Century agreed “not to assign, or otherwise transfer, this Agreement or your rights under it, delegate your obligations, or resell any Service, without prior written consent (id. at AC 03888). It further provided that any attempt to do so was “void” (id.). Section 2.1 of the Customer Agreement sets forth the specific IBM warranties (id. at AC 03890-03891), and section 2.2 expressly disclaims implied warranties of merchantability and fitness for a particular purpose in an all-caps font (id. at AC 03891).

Sometime after the Customer Agreement was signed, American Century was contacted by Ronald A. Katz, and his companies, Ronald A. Katz Technology Licensing L.P. and A2D, L.P. (collectively, Katz), an inventor holding over 40 patents, which, among other things, allegedly cover various aspects and methods of using interactive automated phone services systems (Complaint, ¶ 15). Katz asserted that the DirecTalk system sold to American Century infringed one or more of Katz’s patents (id.).

By March 12, 1999, American Century advised IBM of the infringement claims, and requested that IBM indemnify and hold it harmless against Katz’s claims pursuant to its obligations under the Customer Agreement (id., ¶¶ 17-18).

In May 2000, IBM settled patent infringement claims and entered into a licensing agreement with Katz, solely for its own benefit and protection (id., ¶ 20).

By letter dated December 20, 2000, IBM disclaimed American Century's claims, arguing that DirecTalk did not infringe on Katz's patents, and that the defense and indemnification provisions in the Customer Agreement did not apply (*id.*, ¶ 19).

On December 28, 2000, IBM and American Century entered into a tolling agreement with regard to American Century's indemnification claims against IBM with regard to the Katz patent infringement claims (Exhibit D to Notice of Cross Motion). The "tolling period" would begin on the "Effective Date," that is, December 28, 2000, and would end on April 9, 2001 (*id.*).

By letter dated February 14, 2001, American Century's counsel informed IBM that it was engaged in settlement negotiations with Ronald Katz and his companies, the amount of the possible settlement, and offered IBM the opportunity to assume control over and responsibility for the settlement negotiations, and to indemnify and hold American Century harmless with respect to any loss, liability, and expense relating to the Katz claims (Exhibit B to Notice of Cross Motion). On February 21, 2001, IBM responded to this letter by asserting that under the Customer Agreement, and the accompanying IBM Program Licensing Agreement (IPLA), there was no contractual indemnification provision with regard to IBM's DirecTalk system (Exhibit C to Notice of Cross Motion, IBM Letter of February 21, 2001). IBM further stated that even if section 1.6 of the Customer Agreement applied, DirecTalk did not infringe a Katz patent (*id.*).

In February 2001, American Century's negotiations with Katz culminated in a License and Release Agreement issued to it by Katz (*id.*, ¶ 21). Before signing that agreement, American Century gave IBM a final opportunity to assume negotiations with Katz or acknowledge its obligations to indemnify or hold American Century harmless, which IBM declined. American Century paid Katz \$3,403,326.00 to resolve all of his claims, obtaining a release and license,

incurring \$77,305.67 in counsel fees (id.).

American Century then asserted a claim for coverage under the Policy issued by plaintiff for the payment and defense costs. AISLIC paid \$2.9 million to American Century to indemnify it for the monies paid to Katz (id., ¶ 22).

On September 23, 2004, American Century and IBM executed a Seventh Amended and Restated Tolling Agreement (Exhibit E to Notice of Cross Motion), in which the parties extended the “tolling period” to April 12, 2005.

This action was commenced on February 28, 2005.

The complaint contains four causes of action. The first is for breach of the Customer Agreement. The second is for negligent misrepresentation – that is, that IBM negligently misrepresented that its software, products and licenses were free of patent infringement claims. The third alleges that IBM breached the common-law duty of indemnification, by refusing to indemnify American Century for the Katz settlement. The fourth is for breach of implied warranties under the common law and the Uniform Commercial Code § 2-312.

IBM now moves to dismiss on several grounds. First, it contends that the Customer Agreement bars any assignment of American Century’s rights, and that the anti-assignment clause, section 1.9 of the Customer Agreement, plainly makes such assignment void. Therefore, IBM asserts that plaintiff lacks standing to bring any claims, as subrogee, against IBM with regard to the Customer Agreement. Second, IBM urges that the claims for negligent misrepresentation, common-law indemnification, and breach of implied warranty are precluded by specific provisions of the Customer Agreement. It argues that section 1.6 of the Customer Agreement expressly sets forth its entire obligation to American Century regarding any claim of

infringement. Thus, American Century's claims of breach of various non-contractual duties, including negligent misrepresentation, indemnification, and breach of implied warranties, are barred. Moreover, IBM asserts that section 2.2 of the Customer Agreement clearly states that the implied warranties of merchantability and fitness for a particular purpose are replaced by the express contractual warranties, which replacement is enforceable under the law. Accordingly, IBM maintains that the complaint should be dismissed.

Plaintiff disputes all of IBM's above assertions.

In its cross motion to dismiss IBM's statute of limitations and laches defenses, plaintiff contends that, as subrogee, it stands in American Century's shoes, and is entitled to the benefit of the several tolling agreements entered into between IBM and American Century. These tolling agreements set forth a tolling period of December 28, 2000 through April 12, 2005, which period of time was not to be counted in computing the time applicable to a statute of limitations or laches defenses. Plaintiff urges that section 1.8 (7) of the Customer Agreement provides that neither party will bring legal action more than two years after the cause of action arose, that is, when the third party's claim (i.e. Katz's claim) was made against American Century (Exhibit 2 to Notice of Motion to Dismiss at AC 03888, AC 03901). It contends that the limitations period began in February 2001, when IBM refused to defend and indemnify it. Alternatively, at the most, the limitations period ran from March 1999, when American Century requested that IBM defend and indemnify it, until the tolling agreements became effective in December 2000, i.e., for 21 months. Plaintiff argues that this action was commenced while the tolling agreements were still in effect, in February 2005. Therefore, it has been timely brought within the contractual two-year limitations period.

DISCUSSION

IBM's motion to dismiss is granted only to the extent of dismissing the third cause of action, and is otherwise denied. The cross motion to dismiss the affirmative defenses of statute of limitations and laches is granted, and those defenses are dismissed.

The third cause of action, for breach of the duty to indemnify, is dismissed. This claim is based on allegations that, under the contractual obligations between IBM and American Century, IBM had an implied duty to provide products and licenses to American Century that would not expose American Century to patent infringement claims, and a duty to indemnify American Century for the amounts it paid to settle such claims, arising out of IBM's wrongdoing (Complaint, ¶ 37). The Complaint alleges that IBM breached its duty to indemnify American Century the costs of defending and settling the Katz claims (*id.*, ¶ 38). The Customer Agreement, however, in section 1.6, specifically addresses IBM's indemnification obligation with regard to such patent infringement claims. It provides that IBM would pay costs, damages and attorney's fees if American Century promptly notified it in writing, cooperated with IBM and allowed it to control the defense and related settlement negotiations (Exhibit 2 to Notice of Motion, Customer Agreement § 1.6, at AC 03901). The section also states that it contained IBM's "entire obligation to [American Century] regarding any claim of infringement" (*id.* at AC 03887). Thus, Plaintiff has a claim for contractual indemnification only, and there is no basis for an implied indemnification claim (see Service Sign Erectors Co. v Allied Outdoor Adv., Inc., 175 AD2d 761 [1st Dept 1991]). Accordingly, the third cause of action is dismissed.

The remaining causes of action, however, sufficiently state claims. IBM's argument that all of the claims in the complaint are barred because plaintiff lacks standing, is unpersuasive.

Plaintiff has appropriately asserted these claims as subrogee of American Century. IBM's contention that the anti-assignment clause in the Customer Agreement applies to the claims is unavailing. As plaintiff aptly points out, IBM's analysis ignores the distinction between subrogation and assignment. Subrogation is an equitable doctrine, in which an insurer stands in the shoes of its insured in order to seek indemnification from a third party whose wrongdoing caused the loss for which the insurer was obligated, under the insurance policy, to reimburse its insured (North Star Reins. Corp. v Continental Ins. Co., 82 NY2d 281, 294 [1993]; American Ref-Fuel Co. of Hempstead v Resource Recycling, Inc., 307 AD2d 939, 941-42 [2d Dept 2003]). Its purposes are to prevent an insured from recovering twice for one harm, and to allocate responsibility for a loss upon the party who caused the damage, and avoid absolving a wrongdoer from liability simply because the insured had the foresight to obtain insurance (North Star Reins. Corp. v Continental Ins. Co., *supra*; American Ref-Fuel Co. of Hempstead v Resource Recycling, Inc., 307 AD2d at 942). The right to subrogation arises by operation of law when the insurer pays for the loss to its insured (North Star Reins. Corp. v Continental Ins. Co., *supra*; Federal Ins. Co. v Arthur Andersen & Co., 75 NY2d 366, 371-72 [1990] *see* 22 Applemint on Insurance 2d § 141.1 [C] [1] [2003]; 16 Couch on Insurance 3d § 222.5 [2005]). The doctrine is liberally applied to protect insurers who have been compelled by contract to pay the loss caused by the negligence or wrongdoing of a third party (*see* Winkelmann v Excelsior Ins. Co., 85 NY2d 577 [1995]). The insurer's rights are limited to the rights of its insured against the third party for its default or wrongdoing (Federal Ins. Co. v Arthur Andersen & Co., *supra*). Thus, its claim is subject to any defenses the third party might have had against the insured (*id.*).

While assignment shares some similarities with subrogation, they are distinct legal

concepts. An assignment occurs after the loss has been incurred, and the assignee, a volunteer, pays the damaged party in return for an assignment of the damaged party's rights (22 Applemint on Insurance 2d § 141.1 [B]; 16 Couch on Insurance 3d § 222.2, at 222-13). Subrogation, on the other hand, involves a contractual obligation, the insurance contract, which existed before the third party acted and the insured was damaged, under which the insurer reimburses its insured, and is, by operation of law, entitled to subrogation (*id.*, citing United States v Aetna Cas. & Sur. Co., 338 US 366, 373 [1949] [subrogation is not a voluntary assignment within the "anti-assignment" statute, 31 USC § 3727, regulating the assignment of claims against the government]).

In this action, plaintiff was obligated under its Policy to pay American Century for certain losses covered thereunder, in accordance with the Policy's terms. Plaintiff alleges that American Century suffered a loss, the settlement it paid to Katz with regard to the patent infringement claims, for which IBM is liable. Plaintiff further alleges that it paid American Century for this loss in accordance with its obligation under the Policy. Further, American Century could have pursued the action against IBM had it not been compensated for the loss by plaintiff. Plaintiff's rights are clearly in subrogation, and its allegations sufficiently state a claim for subrogation. The anti-assignment clause in section 1.9 of the Customer Agreement, was intended to prevent American Century from replacing itself with a party IBM did not know or want to deal with in the performance of the contract. It clearly does not preclude plaintiff's right to subrogation.

The cases relied upon by IBM do not warrant a different conclusion. Two of the cases, Allhusen v Caristo Constr. Corp. (303 NY 446, 452 [1952]) and State Bank v Central Mercantile Bank (248 NY 428, 435 [1928]), simply stand for the principle that a contract can prohibit

assignment.

IBM's reliance upon Spinex Labs. v Empire Blue Cross and Blue Shield (212 AD2d 906 [3d Dept 1995]) is misplaced, because the facts in that case are clearly distinguishable. In Spinex, a health-care patient assigned his right to reimbursement from his health-care insurer to a medical provider by means of a "subrogation agreement." The medical provider brought an action against the insurer, alleging breach of contract for its wrongful refusal to pay the claims (id.). The health insurance policy contained a prohibition against assignments, stating that the patient could not assign any benefits or monies due under the plan, and that such assignment would be void (id.). The court held that the assignment to plaintiff medical provider was void, and dismissed the complaint, rejecting the plaintiff's tactic of labeling itself as a subrogee rather than an assignee (id.). Here, in contrast, plaintiff did not just pay American Century as a volunteer, and obtain an assignment in return. Plaintiff has a pre-existing right in subrogation based on its pre-existing insurance contract with American Century. It did not attempt to take an assignment after the loss occurred, as the medical provider did in the Spinex case. Accordingly, plaintiff has standing as the subrogee of American Century, and may pursue its claims against IBM.

The second cause of action states a claim for negligent misrepresentation. In that claim, plaintiff alleges that IBM negligently misrepresented or omitted to apprise American Century of Katz's claims of patent rights over the products, software, and licenses it sold with the DirecTalk system, that American Century reasonably relied on IBM's misrepresentations, and that it was damaged. A claim for negligent misrepresentation may be interposed where a defendant owes a duty to the plaintiff to use reasonable care to impart correct information (White v Guarente, 43

NY2d 356 [1977]), the information provided was false, and the plaintiff reasonably relied on the information (see Fresh Direct v Blue Martini Software, Inc., 7 AD3d 487 [2d Dept 2004]). The claim requires a special relationship of trust or confidence between the parties, which creates the duty to impart correct information (see Saunders v AOL Time Warner, Inc., 18 AD3d 216 [1st Dept 2005]; United Safety of Am., Inc. v Consolidated Edison Co., 213 AD2d 283, 286 [1st Dept 1995]; Delcor Labs., Inc. v Cosmair, Inc., 169 AD2d 639 [1st Dept], lv dismissed 78 NY2d 952 [1991]). While regular arm's length business transactions will not normally create such a relationship (see Andres v LeRoy Adventures, Inc., 201 AD2d 262 [1st Dept 1994]), where one party has a unique or special expertise, that will be enough to establish the special relationship (Kimmell v Schaefer, 89 NY2d 257, 263 [1996] [unique, special expertise]; Fresh Direct v Blue Martini Software, Inc., 7 AD3d 487, supra [special expertise in software licensing arrangement]). Here, plaintiff pleads that American Century relied on IBM's expertise, as a manufacturer and developer of products and software, in knowing and representing that the software licensed to American Century did not infringe any patents. Moreover, plaintiff alleged that IBM made false representations as to existing facts, that the software and licenses in connection with the DirccTalk system did not infringe on any patents, regarding matters which were collateral to the contract itself (see Alamo Contr. Bldrs. v CTF Hotel Co., 242 AD2d 643 [2d Dept 1997]) and that it justifiably relied on those representations (Fresh Direct v Blue Martini Software, Inc., 7 AD3d at 489). Accordingly, the negligent misrepresentation claim is sufficiently pleaded.

The fourth cause of action also withstands defendant's motion. Contrary to IBM's characterization, the fourth cause of action is for breach of warranty under UCC 2-312. It alleges that when IBM entered into the Customer Agreement with American Century, it warranted that

title in both the license and the products for the DirecTalk phone system was good and valid, and that the transfer of the rights to DirecTalk was rightful and free of any claims of infringement (Complaint, ¶ 41). UCC 2-312 (1) specifically provides that in a contract of sale, there is a warranty by the seller that the title is good and its transfer is rightful (UCC 2-312 [1]). It further provides, in subsection 2, that the warranty will be excluded or modified only by specific language or circumstances giving the buyer reason to know that the person selling does not claim title in itself (UCC 2-312 [2]). Official Comment 6 states that the warranty in subsection 1 is not designated as an “implied warranty,” and, therefore, is not subject to UCC 2-316 (3). Instead, it is subject to subsection 2 of UCC 2-312, which requires either specific language excluding or modifying that warranty of title, or the described circumstance giving the buyer reason to know there was no such warranty. Therefore, IBM’s argument that UCC 2-316 applies, and that the Customer Agreement contains an exclusion of this implied warranty is rejected. The language in the Customer Agreement, at section 2.2, excluding “OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE,” does not specifically address the warranty that title is good and not infringing (UCC 2-312 [2]), and thus, does not exclude or modify the warranty which forms the basis of plaintiff’s fourth cause of action. Accordingly, the fourth cause of action sufficiently states a claim.

The cross motion to dismiss the affirmative defenses of statute of limitations and laches is granted. The Customer Agreement provides that any claims are to be brought within two years of accrual (Exhibit 2 to Notice of Motion, Customer Agreement § 1.8, at AC 3901). However, American Century and IBM entered into several tolling agreements effective as of December 28,

2000 (Exhibit D to Notice of Cross Motion). The tolling agreements suspended the running of the statute of limitations (id. at 2), from December 28, 2000 through April 12, 2005. The Customer Agreement provides that American Century's claim against IBM "shall be deemed to have arisen at the time such third party's claim [i.e., Katz's claim] was made against [American Century]" (Exhibit 2 to Notice of Motion, at AC 3901). The earliest this could have occurred was on March 12, 1999, when American Century first advised IBM of Katz's claims. Thus, the limitations period ran for 21 months from that time until December 28, 2000, when the first of the tolling agreements became effective. This action was commenced in February 2005, before the tolling period ended, and, therefore, was within the two-year period. Therefore, IBM's defenses of statute of limitations and laches are dismissed.

Accordingly, it is

ORDERED that the motion to dismiss is granted only to the extent that the third cause of action of the complaint is dismissed and is otherwise denied; and it is further

ORDERED that the cross motion to dismiss is granted and the third and sixth affirmative defenses, based on laches and statute of limitations respectively, are dismissed; and it is further

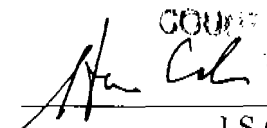
ORDERED that the action, shall, in all other respects, continue.

Dated: June 21, 2006

FILED

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JUN 26 2006


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