



CONVERGING RISKS IN A DIGITAL ECONOMY:

APPAREL DESIGN, MANUFACTURE AND SALE

This is one installment in a series of “White Papers” prepared by ThinkRisk Underwriting Agency discussing the converging media and technology risks facing various industry segments. The white papers provide real-world claims examples, and explore the insurance ramifications of these emerging exposures. This installment of the series discusses risks faced by companies in the apparel industry, including clothing designers, manufactures and retailers.

Introduction to the convergence phenomenon: Digital technology is a powerful tool that has changed the way businesses and other organizations operate. It has unleashed corporate creativity, leading to new products, new ways to manage and store data, and new ways to interact and communicate with constituencies. At the same time, digitization and the way it permits companies to gather, create, distribute and store information and media content has altered the risks of doing business in a fundamental way and exposes inadequacies in the current insurance response to these new risks. Here’s how this phenomenon affects the apparel industry.

Content: It has become a cliché that in today’s information-based environment, “everyone’s a publisher.” This seems particularly true with respect to the apparel industry, where clothing designers, manufacturers and retailers look to reach their desired audiences by “telling a story” through their branding and advertising. Indeed, many apparel businesses more closely resemble entertainment companies than standard commercial enterprises, with frequent use of celebrity endorsers, creative internet and social media strategies, and other “new media” practices. As a result, apparel companies can face content-related claims from a wide variety of sources, ranging from traditional media and advertising activities, such as billboards and print and broadcast ads, to branding, publishing, product placement, entertainment programming and other media activities. For example:

- Producers of the hit movies series *Twilight* sued apparel company Bb Dakota for marketing a blue cotton coat by emphasizing the item's link to the vampire franchise. Dakota’s advertising used the line, "Bella Swann [sic] wears this jacket in *Twilight* and scores the hottest vampire in high school, and so can you!" The advertising ploy riled Summit Entertainment, the studio

behind the Twilight films, which filed a lawsuit against the clothing company claiming copyright and trademark infringement.

- Clothing company American Apparel settled a lawsuit brought by actor Woody Allen for \$5 million. The suit was over two unlicensed, unauthorized billboards for American Apparel that appeared in New York and Los Angeles in May 2007. The billboards depicted Woody Allen as an Orthodox Jew in a still photo taken from his movie *Annie Hall*, along with Yiddish text declaring Allen “the High Rabbi.” Allen claimed that unauthorized use of his image constituted a misappropriation of his right of publicity.
- The University of Kansas (KU) sued Joe-College.com, a local T-shirt company in Lawrence, Kansas, for selling T-shirts that KU alleged infringed upon its trademarks. Among other things, KU alleged that Joe-college.com could not use the colors blue or red together with the words “Kansas,” “Jayhawk” and other similar terms. After trial, several of Joe-college.com’s shirts were indeed found to be infringing, and the T-shirt shop was ordered to pay damages of \$127,000 and attorneys fees of over \$650,000.
- Designer Derek Andrew Inc. sued Poof Apparel over the use of the trademark “Twisted Heart” on hang tags in connection with a line of clothing. Andrew began using this trademarked logo beginning in 2003, and first noticed Poof’s infringing use in 2005. The district court imposed damages of \$685,000, representing Poof’s profits from the infringing use of the logo.

Design. In addition to media content, businesses in the apparel industry face a myriad of intellectual property exposures arising out of the design of clothing itself – creative elements such as stitching, textile design, patterns, images, photographs and other elements incorporated into the design of the product. Although the apparel industry has faced intellectual property challenges probably since the time of the toga, digital technology has aggravated the problem. Advances in technology have dramatically shortened the product development lifecycle. New designs can be developed digitally and placed into production so quickly that often there is no opportunity for legal review or other sober reflection on the risks. Images, patterns and other protected intellectual property can easily be copied electronically and incorporated into new designs. And the ease of online sales platforms means that new designs can be brought to market, globally, in days as opposed to months or years.

As a result, it is not surprising that there are a great many recent examples of design-related claims against the apparel industry, including:

- “Fast fashion” giant Forever 21 faced at least 20 lawsuits alleging infringement of intellectual property rights as of January 2006. These lawsuits included conflicts with designers Diane von Furstenberg, Gwen Stefani, Anna Sui and others. The majority of the lawsuits involve copyright infringement of fabric design.
- NBA player Dennis Rodman filed a lawsuit against Fanatix Apparel, Inc., alleging that the clothing company violated his right of publicity. Fanatix had designed and marketed long-sleeved T-shirts purporting to contain an exact depiction of the tattoos on Rodman’s arms. Fanatix marketed the product as the “Dennis Rodman T-Shirt.” Rodman sought \$1m in damages.
- Fashion Stores group Hennes & Mauritz (H&M) has sued budget retailer Primark, alleging that the discount store has copied motifs, prints and designs used on fashions ranging from shirts

and dresses to a baby's sleepsuit. H&M claims Primark copied a dragon design, a target-style design, and a graffiti pattern.

- California apparel company Juicy Couture sued Victoria's Secret, accusing the company of stealing the idea of placing logos on the seat of sweatpants and other similar garments. Juicy also claims infringement over the sale of apparel wrapped in the shape of bon bons and ice cream cones.
- The owners of the Levi Strauss brand of jeans sued a rival, Gardeur, in 2010 for trademark infringement in connection with the stitching design on the rear pockets of jeans. Levi Strauss claims that it has used the design continuously since 1873 and that it is the oldest clothing-related trademark in the United States.

Network security and data privacy

Digital technology makes gathering and storing data easier, creating opportunities for companies to collect and store vast amounts of data, including employee information but also data concerning customers, vendors, website visitors and many others. In addition, many apparel companies have online stores, and therefore may collect credit card or other personal financial information from customers. In the event of a breach of security, state laws in most jurisdictions require the data holder to notify all potentially impacted persons, the cost of which can be astronomical. If the information is used in a way that is damaging, the company could face liability claims as well. In addition, apparel companies are likely to have digital versions of many designs, patterns, and other creative works belonging to vendors, independent contractors and other third parties, the value of which might be compromised if the digital copies were accidentally released.

There have been many instances of data security breaches involving apparel companies, including probably the single most infamous data security case, which involved the apparel retailer TJ Maxx:

- TJX Cos., owner of the apparel retailers TJ Maxx and Marshalls, was the subject of one of the largest data breach incidents in corporate history. Unidentified hackers placed software on the company's network and were able to obtain data on approximately 45 million credit and debit cards. Some of this data was used to make fake credit cards, which were then used to purchase millions of dollars of electronics from Wal-Mart and other stores. TJX has estimated the total costs of the breach at around \$250 million, which includes notifying impacted consumers, investigating the breach, restoring defective computer systems and responding to lawsuits.
- In February 2007, data concerning employees of Rabun Apparel, a former subsidiary of Fruit of the Loom, was accidentally available for over a month on the internet. The data consisted of over 1000 records and included employees' names and social security numbers.

Coverages in the standard insurance marketplace

Most media and entertainment companies purchase specialized "media liability" policies to protect themselves against intellectual property and related claims. Most apparel companies, however, do not. Instead, they have historically relied on the "advertising injury" coverage in the Commercial General Liability ("CGL") policy.

Typical CGL policies, however, provide very limited coverage for the types of design, media and network security claims discussed above. Libel and invasion of privacy in publications may be covered, but that leaves much media activity unprotected. For instance, intellectual property is excluded, except for copyright in “advertisements.” This means that the litany of copyright, trademark and related intellectual property claims discussed above arising out of apparel design would likely not be covered. Similarly, website content is generally not covered, unless the content is considered “advertising,” which is construed narrowly. Chat rooms, bulletin boards and other interactive media are excluded. Data breaches are generally outside the scope of the GCL.

Similarly, although some D&O policies can include personal and advertising injury coverage similar to CGL policies, those coverages may not be offered to apparel companies. Likewise, many D&O policies have intellectual property and other similar exclusions that would defeat coverage in many of the high-exposure areas discussed in this paper. Even when such coverage is provided, it is generally not robust, and the carrier may not have the necessary legal expertise to deal with highly specialized or technical claims.

ThinkRisk’s Converging Risk Liability Policy:

The Converging Risk Liability Policy from ThinkRisk is tailored (no pun intended) to address these unique and emerging exposures, and fill the gaps left by traditional policies. The policy is “modular” and can therefore be customized to meet the needs of the particular institution. Coverage Part A of the Policy provides coverage for claims arising out of the distribution of content, whether by print, electronic or any other means. This coverage can be endorsed to provide Design Coverage for similar types of claims (e.g., copyright, trademark, etc.) arising out of apparel design. To the extent that the apparel company provides any type of professional services (such as design services for others, or other consulting services), Coverage Part B provides coverage for claims alleging errors and omissions in the course of providing such services. Coverage Parts C and D provide network security coverage, both for liability claims brought against the insured (Part C) and for certain costs incurred by the insured in responding to a breach (Part D), such as the cost of notifying impacted persons.

To obtain a quote, please contact your insurance agent. To our agents: For more information, contact us at info@thinkriskins.com or (816) 994-6400. Submissions may be sent to submissions@thinkriskins.com.