The Coverage Inkwell

Emerging Coverage Issues in Intellectual Property, Privacy, and Cyber Liability

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July 20, 2012

MARK *THIS* DOWN: CLEARANCE SALE QUALIFIES AS PRODUCT DISPARAGEMENT FOR PURPOSES OF DUTY TO DEFEND

We live in a world of "buy one, get one free" and season-ending sales. Because of new styles and inventory, merchandise has a short shelf life—what isn't sold today, is pushed with discounts and deals tomorrow. Anyone who shops at Gap® knows this. But consider this: is a clearance markdown a disparagement of the merchandise being sold? For purposes of insurance coverage, the California Court of Appeals thinks it is.

In *Travelers Prop. Cas. Co. v. Charlotte Russe Holding, Inc.,* -- Cal. Rptr. 3d ---, 2012 WL 2866421 (Cal. App. Ct. July 13, 2012), the California appellate court held that an insurer had a duty to defend litigation alleging breach of contract, declaratory relief regarding trademark dilution, fraudulent and negligent misrepresentation, and intentional interference with a contractual relationship—all claims which were not intended to be covered—on the basis of disparagement. That is one heck of a sale.

The significance of this case lays not just in the court's reasoning, but also because, in an economy where discounting is common, the facts in *Charlotte Russe* can be replicated easily. In addition, by order dated July 13, 2012, the California Court of Appeals certified its decision for reporter publication, thereby ensuring that the decision will garner greater attention and judicial weight in the eyes of other jurists. (*Charlotte Russe* was already in *The Coverage Inkwell* pipeline, but the July 13 publication order bumped it to the top.) If the court's reasoning and analysis are followed by other courts, a whole new catalog of coverage claims could open.

In the case, the insured Charlotte Russe Holding and other related entities (collectively, Charlotte Russe), a clothing retailer, had entered into a contract with Versatile Entertainment, Inc., and its parent, People's Liberation, Inc. (collectively, Versatile), to become the exclusive sales outlet for Versatile's "People's Liberation" brand of apparel of jeans and knits. Slip Op., p. 2. According to the underlying pleadings, Versatile identified the People's Liberation brand as a "premium," "high-end" brand of clothing, claiming that it had "invested millions of dollars developing the [People's Liberation] [b]rand so that it became associated in the marketplace with high-end casual apparel" which "was distributed ... exclusively through fine department stores and boutiques...." *Id.*, p. 3

Although Charlotte Russe had never before offered high-end apparel for sale, Versatile agreed to make Charlotte Russe its exclusive sales outlet because Charlotte Russe "had promised to provide the investment and support necessary to 'promote the sale of premium brand denim and knit products in order to encourage [Charlotte Russe's] customers to purchase such premium products at a higher price point at its [Charlotte Russe] stores.'" *Id.* Apparently, the clothing did not sell well.

According to Versatile, Charlotte Russe failed to live up to its representations and began "the fire sale" of People's Liberation branded apparel at "close-out" prices." *Id.* Versatile alleged that the sale of the apparel "at severe discounts" not only violated the parties' agreement, it also "will also certainly result in significant and irreparable damage to and diminution of the People's Liberation Brand and trademark." *Id.* Versatile commenced two actions against Charlotte Russe, alleging breach of contract, declaratory relief, fraudulent and negligent misrepresentation, and intentional interference with a contractual relationship. *Id.*, p. 2. Versatile sought damages for "Defendants' breaches, including damage to and diminution of the People's Liberation Brand and trademark which will certainly result from Defendants' 'fire sale' of People's Liberation Branded goods at 'close-out' prices." *Id.*, p. 3. No causes of action were alleged for trade libel, slander, or disparagement.

Charlotte Russe sought coverage under CGL policies issued by Travelers. The policies defined "personal injury" in part as "injury arising out of '[o]ral, written, or electronic publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services, provided that claim is made or 'suit' is brought by the person or organization that claims to have been slandered or libeled, or whose goods, products or services have allegedly been disparaged[.]'" *Id.*, p. 4.

Charlotte Russe contended that it was entitled to defense coverage because Versatile's discounting claims "involved disparagement." *Id.*, p. 5. Charlotte Russe informed Travelers that Versatile's discounting claim was factually based on Charlotte Russe's "public display of signs in store windows and on clothing racks announcing that People's Liberation brand jeans were on sale," as well as on their "written mark-downs on individual People's Liberation clothing items." *Id.*, p. 3. Much later, Charlotte Russe proffered evidence that its markdowns were at 70-85%. *Id.*

Travelers, however, denied coverage, explaining that "the reduction of a product's price is not ... a disparagement of that product." *Id.*, p. 5. In the ensuing coverage action, Travelers moved for summary judgment, arguing that its policies did not provide coverage because none of the claims asserted by Versatile amounted to an actionable claim for trade libel. Specifically, Travelers argued that the allegations alleged against Charlotte Russe "must be compared with the elements of the trade libel tort in order to properly assess the potential for coverage under the Travelers' disparagement coverage." *Id.* Because the cause of action for trade libel or disparagement requires an allegation of the publication of a false statement and resulting loss of business, and that no such allegations were made against Charlotte Russe, Travelers argued there was no coverage. *Id.* The trial court agreed and granted summary judgment. *Id.*, p. 6. The California Court of Appeals reversed. *Id.*

The Court of Appeals expressly rejected the notion that in order to implicate coverage, an underlying complaint must allege claims "expressly phrased" in terms of disparagement or trade libel. Instead, if the conduct is merely implied, the duty to defend is triggered. *Id.*, p. 9. The issue was not whether the underlying claims expressly allege that Charlotte Russe disparaged Versatile's products, "but whether

the allegations may be understood to accuse" Charlotte Russe of conduct "that slanders or libels a person or organization or disparages a person's or organization's goods, products or services…." *Id.*, p. 10 (emphasis added). Here, Versatile alleged that Charlotte Russe's markdown of People's Liberation apparel caused "significant and irreparable damage to and diminution of the People's Liberation Brand and trademark," thereby harming the apparel's "marketability and salability." *Id.*, p. 9. That was enough.

> However, Versatile's pleadings alleged that the People's Liberation brand had been identified in the market as premium, high-end goods; and that the Charlotte Russe parties had published prices for the goods implying that they were not. It therefore pled that the implication carried by the Charlotte Russe parties' pricing was false. That is enough.

Id., p. 11.

The court further explained that its basis for determining coverage rested on its inability "to rule out the possibility" that someone might construe Versatile's complaint to imply an implication of disparagement claim:

> We cannot rule out the possibility that Versatile's pleadings could be understood to charge that the dramatic discounts at which the People's Liberation products were being sold communicated to potential customers the implication—false, according to Versatile—that the products were not (or that the Charlotte Russe parties did not believe them to be) premium, high-end goods.

Id., p. 12.

I can't say which is worse: basing coverage on a wink-wink—that is, on a claim that is never made, but "could reasonably be read" in the pleading as implied—or that the Court of Appeals construes discounting and markdowns as implied disparagement. (Apparently, the Court does not shop in Banana Republic or Macy's after the December holidays. One can just see the headline: J. Crew sues itself—and gets coverage!)

The court also deflected the argument that even if an implied disparagement claim could be read in the litigation, there still should be no coverage because the elements of disparagement were not plead (probably because no disparagement claim was alleged). The court reasoned that coverage still was appropriate because an "insurer's duty to defend is not conditioned on the sufficiency of the underlying pleading's allegations of a cause of action." *Id.*, p. 11.

The court also noted that there was no suggestion in the policies' definition for "personal and advertising injury" (or elsewhere) that, as a prerequisite for coverage, all of the essential elements of a trade libel must be alleged:

> The claims asserted by Versatile were sufficient to raise reasonable inferences that the Charlotte Russe parties had disparaged the People's

> Liberation products and brand, within the meaning of the policy language. As noted above, that language provides personal injury coverage for "publication of material that slanders or libels a person or organization *or* disparages a person's or organization's goods, products or services...." (Italics added.) That phraseology makes coverage for disparagement an alternative to coverage for libelous materials, not an element of that coverage. Under it, the policy covers publication of material *either* that slanders or libels a person or organization, *or* that disparages a person's or organization's goods, products or services; both are not required.

Id., pp. 12-13. (The court also fails to appreciate that disparagement of an organization's goods is trade libel, not an alternative to it. But never mind.) Underwriters, take note.

So where will *Charlotte Russe* lead us? What makes this case significant is that the underlying complaints do not allege claims for disparagement or trade libel. Nor do they allege any statements made by the insured that the claimant's products were deficient, inferior, or tawdry. They just didn't sell well and were the subject of markdowns. These facts can be easily recreated in other litigation.

It might take some time to appreciate the decision's full impact. In the meantime, here is what *Charlotte Russe* tells us: if the underlying complaint may be construed to imply a disparagement, or, in the court's own words, an insurer "cannot rule out the possibility" that the complaint "could be understood to charge" a false implication, there is a duty to defend. Here, that meant more than a markdown, it resulted in "free" coverage.

A copy of the opinion can be found at: http://www.courts.ca.gov/opinions/documents/B232771.PDF

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