

The Coverage Inkwell

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



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SWIFT DISTRIBUTION WITH SWIFT CRITICISM FOR CHARLOTTE RUSSE (AND OH, MERE PASSING OFF ISN'T TRADE LIBEL)

It's not often that a decision comes along that warrants special attention for not one, but two distinct reasons. It's like those old Doublemint gum commercials – double the pleasure, double the fun. *Hartford Cas. Ins. Co. v. Swift Distribution, Inc.*, -- Cal. Rptr. 3d --, 2012 WL 5306248 (Cal. Ct. App. Oct. 26, 2012) is one of those cases. First, *Swift Distribution* provides another reminder as to why claims of mere “passing off” (that is associating one's products with the products of another) should not constitute trade libel. In holding so, the court also does an excellent job of distinguishing the case before it from other cases previously discussed here in the Inkwell.

Second, the *Swift Distribution* court takes the opportunity to condemn (okay, that's my word) *Charlotte Russe*, a highly controversial decision also issued by the California Court of Appeal this past summer. As you may recall, *Charlotte Russe* held that a breach of contract/negligent and fraudulent misrepresentation lawsuit over the price markdown of name brand clothing constituted trade libel for purposes of triggering defense coverage under a CGL policy. (See The Coverage Inkwell's July 20, 2012 issue.) Remarkably, in *Charlotte Russe*, the underlying complaints at issue did not allege claims for disparagement or trade libel. Nor did they allege any statements made by the insured that the claimant's products were deficient, inferior, or tawdry. The products just didn't sell well and were later subject of markdowns. In finding that coverage existed, the *Charlotte Russe* court held that:

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.

The *Charlotte Russe* decision was shocking. (I, for one, never get over the looks of disbelief I receive when I lecture about this case.) Apparently, the court in *Swift Distribution* agreed, and took the opportunity to reject the reasoning behind the decision.

The *Swift Distribution* case, which involved underlying patent and trademark infringement claims levied against the insured, is as follows.

Gary–Michael Dahl (“Dahl”), who manufactured and sold the “Multi–Cart”—a cart that can be manipulated into eight configurations to move music, sound, and video equipment quickly and easily—commenced a lawsuit against the insured Swift Distribution d/b/a Ultimate Support Systems and others (collectively, “Ultimate”) for patent and trademark infringement, unfair competition, dilution of a famous mark, and false advertising arising from the insured’s sale of the product, the “Ulti–Cart.” *Id.*, *1-2. Yes, you guessed it – a copycat product. The underlying complaint alleged that the insured impermissibly manufactured, marketed, and sold the “Ulti–Cart,” thereby infringing patents and trademarks held for Dahl’s Multi–Cart, and also diluted Dahl’s “Multi-Cart” trademark. The complaint attached advertisements for the Ulti–Cart as exhibits. Notably, the advertisements did not name the Multi–Cart or Dahl, or any other product other than the Ulti–Cart. *Id.*

Dahl’s Lanham Act unfair competition claim alleged that Ultimate infringed Dahl’s patents and trademark, and that Ultimate intended to mislead the public as to the origin and ownership of rights in Dahl’s mark, and/or to mislead the public into believing that Ultimate’s products were the same as Dahl’s or were authorized by or related to Dahl’s Multi–Cart. *Id.*, *4. The complaint also alleged that Ultimate’s advertising falsely made it appear that Ultimate had designed, or was authorized to manufacture and sell, infringing products, and that the insured owned rights to the Multi–Cart. *Id.*

In its claim for false advertising, the Dahl complaint alleged that Ultimate falsely claimed to be the manufacturer, wholesaler, or importer, or otherwise owned the intellectual property incorporated into, the Multi–Cart, and that these violations caused Dahl’s potential clients to buy the Ulti–Cart instead of the Multi–Cart. The complaint further alleged that through the false designation of origin, Dahl’s intellectual property, mark, and patents were being inaccurately associated with Ultimate and its product. *Id.*

Finally, in its application for a TRO, Dahl alleged the following:

- (1) that Ultimate marketed a knock-off of Dahl’s “Multi–Cart,” and by dropping the “M” from “Multi–Cart,” adopted a nearly identical name for its cart that created a likelihood of confusion with Dahl’s “Multi–Cart” trademark;
- (2) that Ultimate’s use of a near-identical mark was detrimental to Dahl’s trade reputation and goodwill;
- (3) that if not enjoined by the court, Ultimate’s use of the confusingly

similar “Ulti–Cart” mark would cause confusion in the public and loss of sales and customers to Dahl; (4) that the infringing “Ulti–Cart” mark would be used to Dahl's detriment since he would have no control over the nature and quality of Ultimate's carts; (5) that any fault with those goods would adversely affect Dahl's future sales and would tarnish his name and reputation; (6) that industry and the consuming public recognized the “Multi–Cart” mark as associated with Dahl and as having a reputation for high quality and the patented design Dahl invented; and (7) that Ultimate's use of the “Ulti–Cart” mark and name would cause confusion or mistake, or would deceive the public as to the source of Ultimate's goods and services.

Id., *4.

The insured tendered the defense of the action to its insurer, which declined coverage. In the subsequent coverage litigation commenced by the insurer, the trial court granted the insurer's motion for summary judgment, holding there was no alleged trade libel or disparagement to implicate coverage under “personal and advertising injury.” The California Court of Appeal affirmed. *Id.*, *2.

I. The Dahl Complaint Did Not Allege Trade Libel

The insurance policy at issue defined “personal and advertising injury” to include an 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.” *Id.*, *5. The court noted that this “provision provides coverage for product disparagement, which is ‘an injurious falsehood directed at the organization or products, goods, or services of another[.]’” *Id.* (citation omitted). Disparagement or injurious falsehood may consist of publication of matter derogatory to plaintiff's title to his property, its quality, or his business. *Id.* Tortious product disparagement also involves publication to third parties of a false statement that injures the plaintiff by derogating the quality of goods or services. *Id.* Here, the court held that there were no allegations of published derogatory material.

Specifically, the court explained that a claim for injurious falsehood “must specifically refer to the derogated property, business, goods, product, or services either by express mention or reference by reasonable implication.” *Id.* Here, the Dahl complaint and Dahl's application for a TRO (as well as responses in underlying discovery) did not allege that Ultimate's advertisements specifically refer to Dahl or the Multi-Cart. *Id.* Therefore, there was no express false, derogatory statement to implicate coverage.

Nor did the court agree that the insured's use of "Ulti-Cart," a name similar to Dahl's "Multi-Cart," constitute a reference to Dahl's product by reasonable implication (that is, implied disparagement). The Court explained that even if the name could be construed as an implied reference to the Multi-Cart, there still was *no derogatory* reference to implicate coverage:

Even if the use of "Ulti-Cart" could reasonably imply a reference to "Multi-Cart," however, Ultimate's advertisement contained no disparagement of "Multi-Cart." As stated, disparagement involves "an injurious falsehood directed at the organization or products, goods, or services of another...." [Citation omitted.] The injurious falsehood or disparagement may consist of matter derogatory to the plaintiff's title to his property, its quality, or to his business in general. The advertisements for the "Ulti-Cart" did not include any of these derogations. Ultimate's advertisements referred only to its own product, the Ulti-Cart, and did not refer to or disparage Dahl's Multi-Cart. Dahl's complaint alleged that by using a product name (Ulti-Cart) that was very similar to Dahl's Multi-Cart product, Ultimate deceived the public that Ultimate was the originator, designer, or authorized manufacturer and distributor of its infringing products. This, however, was not disparagement.

Id.,*5.

Contrasting the case from *E.piphany, Inc. v. St. Paul Fire & Marine Ins. Co.*, 590 F. Supp. 2d 1244 (N.D. Cal. 2008), the Court held that there was no implied disparagement because Ultimate's advertisements never claimed that its product exceeded another in quality or performance:

The *Dahl* complaint contained no allegations that Ultimate's advertising falsely stated it was the only producer of a product with features also available on Dahl's "Multi-Cart;" that Ultimate's advertising suggested that its competitor's technology was behind that of Ultimate; or that Ultimate made false claims about the superiority of the Ulti-Cart which necessarily implied the inferiority of Dahl's competing product. Ultimate's advertisements did not disparage another's product, either expressly or by implication; they said nothing about a competitor's product.

Id.,*8.

Nor did the underlying action fit within the facts of *Michael Taylor Designs, Inc. v. Travelers Prop. Cas. Co. of Am.*, 761 F. Supp. 2d 904 (N.D. Cal. 2011), because there were no allegations

that Ultimate informed customers that its products were Dahl's, and that the products were inferior, all to the detriment of Dahl's reputation:

It does not allege that Ultimate displayed photos of the Multi-Cart in advertisements and then steered customers to purchase the Ulti-Cart, or led customers to believe the Ulti-Cart was Dahl's own product.

Id., *9. Nor, in contrast to the insured in *Burgett, Incl. v. American Zurich Ins. Co.*, 830 F. Supp. 2d 953 (E.D. Cal. 2011), did Ultimate allegedly state that it was the “only holder of the Multi-Cart trademark,” or that “Dahl did not have the rights to use the [Multi-Cart] mark.” *Id.*

Simply put, in *Swift Distribution*, we have a court concluding that advertising and selling a copycat product in violation of intellectual property and unfair competition laws, should not automatically be construed as expressly or implicitly disparaging the copied and infringed product. It seems like an obvious conclusion. Yet, not many courts have reached it.

II. *Swift Distribution Roundly Criticizes Charlotte Russe*

Perhaps what makes this decision even more relevant is its sharp criticism of the *Charlotte Russe* decision. What is more striking is the fact that after distinguishing *Charlotte Russe* from the case before it, the *Swift Distribution* court could have moved on with its analysis. It didn't. Instead, the Court went on it pan the decision. Cutting to the chase, after the *Swift Distribution* court held the case before it factually inapposite from *Charlotte Russe*, it then stated: “More importantly, we disagree with the theory of disparagement apparently recognized in *Charlotte Russe*.” *Id.*, *5.

The Court explained that “[w]e fail to see how a reduction in price—even a steep reduction in price—constitutes disparagement. Sellers reduce prices because of competition from other sellers, surplus inventory, the necessity to reduce stock because of the loss of a lease, changing store location, or going out of business, and because of many other legitimate business reasons. Reducing the price of goods, without more, cannot constitute a disparagement; a price reduction is not ‘an injurious falsehood directed at the organization or products, goods, or services of another....’” *Id.*, *5 (citation omitted). The Gap and Old Navy can breathe a sigh of relief.

Recognizing that the theory of disparagement espoused by *Charlotte Russe* would be unworkable in today's economy, the Court further observed:

A price reduction may allegedly be injurious to the brand or its high-end, high-quality reputation, but it is not false and is thus not disparagement. Such an “injury” is a common experience in the everyday world of free market competition.

Id.

Finally, the Court also raised the issue of an insured's reasonable expectations, questioning how such a claim could satisfy them. *Id.*,*7. The Court reasoned that a reduction of price could be viewed neither as a "publication" nor a reference to the claimant's products *in* the publication itself to meet the requirements of a trade libel claim:

We also question whether the insured could have objectively reasonable expectations [citation omitted] that the insurer would provide a defense and indemnity coverage for a claim made against the insured for placing goods on sale at a reduced price. The insurance policy in *Charlotte Russe* provided 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." As we have already noted, there was neither a publication nor a specific reference to the manufacturer's products. For these reasons, we reject the analysis of *Charlotte Russe*.

Hopefully, this criticism will satiate the temptation of any other court to follow *Charlotte Russe's* logic. Questions are welcome.

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