The Coverage Inkwell

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

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CALIFORNIA COURT SAYS "PALMING OFF" IS NOT SLANDER OR MISAPPROPRIATION OF A STYLE OF DOING BUSINESS

While in the car the other day, I heard on local radio the Pretenders' cover of "Thin Line Between Love and Hate." Perhaps because I now have the song's refrain glued (mercilessly) in my head, I've been thinking about a similarly thin line between concepts of counterfeiting and "palming off." This "thin line," I further believe, has led some insureds to argue that a media coverage or CGL policy should cover claims of "palming off."

After all, some courts have held that counterfeiting merchandise—the act of producing or selling a sham product that is an intentional and calculated reproduction of the genuine item—can constitute trade disparagement to implicate a duty to defend under a CGL policy. Not surprisingly, some would have the same coverage for "palming off"—whereby one holds out another's product as one's own.

In *So. Cal. Gold Prods., Inc. v. Zurich-American Ins. Group*, No. B234720 (Cal. Ct. App. May 3, 2012), the California Court of Appeals, Second Appellate Division, addressed this issue. There, it held that "palming off" does not constitute trade disparagement and, therefore, the insurers had no duty to defend. Whether the line between counterfeiting and "palming off" is thin or not, the bases of the two claims are different. In order for a duty to defend to be implicated, there must be allegations of slander or defamation, and there is none in a "palming off" claim. The court also held that "palming off" does not constitute a "misappropriation of a style of doing business." Finally, the court rightfully affirmed the trial court's rejection of the insured's attempts to bootstrap coverage though the use of affidavits and a bad faith claim.

In *So. Cal. Gold*, the underlying plaintiff, American Defense Systems, Inc. (ADSI) commenced an action against the insured, Southern California Gold Products, Inc. (SCGP), alleging that SCGP had misappropriated its trade secrets and confidential information, falsely represented on its website that it had an affiliation with the United States military, and falsely claimed that its armor solution products had been tested and approved by the military. (*Id.*, p. 1.) ADSI also alleged that SCGP's website wrongfully had used pictures of ADSI's own products to "palm off" as SCGP's own, and that SCGP falsely claimed it had an ongoing affiliation with ADSI. (*Id.*, p. 2.)

SCGP tendered a defense of the lawsuit to its insurers under their respective policies' coverage for "personal and advertising injury." The policies defined such injury to include injury arising from:

> "Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services," and "Misappropriation of advertising ideas or style of doing business" and "Infringing upon another's copyright, trade dress or slogan in your 'advertisement.'"

(*Id.*, pp. 2-3.) Reviewing the underlying complaint, both insurers disclaimed coverage. Both denial letters requested additional information from SCGP that might demonstrate coverage—requests that went unanswered. (*Id.,* p. 3.)

In the ensuing coverage litigation, SCGP moved for summary judgment, arguing that the underlying action alleged that SCGP disparaged ADSI's products. The trial court disagreed and denied SCGP's motion. The court concluded that while SCGP had been accused of wrongfully using ADSI's products to promote its own products, there were no allegations that SCGP had criticized ADSI's products.

> Here the underlying complaint does not allege that SCGP was disparaging [ADSI's] products, but that SCGP was wrongfully using [ADSI's] products, patents and contracts to promote its own products, and that SCGP had been an affiliation with [ADSI]. There was no criticism of [ADSI's] products so much as the claim that SCGP was bootstrapping its own product line onto that of [ADSI].

(*Id.*, pp. 3-4.)

After the court's denial of SCGP's motion, both insurers moved for summary judgment. SCGP opposed the motions, submitting two affidavits: one of an expert, who opined that the insurers' investigation of the claim before disclaiming coverage fell below the good faith standard of care; the other of ADSI's president, Tony Piscitelli, stating that SCGP's published statements had disparaged ADSI and misappropriated ADSI's style of doing business. (*Id.*, p. 4.) The trial court granted summary judgment, concluding that there was no coverage and that the affidavits were irrelevant and speculative.

> The court finds here that there is no misappropriation of advertising ideas or misappropriation of style of doing business alleged in the underlying complaint. An insurer has a duty to timely investigate to determine if there are extrinsic facts which would trigger a duty to defend, but this is not a continuous duty. If it has made an informed decision on the basis of the complaint and extrinsic facts known at the time of the tender, it may refuse a defense.

> The declaration of David Peterson is irrelevant because coverage is a question of law for the court to decide. Mr. Peterson has extensive qualifications, but his opinions are better suited to a bad faith case. The opinions of Tony Piscitelli are both speculative and late received with regard to [the insurers'] knowledge at the time they were evaluating coverage.

(*Id.*) The California Court of Appeals, Second Appellate District, affirmed.

The Appellate Court rejected the notion that SCGP's alleged "palming off" of ADSI's products (or photographs of such products) as SCGP's own products, and assertions of an ongoing affiliation with ADSI, constituted disparagement. The court explained that "[t]he term 'disparagement' has been held to include statements about a competitor's goods that are untrue or misleading and are made to influence potential purchasers not to buy….Where the statements are merely about the insured's own products, no disparagement claim will lie." (*Id.*, p. 6, citations omitted.)

Here, there were no such claims. To the contrary, ADSI only alleged that SCGP had misrepresented its own expertise, experience, and quality of its products, along with false assertions of SCGP's affiliations. The court explained that while such claims may represent false advertising as to SCGP's own abilities, they do not constitute a disparagement of ADSI's products or services:

> The FAC does not allege that SCGP made any derogatory comments about the quality of ADSI's products, nor does it allege that it advertised that its products were "better" than ADSI. Instead, the FAC alleges that SCGP misrepresented its own expertise and experience, misrepresented that it worked closely with the United States military, and misrepresented that its armor solutions had undergone testing and approval by the military. While these claims may represent false advertising as to SCGP's own abilities, these claims do not constitute a disparagement of the quality of ADSI's goods, products or services.

(*Id.*, p. 9.)

The court also rejected the notion that that the underlying action alleged indirect or implied disparagement. In doing so, it distinguished the case before it from *E.piphany, Inc. v. St. Paul Fire & Marine Ins. Co.*, 590 F. Supp. 2d 1244 (N.D. Cal. 2008), a California federal court decision that has received more and more attention as of late (and whose implications I discussed in a previous *Coverage Inkwell* issue). Here, the court explained that because SCGP's alleged false advertising did not assert that SCGP's products were the "only" products to achieve a certain quality, the *E.piphany* decision did not apply.

> Indirect or implied disparagement may occur where a publication does not expressly identify a product, but the product is clearly implied. …

> *E.piphany* is factually inapposite. In that case, the court found a complaint stated a potential claim for disparagement by implication where the advertisement stated that the insured falsely stated that it was the "only" company to provide a certain product. [citation omitted.] Here, the advertisement did not contain representations that SCGP was the "only" company that had worked closely with the United States military, or the "only" company whose armor solutions had undergone testing and approval by the military. Rather, the underlying complaint alleged that SCGP used photographs of ADSI products and misrepresented that they were SCGP products. At most, this constitutes a claim that SCGP "palmed off" ADSI products as its own, not that SCGP made a false or injurious statement about the quality of ADSI's products.

(*Id.,* citations omitted.) Because this was a pure "palming off" claim, there were no allegations of disparagement that could support finding of coverage.

The California Court of Appeals also held that the underlying action did not allege "misappropriation of style of doing business." The term "style of doing business" refers to "a company's comprehensive manner of operating." (*Id.*, 10, p. 10.) Here, the court ruled that there was no support for SCGP's contention that its false claims of product testing constituted a "style of doing business."

> SCGP cites no authority supporting its contention that product testing and approval by the United States military, or any other narrow component of a business's operation, constitutes a "comprehensive manner of operating." Cases which have found an overall style of doing business demonstrate the difference. In a restaurant setting, for example, such things as use of a type of furniture, a certain physical setup, an exposed cooking area, a type of music and a limited menu constituted a comprehensive manner of operating. [citation omitted.] In a retail operation, style of doing business included a "uniform plan of retailing the ice milk product in prototype buildings that are distinctive from other stores dealing in similar products." [citation omitted.] In contrast, the underlying complaint in this case contains no allegation that SCGP appropriated any element of ADSI's style of doing business but only that it made false claims concerning its own products and its own affiliations.

(*Id.*)

Finally, the court affirmed the trial court's rejection of the bad faith claim. The court explained that "[a]n insurer's duty is to conduct a *reasonable* investigation," and that if an insurer is unaware of any extrinsic facts which affect the issue of coverage, it discharges its duty by examining the facts presented

to it and the terms of the policy to determine the potential for coverage. (*Id.*, p. 11, emphasis in original.)

"The key issue in determining whether the insurer conducted a reasonable investigation is the nature of the facts known to it…. If there is nothing in those facts which suggests a potential liability under the policy, there is no duty to investigate further." (*Id,.* citation omitted.) That was the case here.

> At the time of SCGP's tender, the insurer had no facts other than those contained in the underlying complaint on which to base its coverage decision. Its request to SCGP to provide it with additional facts relevant to its coverage decision went unanswered. When the lawsuit itself raises no potential for coverage, an insurer does not have a continuing duty to investigate whether there is a potential for coverage. [citation omitted.] At that point, it is the insured's burden to bring additional extrinsic facts to the attention of the insurer.

(*Id.*)

A copy of the *So. Cal. Gold* opinion is attached.

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