

The Coverage Inkwell

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



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CALIFORNIA COURT HOLDS THAT TRADING ON SOMEONE ELSE'S REPUTATION IS NOT DISPARAGEMENT

I want to thank everyone for spreading the word about *The Coverage Inkwell*. Membership to the Inkwell is growing fast, and just recently, in the June 2012 issue of the *Policy Wording Matters* newsletter, editors of the Gen Re periodical gave the Inkwell a great review in its "Good Reading" section. It couldn't be done without you, the readers. Thank you.

Well, we now approach another August of a Presidential Election year—a traditionally slow month and, therefore, a potential killing season for politicians. In August, anything can become front page fodder. Need proof? Just Google® "Carter and the Killer Rabbit." No, it's not a Monty Python skit. Dubbed "PAWS" by the press (after JAWS), that funny bunny became an embarrassment for Jimmy Carter faster than a jack rabbit. The episode made the front page of the *Washington Post* and became fodder for Carter's opponents, who framed his presidency as weak and hapless. Carter's press secretary later wrote that this rabbit was "not one of your cutesy, Easter Bunny-type rabbits," but was going "berserk," and was a "large, wet animal, making strange hissing noises and gnashing its teeth." Tim, the Enchanter of Monty Python—who warned of the Rabbit of Caerbannog: "Look, that rabbit's got a vicious streak a mile wide! It's a killer!"—couldn't have said it better.

So, what does all of this have to do with insurance coverage? It's about the value of reputation. Reputation is essential to success in politics. It's also essential for success in business, which is why many unfair competition claims in litigation often involve allegations of injured business reputation and disparagement, even where the lawsuit itself does not assert a cause of action for slander or trade libel. In very recent years, the scope of potential disparagement claims—even when not asserted as a cause of action—also has become important in the context of insurance coverage and determining whether the underlying allegations implicate an insurer's duty to defend under an insurance policy's definition for "personal and advertising injury."

One such situation is where a claimant alleges causes of action for false advertising and unfair competition based on a company's efforts to exploit and trade on the business successes and relationships of another by passing them off as its own. This may happen when a company expands into a new market and hires employees from a competitor firmly established in the market, or where former

employees band together to create their own company, and thereafter tout past experiences—obtained while working for the competitor—as the experiences of their new company. Although such actions may constitute false advertising and unfair competition, the question remains as to whether it also constitutes disparagement to implicate insurance coverage.

In *Bullpen Distribution, Inc. v. Sentinel Insurance Company*, 2012 WL 1980910 (N.D. Cal. June 1, 2012), the United States District Court for the Northern District of California addressed this issue, holding that it did not. In that case, A.Y. International (AYI) commenced a lawsuit against its upstart competitor, the insured, Bullpen Distribution, Inc. (Bullpen), Bullpen’s president, John Brill, and against a third individual (Adelman), alleging claims for misappropriation of trade secrets, breach of fiduciary duty, intentional interference with prospective economic advantage, conversion, false advertising, and unfair competition, among other claims. *Id.* at *1. AYI alleged that Bullpen, through Brill and Adelman—both former AYI employees—had engaged in an unlawful campaign to deliberately disrupt AYI’s business and steal its customers by claiming AYI’s experience and expertise as its own. *Id.*

The complaint alleged that:

. . . Bullpen’s web site made false and misleading statements by which Defendants sought to take credit for AYI’s business practices as if they [were] their own. The Bullpen web site greeted customers with a false and misleading statement that “[s]ince 1996, the Bullpen team has been helping specialty foods manufacturers and distributors move excess inventory—quickly and with integrity.” By such false and misleading statements Defendants sought to deceive the public, including AYI’s customers and vendors, into believing Bullpen had been in business for 15 years and had a proven track record.

Id.

The AYI complaint further alleged that the web site sought to trade on the AYI’s business reputation with the assertions that: “[a]veraging 15 years’ experience ... we have built trusted relationships with large manufacturers, distributors and national discount retailers,” and that “[w]e also work with smaller, regional players—some of whom we have worked continuously with for 10 years or more.” *Id.* at *2. AYI contended that these statements were false and misleading because “these are relationships that AYI built with its vendors and customers, and Brill and Adelman’s status as former AYI employees does not give them or Bullpen the right to pass those achievements off as their own.” *Id.*

AYI also maintained that Bullpen’s website “is a direct representation that Defendants, rather than AYI, timely paid its vendors for 15 years all to the benefit of Bullpen and to the detriment of AYI. Bullpen ... does not have a 15 year track record—or any track record—of paying customers promptly. AYI has that track record.” *Id.* AYI alleged that “Defendants have benefitted from their improper activities by realizing revenue and profit that belongs to AYI,” and that Bullpen has “falsely represented that Bullpen

... is simply a continuation of AYI under a new name, and have sought to trade on AYI's business success and relationships and to pass them off as Defendants' own." *Id.*

Bullpen sought defense coverage under its business liability policy issued by Sentinel Insurance. The policy provided defense and liability coverage for "personal and advertising injury," defined in part as "[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.* at *1. The Bullpen website did not mention AYI by name. Nevertheless, Bullpen argued that the AYI lawsuit alleged disparagement and, therefore, was entitled to defense coverage.

Bullpen relied on *E.piphany, Inc. v. St. Paul Fire & Marine Ins. Co.*, 590 F. Supp. 2d 1244 (N.D. Cal. 2008)—a case discussed in prior issues of *The Coverage Inkwell*—for the proposition that disparagement by implication can implicate insurance coverage even where the claimant is not named in the alleged false advertising on the basis that the false advertising itself still diminishes the claimant's products. *Id.* at *4. (In *E.piphany*, the insured was alleged to have falsely promoted itself as the "only" developer of "all Java" and "fully J2EE" software. The California federal court held that these allegations showed disparagement by implication because E.piphany's alleged statements suggested that the claimant's products did not have the same capabilities, thereby implying that they were inferior, even though neither the claimant nor its products were named in the insured's advertisements.

Sentinel, on the other hand, argued that no coverage was owed. Relying on *Jarrow Formulas, Inc. v. Steadfast Ins. Co.*, 2011 WL 1399805 (C.D. Cal. Apr. 12, 2011) (holding underlying action did not allege disparagement or implicate coverage where alleged false advertising only addressed benefits of insured's product and did not refer to claimant's product), Sentinel argued that Bullpen was not entitled to coverage because the alleged false advertisements never referenced AYI or made comparisons between Bullpen's services and AYI's services. *Id.* at *5. Instead, the advertisements merely falsely alleged the attributes of Bullpen's business. The court agreed.

The court concluded that the AYI lawsuit only alleged that the Bullpen website falsely alleged the attributes of Bullpen's own business without referral to the business of another. Specifically, and unlike other cases in which insurance coverage was found to exist, here, AYI did not allege that Bullpen represented or implied that it was the only producer of certain products and services, that it offered products and services that were superior to those of others, or that it promoted its inferior products as its competitors' superior products. Therefore, there was no alleged disparagement, direct or implied.

In the website advertising of which AYI complains, Bullpen described itself as having the business achievements and longevity that AYI had. However, in its advertising, Bullpen did not compare itself to AYI or indicate that it was superior to AYI. Plaintiffs cite nothing to indicate that AYI described Bullpen's advertising as implying that AYI did not also have business achievements and longevity. As in *Total Call* and *Jarrow*, where the insured's false advertising did not refer to the underlying

plaintiff or its products or services, Bullpen's allegedly false advertising does not make reference to AYI, directly or by implication.

Id. (emphasis added).

What does this all mean? For one, it's nice to see a court draw the line on coverage via disparagement by implication. Although the doctrine of implied disparagement can have a broad impact on insurance coverage, the doctrine has limits.

In order for defense coverage to be implicated, the alleged false advertisement must do more than tout the insured's own products or services. It must do so at the expense of others, in a manner that casts doubts on another's products or services. Here, the California federal court held that if the insured's alleged false advertising does not try to draw a comparison with another product—however direct or indirect—there will be no disparagement claim. According to the California federal court, Bullpen's ballyhoo of touting its experience, longevity, and reliability—whether false or not—never drew a comparison with AYI. An alleged harmful effect from false advertising—without more—is not disparagement.

For this reason, there was no claim of disparagement and, hence, no coverage.

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