Liability Insurance Coverage For False Advertising Claims

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Under both federal and state law, companies may bring claims for false advertising against a competitor where the competitor's advertising overstates the attributes of its own goods or services or is otherwise misleading to the plaintiff's economic detriment. In those cases where a competitor actually denigrates or disparages the plaintiff's goods or services in an advertisement, the case for liability coverage under the advertising injury component of a CGL policy seems fairly straightforward.

But even in those cases where the competitor does not mention the plaintiff or its goods or services by name in its advertisement, or where there is no overt disparagement of the plaintiff or its goods or services by the competitor, coverage for a false advertising claim can nonetheless be established under the law that is developing in certain US jurisdictions.

Consider a situation in which a company makes the false claim that its products meet a certain industry benchmark or standard. A competitor of that company (whose products in fact meet the pertinent industry benchmark or standard) brings suit for false advertising under federal and state law. The gist of the false advertising suit is that although neither the plaintiff nor its products are identified by name in the advertisements, the company's false advertising of its own products have caused consumers to erroneously buy those products, thereby cutting into the plaintiff's sales and market share.

A key challenge in securing coverage in such a case is that the insured often must establish that its advertisements include some material that "slanders or libels a person or organization or disparages a person's or organization's goods, products or services …".

Nevertheless, the developing law in some US jurisdictions now makes it clear that a finding of such "disparagement" (sufficient to trigger coverage under a CGL policy having language similar to that cited above) can be established even where neither the claimant in the underlying false advertising case nor its products is identified by name.

For example, in Tosoh Set v. Hartford Fire Ins. Co., 2007 Cal. App. LEXIS 3542, 2007 WL 1242172 (Cal. App. 2007), the California Court of Appeal, in an unpublished opinion, held that the insured's advertisement need not mention the competitor by name in order to trigger coverage.

In Tosoh Set, the insured was sued by a third party (Applied Materials) for unfair competition and false advertising. In that lawsuit, Applied Materials alleged that Tosoh Set had falsely advertised that it designed its parts even though (according to Applied Materials) Tosoh had misappropriated design and specification trade secrets that were developed by Applied Materials. Applied Materials further alleged that Tosoh had falsely advertised that it was 'the only

company' to have developed all of the pertinent specifications and tolerances of the subject goods.

In the coverage suit between Tosoh Set and its liability carrier, the trial court held that there was no coverage under the 'advertising injury' portion of Tosoh Set's commercial general liability policy because, among other reasons, Applied Materials' complaint contained no allegation that Tosoh Set had disparaged or libelled Applied Materials' goods, products or services in any advertisement.

The Court of Appeal reversed, determining that 'disparagement' could be found even where the insured's competitor was not identified by name. The Court held that 'even when a statement falsely comparing an insured's products or services to competing products or services does not specifically name a competitor, the statement may nonetheless constitute disparagement of the competitor if the claim is a factual assertion capable of being proved or disproved'. Id. at *11-12.

One year later the US District Court for the Northern District of California, in E. Piphany, Inc. v. St. Paul Fire & Marine Insurance Co., 590 F.Supp.2d 1244 (N.D.Cal. 2008), also held that coverage for a false advertising claim would be found under a CGL-type policy where the insured had made false assertions about the characteristics of its products, even though neither the claimant in the underlying suit nor its products were mentioned by name. Coverage was sustained in that case based on the fact that the insured's false claims about its own products constituted "implied disparagements" of the claimant's products and hence triggered coverage under the personal injury and advertising injury sections of the policy. Id. at 1253-54.

In that case, E. Piphany was sued by Sigma Dynamics, Inc. ("Sigma") for false advertising and unfair competition. Sigma and E. Piphany were direct competitors in the market for customer management software. Sigma's complaint alleged, among other things, that an important differentiator between products in that market is whether the software is written in Java and is compliant with J2EE application server technology.

Sigma further alleged that E. Piphany had been falsely advertising its product suite as "all Java" and "fully J2EE", when in fact E. Piphany's products did not have these characteristics. Sigma further alleged that E. Piphany's misrepresentations about the characteristics of its products had given it an unfair and undeserved advantage over its competitors, including Sigma. Sigma alleged that E. Piphany's false advertising had damaged Sigma's market share, sales, profits and goodwill and had caused potential purchasers of Sigma's products and services to choose E. Piphany's instead of Sigma's. Id. at 1249-50.

E. Piphany was insured under a Technology Global Companion Liability Protection Policy issued by St. Paul Fire & Marine Ins. Co ("St. Paul"). Coverage under the personal injury and advertising injury sections of that policy was afforded where E. Piphany had made "known to any person or organization covered material that disparages the business, premises, products, services, work or completed work of others…"

E. Piphany tendered the Sigma complaint to St. Paul, which declined to provide coverage. Thereafter E. Piphany sued St. Paul in District Court for a determination that it was covered for the Sigma suit under the St. Paul policy. On cross-motions for summary judgment, the District

Court, applying California law, held that Sigma's false advertising claims triggered coverage under the policy.

In so ruling, the District Court found that it was immaterial that Sigma was not directly mentioned in E.Piphany's advertising:

In this case, the Policy covers the offenses of "personal injury" and "advertising injury," which are defined in the policy as "[m]aking known to any person or organization covered material that disparages the business, premises, products, services, work, or completed work of others." (Zacharski Deck, Ex. A.) The parties do not dispute that the Policy, by its explicit terms, covers "disparagement." Rather, the parties contest whether the Underlying Complaint made allegations sufficient to demonstrate a potential for "disparagement" coverage, because the E. Piphany publications alleged in the Underlying Complaint did not specifically identify Sigma or any Sigma products, but rather made allegedly false representations about E. Piphany's own products. Id. at 1251.

Taken together, these allegations show a claim for disparagement by "clear implication." Blatty, 42 Cal.3d 1044 n. 1, 232 Cal.Rptr. 542, 728 P.2d 1177. That is, Plaintiff's alleged statement that its product was, for example, "the only component-based, fully J2EE complete CRM suite available" necessarily suggests that competitor products did not have such capabilities. Plaintiff's alleged claim of having "a couple of year lead" on competitors also necessarily suggests that competitors were well behind Plaintiff in terms of technology development. In addition, the Underlying Complaint alleges that Plaintiff and Sigma were competitors, that Plaintiff's competitor's actually were selling "all Java" and "fully J2EE" software at the time of Plaintiffs misrepresentations, and that Sigma suffered pecuniary and reputational damage as a result of these purported misrepresentations. Id. at 1253.

The decision in E. Piphany was followed last year by the California Court of Appeal decision in Travelers Prop. Cas. of Am. v. Charlotte Russe Holdings, Inc., 207 Cal.App.4th 969 (2012).

In Charlotte Russe, Travelers' insured Charlotte Russe was the exclusive sales outlet for Versatile's "People's Liberation" brand of apparel. According to Versatile, 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 [its] customers to purchase such premium products at a higher price point at [its] stores."

Versatile brought the lawsuit claiming that Charlotte Russe had marketed Versatile's products in a "fire sale" manner and at "close-out" prices. Versatile alleged that Charlotte Russe's marketing practices not only violated the parties' agreement, but also would result in damage to and diminution of the People's Liberation brand and trademark.

Charlotte Russe tendered the claim to Travelers, its CGL carrier. In support of that tender, Charlotte Russe pointed to the fact that Versatile's discounting claim was based on "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." Charlotte Russe also supported its tender by pointing to evidence that such markdowns and "dramatic price reductions[s], promoted in such a manner, had the potential to have a disparaging effect on the People's Liberation brand" (emphasis added).

The Travelers' policy contained both "personal injury" and "advertising injury" liability coverage. Both provided broad offense-based coverage for claims alleging injury arising out of "oral or written … publication of material that … disparages a person's or organizations goods, products or services."

The trial court granted summary judgment to Travelers, finding no coverage under the policy. The trial court reasoned that in order to be covered Versatile's claims must amount to actionable claims of trade libel.

The Court of Appeal reversed, holding that Charlotte Russe's marketing practices could constitute an "implied disparagement" of Versatile's products and further that such a disparagement claim need not rise to the level of trade libel in order to be covered.

At the threshold, the Court held that for purposes of coverage analysis "disparagement" may be implied and that Charlotte Russe's marketing practices (which could have suggested to consumers that Versatile's products were lower-end merchandise) satisfied this requirement. As the Court explained, "the question here…is not whether the underlying claims expressly allege that the Charlotte Russe parties disparaged Versatile's products, but whether the allegations may be understood to accuse the Charlotte Russe parties of statements and conduct 'that…disparages a person's or organization's goods, products or services'." Charlotte Russe, supra, 207 Cal.App.4th at 978.

Lest it be concluded that the E.Piphany and Charlotte Russe cases are simply phenomena of the California courts, cases from other US jurisdictions are in accord with their core holdings. See, e.g., Sun Elec Corp v. St. Paul Fire & Marine Ins. Co., 1995 US Dist. Lexis 6109, 1995 WL 270230 (N.D. Ill. 1995) (in which the underlying complaint alleged that the insured claimed that its products were "more effective" or "superior" in the industry); Vector Products, Inc. Hartford Fire Insurance Company, 397 F.3d 1316 (11th Cir. 2005) (where the court found coverage, subject to exclusions, for false advertising claim even where neither competitor nor its products were mentioned in the insured's advertising); Pennfield Oil Co. v. American Feed Industry Ins. Co. Risk Retention Group, Inc., 2007 WL 1290138 (D. Neb. 2007) (finding of coverage under CGL policy where advertisements hurt the "sales, profits and good will" of another company, where other company's name not mentioned).

The lesson of these cases is that companies sued in intellectual property cases should aggressively fight for insurance coverage.