Client Alert

May 2014

California Federal Judge Rules That Carrier Owes A Duty To Defend False Advertising Lawsuits

On May 13, 2014, in *Millennium Laboratories, Inc. v. Darwin Select Insurance Company*, Case No. 12-CV-2742 H (KSC), a California federal district court ruled that Darwin Select Insurance Company breached its duty to defend Millennium in a pair of lawsuits in which two business rivals accused Millennium of false advertising, finding that the underlying lawsuits sufficiently alleged covered disparagement claims. In so doing, the court reaffirmed the longstanding rule in California that a carrier's duty to defend is broad and requires the carrier to defend where there exists a mere "potential for coverage" under the policy. Here, the court determined that the underlying actions fell within the policy's coverage of claims based on disparagement of an organization's goods, product or services, even though the underlying parties did not allege a formal disparagement-related cause of action.

Background

Millennium Labs is a diagnostics laboratory that provides specialty testing services for various health care providers. Specifically, Millennium provides analysis of urine drug testing samples. Darwin insured Millennium under a general liability insurance policy, which provided coverage for "claims alleging Personal or Advertising Injury caused by an offense that takes place during the policy period." "Personal or Advertising Injury" is defined to include, "injury, other than bodily injury, arising out of … [o]ral or written publication, in any manner, that slanders or libels a person or organization or disparages a person's or organization's goods, product or services."

Millennium tendered two lawsuits to Darwin seeking coverage under the GL policy: (1) a lawsuit brought by one of Millennium's competitors, Ameritox Ltd., which raised seven causes of action, including false advertising, tortious interference and unfair competition, and (2) a countersuit brought in a lawsuit initiated by Millennium against Calloway Labs, another competitor, wherein Calloway raised the following counterclaims: interference with contractual relations, unjust enrichment and unfair and deceptive practices in violation of a state statute. Neither lawsuit contained a specific disparagement-related cause of action. Instead, the court focused on the following key factual allegations, which were alleged in both lawsuits: "In [Millennium's] 2012 Annual Meeting Millennium's general counsel prepared a power point presentation documenting its marketing strategy through litigation…. By literally showing [Ameritox/Calloway] as a target in a firing range with gunshots heard in the background and then in a body bag with toe tags [hanging from it] … Millennium's general counsel stated that Millennium's goal was to see to it that [Ameritox/Calloway] was put out of business." Darwin responded to Millennium's tender by stating that neither lawsuit was covered under its policy "on the grounds that those actions did not allege any instances of Personal or Advertising injury within the meaning of the policy."

Court's Ruling

In granting Millennium's motion for summary judgment, United States District Judge Marilyn L. Huff reaffirmed California's broad duty to defend standard, including that "an insurer must defend its insured against claims that create a potential for indemnity under the policy" and that "the precise causes of action pled by the third party complaint may fall outside policy coverage does not excuse the duty to defend where, under the facts alleged, reasonably inferable, or otherwise known, the complaint could be

fairly amended to state a covered liability." In applying this standard, the court determined that the underlying third parties' allegations, that Millennium engaged in a concerted effort to attack its competitors through its marketing efforts by stating that its competitors engaged in "bad science" and harmed patients, fell within the policy's coverage of claims based on disparagement of an organizations' goods, product or services. Therefore, the court ruled that Darwin owed Millennium a defense and the question of whether Darwin may have engaged in bad faith conduct is a triable issue of fact for a jury to determine.

Implications

Most standard form GL policies typically do not afford coverage for claims alleging unfair competition and false advertising. *Millennium* significantly broadens the scope of coverage available under those policies by extending the carrier's duty to defend beyond straightforward defamation cases to now include cases alleging unfair competition, false advertising and trademark infringement where the lawsuit contains implied disparagement allegations. *Millennium* is one in a series of fairly recent decisions interpreting the scope of coverage for "implied disparagement" claims under California law. Indeed, the California Supreme Court is expected to clarify the scope of insurance coverage for "implied disparagement" shortly in *Hartford Casualty Insurance Co. v. Swift Distribution Inc*., Case Number S207172.

Millennium also serves as yet another reminder that insurance coverage does not depend solely on the stated causes of action and that coverage may be available even for uncovered causes of action where there also exist factual allegations that have the potential to support a covered claim. Companies should review all complaints (and any counterclaims) carefully and consider all possible bases for liability when assessing the potential for insurance coverage, as the carrier may still have a duty to defend a lawsuit that only alleges uncovered causes of action if the allegations are sufficiently broad enough to create a potential for covered liability.

Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken, II
lbracken@hunton.com

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehniger@hunton.com

William T. Um
wum@hunton.com