SHORT FORM ORDER

INDEX No. 97-7448

SUPREME COURT - STATE OF NEW YORK
I.A.S. PART 43 - SUFFOLKCOUNTY

P R E S E N T :

Hon. ARTHUR G. PITTS
Justice of the Supreme Court

MOTION DATE 8/21/02
ADJ. DATE 6/19/03
Mot. Seq. # 004 - MotD

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AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY,

Plaintiff,

- against -

QUALITY KING DISTRIBUTORS, INC.,

Defendant.

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RIVKIN RADLER LLP
Attorneys for Plaintiff
EAB Plaza
Uniondale, New York 11556-0111

EDWARDS & ANGELL, LLP
Attorneys for Defendant
750 Lexington Avenue
New York, New York 10022

Upon the following papers numbered 1 to 39 read on this motion for summary judgment; Notice of Motion/ Order to Show Cause and supporting papers 1 - 20; Notice **of** Cross Motion and supporting papers _____, Answering Affidavits and supporting papers 21 - 36; Replying Affidavits and supporting papers _____; Other 37 - 39; (~~and after hearing counsel in support and opposed to the motion~~) it is,

ORDERED that this motion by the defendant, Quality King Distributors, Inc. (hereafter Quality King) for summary judgment in this action for a declaratory judgment and to have the record herein sealed is considered under CPLR 3212 and is decided as follows:

This action for a declaration that plaintiff insurer does not have to defend and indemnify defendant in an action brought against it by The Procter & Gamble Company (hereafter P&G) in the United States District Court for the Eastern District of New York was decided after reargument by order of the Second Department Appellate Division, dated October 15, 2001, which held that:

> Procter & Gamble alleged that the defendant used its trademark or dress mark in connection with the defendant's sale or advertising of the counterfeit "Head & Shoulders" shampoo. Because the allegations of the complaint expressly alleged that the defendant's advertising activities violated Procter & Gamble's trademark, the allegations potentially bring the claim within the protection purchased. Therefore, contrary to the determination of the Supreme Court, the plaintiff is obligated to defend the defendant in the underlying action ... Based on the record before us, we do not reach the issue of whether the plaintiff has a duty to indemnify the defendant in the underlying action.

In the United States District Court action by order dated December 4,2000, Judge Spratt found that defendants, including Quality King, violated 15 USC § 1114(1) prohibiting trademark infringement and that P & G was entitled to judgment as a matter of law on the issue of liability under that statute. The statute known as the Lanham Act provides that civil liability attaches to any person who without the consent of the trade mark registrant uses in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services, thereby causing consumer confusion. The court recited that Quality King had sold the counterfeit bottles of "Head & Shoulders" shampoo to Kroger, a grocery store. The court set the matter down for selection of a jury to try damages ***(Procter & Gamble Co. v Quality King Distributors, Inc.,*** 123 FSupp2d 108, 62 USPQ2d 1006). Thereafter on January 10,2001, Quality King settled the matter with P&G for $500,000.00 over time plus interest.

Quality King now seeks judgment against plaintiff for attorney's fees and costs in the P&G case in the amount of $423,333.86; for attorney's fees and costs in this matter in the amount of $99,217.48; and for damages in the P&G matter in the amount of $500,000.00 plus interest.

Plaintiff counters that issues of fact exist as to the reasonableness and necessity of the attorney's fees, and that defendant has failed to set forth the proof required for such recovery. Regarding the issue of the settlement damages, plaintiff argues that the insurance policy only provides coverage for damages caused by advertising, and since the actual facts upon which liability was based have not been established, summary judgment is inappropriate. In any case there are exclusions under the advertising injury endorsement which bar coverage. The policy applies to an advertising injury caused by an offense committed in the course of advertising your goods, products or services. "Advertising injury" is defined under the policy as an injury arising out of one or more of the following offenses:

a. 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;
b. Oral or written publication of material that violates a person's right of privacy;
c. Misappropriation of advertising ideas or style of doing business; or
d. Infringement of copyright, title or slogan.

The law is clear that if the claims asserted in the complaint, though frivolous, are within policy coverage, the insurer must defend irrespective of ultimate liability. A declaration that an insurer is without obligation to defend a pending action can be made only if it can be concluded as a matter of law that there is no possible factual or legal basis on which the insurer might eventually be held to be obligated to indemnify the insured under any provision of the insurance policy. The duty to defend is measured against the allegations of pleadings, but the duty to pay is determined by the actual basis for the insured's liability to a third person. There can be no duty to indemnify unless there is first a covered loss (***Servidone Constr. Corp. v Security Ins. Co. of Hartford,*** 64 NY2d 419,488 NYS2d 139,477 NE2d 441). Unlike in Servidone, where the lower court could not conclude from the summary judgment submissions that coverage had been established as a matter of law, here the United States District Court concluded that liability for trademark infringement was based on the sale of a counterfeit product by Quality King. Although the pleadings included allegations of advertising activities, such was not the basis for liability but rather, as noted above, only the basis upon which the Second Department Appellate

Division concluded that plaintiff was required to defend.

Defendant counters that any liability for trademark infringement necessarily falls within the ambit of the advertising injury endorsement of the standard general commercial liability policy and cites to ***Allou Health & Beauty Care, Inc. v Aetna Cas. and Sur. Co.*** (269 AD2d 478, 703 NYS2d 253), in which the Appellate Division, Second Department held that the ordinary meaning of the phrase "misappropriation of advertising ideas or style of doing business," found in the standard advertising injury endorsement, can include the alleged misuse of another's trademark. However, the court also found that there was at bar a sufficient causal connection between the injury alleged in the underlying action and plaintiff's advertising activities to afford coverage under the policy. More broadly in 1996, an Illinois Court, ostensibly applying New York law, held that where the policy defines advertising injury to include the misappropriation of advertising ideas or style of doing business, it encompasses trademark infringement from the mere sale of a counterfeit or knock-off product (***B.H. Smith, Inc. v Zurich Ins. Co., 285*** IllApp3d 536, 676 NE2d 221). The Illinois court held that it would be artificial to deny coverage by constructing a distinction between the injuries arising from the manufacture and sale of infringing goods and injuries arising from the marketing of these same goods by means of display or advertisement of the goods, citing to ***Massachusetts Bay Insurance Co. v Penny Preville, Inc.,*** No. 95 Civ 4845, 1996 WL 389266, SDNY, July 10, 1996 ***(B.H. Smith, Inc. v Zurich Ins. Co., supra,*** 540). However, in ***B.H. Smith*** and ***Massachusetts Bay,*** it was clear that the insured had engaged in distinct advertising activities, not just the sale of the counterfeit product to a retail store. In ***Energex Systems Corp. v Fireman's Fund Ins. Co.,*** 1997 WL 358007, SDNY, also cited in ***Allou***, where the United States District Court held that trademark infringement necessarily implies some communication between seller and consumer, the court found that the insured had advertised by mailing brochures and price lists to potential customers even though the complaint did not include such allegations. In ***Energex Systems*** and ***Massachusetts Bay,*** the court did not rule concerning the duty to indemnify. In ***B.H. Smith,*** although the court did not discuss the duty to indemnify, it granted judgment for a $50,000.00 settlement.

Although research has not yielded a case on point, this court finds that the duty to indemnify under the standard "advertising injury" endorsement requires a stricter showing than the duty to defend. It requires not only that the insured's offense is one enumerated in the policy's definition of "advertising injury" but that it was committed by the insured in the course of advertising its goods, products or services ***(A. Meyers & Sons Corp. v Zurich Am. Ins. Group***, 74 NY2d 298, 546 NYS2d 818, 545 NE2d 1206; ***GRE Ins. Group v GMA Accessories, Inc.,*** 180 Misc2d 927, 691 NYS2d 244) or that at least the insured engaged in some advertising activity. Although it may not require a showing that the actual injury occurred from the advertising as opposed to the sale, as such a distinction may, as a practical matter, be impossible to prove, the insured must have engaged in some marketing or promotional activity to trigger the endorsement. The plain meaning of the word "advertise" does not merely include the placing of a product with a label on a shelf for sale, **it** requires an act to induce the consumer to purchase the product.

Here settlement occurred after liability was determined, based on the sale of the counterfeit product. The United States District Court made the following factual finding concerning the origins of the counterfeit shampoo and the role of defendant, Quality King:

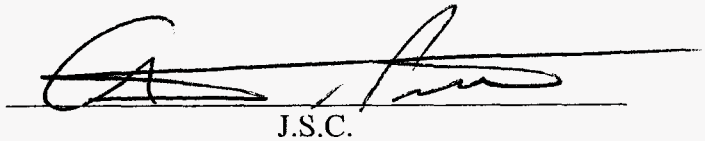
In late 1994 or early 1995, defendant Paul Doubilet ("Doubilet"), of defendant A Gruda Products Co. ("Gruda"), approached defendant Ayesha Alam ("Alam"), a chemist and former Ianco employee, and asked her to fill roughly 30,000 bottles with blue shampoo. Alam obtained eight drums of P & G waste, containing a form of Head & Shoulders, from Ianco and mixed the contents with four drums of water and salt. She was able to fill 10,000 of the bottles with this mixture. Alam filled the remaining 20,000 bottles with shampoo blends that she had received from a variety of companies and to which she added blue coloring. Doubilet sold the 30,000 bottles of blue shampoo to defendant Frank Pandullo ("Pandullo"). Pandullo sold the 30,000 bottles of shampoo to defendant Beverly Zoeller ("Zoeller") of defendant Zoeller International Trading, Inc. At the time of the sale, the bottles were labeled as Head & Shoulders. Zoeller resold the shampoo to defendant Salvatore ("Sal") Arzillo ("Arzillo"), the owner and operator of Rapid Air & Ocean, Inc. ("Rapid Air") and Southern Trading International, Inc. ("Southern Trading"). Arzillo sold the shampoo to Omni, and Omni sold it to David Rothenberg ("Rothenberg") at defendant Quality King. In turn, Quality King sold approximately 14,400 bottles of shampoo bearing the Head & Shoulders label to Peyton's, which is an operating division of the grocery store, The Kroger Company. In 1995, P & G received several consumer complaints regarding bottles of alleged Head & Shoulders that had been purchased from Kroger stores ***(Procter & Gamble Co. v Quality King Distributors, Inc.***, *supra*, 110).

These findings constitute the factual basis upon which liability was found and are the law of the case. Accordingly, this court finds that Quality King's act of reselling the counterfeit shampoo to a retailer while a trademark infringement under the Lanham Act does not come within the ambit of the advertising injury endorsement because there is no factual finding that the insured marketed the product. Accordingly, there is no duty to indemnify.

However, plaintiff clearly had the duty to defend and, accordingly, is liable for reasonable counsel fees in the P&G action as well as the declaratory judgment action ***(GRE Ins. Group v GMA Accessories, Inc.***, 180 Misc2d 927, 691 NYS2d 244). Plaintiff **postures** that it has not had the opportunity to conduct discovery of the P&G litigation file. However, Quality King presents proof that it was given the opportunity to do so. Quality King has also submitted the invoices in support of the requested fees. Given the protracted nature of the litigation and the significant amount of the fees and invoices, the matter is referred to the Honorable Harry Seidell, JHO, to hear and determine (CPLR 4317[b]).

Finally, the record is sealed as to the settlement agreement and all documents herein that reference the terms of the agreement.

Dated: August 20.2003



J.S.C.

____ FINAL DISPOSITION __X__ NON-FINAL DISPOSITION