

Natural Organics, Inc. v Onebeacon Am. Ins. Co.

2011 NY Slip Op 30240(U)

January 20, 2011

Sup Ct, Nassau County

Docket Number: 012763/2010

Judge: Ira B. Warshawsky

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SHORT FORM ORDER

**SUPREME COURT: STATE OF NEW YORK
COUNTY OF NASSAU**

**HON. IRA B. WARSHAWSKY,
Justice.**

TRIAL/IAS PART 7

NATURAL ORGANICS, INC.

Plaintiff,

INDEX NO.:012763/2010
MOTION DATE: 11/3/10
SEQUENCE NO. : 01, 02

- against -

ONEBEACON AMERICA INSURANCE CO.,

Defendants.

The following documents were read on this motion:

Motion by Plaintiff for Partial Summary Judgment for Defense Costs 1
 Plaintiff's Memorandum of Law in Support of Summary Judgment Motion 2
 Affirmation in Opposition to Plaintiff's Motion for Partial Summary Judgment 3
 Defendant's Motion for Summary Judgment..... 4
 Affidavit of Janet Hansmeier in Support of Defendant's Motion 5
 Memorandum of Law in Support of Defendant's Motion for Summary Judgment 6
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 Plaintiff's Memorandum of Law in Opposition to Defendant's Motion 8
 Plaintiff's Reply Memorandum of Law in Further Support of Motion 9
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 Affirmation in Opposition to Request for Commercial Division Assignment 13

PRELIMINARY STATEMENT

Plaintiff moves for partial summary judgment in the form of a declaration that defendant is obligated to pay plaintiff's defense costs and breach of contract for failure to provide a defense in an action brought against it in United States District Court, EDNY, *Nature's Plus Nordic A/S and Dermagruppen A/S v. Natural Organics, Inc., House of Nature A/S and Hans Kare Lundestad*. Defendant's moves for dismissal of the complaint, or, alternatively, for a protective order.

BACKGROUND

Plaintiff contends that as a matter of law, based upon a reading of the pleadings in the federal action and the terms of the policy, defendant OneBeacon is obligated to provide a defense to the defendants in that action. OneBeacon issued Policy No. 711-01-02-81-00001 to Natural Organics for the period November 30, 2008 to November 30, 2009. (Exh. "A" to Affirmation of Janet Hansmeier in Support of Defendant's Motion). Plaintiff notified Defendant of the existence of the federal litigation by letter dated October 12, 2009. Defendant denied coverage by letter dated November 17, 2009, on the ground that the underlying complaint did not allege "personal and advertising injury" within the meaning of the policy. Furthermore, defendant claimed that, even if the complaint alleged personal and advertising injury, the allegation that it knowingly did so brought it within the policy exclusions for knowingly violating the rights of another, publishing material with knowledge of its falsity, and breach of contract. Requests by plaintiff's insurance broker and plaintiff itself for reconsideration were denied by letters from defendant dated January 31, 2010 and June 1, 2010.

DISCUSSION

Commercial Division Jurisdiction

Defendant objects to assignment of the matter to the Commercial Division based upon the language of 22 NYCRR § 202.70 (c)(2), which excludes from consideration cases which seek a declaration of insurance coverage for personal injury or property damage. Plaintiff seeks coverage under the Personal and Advertising Injury terms of the policy. (Exh. 3 to Plaintiff's Motion). The question is whether the term "personal injury or property damage" in § 202.70

(c)(2) is interchangeable with the term “personal and advertising injury” as referred to in the policy. The Court concludes that the latter term, while incorporating bodily injury, is substantially more expansive. The term in § 202.70 is limited to the traditional notions of bodily injury, in addition to property damage. The policy definition includes “bodily injury”, but only as a corollary of false arrest, malicious prosecution, wrongful eviction, slander or libel, publication of disparaging material, publication of material which violates a right of privacy, misuse of another’s advertising ideas, copyright infringement, trade dress or slogan in advertising.

In the underlying case, plaintiffs are not seeking damages for personal injury or property damage within the traditional concepts as intended by the exclusionary language of § 202.70. A review of the underlying complaint substantiates this conclusion. (Exh. 4 to Motion by Plaintiff). The claims are breach of contract, violation of the New York franchise disclosure statute, N.Y. Gen. Bus. Law Article 33 §§ 680 — 695, interference with prospective contractual relations, interference with prospective economic advantage, and breach of fiduciary duty. There is no claim of bodily injury or physical injury to property, such as are intended in the language of the Rules of the Commercial Division.

The matter is appropriate for consideration by the Commercial Division.

Allegations of the Underlying Complaint

Plaintiffs, Nature’s Plus Nordic A/S (“NPN”) and Dermagruppen seek relief against the actions of Natural Organics, Inc. (“NOI”), House of Nature A/S (“HON”), and a former employee of plaintiffs, Hans Kare Lundestad. NPN is a Norwegian company which is part of the Dermagruppen family of companies. Dermagruppen’s business includes sales of skin care, makeup, and health supplements in the Nordic region. Following Dermagruppen’s acquisition of NPN they appointed defendant Lundestad its Managing Director. He had been the Business Development Manager at Benevo, the former name of NPN. In this capacity he was in a fiduciary relationship with both Dermagruppen and NPN. Because of failure to meet target business objectives, and other reasons, Dermagruppen asked Lundestad to resign his position with NPN. His resignation was effective June 19, 2009.

NOI is a manufacturer of health supplement products which are sold under various trade

names, including "Nature's Plus". On or about December 1, 2007 Benevo entered into a sole distributorship agreement with NOI. Benevo was to serve as the exclusive distributor of NOI's products in Norway, Sweden, Denmark and Finland. The original term was for ten years, with additional ten-year options.

In or about May 2008 the shareholders of Benevo invited Dermagruppen to acquire shares in Benevo. In June 2008, while the acquisition was pending, Dermagruppen forwarded \$525,000 to Benevo for ongoing operating expenses. In August Dermagruppen provided an additional loan of \$171,000 and exercised its right to convert an existing loan into equity, making Dermagruppen a 96% owner of NPN. It was at this juncture that Lundestad became Managing Director of NPN.

During his tenure in that position, Lundestad had access to confidential information and was subject to Dermagruppen's confidentiality policy. After his discharge and forced resignation effective June 2009, Lundestad formed HON, a distributor in the health food and therapy field, making it a direct competitor of NPN in the Nordic market. A press release stated that, at the request of NOI, NON had taken over the exclusive distribution rights of Nature's Plus in the Nordic region, replacing NPN as sole distributor.

Plaintiffs allege that Lundestad used his relationship with NOI, developed during his tenure as Managing Director of NPN, as well as confidential, proprietary and trade secret information, to negotiate a sole distributorship agreement for Nature's Plus products in the Nordic region. Despite his contractual obligations to the contrary, he used confidential, trade secrets and trade secret information to conspire with NOI to terminate the Agreement with NPN.

HON, Lundestad's company, distributed the press release announcing the replacement of NPN by HON as the exclusive distributor of Nature's Plus products in the Nordic region. By letter dated August 6, 2009 NOI sought to terminate its relationship with NPN. The letter of notification stated that the basis for the termination was the failure of Benevo to meet the contractual minimum sales agreements for the period January 1, 2008 through December 31, 2008. Plaintiff states that the minimum requirement pursuant to the contract was for Benevo to purchase \$600,000 of NOI product during that period. They further claim that the contractual minimum was surpassed, with sales by NOI to NPN in excess of \$700,000. Despite obligations to the contrary, NOI allegedly did not give NPN the requisite notice and opportunity to cure as

provided for in the Agreement. As of August 13, 2009 HON held itself out as the sole distributor of Nature's Plus products.

Plaintiff contends that the effect of the breach of agreement by NOI has been to terminate virtually all of their sales of Nature's Plus products in the region. The agreement was written so as to continue the relationship until December 31, 2017, with potential 10-year renewals. They contend that the total Nordic market for health foods is approximately \$1.54 billion USD, and that they expected that their annual share of the market with the relationship with NOI would have been in the range of \$1.36 million. NPN is unable to sell the substantial inventory in its possession because of the reluctance of purchasers to act in the absence of a guaranteed long-term relationship.

Based upon the foregoing, plaintiffs Nature's Plus Nordic and Dermagruppen assert the following causes of action:

FIRST: Unfair competition under 15 U.S.C. § 1125 (a) in that the NOI press release was a false and misleading description of fact likely to cause, and which has caused, confusion and mistake, and deceives consumers as to the relationship between HPN, HON, and NOI;

SECOND: Unfair competition under 15 U.S.C. § 1125 (a) against House of Nature A/S in that HON misrepresented itself as the sole distributor of Nature's Plus products, which was likely to cause and did cause confusion and mistake and has deceived consumers as to relationship of NPN, HON, and NOI.

THIRD: Breach of Contract against Natural Organics, Inc, in that NOI's actions constituted a material breach of the agreement with NPN, causing irreparable harm to NPN and Dermagruppen;

FOURTH: Violation of N.Y. Gen. Bus. Law Art. 33, claiming that the arrangement between NOI and NPN is a franchise agreement, requiring distributor to expend a portion of their net purchases on advertising for each contract year, with limitations on the type of advertising and documentation, the use of NOI trademarks, and minimum sales requirements. Plaintiff asserts that NOI has failed to satisfy the disclosure requirements of Gen. Bus. Law § 683, and their actions constitute fraudulent and unlawful practices under Gen. Bus. Law § 687;

FIFTH: Interference by HON and Lundestad with NPN's contract with NOI;

SIXTH: Plaintiffs allege that they had valid contracts and business relationships with customers and prospective customers in Norway, Sweden, Finland and Denmark, all of which were known to HON and Lundestad. Despite this knowledge, HON and Lundestad intentionally and maliciously interfered with these relationships, and that this conduct involved the misappropriation of confidential information, unfair competition, and other tortious conduct. As a result, plaintiffs demand compensatory and punitive damages;

SEVENTH: Tortious interference with prospective economic advantage in that NPN and Dermagruppen had a reasonable expectation of economic advantage with past and present customers, but, that such advantage was lost because of the actions of Lundestad and HON, who intentionally interfered with NPN's prospective contractual relationships with customers of Nature's Plus products. The misappropriation involved misappropriation of confidential information, unfair competition and other tortious conduct. Plaintiffs seek compensatory and punitive damages.

EIGHTH: HON and Lundestad intentionally interfered with plaintiffs' contract with NOI.

NINTH: Tortious interference with NPN's contracts and business relationships on the part of Lundestad, which involved the misappropriation of confidential information, unfair competition and tortious conduct;

TENTH: Tortious interference with prospective economic advantage by HON and Lundestad, which were lost by the conduct of Lundestad and HON, involving misappropriation of confidential information, unfair competition and tortious conduct.

ELEVENTH: Breach of fiduciary duty against Lundestad by virtue of his misappropriation of confidential, proprietary, and trade secret information of NPN and Dermagruppen in order to willfully and maliciously interfere with NPN's contractual relationships.

TWELFTH: Violation of the Norwegian Marketing Practice Act against Lundestad. The Act prohibits a current or past employee from using confidential, proprietary, or trade secret information belonging to an employer, or knowledge or know-how gained from an employer to compete directly with that employer. Lundestad's conduct allegedly violated at least section 25

of the Act.

THIRTEENTH: Misappropriation of Confidential Information and Trade Secrets against Lundestad.

Claims Against Natural Organics, Inc.

The claims against which Natural Organics, Inc. must defend are contained in the following causes of action:

- FIRST: Unfair Competition Under 15 U.S.C. § 1125 (a);
- THIRD: Breach of Contract with NPN against NOI;
- FOURTH: Violation of Gen. Bus. Law §§ 683 and 687, consisting of failure to comply with franchise disclosure requirements and fraudulent and unlawful practices;

The Policy

Plaintiff annexes as Exh. "2" to its motion, a copy of Policy Number 711-01-02-81-0001, issued by OneBeacon to Natural Organics, Inc., for the period from November 30, 2008 through November 30, 2009. The policy includes Commercial General Liability Coverage, providing, among other coverages, damages for bodily injury and property damage. There is a separate coverage for Personal and Advertising Injury in the amount of \$1,000,000. It is under this form of coverage, Coverage B at p. 5 of the Commercial General Liability Form, that plaintiff seeks a declaration that defendant OneBeacon is obligated to provide a defense under the terms of the policy.

The term "personal and advertising injury" is defined at p. 5 of the Commercial General Liability Form, and amended in an Endorsement to the policy, a copy of which is annexed as Exh. "3" to plaintiff's motion. The definition as amended, to the extent relevant for this motion, is as follows:

14. "Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following offenses:

...

d. Oral or written publication of material that slanders or libels a person or organization. This does not include any slander or libel related to the actual or alleged infringement or violation of any intellectual property rights or laws;

e. Oral or written publication of material that disparages a person's or organization's goods, products or services. This does not include any disparagement related to the actual or alleged infringement or violation of any intellectual property rights or laws;

...

Plaintiffs assert that the allegations of the complaint in the underlying action, alleging that the representations made by plaintiff in its press release, in which they identify HON as the exclusive distributor of Nature's Choice products in the Nordic Region, are sufficient to trigger the obligation of defendant to, at the least, provide a defense to NOI in that action. Defendant argues to the contrary, that the assertion that HON was the sole distributor, to the exclusion of NPN, does not constitute libel or slander and does disparage NPN's product.

An Insurer's Duty

An insurer is bound to undertake the defense of an action in which at least one of the allegations of the complaint is within the coverage of a liability insurance policy, even though other allegations may not be. (*Villa Charlotte Bronte, Inc. v. Commercial Union Ins. Co.*, 64 N.Y. 2d 846 [1985]). It is well recognized that an insurer's duty to defend is broader than its duty to indemnify. (*Nationwide Insulation & Sales, Inc. v. Nova*, 74 A.D.3d 1297, 1298 [2d Dept. 2010]). To be relieved of its duty to defend on the basis of a policy exclusion, the insurer bears the burden of demonstrating that allegations of the complaint are wholly within the language of the exclusion. (*Exeter Building Corp. v. Scottsdale Insurance Company*, 2010 WL 5141880n[2d Dept. 2010]).

In this case, OneBeacon does not rely upon an exclusion under the policy; rather, it asserts that the language of the complaint does not assert any factual basis upon which the insurer might be eventually obligated to indemnify the insured, and, therefore, there is no obligation to provide a defense. This, they claim, is so because the policy covers libel, slander and disparagement of product, and that NOI is not accused of doing any such thing. They are accused of breach of contract, which is an exclusion, and asserting in a press release that HON is the sole authorized distributor of their Nature's Plus products in the Nordic region. The issue is whether, under any reasonable interpretation of the policy, a statement which, in effect, states that the

Nature's Plus products sought to be sold by NPN, are somehow "unauthorized", could be considered a libel, slander, or disparagement of the inventory of products which NPN has accumulated, and, as they allege, are unable to sell in the Nordic market.

The tort of trade libel or defamation is the knowing publication of a false matter, derogatory of the business of another, and calculated to prevent or interfere with relationships between the plaintiff and others, to the detriment of the plaintiff. Plaintiffs in the underlying action allege that the termination by NOI of its contract with NPN was knowingly based upon a false premise, and NOI was fully aware that there had been no failure to meet sales quotas as claimed in the termination letter. While this breach is not covered by the policy of insurance, the pronouncement shortly thereafter that HON, Lundestad's company, was the exclusive distributor of Nature's Plus products in the Nordic Region, could be interpreted as knowingly false and calculated to hurt the business of Nature's Plus Nordic and Dermagruppen. This may well, under all the circumstances, constitute an untrue statement, made with knowledge that it is untrue, published to a third party, and done for the purpose of causing economic damage to another, and productive of special damages.

Special damages are limited to losses having pecuniary or economic value, and must be "fully and accurately stated". (*Drug Research Corp. v. Curtis Publishing Co.*, 7 N.Y.2d 435 [1960]). In the underlying action, plaintiffs have specifically enumerated the sales value of the Nature's Plus products in the Nordic region. It is clear that the press release constituted a publication to third persons, with the express intention of causing distributors and individual purchasers to deal with HON, to the exclusion of NPN, insinuating as it does, that the product acquired from any distributor other than HON was an unauthorized product. It is reasonable that consumers would be unwilling to deal with a supplier whose source of product was either improper or short-lived.

The foregoing allegations fall within the coverage provided for product disparagement or trade libel. Defendant OneBeacon America Insurance Co. is therefore obligated to provide a defense to Natural Organics, Inc. in the action entitled *Nature's Plus Nordic A/S, and Dermagruppen A/S v. Natural Organics, Ind., House of Nature A/S, and Hans Kare Lundestad*, pending in United States District Court, Eastern District of New York, under Case No. 09-4256.

Defendants contention that the policy exclusion of claims of intentional misconduct is without merit. They have not met their burden of establishing that, under no circumstance, could the obligation to indemnify NOI arise. As NOI has pointed out, their termination of the exclusive distribution contract with NPN may conceivably have been done in good faith, reasonably believing that the HON, or its predecessor, had failed to meet the minimum sales requirements. In such case, their conduct would not necessarily be intentional or malicious so as to trigger the exclusion in the policy.

Defendants' motion for summary judgment is denied.

This constitutes the Decision and Order of the Court.

Dated: January 20, 2011


J.S.C.

ENTERED
JAN 28 2011
NASSAU COUNTY
COUNTY CLERK'S OFFICE