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Amending the Complaint Won't Amend the Policy

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In a recent decision, the California Court of Appeal, Second Appellate District, has held that an insured cannot state a claim for breach of contract or bad faith based on an insurer's refusal to defend, where the underlying action was not potentially covered because it involved allegations of misrepresentations regarding the quality of the insured's own products. An insurer's demurrer to the "duty to defend" complaint was sustained by the trial court without leave to amend.

In its de novo review, the Court of Appeal took into consideration the insured's complaint, the complaint in the underlying lawsuit, and the policy itself before finding that the underlying lawsuit simply was not the type of lawsuit covered by the policy. *Total Call International v. Peerless Insurance Company*, B212923 (Los Angeles Sup. Ct. Case No. BC396192), filed January 21, 2010.

Total Call International ("TCI"), a provider of long-distance phone cards, filed a complaint for, inter alia, breach of contract and bad faith against its insurer, Peerless Insurance Company ("Peerless"), after Peerless refused to defend TCI in a lawsuit regarding TCI's advertising practices.

The commercial general liability policy issued to TCI by Peerless provided coverage for amounts TCI might incur as damages due to "personal and advertising injury," and provided that Peerless would have the duty to defend TCI in any suit seeking those damages. "Personal advertising injury" was specifically defined, in pertinent part, as injury arising out of publication that "slanders or libels a person or organization or disparages a person's or organization's goods, products or

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services." The policy specifically excluded coverage for any advertising injury arising out of the "failure of goods, products or services to conform with any statement of quality or performance made in [the insured's] 'advertisement.'"

In the underlying lawsuit, two of TCI's competitors, IDT Telecom and Union Telecard Alliance (collectively, "IDT"), alleged that TCI misrepresented the performance and value of its own phone cards, thereby damaging IDT's sales, market share, and reputation as the leader in phone card value. Specifically, IDT alleged that TCI systematically lied to consumers about the number of calling minutes they would receive on a TCI phone card of a certain price. Peerless refused to defend TCI, asserting that there was no coverage under the policy for this type of lawsuit. TCI eventually settled with IDT and sued Peerless for refusing to provide a defense.

In reviewing TCI's complaint de novo, the Court did not limit its review to the facts pled in the complaint itself. Rather, the Court also turned to the policy and to IDT's complaint, as these documents constituted the "foundation" of TCI's duty to defend claims and were "incorporated" into TCI's complaint. Based on its review of these documents, the Court found that there was "no basis for policy coverage" and held:

First, IDT's lawsuit did not fall within the policy definition for "personal and advertising injury" because it was not based on disparagement or trade libel against another entity's products, but rather on TCI's false advertisement of TCI's own products.

Second, coverage was precluded under the "nonconformity" exclusion because IDT's lawsuit centered upon the disparity between TCI's phone cards as advertised and the actual performance of those phone cards. The Court held that this provision was not ambiguous, and even if it were, that ambiguity could be resolved by the Court as a matter of law.

Third, the Court upheld the trial court's decision to sustain Peerless' demurrer without leave to amend because TCI offered "no allegations to support the possibility of amendment and no legal authority showing the viability of new causes of action."

For additional information on this issue, contact:

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