No Breach of Settlement Agreement Where Conduct Not Prohibited by Non-Disparagement Clause

by Thomas E.L. Dewey

Parties frequently use settlement agreements to restrict or prohibit potentially harmful conduct, such as disparagement. While non-disparagement provisions in settlement agreements are commonplace, the specific language used in such provisions is critically important, because it is the text of those provisions that determines which specific conduct is restricted or prohibited.

In *SA Luxury Expeditions v. Schleien*, a tour operator who had entered into a settlement agreement with a competitor sued the competitor, alleging breach of a non-disparagement clause in their settlement agreement. Specifically, the tour operator alleged that the competitor had published online reviews that cast doubt on the value of the tour operator's services. The tour operator also asserted unfair competition claims against the competitor based on an allegedly high volume of fraudulent clicks and leads that had imposed higher costs on the tour operator.

In its Aug. 29, 2022 decision, the district court (Caproni, J.) granted the competitor's motion to dismiss the tour operator's complaint. As to the breach of contract claim, the court explained that, while the parties' settlement agreement prohibited the competitor from making disparaging statements describing the tour operator "in a manner that could reasonably be construed to portray [it] in a negative light"—including, for example, by describing the tour operator as "dishonest, incompetent, [or] corrupt"—the alleged online reviews undisputedly contained no negative description of the tour operator's services and, thus, were not in and of themselves disparaging. Thus, even if those reviews had lowered the tour operator's aggregate rating on a third-party review platform, the competitor's conduct did not breach the parties' settlement agreement. The court also held that the tour operator's unfair competition claims, which sounded in fraud, failed to satisfy Federal Rule of Civil Procedure 9(b)'s heightened pleading standard.

This decision is significant because it makes clear that conduct that may have the intent or effect of disparagement—but is not itself disparaging—may not breach a settlement agreement's non-disparagement clause unless such conduct is expressly prohibited by that clause.

Background

In September 2014, SA Luxury Expeditions, a tour operator, filed a lawsuit in the Northern District of California against Bernard Schleien—who controls companies that compete with SA Luxury—and one of his companies. In that action, SA Luxury alleged that Schleien had created and published negative reviews of SA Luxury on third-party websites. About a year later, SA Luxury and Schleien entered into a settlement

agreement to resolve that action. The settlement agreement contained a provision requiring Schleien not to make written or oral statements disparaging SA Luxury, including by posting negative reviews of SA Luxury online. In particular, that non-disparagement provision prohibited Schleien from making disparaging written or oral statements "describing [SA Luxury] in a manner that could reasonably be construed to portray [it] in a negative light, including by describing [it] as dishonest, incompetent, corrupt, immoral, unethical, weak, unimportant, evil, or craven."

On May 11, 2022, SA Luxury filed a complaint in the Southern District of New York against Schleien and Peru for Less (together with Schleien, "defendants"), an entity controlled by Schleien that was not a party to the California federal court action or the settlement agreement. In SA Luxury's complaint against defendants, SA Luxury asserted a breach of contract claim against Schleien and unfair competition claims against Schleien and Peru for Less.

In its breach of contract claim, SA Luxury alleged that Schleien had breached the settlement agreement by publishing four-star reviews on TrustPilot.com, a third-party review platform, that lowered SA Luxury's overall rating on that platform. Specifically, SA Luxury alleged that an influx of four-star ratings of SA Luxury appeared on TrustPilot during 2020 and 2021. SA Luxury alleged that those reviews were "written in a clever way that attempted to cast doubt on [the] value of SA Luxury's services, but without being explicitly negative" and that those reviews lowered its aggregate rating on TrustPilot. SA Luxury also alleged that TrustPilot later removed the four-star ratings at issue from its platform.

SA Luxury premised its unfair competition claims on alleged "fraudulent activity" concerning its pay-per-click (PPC) Internet advertising and client leads that began in 2022. In its complaint, SA Luxury alleged that PPC advertising requires advertisers to pay a provider (e.g., a search engine such as Google) each time an advertisement is clicked. SA Luxury alleged that it had experienced both a large number of fraudulent clicks and fraudulent leads, which caused it to have higher costs. SA Luxury alleged that the fake leads were all submitted during Peruvian business hours and that it did not receive any fraudulent leads during Peruvian holidays or non-business hours in Peru. SA Luxury alleged that in March 2022, it saw a 429% increase in fake leads compared with October 2021 and that an investigation concluded that at least two of the fake leads were submitted by Schleien and a Peru for Less employee.

Defendants filed a motion to dismiss SA Luxury's complaint pursuant to Federal Rule of Civil Procedure 12(b)(6).

The Court's Ruling on the Breach of Contract Claim

As a threshold matter, the court held that SA Luxury's breach of contract claim did not sound in fraud and therefore was not subject to Federal Rule of Civil Procedure 9(b)'s heightened pleading standard.

The court then stated as to that claim that while SA Luxury had plausibly alleged that the surge in four-star reviews lowered its overall review on TrustPilot, SA Luxury had failed adequately to allege a breach of the non-disparagement clause in the settlement agreement. While that clause prohibited Schleien from making disparaging written or oral statements "describing [SA Luxury] in a manner that could reasonably be construed to portray [it] in a negative light, including by describing [it] as dishonest, incompetent, corrupt, immoral, unethical, weak, unimportant, evil, or craven," SA Luxury acknowledged that the text of the four-star reviews at issue did not portray its services in a negative light.

Instead, SA Luxury argued that the intent or effect of the four-star reviews was to disparage it services because the lower reviews described SA Luxury in a worse light than if those reviews had not been posted. The court then held that the settlement agreement's text "reaches only statements that are, in and of themselves, disparaging," stating that Schleien apparently had "constructed or lucked upon a loophole" in the settlement agreement that permitted it to make public statements about SA Luxury that were not, "in and of themselves, disparaging" as to SA Luxury—even if their purpose or effect was disparagement of SA Luxury's services. Thus, the court held that, while Schleien's conduct may have been "devious", it did not breach the settlement agreement.

The Court's Ruling on the Unfair Competition Claims

SA Luxury asserted two unfair competition claims against defendants: (1) a common law unfair competition claim against defendants under New York law, and (2) an unfair competition claim against defendants under California law. The court dismissed both claims because, among other reasons, the allegations in SA Luxury's complaint failed to satisfy Federal Rule of Civil Procedure 9(b)'s heightened pleading standard.

First, the court held as to the unfair competition claim under New York law that the allegations about fake leads in the complaint were vague and conclusory because they lacked factual allegations showing that the alleged fake leads were submitted to SA Luxury by the defendants. Similarly, the court held that the allegations in the complaint purporting to tie defendants to that alleged conduct were conclusory because they were based on ipse dixit. The court also held that, even if SA Luxury's conclusory allegations had been adequately pleaded, the alleged fake leads failed to satisfy Rule 9(b)'s particularity requirement because SA Luxury had not alleged the "where and when" of those fake leads. In addition, the court held that the tour operator had failed adequately to allege special damages, a requirement to plead an unfair competition claim under New York law.

Second, as to SA Luxury's unfair competition claim under California law, the court rejected defendant's argument that the settlement agreement precluded that claim because, while the settlement agreement "expressly prohibits disparaging activity," "it is silent regarding other conduct designed unfairly to harm" SA Luxury, "such as the submission of fraudulent clicks or leads." In addition, even if fraudulent clicks or leads were part of the Northern District of California action that was resolved in the settlement

agreement, the fraudulent activity alleged in the Southern District of New York action concerned "newly submitted false leads."

Nevertheless, the court held that SA Luxury failed to plead the "who, what, when, where, and how of the misconduct alleged" required by Rule 9(b). For example, if SA Luxury determined that at least two leads were submitted by Schleien and a Peru for Less employee, SA Luxury was required to plead those allegations with "more specificity", including "more precisely when the leads were submitted, how they were submitted, how [SA Luxury] knows they came from Defendants, and what they said."

Conclusion

The court's decision in *SA Luxury* illustrates a fundamental point that counsel and their clients must keep in mind when drafting or analyzing settlement agreements that contain provisions restricting or prohibiting conduct: Only conduct that is *expressly* restricted or prohibited by the text of those provisions is not permitted. Thus, if a settlement agreement is silent on whether a party may make statements that are not themselves disparaging but nevertheless have a disparaging effect on the other party, such conduct may remain permissible even if the settlement agreement contains a non-disparagement clause.

Counsel and clients should therefore pay close attention to the text of provisions in settlement agreements that restrict or prohibit conduct—including non-disparagement clauses—so that they are aware of exactly what types of conduct are not permitted by those provisions and what types of conduct may remain permissible.

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