

coverage provided by the insurance contract, they also fall within the exclusions from coverage for claims that arise out of either a breach of contract or an oral or written publication of material, done by the insured with knowledge of its falsity. The Court will, therefore, grant the defendant's motion for summary judgment and deny the plaintiff's motion for partial summary judgment.

I. Facts

A. The Underlying Lawsuit

In July, 2002, six NutriSystem franchisees filed suit against NutriSystem and ten other defendants in the Circuit Court of the First Judicial Circuit, Jackson County, Illinois. The case was subsequently removed to the United States District Court for the Southern District of Illinois, in the civil action captioned Realife, Inc., et al. v. NutriSystem, Inc., et al. (the "Realife" action).

NutriSystem is a national franchisor and distributor of weight loss products. The Realife plaintiffs are NutriSystem franchisees, operating NutriSystem weight loss centers pursuant to a franchise agreement with NutriSystem.

This most recent lawsuit is the culmination of a twenty year battle between NutriSystem and its franchisees over NutriSystem's direct marketing of products within its

franchisees' exclusive marketing areas. Two previous lawsuits resulted in settlement agreements, entered into in 1984 and 1994, each of which were subsequently incorporated into all future NutriSystem franchise contracts.

The franchise contracts, together with the incorporated settlement agreements (collectively, the "franchise agreements"), prohibit NutriSystem from marketing and selling NutriSystem weight loss products, either directly or through a third party, to customers in franchisees' exclusive marketing areas. They require NutriSystem to provide management support, training programs, and advertising assistance to the franchisees and to conduct meetings for franchisees at the regional level.

The Realife complaint alleges that NutriSystem violated these agreements by marketing to individuals in the franchisees' exclusive marketing areas directly and through a third party, QVC, Inc. ("QVC"). It also claims that NutriSystem entered into contracts with QVC to accomplish this direct marketing through the QVC broadcast network and website. Other alleged violations of the franchising agreements are a failure to provide the franchisees with training programs, operations and management guidance, marketing programs and advertising; and a failure to hold regional meetings for the franchisees.

In paragraphs 55 and 56 of the ReaLife complaint, the plaintiffs allege various false and misleading statements made by

NutriSystem with knowledge of their falsity in connection with their direct marketing to customers in the franchisees' exclusive marketing areas. These false statements concerned NutriSystem weight loss products, services and programs; the financial stability of the franchisees; and the relative cost of products obtained directly from NutriSystem as compared to products purchased from the franchisees.

The Realife complaint contains eleven counts: (1) violation of the Robinson-Patman Act; (2) breach of contract; (3) tortious interference with a business expectancy; (4) tortious interference with contract; (5) unjust enrichment; and (6) through (11) violation of various state consumer protection and trade practice laws.

NutriSystem paid \$31,848.00 in attorneys' fees and \$365,000.00 in settlement of the Realife action. NutriSystem also paid \$20,155.00 to indemnify QVC for legal expenses QVC incurred in its defense of the Realife action. NutriSystem now seeks to recover these fees, plus the fees and costs incurred in bringing this action, from National.

B. Relevant Provisions of the Insurance Policy

National issued a commercial general liability policy to NutriSystem for the period October 1, 2001 through October 1, 2002, through AON Risk of One Liberty Place, Philadelphia,

Pennsylvania. The insurance policy provided, in pertinent part, that National must indemnify NutriSystem for any damages that NutriSystem would be required to pay as a result of "advertising injury" and that National must defend NutriSystem in any "suit" seeking those damages. Insurance Contract § I.B.1.a.

The insurance policy defines "advertising injury" as an injury arising out of four separate offenses, including the "[o]ral 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." Insurance Contract § V.14.d.

The insurance contract specifically precludes coverage for any "advertising injury":

- (1) Caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict advertising injury;
- (2) Arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity; [or]
- (6) Arising out of a breach of contract.

Insurance Contract § I.B.2.(1), (2), (6).

C. Denial of Coverage for the Underlying Lawsuit

Although National acknowledged that some of the claims in the Realife complaint alleged wrongdoing that resulted in advertising injury, National disclaimed coverage on the basis that several of the policy exclusions, either alone or as a group, preclude coverage for the Realife action. (Pl.'s Mot. for Partial Summ. J., Ex. 3-A, Letter from National to NutriSystem of 11/8/02 at 8.) Primarily, National denied coverage based on the breach of contract exclusion because "all the losses asserted by Realife stem from the alleged conduct by [NutriSystem] in violation of contractual agreements between the parties." (Pl.'s Mot. for Partial Summ. J., Ex. 3-F, Letter from National to NutriSystem of 3/20/03 at 2.) National also denied coverage based on the policy exclusions for advertising injury committed with knowledge of its falsity and advertising injury committed with knowledge that the act would violate the rights of another. (Pl.'s Mot. for Partial Summ. J., Ex. 3-A, Letter from National to NutriSystem of 11/8/02 at 9.)

II. Analysis

The plaintiff moves for partial summary judgment as to liability only. The plaintiff seeks a ruling that the defendant was obligated to defend and indemnify it in the underlying litigation and that the defendant's denial of coverage

constitutes bad faith. The defendant contends that final summary judgment should be entered in its favor because it was not obligated to defend or indemnify the plaintiff in the underlying lawsuit. The defendant further asserts that summary judgment should be granted on the bad faith claim both because there can be no bad faith where there is no duty to defend and also because there is no evidence of bad faith here.

A. Legal Framework

Interpretation of an insurance contract is a question of law that may properly be decided by the Court in a motion for summary judgment. See Gen. Accident Ins. Co. v. Allen, 692 A.2d 1089, 1093 (Pa. 1997).

National issued the commercial general insurance policy to NutriSystem through AON Risk of One Liberty Place, Philadelphia, Pennsylvania. Interpretation of the insurance contract is, therefore, governed by Pennsylvania law. Pittsburgh Bridge & Iron Works v. Liberty Mut. Ins. Co., 444 F.2d 1286, 1288 n. 2 (3d Cir. 1971) (Pennsylvania conflict laws prescribe that the interpretation of insurance contracts is governed by the law of the state where the policy is issued and delivered).

Pennsylvania law requires that a court read an insurance policy as a whole and construe it according to the plain and ordinary meaning of its terms. Frog, Switch & Mfg. Co.

v. Travelers Ins. Co., 193 F.3d 742, 746 (3d Cir. 1999); Pac. Indem. Co. v. Linn, 766 F.2d 754, 760-61 (3d Cir. 1985). Where a provision is ambiguous, it should be construed against the insurer as the drafter of the agreement. Pac. Indem., 766 F.2d at 761; Standard Venetian Blind Co. v. Am. Empire Ins. Co., 469 A.2d 563, 566 (Pa. 1983). “[A] provision is ambiguous only if reasonable people could, in the context of the entire policy, fairly ascribe differing meanings to it.” Frog, 193 F.3d at 746. The question of whether an ambiguity exists must be resolved in reference to a particular set of facts. Madison Constr. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 106 (Pa. 1999).

An insurer’s duty to defend an insured in litigation is broader than the duty to indemnify. Gen. Accident, 692 A.2d at 1095. Both duties “flow from a determination that the complaint triggers coverage” under the insurance policy. Id. If the Court decides that there is no duty to defend, it follows that there is no duty to indemnify.

The duty to defend is triggered if the underlying complaint avers any facts that potentially could support a recovery under the policy. Gen. Accident, 692 A.2d at 1095. The obligation to defend is determined solely by the allegations of the complaint which are accepted as true and liberally construed in favor of the insured. Aetna Cas. & Sur. Co. v. Roe, 650 A.2d 94, 98-99 (Pa. Super. Ct. 1994); Biborosch v. Transamerica Ins.

Co., 603 A.2d 1050, 1052 (Pa. Super. Ct. 1992). If a single claim in a complaint is potentially covered, the insurer must defend all claims "until there is no possibility" of recovery on a covered claim. Frog, 193 F.3d at 746.

B. Coverage Analysis

The threshold question is whether coverage under the policy has been triggered by the Realife complaint. The answer to that question depends on whether the underlying complaint seeks damages for advertising injury that is defined, in pertinent part, as an injury arising out an "[o]ral 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." Insurance Contract § V.14.d.

National does not dispute that some claims in the Realife complaint do constitute advertising injury. For example, paragraphs 55 and 56 of the Realife complaint allege that Nutrisystem made false and misleading statements about the products and services of the franchisees, their financial stability, and the cost of the products charged by the franchisees.

National instead argues that any advertising injury alleged in the Realife complaint is not covered by the policy because it is subject to one or more of the following three

exclusions: it arises out of a breach of contract; it arises out of oral or written publication of material done by the insured with knowledge of its falsity; and/or it was caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict advertising injury. The defendant also argues that as a matter of Pennsylvania public policy, there is no coverage because the loss or damage alleged in the underlying complaint was non-fortuitous; that is, it was not accidental or otherwise outside the control of the parties to the insurance contract. National bears the burden of establishing that a particular exclusion applies. See Madison Constr., 735 A.2d at 106.

Because the Court finds that the exclusions for claims arising out of a breach of contract and a knowing false disparagement apply here, it will not consider the applicability of the third exclusion or the argument based on Pennsylvania public policy.

1. Exclusion for Advertising Injury Arising Out of a Breach of Contract

Although some counts in the Realife complaint are characterized as tort claims, National argues that the Realife plaintiffs' claims arise out of a breach of the franchise agreements under the gist of action doctrine adopted by the Pennsylvania Superior Court in seminal cases like Redevelopment

Authority v. International Insurance Co., 685 A.2d 581 (Pa. Super. Ct. 1996), and Phico Insurance Co. v. Presbyterian Medical Services Corp., 663 A.2d 753 (Pa. Super. Ct. 1995).

In Phico Insurance Co. v. Presbyterian Medical Services Corp., the Pennsylvania Superior Court was faced with the question of whether allegations sounding in tort fell within an insurance policy's exclusionary provision for claims arising from a breach of contract. 663 A.2d at 756. The court decided that the insurer was not obligated to defend or indemnify its insured in an underlying action alleging gross negligence and willful misconduct. Id. at 756-58. After reviewing the underlying complaint, the court concluded that the allegations arose out of the insured's performance of a management consulting agreement and, thus, fell within the policy's specific exclusion for contractually based claims. Id. at 758.

In Phico, the Pennsylvania Superior Court looked beyond the plaintiff's characterization of the claims in the underlying complaint and focused on the nature of the claims. Id. at 757. The court stated that, "to be construed as a tort action, the wrong ascribed to the defendant must be the gist of the action with the contract being collateral." Id. at 757. The court stated that "the important difference between contract and tort actions is that the latter lie from the breach of duties imposed as a matter of social policy while the former lie for the breach

of duties imposed by mutual consensus." Id. The court concluded that, while the underlying plaintiff alleged that the insured engaged in both gross negligence and willful misconduct, the misconduct occurred in the performance of the contract. Id. at 758. See also Redev. Auth., 685 A.2d at 583-84, 589 (claims for negligence and unjust enrichment stemming from the performance of agreement to operate a water system arose from breach of contract).

Whether the defendant is successful with this argument depends on how broadly one interprets the "gist of the action" doctrine. National understandably argues for a broad interpretation. It contends that one must look to the entire complaint and ask: but for the contract, would the case exist; is the contract collateral to the complaint. The defendant argues that if the answers to these questions is no, the exclusion applies. The Court agrees that the answers to these questions is no, but is not persuaded that the test is so broad.

The Pennsylvania Superior Court appears to limit the gist of the action doctrine to claims based on allegations that a party committed a tort in the performance of duties under a contract. To state it another way, negligence in the performance of the contract fits the exclusion, but not negligence separate from the obligations under the contract. This interpretation is supported by the Phico court's distinguishing between torts that

arise from the breach of duties imposed as a matter of social policy and torts that arise from the breach of duties imposed by the contract. See Phico, 663 A.2d at 757; see also Snyder Heating Co. v. Pennsylvania Mfrs. Ass'n Ins. Co., 715 A.2d 483, 487 (Pa. Super. Ct. 1998) (claim for damage to school boiler arose from failure to properly perform under the terms of a maintenance agreement); Pro Dent Inc. v. Zurich U.S., No. CIV.A.99-5479, 2001 WL 474413, at *1-2 (E.D. Pa. Apr. 30, 2001) (negligence claim arose from breach of contract because obligation to install PVC piping rather than copper piping not imposed as a matter of social policy); Jerry Davis, Inc. v. Maryland Ins. Co., 38 F. Supp. 2d 387, 391-92 (E.D. Pa. 1999) (breach of warranty and negligence claims arose from breach of the contract to install electrical wiring).

The Court's conclusion is also consistent with other decisions by colleagues on this Court who have refused to apply the doctrine where, as here, the cause of action is based on allegations that a party violated duties arising from statutory law. See Cont'l Cas. Co. v. County of Chester, 244 F. Supp. 2d 403, 410 (E.D. Pa. 2003) (due process claim under 42 U.S.C. § 1983 does not arise from breach of contract but from duties imposed as a matter of social policy); TIG Ins. Co. v. Nobel Learning Cmtys., Inc., No. CIV.A.01-4708, 2002 WL 1340332, at *11 (E.D. Pa. June 18, 2002) (copyright infringement claim

encompasses liability which the law imposes on all insureds for their tortious conduct).

The Court finds that four of the eleven counts of the Realife complaint fall within the policy's exclusion for claims arising from a breach of contract. The claim for breach of contract (Count 2) is precluded from coverage because it explicitly arises from a breach of the franchise agreements. The claims for tortious interference with a business expectancy (Count 3), tortious interference with contract (Count 4), and unjust enrichment (Count 5) also are contractual in nature and are based upon duties imposed on NutriSystem as a result of the franchise agreements.

The tortious interference with a business expectancy claim alleges that NutriSystem tortiously interfered with the plaintiff's business expectancy of entering into relationships with potential weight loss customers in plaintiffs' exclusive marketing areas by marketing and selling products in the franchisees' exclusive marketing areas.

Similarly, in the tortious interference with contract claim, the Realife plaintiffs allege that NutriSystem tortiously interfered with their franchise agreements by direct marketing in the franchisees' exclusive marketing areas through the NutriSystem website and by making sales in the franchisees' exclusive marketing areas. The Realife plaintiffs contend that

NutriSystem intended to drive the franchisees out of business and eliminate their exclusive marketing areas.

In the unjust enrichment count, the Realife plaintiffs allege that NutriSystem was unjustly enriched by the sale of products and services in the franchisees' exclusive marketing areas.

These three claims, although characterized as tort claims, are based on violations by NutriSystem of the franchisees' right to exclusive marketing areas. The exclusive marketing areas were created pursuant to the terms of the 1984 settlement and release agreement, as incorporated in the franchise agreements. NutriSystem is alleged to have violated a duty that it owed to the Realife plaintiffs (i.e., to refrain from marketing and selling weight loss products in certain geographical locations) solely as a result of the franchise agreements.¹

The Court cannot find that the remaining counts - six through eleven - arise out of a breach of contract. They allege violation of various state laws prohibiting consumer fraud and

¹ Although paragraphs 55 and 56 are specifically incorporated in each count, they are not essential to any claims other than those alleging violation of various state consumer protection and trade practice laws. National was not obligated to provide coverage for the claims in Counts 2 through 5 because those claims are fundamentally premised on NutriSystem's breach of contractual duties under the franchise agreements and irrespective of any alleged disparagement of the franchisees' products and services.

deceptive practices by the making of false statements by Nutrisystem. The claims arise from duties imposed as a matter of social policy, not from duties imposed by the franchise agreements. The Court does, however, find that counts six through eleven are excluded from coverage by the exclusion for advertising injury committed with knowledge of its falsity.²

2. Exclusion for Advertising Injury Committed With Knowledge of Its Falsity

The insurance policy specifically precludes coverage for claims “[a]rising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity.” The claims alleging violation of state statutes are based on and incorporate paragraphs 55 and 56 of the complaint. These paragraphs allege that NutriSystem “made false and misleading representations” concerning the Realife plaintiffs’ products and services “with knowledge of their falsity.” If the Court looks only to the allegations of the Realife complaint, the exclusion applies.

² The remaining count, alleging price discrimination in violation of the Robinson-Patman Act, does not seek damages for advertising injury within the meaning of the insurance contract. Paragraphs 55 and 56 are incorporated into this count, but the alleged disparagement that may lead to advertising injury has no relevance to this cause of action. For this reason, Count 1 does not trigger a duty to defend even though it is not covered by either exclusion.

NutriSystem argues that there was a duty to defend because the Realife plaintiffs could have amended the complaint to delete the allegations that NutriSystem knew of the falsity of its statements, and allege a theory of negligent or reckless misrepresentation. The plaintiff, however, never attempted to show that the statutes at issue would be triggered by negligent misrepresentation. In any event, the plaintiff's position is inconsistent with decisions of Pennsylvania appellate courts, holding that an insurer's obligation to defend is decided by the allegations of the underlying complaint, the so-called "four corners of the complaint" rule.

In Gene's Restaurant, Inc. v. Nationwide Insurance Co., 548 A.2d 246 (Pa. 1988), the insured sought to recover damages incurred in defending a suit brought by one of its patrons alleging willful and malicious assault. Id. at 246. The Pennsylvania Supreme Court held that the insurer was not required to defend the insured because the policy covered only those bodily injury claims resulting from an accident; the policy did not cover the type of intentional torts alleged in the complaint. Id. at 246-47. The court held that an insurer "may base its decision to defend solely on the allegations" of the underlying complaint. Id. at 246.

NutriSystem argues that the Court should follow the approach to this issue taken in Safeguard Scientifics, Inc. v.

Liberty Mutual Insurance Co., 766 F. Supp. 324 (E.D. Pa. 1991). In Safeguard, a case applying Pennsylvania law to determine coverage under an insurance contract, the insured sought to recover damages that it paid defending a suit by one of its former employees alleging that the insured made knowingly false defamatory statements. Id. at 326-27. The insurer denied coverage based on a policy exclusion for statements made with knowledge of their falsity. Id. at 329. The court decided that the insurer was required to provide coverage because the complaint could have been amended to state a viable claim for reckless or negligent defamation. Id. at 329-30.

The Safeguard decision was an attempt to reconcile the apparent tension between two basic rules guiding an insurer's duty to defend: first that the duty to defend is determined solely by reference to allegations in the complaint; and second, that an insurer is obligated to defend if the factual allegations of the complaint comprehend an injury that is actually or "potentially" within the scope of the policy. Compare Gene's Restaurant, 548 A.2d at 246, with Cadwallader v. New Amsterdam Cas. Co., 152 A.2d 484, 488 (Pa. 1959). In Safeguard, Judge Katz attempted to reconcile the two concepts by requiring an insurer to defend where the complaint could be "reasonably amended" to state a claim under the policy. Safeguard, 766 F. Supp. at 330.

In cases decided after Safeguard, the Pennsylvania Superior Court has adhered to the rule that the duty to defend is determined solely by the allegations in the complaint. See, e.g., Aetna Cas., 650 A.2d at 98; Am. States Ins. Co. v. Maryland Cas. Co., 628 A.2d 880, 887 (Pa. Super. Ct. 1993); Stidham v. Millvale Sportsmen's Club, 618 A.2d 945, 953 (Pa. Super. Ct. 1992); Germantown Ins. Co. v. Martin, 595 A.2d 1172, 1174 (Pa. Super. Ct. 1991).

In light of this line of cases, as well as Judge Robreno's decision in I.C.D. Indus., Inc. v. Fed. Ins. Co., 879 F. Supp. 480 (E.D. Pa. 1995), Judge Katz has since questioned the wisdom of Safeguard. In Am. Planned Cmty's., Inc. v. State Farm Ins. Co., 28 F. Supp. 2d 964, 970 (E.D. Pa. 1998), Judge Katz rejected the argument that an insurer was obligated to defend because the complaint could be amended to state a claim under the policy. As Judge Katz recognized, "Pennsylvania courts have strictly applied the rule that the complaint itself governs coverage and have not been inclined to consider possible alternative pleadings." Id. at 966 (citing I.C.D. Indus., 879 F. Supp. at 487-88).

The Court concludes that under Pennsylvania law a court must look only to the allegations contained in the four corners of the complaint to determine whether a claim comes within the scope of coverage under an insurance policy. In deciding whether

an injury is "potentially" covered, a court is still limited to the allegations of the complaint. If the alleged facts would support a claim not clearly articulated, the duty to defend is triggered. That is not the case here. The allegations of actual knowledge of the falsity of the statements about the franchisees and their products is crucial to this complaint that alleges a conspiracy between NutriSystem and QVC to drive the franchisees out of business.

C. Conclusion

The Court decides that National was not obligated to defend NutriSystem in the underlying action. Although the defendant does not dispute that some allegations in the underlying complaint potentially fall within the scope of coverage for an "advertising injury," the Court concludes that the policy exclusions for claims arising from a breach of contract and claims arising from oral or written publication of material, if done with knowledge of its falsity, preclude coverage under the insurance contract.

The Court does not reach the question of whether the policy exclusion for misrepresentations made with the knowledge that they would violate the rights of others also precludes

coverage in this case. Nor does the Court consider the public policy argument made by NutriSystem.³

An appropriate Order follows.

³ The Court will also grant summary judgment for the defendant with respect to the bad faith claim. Under Pennsylvania law, "bad faith claims cannot survive a determination that there was no duty to defend, because the court's determination that there was no potential coverage means that the insurer had good cause to refuse to defend." Frog, 193 F.3d at 751 n. 9.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

NUTRISYSTEM, INC.,	:	CIVIL ACTION
Plaintiff	:	
	:	
v.	:	
	:	
NATIONAL FIRE INSURANCE OF	:	
HARTFORD,	:	
Defendant	:	NO. 03-6932

ORDER

AND NOW, this 19th day of November, 2004, upon consideration of plaintiff's Motion for Partial Summary Judgment (Docket No. 6), defendant's Motion for Final Summary Judgment (Docket No. 7), defendant's Opposition to Plaintiff's Motion for Partial Summary Judgment (Docket No. 8), plaintiff's Reply to Defendant's Motion for Final Summary Judgment (Docket No. 10, and defendant's Reply in Support of Its Motion for Summary Judgment (Docket No. 12), and after a hearing held on September 17, 2004, IT IS HEREBY ORDERED that defendant's motion is GRANTED and plaintiff's motion is DENIED. Judgment is hereby entered for the defendant and against the plaintiff.

BY THE COURT:

/s/ Mary A. McLaughlin
MARY A. McLAUGHLIN, J.