Alert

January 13, 2022

COZEN O'CONNOR

The Third Circuit Finds Defense Owed for Potentially Covered Advertising Injury

On January 5, 2022, the Third Circuit confirmed that the "potentially covered" standard for the duty to defend is far broader than the "actually covered" standard for the duty to indemnify, also confirming that the duty to defend is based on the factual allegations as they appear in the complaint. See, *Vitamin Energy, LLC v. Evanston Ins. Co.*, — F.4th —, 20-3461, 2022 WL 39839 (3d Cir. Jan. 5, 2022). These principles are applied and discussed with regularity in the context of complaints alleging bodily injury and property damage, but apply equally to alleged advertising injury.

The Allegations and Events Leading to the Third Circuit Opinion

Vitamin Energy is a competitor of 5-Hour Energy and advertised its product by comparing the claimed benefits of its own product to 5-Hour Energy with a chart using script similar to the script used in 5-Hour Energy products. The owners of trademarks for 5-Hour Energy sued Vitamin Energy, alleging a wide variety of wrongs and seeking damages for trademark infringement, false designation of origin, false advertising, and trademark dilution claims based in federal law, and unfair competition. In particular, 5-hour Energy alleged that a comparison chart in Vitamin Energy's advertisements was "false and misleading comparative advertising" because it falsely implied that Vitamin Energy had more Vitamins B and C than 5-Hour Energy and other liquids.

Vitamin Energy sought coverage (defense and indemnity) from its commercial general liability insurer, Evanston Insurance Company, under the policy's coverage for Advertising Injury. Evanston denied coverage on the positions that 5-Hour Energy's complaint did not allege an Advertising Injury and, even if it did, exclusions for trademark violations (which used the phrase "unfair competition") and known loss applied. Disagreeing with the denial of coverage, Vitamin Energy filed suit in state court seeking declaratory relief and damages for breach of contract and bad faith. Evanston removed the case to the U.S. District Court for the Eastern District of Pennsylvania and the parties cross-moved for judgment on the pleadings. The district court granted Evanston's motion, holding that 5-hour Energy's complaint did not allege an Advertising Injury as defined in the policy. Vitamin Energy appealed, and the U.S. Court of Appeals for the Third Circuit reversed.

The Third Circuit Applies the 4-Corners Rule to the "Advertising Injury" Requirement

The Third Circuit's opinion remains true to Pennsylvania's 4-Corners Rule and, throughout, compared the complaint's allegations to the policy language. Focusing first on the definition of Advertising Injury, the court agreed with Vitamin Energy that the complaint's allegations satisfied the definition's enumerated offense of "disparaging material" because the complaint alleged that the chart contained injurious false statements about 5-hour Energy's products. The court rejected Evanston's argument that the comparison chart made false claims only about Vitamin Energy's own products, which would not qualify as an Advertising Injury, explaining that 5-Hour Energy alleged that the comparison chart falsely implied 5-hour Energy's products did not have as much Vitamin C or Vitamin B.

Construing 5-hour Energy's complaint broadly for purposes of the duty to defend, the Third Circuit found that the complaint's allegations about chart's allegedly false comparison of vitamin content, with false information about the vitamin content of 5-Hour Energy, qualified as an Advertising Injury.

The Third Circuit's Application of the 4-Corners Rule to the Exclusions

The Third Circuit also looked at the precise language of the complaint and found that the

Deborah M. Minkoff

Senior Counsel

dminkoff@cozen.com
Phone: (215) 665-2170
Fax: (215) 665-2013

Alissa K. Christopher

Co-Chair, Bad Faith Group

akchristopher@cozen.com
Phone: (214) 462-3036
Fax: (214) 462-3299

Related Practice Areas

- Insurance Coverage

allegations, at least potentially, could survive exclusions.

The court rejected Evanston's argument that the complaint fell within the scope of the Intellectual Property exclusion, which negated coverage for "any Claim based upon or arising out of Personal Injury or Advertising Injury arising out of piracy, unfair competition, the infringement of copyright, title, trade dress, slogan, service mark, service name or trademark, trade name, patent, trade secret or other intellectual property right." The court found that the exclusion would bar coverage for the complaint's allegations of trademark infringement but did not exclude the allegations of disparagement. The court also rejected Evanston's argument that the exclusion's use of the term "unfair competition" encompassed the allegations in the complaint, noting that exclusions should be read narrowly and, in context, the phrase did not unambiguously refer to Vitamin Energy's comparative misrepresentation. We note that other courts have likewise interpreted unfair competition narrowly when referenced in an exclusion.

As to the exclusions for "Incorrect Description" and "Failure to Conform," the Third Circuit ruled that these exclusions apply to allegations about the insured's own products (here, Vitamin Energy) and not to statements regarding 5-hour Energy's products.

The court likewise refused to uphold a denial of defense based on two exclusions aimed at the insured's knowledge. One negated coverage for "Advertising Injury caused by or at the direction of the Insured with the knowledge that the act would violate the rights of another" and the other negated coverage for "Advertising Injury arising out of the oral or written publication of material, if done by or at the direction of the Insured with the knowledge of its falsity." In our experience, some panels are reluctant to apply an exclusion that rests on the insured's knowledge in the absence of compelling "knowledge" allegations within the complaint.

Although the court found that a defense was owed, based on the potentiality standard, the court made clear that Evanston may be able to prove that the allegations would not require indemnity.

Observations

The Third Circuit did not sway from established Pennsylvania principles. The court continued to apply a potentiality standard to the duty to defend and continued to look carefully at the complaint's factual allegations to evaluate that potentiality. With respect to cases specific to the context of Advertising Injury, the opinion does not detract from the precedent that false statements as to an insured's own products do not qualify as Advertising Injury. The case warrants caution in handling Coverage B claims where, as in *Vitamin Energy*, the insured engages in comparative advertising that discredits a competitor's product.