

INSURANCE

Coverage for Defense Costs In Consumer Fraud Actions

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A hot topic in the insurance coverage arena is whether insurers have a duty to defend policyholders against lawsuits alleging violations of state consumer fraud and deceptive trade practices statutes. In recent years, a growing number of plaintiffs have brought such lawsuits against companies even when similar damages could be recovered under other theories of liability that may be easier to prove—because consumer fraud statutes frequently permit plaintiffs to recover their attorney's fees in addition to damages. Because these consumer fraud statutes typically require plaintiffs to allege that their injuries were the result of intentional or knowing conduct, however, insurers often attempt to avoid any obligation to defend such lawsuits on the ground that their policies do not cover such intentional conduct. But just because a complaint alleges intentional conduct does not mean that any injuries flowing from that conduct were not accidental and, therefore, potentially covered by insurance.

CGL policies typically cover property

damage or bodily injury arising out of an "occurrence" (often defined to mean an "accident"). With respect to other coverages potentially at issue, such as "personal injury" or "advertising injury," these policies also generally exclude coverage for intentionally inflicted injury. Insurers often contend that they have no duty to defend against allegations of consumer fraud and deceptive practices because they involve intentional or know-



ing acts which, insurers say, necessarily fall outside of the policy's coverage provisions because they do not involve an accident or "occurrence" or because they otherwise come within exclusions barring coverage for intentionally inflicted injury.

Policyholders should not, however, be led to automatically conclude that they have no defense coverage under these circumstances. First, allegations of intentional conduct giving rise to a consumer fraud or deceptive practices claim do not necessarily foreclose defense coverage because the duty to defend will typically turn on whether intentional injury is alleged. Second, certain states will find a duty to defend notwithstanding the allegations against the policyholder where there is a possibility that the facts, as developed at trial, could give rise to the potential for coverage. Thus, policyholders facing consumer fraud allegations should carefully scrutinize the particular factual allegations against them, as well as the consumer fraud statute at issue.

Injury and Intention

In many jurisdictions, the duty to defend is typically determined by comparing the allegations in the complaint with the terms of the applicable insurance policy; if the complaint alleges any facts that, if true, might result in potentially covered damages under the insurance policy, then the insurer must defend the lawsuit.¹ The rule favors the insured, as the allegations are to be construed liberally and all doubts are to be resolved in favor of finding a duty to defend.² Whether an insurer will ultimately have a duty to indemnify the policyholder against liability is irrelevant to this inquiry, as the duty to defend is broader than the duty to indemnify.³

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Applying these principles, courts in several jurisdictions have upheld policyholders' right to defense coverage for lawsuits asserting causes of action under state consumer fraud and unfair practices statutes, because although the underlying complaints alleged some intentional or knowing conduct, they did not allege that the policyholder expected or intended the injuries resulting from that conduct.

In *Virtual Bus. Enters., LLC v. Maryland Cas. Co.*,⁴ for example, the Delaware Superior Court considered whether an insurer had a duty to defend an action alleging that its policyholder solicited former clients in violation of Delaware's Deceptive Trade Practices Act. The insurance policy at issue provided coverage for personal and advertising injury, but excluded any injury "[c]aused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict 'personal and advertising injury.'"⁵

The court found a duty to defend even though the complaint against the policyholder alleged that it lured away the plaintiff's clients through intentional communications with those clients. The court reasoned that when read as a whole, the complaint could be understood to allege that the insured either inadvertently caused plaintiff's injury to its goods, products or services, or did so without knowledge that the communications would violate the plaintiff's rights.⁶ The court recognized that, ultimately, the facts of the case could tell a different story, but this fact did not impact the policyholder's right to defense coverage.⁷

In *Home Owners Mgmt. Enters. Inc. v. Mid-Continent Cas. Co.*,⁸ the U.S. District Court for the Northern District of Texas considered whether an insurer had a duty to defend a lawsuit alleging that its policyholder's faulty workmanship caused damage to the plaintiffs' property foundations. The plaintiffs asserted causes of action against the homebuilder that included, among other things, violations of the Texas Deceptive Trade Practices Act and Consumer Protection Act. The insurance policy at issue provided coverage for property damage caused by an "occurrence," which

was defined by the policy as an "accident including continuous or repeated exposure to substantially the same general harmful conditions."

The district court explained that the relevant inquiry in determining whether there was an "occurrence" was not whether the policyholder intended to engage in the conduct that gave rise to the injury, but rather whether the policyholder intended to produce the result.⁹ The court determined that the insurer had a duty to defend, finding that the complaint did not allege that policyholder had intended to cause foundation damage.¹⁰

The U.S. District Court for the Southern District of Iowa reached a similar conclusion in *Liberty Mut. Ins. Co. v. Pella Corp.*¹¹ The district court considered whether an insurer had a duty to defend lawsuits

Allegations of intentional conduct giving rise to a consumer fraud or deceptive practices claim do not necessarily foreclose defense coverage because the duty to defend will typically turn on whether intentional injury is alleged.

alleging that its policyholder sold defective windows that caused water-related damage to end-users' homes. The plaintiffs in two underlying lawsuits asserted causes of action against the homebuilder that included violations of state consumer fraud and deceptive practices statutes, and in one lawsuit, the sole cause of action remaining was for a violation of the Illinois Consumer Fraud Act. The policies at issue provided coverage for property damage caused by an "occurrence," which was defined as "an accident including continuous or repeated exposure to substantially the same general harmful conditions."¹²

The district court found that the insurer's defense obligations were triggered even though the complaints alleged that the policyholder sold its windows with knowledge of the existence of the alleged defect. Under Iowa law, an accident is an unexpected event, and a policyholder is deemed to

expect injury when he knew or should have known that there was a substantial probability, not mere foreseeability, that certain consequences will result from his actions.¹³ The district court reasoned that because the complaints did not allege that the policyholder expected that the defect would result in damage, the complaints raised the potential for coverage under the policies.¹⁴

Consistent with the foregoing cases, the U.S. Court of Appeals for the Fifth Circuit, in *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Puget Plastics Corp.*,¹⁵ confirmed that allegations of intentional conduct under consumer fraud and deceptive practice statutes, without more, are insufficient to deprive a policyholder of its rights under an insurance policy. There, the court determined that an "occurrence" (i.e., an accident) cannot be presumed merely because a policyholder may have knowingly violated a consumer fraud and deceptive practices statute.¹⁶ As the court explained, a knowing violation of a consumer fraud statute is not the equivalent of the commission of an intentional tort, because liability under such a statute does not require the level of proof and proximate cause necessary for a common law fraud claim. A policyholder could thus conceivably be found liable under the statute, and yet his conduct could fall short of showing that he "expected" the injury suffered, preserving his right to defense coverage.¹⁷

Facts to Be Developed at Trial

Even where an underlying complaint alleges intentional injury, an insurer still may owe a defense for consumer fraud claims. Courts in some jurisdictions have held that even if the complaint alleges the level of intent that would take the complaint outside the potential for coverage under the policy language, an insurer still owes a duty to defend if the policyholder could be found liable for consumer fraud or deceptive practices on lesser conduct that would not be excluded by the policy.¹⁸

Some of the courts requiring a defense in this situation have done so because their jurisdictions permit the court to look beyond the allegations contained in the complaint in determining an insurer's

defense obligations, and to consider whether events giving rise to the complaint may be shown at trial to fall within the policy's coverage.¹⁹

Some courts also have reasoned that such a result is consistent with the principle that the duty to defend is broader than the duty to indemnify. In other words, a finding of a duty to indemnify must always be accompanied by a finding of a duty to defend; as such, it would be improper for a court to conclude that an insurer has no duty to defend if there is a potential for indemnity once the facts of the complaint are developed and established at trial.²⁰

For instance, in *Auto Europe LLC v. Connecticut Indem. Co.*, the U.S. Court of Appeals for the First Circuit addressed whether an insurer was obligated to defend the policyholder against a lawsuit alleging violations of the Maine Unfair Trade Practices Act for the insured's alleged deceptive concealment of add-ons to charges for foreign rental cars. The policy language provided coverage for all sums the insured became obligated to pay because of "any negligent act, error or omission of the 'insured'" and excluded "liability arising out of any act, error or omission which is willfully dishonest, fraudulent or malicious, or in wilful violation of any penal or criminal statute or ordinances, and is committed (or omitted) by or with the knowledge or consent of the 'insured.'"²¹

The complaint at issue alleged only intentional fraud, bringing it within the policy exclusion for willfully dishonest or fraudulent acts. However, the court recognized that an act may be deceptive under the Maine statute even if the defendant had no purpose to deceive and acted in good faith. The court thus concluded that because it was "certainly possible in this case that the facts as developed at trial would reveal an improper practice that was unaccompanied by an intent to deceive"—and plaintiffs would still recover damages under that scenario—the insurer was obligated to defend the lawsuit.

Conclusion

In sum, policyholders should not assume that complaints alleging violations of consumer fraud and deceptive trade statutes are not covered by insurance. In analyzing

that issue, it is important for policyholders to closely examine the allegations in the complaints, as well as the terms of the statute at issue.



1. See, e.g., *Capitol Indem. Corp. v. Elston Self Svc. Wholesale Groceries Inc.*, 559 F.3d 616, 619 (7th Cir. 2009) (Illinois law); *Lime Tree Vill. Cmty. Club Ass'n Inc. v. State Farm Gen Ins. Co.*, 980 F.2d 1402, 1405 (11th Cir. 1993) (Florida law); *American Ins. Grp. v. Risk Enter. Mgmt., Ltd.*, 761 A.2d 826, 829 (Del. 2000); *Seaboard Surety Co. v. Gillette Co.*, 486 N.Y.S.2d 873, 876 (N.Y. 1984) ("the duty to defend arises whenever the allegations in a complaint against the insured fall within the scope of the risks undertaken by the insurer, regardless of how false or groundless those allegations might be"); 14 Lee R. Russ & Thomas F. Segalla, *Couch on Insurance*, §200:19 (3d ed. 2007) ("Even if the allegations are groundless, false or fraudulent the insurer is obligated to defend").

2. See, e.g., *Capitol Indem. Corp. v. Elston Self Svc. Wholesale Groceries Inc.*, 551 F.Supp.2d 711, 718 (N.D. Ill. 2008), *aff'd*, 559 F.3d 616 (7th Cir. 2009) ("In a duty to defend action, we begin with the deck stacked in favor of the insured" such that if the facts of the complaint, construed liberally, potentially fall within the policy's coverage provisions, the insurer has a duty to defend); *Lime Tree*, 980 F.2d at 1405 ("If the allegations of the complaint leave any doubt as to the duty to defend, the question must be resolved in favor of the insured"); *Building Specialties Inc. v. Liberty Mutual Fire Ins. Co.*, No. 09-0823, 2010 U.S. Dist. LEXIS 56842 (S.D. Tex. May 17, 2010) ("When an underlying petition does not include allegations clearly showing that the case is within or without coverage, the insurer is obligated to defend if there is potentially a case within the policy coverage") (citing *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d 687, 693 (5th Cir. 2010)).

3. See, e.g., *Seaboard Surety*, 486 N.Y.S. 2d at 876-77 ("the veracity of the allegations and the ultimate liability of [the insured], as well as the ultimate obligation of [the insurer]...under its duty to indemnify, are irrelevant to its duty to defend").

4. *Virtual Bus. Enters., LLC v. Maryland Cas. Co.*, C.A. No. 07C-12-070 MMJ, 2010 Del. Super. LEXIS 141 (April 9, 2010).

5. *Id.* at *21.

6. *Id.* at *22-23.

7. *Id.* at 23 (noting that "[a]lthough the insured may have had this requisite knowledge, that information is not clear from the underlying pleading").

8. *Home Owners Mgmt. Enters. Inc. v. Mid-Continent Cas. Co.*, 3:04-CV-2061-BF (H), 2005 U.S. Dist. LEXIS 22524 (N.D. Tex. 2005), *aff'd*, 2008 U.S. App. LEXIS 18597 (5th Cir. Aug. 26, 2008).

9. *Id.* at *14.

10. *Id.* at *16.

11. *Liberty Mut. Ins. Co. v. Pella Corp.*, 631 F. Supp.2d 1125 (S.D. Iowa 2009).

12. *Id.* at 1130.

13. *Id.* at 1130.

14. *Id.* at 1133.

15. *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 532 F.3d 398, 402 (5th Cir. 2008).

16. There was no dispute that the policyholder committed a knowing violation of the Texas Deceptive Trade Practices Act, as a jury had already awarded \$22 million for that violation.

17. *Id.* at 402; see also *Pella Corp.*, 631 F. Supp.2d at 1133-34.

18. See, e.g., *Auto Europe, LLC v. Connecticut Indem. Co.*, 321 F.3d 60 at 68 (1st Cir. 2003); *Orlando Nightclub Enters. Inc. v. James R. Ins. Co.*, No. 6:07-cv-1121-Orl-19KRS, 2007 U.S. Dist. LEXIS88320 (M.D. Fl. Nov. 30, 2007).

19. See, e.g., *Auto Europe*, 321 F.3d at 66 (under Maine law, the duty to defend is determined by comparing the complaint in the underlying lawsuit with the insurance policy to ascertain "if there exists any legal or factual basis which could be developed at trial which would obligate insurers to pay under the policy").

20. *Orlando Nightclub Enters.*, 2007 U.S. Dist. LEXIS 88320, at *28-29; *Auto Europe*, 321 F.3d at 68.

21. *Auto Europe*, 321 F.3d at 63.

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