# INSURANCE COVERAGE FOR STATUTORY DAMAGES UNDER PROFESSIONAL LIABILITY POLICIES

By Timothy P. Law and Miranda A. Jannuzzi

*The authors of this article discuss statutory damages under professional liability policies, with a focus on the specified damages that are used as the basis of class actions under the Telephone Consumer Protection Act and the Fair Credit Reporting Act.*

Professional service companies are sued for professional negligence. It comes with the territory. Increasingly, however, professionals are faced with putative class actions involving violations of statutes that contain provisions mandating certain damages or ranges of damages. One question raised is whether these "statutory damages" are uncovered "fines" or "penalties" or whether they are covered losses.

Professional liability policies generally provide coverage for "Loss" resulting from a "Claim" for a "Wrongful Act" committed by the insured in the performance of (or failure to perform) specified professional services.[1] "Loss" is typically defined to include damages (often including punitive or exemplary damages, where insurable), judgments, settlements, and interest. Policies also normally define "Loss" to "not include" (*i.e.*, exclude) items such as "taxes, fines or penalties imposed by law."

Some statutes provide for specified damages that are used as the basis of class actions. Perhaps most prominent are the Telephone Consumer Protection Act ("TCPA")[2] and the Fair Credit Reporting Act ("FCRA").[3] Unlike damages based solely on the provable harm caused by a wrongful act, statutory damages are a finite, specified amount or range of damages, designated by statute. Often, statutes provide for such damages as an alternative to actual damages where the precise value of loss would be difficult to determine. Such damages are contained in numerous statutes, including consumer protection and intellectual property laws. When awarded, these damages are paid directly to the individuals harmed by the misconduct. This article focuses on the TCPA and FCRA,[4] as examples.

## Statutory Language

### *TCPA*

A person or entity may, if otherwise permitted by the laws or rules of court of a State, bring in an appropriate court of that State . . .

(B) an action to recover for actual monetary loss from such a violation, or to receive $500 in damages for each such violation, whichever is greater . . . .

If the court finds that the defendant willfully or knowingly violated this subsection or the regulations prescribed under this subsection, the court may, in its discretion, increase the amount of the award to an amount equal to not more than 3 times the amount available under subparagraph (B) of this paragraph.[5]

### *FCRA*[6]

Any person who willfully fails to comply with any requirement imposed under this subchapter with respect to any consumer is liable to that consumer in an amount equal to the sum of

(1)(A) any actual damages sustained by the consumer as a result of the failure or damages of not less than $100 and not more than $1,000; or

(B) in the case of liability of a natural person for obtaining a consumer report under false pretenses or knowingly without a permissible purpose, actual damages sustained by the consumer as a result of the failure or $1,000, whichever is greater;

(2) such amount of punitive damages as the court may allow; and

(3) in the case of any successful action to enforce any liability under this section, the costs of the action together with reasonable attorney's fees as determined by the court.[7]

. . . [T]he Federal Trade Commission may commence a civil action to recover a civil penalty in a district court of the United States against any person that violates this title. In such action, such person shall be liable for a civil penalty of not more than $2500 per violation.[8]

## Guidelines for Determining Whether Statutory Damages Are a Fine or Penalty

### *Guideline 1: Where a Statute Calls the Statutory Damages at Issue "Damages" and/or Separately Sets Forth Punitive Damages or a Civil Penalty, the Statutory Damages Are Compensatory in Nature and Do Not Constitute "Penalties."*

The language of many statutes call statutory damages what they are—*damages*, not penalties. For instance, as set forth above, section 1681n(a)(1) of the FCRA provides for an award of "[a]ny actual damages sustained by the consumer as a result of the failure or *damages of not less than $100 and not more than $1000.*"[9] Similarly, the TCPA provides that an individual may recover his "actual monetary loss from such a violation, or ... *$500 in damages* for each such violation, whichever is greater."[10] The legislature's use of the word "damages" shows that it did not intend the statutory damages to be "penalties." Indeed, by providing for the recovery of either actual damages or statutory damages (as an alternative to or proxy for actual damages), the legislature demonstrated its intent that the statutory damages be considered compensatory in nature.

This point is particularly stark where the statute at issue contains *separate* provisions that provide for punitive damages and/or a civil penalty. By way of example, the FCRA contains both punitive damages and civil penalty provisions. Section 1681n(a)(2) provides for punitive damages, which may be awarded in addition to the actual or statutory damages. Section 1681s, on the other hand, explicitly provides for the imposition of a civil penalty in actions brought by the Federal Trade Commission.[11] Significantly, there is no private right of action under section 1681s, so no consumer can bring a claim for civil penalties. Such punitive damages and civil penalty provisions establish, by way of contrast, that the statutory damages provision is not a "penalty" or "fine" under the structure of the statute. Statutory damages and attorney fee reimbursement provisions are designed to compensate the plaintiff, while penalties and fines are designed to punish the defendant.

In a recent ruling in New York state court, *Navigators Insurance Company v. Sterling Infosystems, Inc.* ("*Sterling Infosystems*"), the court ruled that FCRA statutory damages were not "penalties" under an errors and omissions policy.[12] Sterling Infosystems sought coverage from its insurance company for two underlying FCRA actions, where only statutory damages for willful violations were claimed.[13] Plaintiffs often only plead the statutory damages for willful violations to avoid individual damage determinations that are necessary for non-willful violations. Such individual damage determinations can prevent class certification.[14]

In *Sterling Infosystems*, the insurance company contended that it did not owe coverage on the basis of the policy's "Fines, penalties, forfeitures or sanctions" exclusion.[15] More specifically, the insurance company claimed that the statutory damages at issue in the underlying actions constituted penalties.[16] The court rejected this argument, concluding that FCRA statutory damages are compensatory in nature.[17] The court rested its decision on three grounds: (1) because actual damages are compensatory, statutory damages that substitute only for those actual damages are necessarily compensatory; (2) FCRA statutory damages facilitate litigation where actual damages are difficult or impossible to calculate; and (3) the FCRA separately provides for punitive damages and thus interpreting statutory damages as punitive is illogical.[18]

The court's decision in *Sterling Infosystems* is supported by cases decided outside of the insurance context, where numerous courts have ruled that statutory damages under the FCRA are compensatory in nature. In *Bateman v. American Multi-Cinema, Inc.*, for example, the plaintiff filed a putative class action suit under the Fair and Accurate Credit Transactions Act ("FACTA"), an amendment to the FCRA which incorporates the FCRA's statutory damages provision.[19] In addressing whether the district court's denial of class certification was proper, the United States Court of Appeals for the Ninth Circuit was required to evaluate the FCRA's statutory damages provision.[20]

The court found that, because Congress provided for punitive damages in addition to any actual or statutory damages, the statutory damages were not penal in nature.[21] In reaching its decision, the court noted:

> That Congress provided a consumer the option of recovering either actual or statutory damages, but not both, supports the presumption that they serve the same purpose. We further note that Congress provided for punitive damages in addition to any actual or statutory damages, which further suggests that the statutory damages provision has a compensatory, not punitive, purpose."[22]

Similarly, other courts have found that because Section 1681n allows an award of statutory damages, in lieu of—as opposed to in addition to actual damages—the provision could not be considered punitive.[23]

Likewise, under the TCPA, courts have consistently ruled that such damages are not penal or punitive in nature. As noted above, the TCPA allows "an action to recover for actual monetary loss from such a violation, or to receive $500 in damages for each such violation, whichever is greater."[24] Thus, like the FCRA, the TCPA allows a consumer the option of recovering his or her "actual" damages *or* statutory damages (for the TCPA, $500; for the FCRA, $100 to $1,000), but not both. In considering the TCPA, the Illinois Supreme Court in *Standard Mutual Insurance Co. v. Lay* found that the "manifest purpose of the TCPA is remedial and not penal" and that "the TCPA-prescribed damages of $500 per violation are not punitive damages."[25]

Another state high court similarly held that statutory damages under the TCPA are not fines or penalties.[26] In *Columbia Casualty Co. v. HIAR Holding, L.L.C.*, the policyholder, a marketing services company, sought coverage for TCPA statutory damages from its commercial general liability insurer.[27] The insurance company argued that the policy's reference to "damages" could not include TCPA claims because the TCPA's statutory damages provision is "a statutory penalty or fine that the law directs cannot be considered 'damages.'"[28] The Supreme Court of Missouri disagreed, ruling that TCPA statutory damages are not "in the nature of fines or penalties."[29] The decisions in *Lay* and *HIAR Holdings* continued an overwhelming trend in the precedent toward finding statutory damages under the TCPA to be remedial in nature.[30]

The takeaway from these decisions is that, in any statutory scheme, different damages may serve different purposes. Many statutory damages are proxies for actual damage that would be burdensome to prove.

### *Guideline 2: Where the Exclusion is for "Taxes, Fines or Penalties," the Term "Penalties" Must Be Read in Context as Payments Made to the Government, Not Statutory Damage Payments Made to an Individual.*

In many professional liability policies, the "penalties" exclusion is located within the phrase "taxes, fines or penalties." The doctrine of *noscitur a sociis* provides that a word gains meaning from the company it keeps; the term "penalties" keeps company with taxes and fines. Fines and taxes are payable to the government. Accordingly, the word "penalties" in this context means penalties payable to the government, not damages payable to private entities or individuals.

This rationale served as the basis for the decision of the United States Court of Appeals for the Fifth Circuit in *Flagship Credit Corp. v. Indian Harbor Insurance Co.*[31] In that case, the policyholder, Flagship Credit Corporation, was sued in a class action under the Texas Business and Commerce Code.[32] The class action plaintiffs claimed that Flagship, a company that provided automobile financing, failed to provide class members with adequate notice of default as required by Texas law.[33] The class members sought statutory minimum damages under the code. The relevant code provision provided that:

> [I]f the collateral is consumer goods, a person that was a debtor or secondary obligor at the time the secured party failed to comply with this subchapter may recover for that failure in any event an amount *not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time price differential plus 10 percent of the cash price.*[34]

Flagship ultimately settled the suit and paid the class members the statutory minimum damages.[35] The insurance company refused to indemnify Flagship for the settlement, claiming that the statutory damages constituted "penalties" and were thus excluded by the policy's "fines, penalties or taxes" exclusion.[36]

In evaluating the exclusion, the Fifth Circuit applied the doctrine of *noscitur a sociis*.[37] Aided by this canon of construction, the Fifth Circuit rejected the district court's broad interpretation of "penalties," noting that "[w]hen a term can have multiple meanings, context often is determinative."[38] When reading "penalties" within the phrase "fines, penalties or taxes," the Fifth Circuit concluded that the term "is limited to payments made to the government."[39] In reaching its decision, the court noted that "[t]he common meaning, though not the exclusive meaning, of all three terms involves a payment to the government."[40]

Indeed, the common and legal definition of "taxes" and "fines" are payments to the government. "Tax" is defined in *Black's Law Dictionary* as "[a] charge, usu. monetary, imposed by the government on persons, entities, transactions, or property to yield public revenue."[41] "Fine" is defined as "[a] pecuniary criminal punishment or civil penalty payable to the public treasury."[42] The definition of "penalty" likewise focuses on payments to the government:

> penalty. (15c) 1. Punishment imposed on a wrongdoer, usu. in the form of imprisonment or fine; esp., a sum of money exacted as a punishment for either a wrong to the state or a civil wrong (as distinguished from compensation for the injured party's loss). Though usu. for crimes, penalties are also sometimes imposed for civil wrongs.[43]

These dictionary definitions support the Fifth Circuit's rationale. Thus, a second takeaway is to analyze the words of any "penalties" exclusion in context. This is particularly important where a policy provides coverage for "punitive damages," but not penalties, a scenario which brings us to our next guideline.

### *Guideline 3: Even if Statutory Damages Are Punitive or Exemplary in Nature, They May Still Be Covered.*

It could be said, with some persuasive value, that some statutory damages provisions are designed not only to compensate, but also to punish and deter. Often, the statute has a public purpose in addition to individual compensation. Even where the statutory damages under a particular statute could be deemed punitive or exemplary, in whole or in part, the insurance policy may provide coverage. As a matter of policy interpretation, statutory damages that are not intended *solely* to punish, even if that is *one* purpose of those damages, should not be considered punitive or exemplary damages in the context of exclusionary language that must be interpreted narrowly.

Where a particular item of statutory damage is intended *solely* to punish, policyholders will need to determine the potentially applicable law and whether punitive or exemplary damages are insurable under that law. Some states will not enforce agreements to insure punitive damages while others enforce such insurance agreements solely if the liability is vicarious or is imposed under a punitive damages regime that does not require an intent to harm, such as statutes that allow punitive damages for willful or reckless conduct. Notably, some insurance policies include expansive language with respect to choice of law. Many policies insure punitive or exemplary damages "to the extent such damages are insurable under the law most favorable to the insurability of such damages of any jurisdiction which has a substantial relationship to the insured." Thus, even if matters of policy interpretation are governed under the law of a state that does not permit the insurability of punitive damages, another more favorable law may apply to bring such damages into coverage.

Where punitive or exemplary damages are insurable, the policyholder can argue that a statutory damages provision that is deemed punitive is expressly covered by the policy at issue. To avoid any attempts by the insurer to conflate "punitive or exemplary damages" with "penalties," courts can avoid rendering any policy provisions superfluous if the term "penalties" is restricted to payments to the government, whereas "punitive or exemplary damages" pertain to damages awarded to private parties solely for the purpose of punishment.

### *Guideline 4: Any "Penalties" Exclusion Must Be Strictly Interpreted in Favor of Coverage and Proven by the Insurer.*

An insurance policy is ambiguous if the language is susceptible to two reasonable interpretations.[44] It is the insurance company's duty to draft a clear insurance policy.[45] Exclusionary language must be strictly construed against the insurance company and must be proven by the insurance company.[46] Although some insurance companies may argue that the "penalties" provision is not in fact an exclusion when contained in the definition of loss, rather than in a section of the policy called "exclusions," the provision is an exclusion because its purpose is to limit coverage. Courts have consistently ruled that the exclusionary effect of insurance policy language, not its location in the policy, controls allocation of the burden of proof.[47] Furthermore, many policies contain coverage for "punitive damages" or "exemplary damages" while excluding "penalties." If the word "penalties" were too broadly construed, that word would swallow up separate provisions addressing punitive or exemplary damages.

## Conclusion

Statutory damages that are intended, in whole or in part, to compensate the plaintiff or claimant should not be considered "fines" or "penalties" under exclusionary language in professional liability insurance policies. Rather, "fines" and "penalties" should be limited solely to statutory provisions requiring payment to the government as punishment.

### *(Endnotes)*

1. Such policies may also substitute the terms "Damages" and/or "negligent act, error or omission" for the terms "Loss" and "Wrongful Act." In any event, the choice of terms does not alter the fact, as discussed in greater detail *infra*, that the "taxes, fines or penalties" exclusion is inapplicable to claims or awards for statutory damages.
2. 47 U.S.C. § 227.
3. 15 U.S.C. § 1681 *et seq.*
4. Statutory damages under the FCRA are at issue in an action currently pending before the United States Supreme Court: *Spokeo, Inc. v. Robins*, No. 13-1339. In *Spokeo*, the plaintiff Thomas Robins brought a putative class action against the operator of a "people search engine," a searchable online database of aggregated publicly available information regarding individuals' personal, educational, employment, and financial data. Robins sought statutory damages for alleged willful violations of the FCRA. The district court dismissed Robins' suit, finding that Robins lacked Article III standing. The district court held that Robins had failed to allege an injury in fact because he had not alleged "any actual or imminent harm." The United States Court of Appeals for the Ninth Circuit reversed, reasoning that the statutory cause of action did not require a showing of actual harm for willful violations and that the violation of a statutory right is a sufficient injury in fact to confer Article III standing. The Supreme Court granted cert on the question of whether a bare violation of a statute is sufficient to confer standing. While the legislative history of the FCRA's statutory damages was discussed, in part, in both the briefing and the November 2, 2015 oral

argument, neither the nature of FCRA statutory damages (as either compensatory or punitive) nor any insurance implications relating to such damages are issues before the Court.

5. 47 U.S.C. § 227(b)(3).
6. As discussed *supra*, statutory damages under the FCRA are at issue in an action currently pending before the United States Supreme Court: *Spokeo, Inc. v. Robins*, No. 13-1339. At oral argument, the Justices directed questions and made comments relating to:
   (1) Whether Congress recognized and identified a concrete harm in statutory violations of the FCRA;
      – Justice Kagan stated that "it seems pretty clear what [Congress] wanted to do here; that this statute is entirely about preventing the dissemination of inaccurate information in credit reports which they seem to think is both something that harms the individual personally and also harms larger systemic issues. And then they gave the cause of action to the people it harmed personally." On the other hand, Justice Scalia noted that Congress did not identify misinformation as the harm for which it allowed suit to be brought, but identified as the harm "the failure to follow the – the procedures that it imposed upon credit reporting agencies."
   (2) Whether, notwithstanding Congress' intent, a violation of the FCRA itself causes a concrete harm and which violations of the FCRA cause a concrete harm;
      – Justice Kagan stated that the dissemination of false information about a particular person "seems like a concrete injury to me." Later, Justice Breyer, in noting that "there could be all different kinds of harm," asked then "why isn't what [Justice Kagan] said right, that one kind of harm could be the harm suffered when somebody tells a lie about you, or gives false information?" On the other hand, Justice Scalia pointed out that, based upon the language of the statute, finding a concrete harm in a violation "would lead to the conclusion that anybody can sue . . . not just somebody who – whose information was – was wrong."
   (3) Whether the specific falsities reported about Robins amounted to a concrete harm;
      – In noting that Robins' marital status was falsely reported, Justice Sotomayor stated that "I will tell you that I know plenty of single people who look at whether someone who's proposed to date is married or not. So if you're not married and there's a report out there saying you are, that's a potential injury. Now, I know the court below said it was speculative, but that's what Congress was worried about: both creditworthiness, and – and your stature as a person, your privacy, your sense of self; that . . . others can identify me with some accuracy." On the other hand, Justice Alito later asked, given then that was no evidence of record that anyone besides Robins did a search for himself, "then isn't that quintessential speculative harm?"

   Depending upon how the Court rules, there could be implications as to whether statutory damages are compensatory in nature or represent some other form of damages, as opposed to fines or penalties.
7. 15 U.S.C. § 1681n.
8. *Id.* § 1681s(a)(2).
9. *Id.* § 1681n(a)(1) (emphasis added).
10. 47 U.S.C. § 227(b)(3)(B) (emphasis added).
11. 15 U.S.C. § 1681s (emphasis added).
12. No. 653024/2013, 2015 WL 4540389, at *4-5 (N.Y. Sup. Ct., N.Y. Cnty. July 28, 2015).
13. *Id.* at *1.
14. *See* Fed. R. Civ. P. 23(b)(3) (providing that a class action may be maintained only if "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members").
15. *Sterling Infosystems*, 2015 WL 4540389 at *2.
16. *Id.*
17. *Id.* at *4-5.
18. *Id.*
19. 623 F.3d 708, 711 (9th Cir. 2010).
20. *Id.* at 717-18.
21. *Id.* at 718.
22. *Id.* (internal citations omitted).
23. *Harris v. Mexican Specialty Foods, Inc.*, 564 F.3d 1301, 1313 (11th Cir. 2009) ("Because the FCRA already contains a punitive damages provision and specifies that statutory damages may only be awarded in lieu of actual damages, the district court erred in concluding that the statutory damages provision is tantamount to a punitive damages provision."); *Stillmock v. Weis Mkts., Inc.*, 385 Fed. App'x 267, 277 (4th Cir. 2010) ("The fact that statutory damages are available in lieu of actual damages suggests that they too serve to compensate individual consumers for their injuries."); *In re Trans Union Corp. Privacy Litig.*, 211 F.R.D. 328, 342 (N.D. Ill. 2002) ("Whatever its reason, the statute unambiguously indicates that statutory damages can be awarded in lieu of, but not in addition to, actual damages. Therefore, the statutory damage provision acts as compensation, and is not punitive."); *see also Ashby v. Farmers Ins. Co. of Or.*, 592 F. Supp. 2d 1307, 1317 (D. Or. 2008) (noting that statutory damages under the FCRA are awarded as an alternative to actual damages); *Ramirez v. Midwest Airlines, Inc.*, 537 F. Supp. 2d 1161, 1168 (D. Kan. 2008) (noting that statutory damages are "in the nature of compensatory damages").
24. 47 U.S.C. § 227(b)(3)(b).
25. *Standard Mut. Ins. Co. v. Lay*, 989 N.E.2d 591, 599, 600 (Ill. 2013).
26. *Columbia Cas. Co. v. HIAR Holding, L.L.C.*, 411 S.W.3d 258, 268 (Mo. 2013).
27. *Id.* at 262.
28. *Id.* at 266.
29. *Id.* at 268.
30. *See Penzer v. Transp. Ins. Co.*, 545 F.3d 1303, 1311 (11th Cir. 2008); *Universal Underwriters Ins. Co. v. Lou Fusz Auto. Network, Inc.*, 401 F.3d 876, 881 (8th Cir. 2005); *Terra Nova Ins. Co. v. Fray-Witzer*, 869 N.E.2d 565, 575 (Mass. 2007); *Motorists Mut. Ins. Co. v. Dandy-Jim, Inc.*, 912 N.E.2d 659, 668 (Ohio Ct. App. 2009).
31. 481 F. App'x 907 (5th Cir. 2012).
32. *Id.* at 909.
33. *Id.*
34. *Id.* (citing Tex. Bus. & Com. Code § 9.625(c)(2)) (emphasis added).
35. *Id.*
36. *Id.* at 909-10.
37. *Id.* at 912.
38. *Id.* at 911-912.

39. *Id.* at 912.
40. *Id.* at 911.
41. *See Black's Law Dictionary* 1594 (9th ed. 2009).
42. *Id.* at 708.
43. *Id.* at 1247.
44. *See Am. Surety Co. of N.Y. v. Pauly*, 170 U.S. 133, 144 (1898) (recognizing as "a well established rule in the law of insurance" that ambiguities in insurance policy language must be construed against the insurance company); *Prudential Prop. & Cas. Ins. Co. v. Sartno*, 903 A.2d 1170, 1177-78 (Pa. 2006) (recognizing that any reasonable interpretation of insurance policy language favoring the policyholder should be adopted, even if there are other reasonable interpretations, because, as the party who selects the language used in the insurance policy, the insurance company must be clear and specific in its use).
45. The New Jersey Supreme Court has described the identical rule, recognizing that in determining the existence of ambiguity, "courts should consider whether more precise language by the insurer, had such language been included in the policy, 'would have put the matter beyond reasonable question.'" *Gibson v. Callaghan*, 730 A.2d 1278, 1282 (N.J. 1999).
46. New York's highest court, the New York Court of Appeals, has ruled that an insurance company bears the burden to prove with competent record evidence three related propositions to negate coverage by virtue of an exclusion: (1) the exclusion is stated in clear and unmistakable language; (2) the exclusion is subject to no other reasonable interpretation; and (3) the exclusion applies in the particular case. *Incorporated Vill. of Cedarhurst v. Hannover Ins. Co.*, 89 N.Y.2d 293, 298, 675 N.E.2d 822, 824, 653 N.Y.S.2d 68, 70 (1996).
47. *See, e.g., Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1205 (2d Cir. 1995) (rejecting insurers' position that the location of the provision controlled); *Borough of Moosic v. Darwin Nat'l Assurance Co.*, No. 12-3141, 2014 WL 407477, at *5 (3d Cir. Feb. 4, 2014) (finding that a "Related Claims" provision located in the policy's "Conditions" section limited coverage and was thus an exclusion); *Auto-Owners Ins. Co. v. Newsome*, No. 4:12-cv-447, 2013 WL 5797729, at *5 n.7 (D.S.C. Oct. 25, 2013) (finding that a provision was an exclusion even though it was listed underneath the definition of an insured); *Munich Reins. Am., Inc. v. Tower Ins. Co. of N.Y.*, No. 09-CV-2598, 2012 WL 2917576, at *4 (D.N.J. July 17, 2012) ("[W]here the language behaves like an exclusion of the coverage grant by the very operation of its terms, the insurer should bear the burden of proving the phrase's application.") (internal quotation marks omitted); *Wall Rose Mut. Ins. Co. v. Manross*, 939 A.2d 958, 962-63 (Pa. Super. Ct. 2007) (placing the burden of proof on insurer to demonstrate that exclusionary clause within the definition of "insured" precludes coverage).

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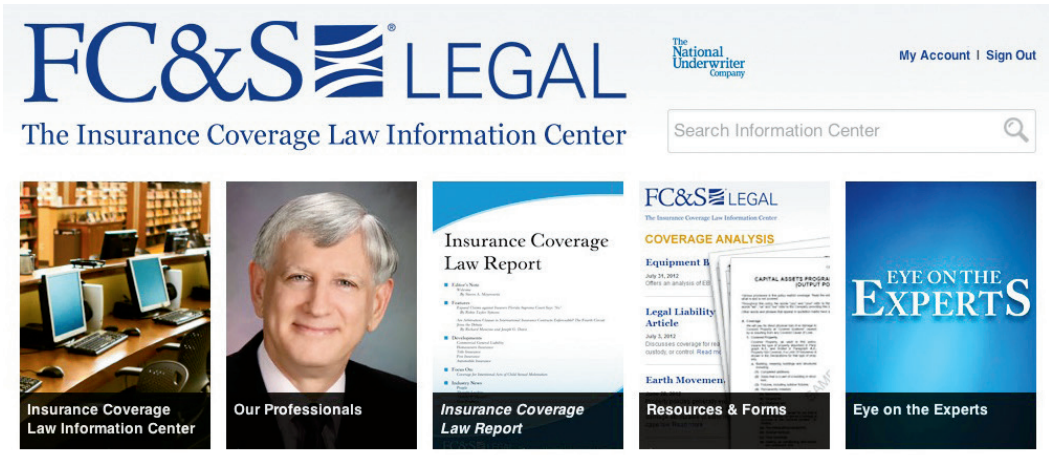


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