

Unfair Trade Practices Exclusion Inapplicable to Claims Arising Under Fair Debt Collection Statutes; Statutory Damages Covered

July 2013

The United States District Court for the Middle District of Pennsylvania has held that an E&O policy issued to a now-bankrupt credit counseling company did not cover claims arising under unfair trade practices statutes, but did cover claims arising under fair debt collection statutes. *Hrobuchak v. Fed. Ins. Co.*, 2013 WL 2291875 (M.D. Pa. May 24, 2013). The court also held that carve-outs from the policy's definition of loss did not preclude coverage for statutory damages or damages representing the return of fees paid to the insured.

In 2008, a putative class action lawsuit alleging violations of the federal Fair Debt Collection Practices Act, the Pennsylvania Fair Credit Extension Uniformity Act and Pennsylvania's Unfair Trade Practices Act (UTPA) was filed against the insured. After the insured filed for chapter 11 bankruptcy protection in January 2009, the class action was stayed, and a class proof of claim was filed with the bankruptcy court on behalf of the same class. The bankruptcy court subsequently entered a "Judgment Allowing Proof of Claim," effectively certifying a class of claimants against the insured for alleged damages resulting from improper debt collection practices and authorizing the claimants to enforce the judgment against the debtors' insurance policy. Following the bankruptcy court's adoption of the insured's liquidation plan, class representatives filed a declaratory judgment action against the insurer in federal district court. After unsuccessfully moving to dismiss the declaratory judgment action, the insurer moved to vacate the bankruptcy court confirmation order and judgment allowing the proof of claim and separately moved for summary judgment. The class claimants moved for class certification and cross-moved for summary judgment.

Addressing the summary judgment motions, the district court first held that the policy did not exclude coverage for claims alleging violation of fair debt collection statutes. A provision of the policy excluded from coverage "any Claim . . . based upon, arising from, or in consequence of allegations of . . . unfair trade practices . . . or any similar provision of any federal, state, or local statutory law or common law." Although the provision excluded coverage for alleged violations of Pennsylvania's UTPA, the court held that the exclusion did not exclude claims for violations of fair debt collection statutes. Those statutes, according to the court, "are not unfair trade practice statutes."

Next, the court held that coverage for the judgment was not barred by the policy's carve-outs from the definition of loss for "the return of fees or other compensation paid to the Insured" and for "taxes, fines or penalties imposed by law." First, the court rejected the insurer's argument that "compensation paid to the Insured" included amounts representing the return of fees allegedly paid to the insured by class members as a result of unlawful collection notices. The insurer argued that allowing coverage for these amounts would result in a windfall. According to the court, however, this provision did not apply "[i]n light of Pennsylvania's limited use of public policy to bar insurance coverage and the finding that there is no possibility of windfall to the tortfeasor in this case" because the insured was bankrupt and would not collect insurance proceeds.

Second, the court rejected the insurer's argument that statutory damages under the federal and state fair debt collection statutes are punitive, rather than compensatory, and thus barred by the carve-out for "taxes, fines or penalties imposed by law." The court distinguished a case holding that statutory damages under the Fair and Accurate Credit Transactions Act are punitive by examining the type of harm caused by the violation, concluding that "the potential risk of harm posed by publication of credit card information [is] markedly different from the type of harm that occurs when an individual personally receives an overbearing collection notice." The court found that in the latter case, "the statutory damage provision . . . provides for administrative efficiency in ascertaining damage to individuals," the "fundamental goal" of which is "to compensate those who suffer legal injury."

The court held, however, that the claims-made policy only provided coverage for claims arising out of wrongful acts occurring after the policy's prior acts date and before the expiration of the policy period, and that the class certified by the bankruptcy court in its order "reflects a larger class" of claims "based on an unlimited temporal scope." But the court did not accept the insurer's contention that the entire claim should fail because the class plaintiffs did not identify which portions of the judgment were attributable to covered activities: "[t]o the extent the [insurer] seeks to challenge the calculations of the judgment, its argument is with the Bankruptcy Court." The district court ultimately held that it could not "provide the ultimate relief the plaintiffs seek, the entry of judgment, because questions remain over which the Bankruptcy Court has retained jurisdiction."

The court also rejected the insurer's motion to vacate as "an untimely appeal" of the bankruptcy court's order, and held that the motion for class certification was moot in light of the bankruptcy court's allowance of the claimants' proof of claim on a class basis. Finally, the court held that, regardless of whether the Pennsylvania direct action statute applied, the class claimants had standing because the insured's liquidation plan as adopted by the bankruptcy court judgment operated as an assignment of the insured's rights under the policy to the plaintiffs.