

Violations of Consumer Protection Law Considered Intentional Acts That Do Not Constitute a “Wrongful Act”

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The United States District Court for the District of Kansas, applying Arizona law, has held that no coverage is available under an E&O policy for a judgment in a Federal Trade Commission (FTC) action against the insured that established that the insured violated certain consumer protection statutes. *Fed. Trade Comm'n v. Affiliate Strategies, Inc.*, 2013 WL 5304082 (D. Kan. Sept. 20, 2013). In so holding, the court ruled that the insured's intentional conduct did not fall within the policy's insuring agreement because the conduct did not constitute a “wrongful act” under the policy and that coverage was further barred by the “regulatory authority” exclusion and dishonesty exclusion.

The FTC and several state attorneys general brought suit against the insured and several other co-defendants alleging that the defendants violated the Telemarketing and Consumer Fraud and Abuse Prevention Act by “marketing and selling goods and services upon the unfounded promise or representation that the buyers of the goods and services would have success in obtaining government grants.” The court ultimately ruled against the insured and entered judgment of approximately \$1.7 million, which was to be used for “consumer redress,” with any remaining funds to go to the U.S. Treasury as disgorgement.

The E&O insurer defended the insured in the underlying action under a reservation of rights. Once judgment was entered against the insured, the FTC filed a writ of garnishment to collect the judgment under the policy. The insurer sought to quash the writ of garnishment.

In the ensuing coverage action concerning the writ of garnishment, the district court held that coverage was not available for the judgment for several reasons. First, the court ruled that the insured's conduct at issue did not constitute a “wrongful act,” which was defined as a “negligent act, error or omission.” The court found that “[t]he conduct ascribed to [the insured] and her company in [the underlying] order does not constitute negligence. It is intentional and conscious wrongdoing or conscious avoidance of knowledge of other defendants' wrongdoing. Therefore, it is not covered” The court rejected the FTC's argument that the insured's conduct might have been intentional but that the resulting harm was unintentional, stating that there was “no possibility” that the FTC, standing in the shoes of the insured, would be able to meet its burden under Arizona law for determining an insured's intent.

The court also held that coverage was further precluded by the "regulatory authority" exclusion, which barred coverage for any claim by "[a]ny regulatory authority or any administrative actions brought by any federal, state or local governmental entity." The court recognized that "[t]his case involved allegations by the FTC and State Attorneys General that [the insured] violated an FTC regulation" and that the FTC and the state attorneys general constituted regulatory authorities implicating the exclusion. The court rejected the FTC's argument that "regulatory authority" exclusions can only be enforced where the exclusion specifically identifies the regulatory entities. The court further rejected the FTC's contention that the reasonable expectations doctrine should preclude enforcement of the exclusion because the exclusion was not prominently displayed in the policy and was "vaguely phrased," finding that the "exclusion is sufficiently clear and obvious to an insured that it should not be considered contrary to reasonable expectations."

In addition, the court held that coverage was further precluded by the exclusion barring coverage for claims "for, arising directly or indirectly out of, or alleging . . . gain, profit or advantage to which [the insured is] not legally entitled." Addressing this exclusion, the court commented that because the underlying judgment "ordered that [the insured] pay as 'consumer redress' the entire amount of compensation she received while substantially assisting the [statutory] violation," the "award of damages arose 'directly or indirectly' from 'gain, profit or advantage' to which [the insured] was not legally entitled, because it derived from her substantial assistance and facilitation of the [statutory] violation." The court also held that coverage was barred by the exclusion precluding coverage for "[a]n act or omission that a . . . court . . . finds dishonest, fraudulent, criminal, malicious or was intentionally committed while knowing it was wrongful" because the underlying court found that the insured "should pay damages for actions which were intentionally committed while knowing they were wrongful."

While the court granted the insurer's motion to quash the writ of garnishment, the court did comment that, notwithstanding the finding of no coverage, the "money judgment ordered by [the underlying court] reasonably falls within" the policy's definition of "damages," which was defined, in relevant part, as a "money judgment, award or settlement, except those for which insurance is prohibited by law." In this regard, the court noted that the underlying judgment refers to the monetary award as "damages" and that Arizona law does "not always hold that damages awarded as restitutionary relief are prohibited by public policy."