

ALERT

Statutory Civil Damages Are "Penalty" and Therefore Not "Loss"

April 29, 2011

The United States District Court for the Southern District of Texas has held that because a policy's definition of "Loss" carved out "penalties," amounts sought in an underlying civil suit for violation of technical notice requirements were not covered when those amounts were calculated without reference to actual damages suffered by the claimant. *Flagship Credit Corp. v. Indian Harbor Ins. Co.*, No. 4:10-cv-3616 (S.D. Tex. Apr. 29, 2011). Wiley Rein LLP represented the insurer.

The underlying litigation was a class action suit for purported violations of Texas U.C.C. provisions regarding notices sent in connection with repossession and resale of vehicles sold to consumers. The underlying plaintiff's court filings stated that the proposed class sought only statutory damages under sections that provide for calculation of damages without reference to any actual harm suffered by the claimant in connection with the lender's violation of the law.

The E&O policy at issue defined Loss as "damages, judgments, settlements or other amounts," and further provided that Loss would not include, among other things, "fines, penalties or taxes imposed by law." The insurer agreed to advance defense costs for the underlying litigation, but declined to indemnify any amounts paid to the claimant to settle the case. It explained that because the statutory damages were punitive and unconnected to any harm to the underlying plaintiffs they were a "penalty" under the policy. The insured company filed suit seeking a declaration of coverage for a proposed settlement, and the insurer filed a cross-complaint seeking a declaration of no coverage for the settlement. On cross-motions for summary judgment, the court granted judgment for the insurer.

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The court rejected the company's argument that a "penalty" is generally understood to be payable to a government body, explaining that the Black's Law Dictionary definition to which the company cited for that understanding defined "penalty" in a broader fashion. The court noted that under the definition in that dictionary, the underlying complaint's prayer for statutory minimum damages not based on actual damages sought a "penalty."

The court also rejected the policyholder's argument that because "penalties" appeared between "fines" and "taxes" in the policy language, the court should construe the term to mean only penalties payable to governmental entities. "Under the plain language of the definition, fines imposed by law, penalties imposed by law, and taxes imposed by law are all excluded from the definition of 'Loss,' whether the fines, penalties, or taxes are payable to governmental bodies or not."

The court further noted that the Texas Supreme Court had described the operation of the statute as imposing a "penalty." The court also rejected the policyholder's argument that the provision was ambiguous, noting that the policyholder had not proposed a reasonable construction of the policy language under which coverage would exist.

Accordingly, the court denied the policyholder's motion for summary judgment, granted the insurer's motion for summary judgment, and dismissed the policyholder's complaint with prejudice.