JENNER&BLOCK

March 5, 2014

Vol. 1, Issue 2

Winter 2014

Insurance Law Update

Illinois Supreme Court Holds That Insurer Must Cover Statutory Liquidated Damages

By Daniel A. Johnson

PRACTICAL POLICYHOLDER ADVICE

Before settling a lawsuit, policyholders should attempt to obtain the consent of any insurers whose policies may fund the settlement, including excess and umbrella liability insurers. Failure to obtain an insurer's consent may result in a forfeiture of coverage. When insurers are unwilling to consent to the settlement, policyholders should review the applicable policy language and law to determine whether coverage would be available for a settlement not consented to by insurers. For example, consent may not be required where the insurer has denied coverage or has provided a defense subject to a reservation of rights. When the insurer refuses to consent, it may be necessary to bring a lawsuit to establish the policyholder's rights, as in the case discussed below, where a policyholder successfully sued to establish that damages under the Telephone Consumer Protection Act (TCPA) were not punitive and thus could be paid by the insurer.

The Illinois Supreme Court recently held that liquidated damages under the Telephone Consumer Protection Act (TCPA) were not punitive in nature, and thus could be indemnified under a commercial general liability (CGL) policy. *Standard Mut. Ins. Co. v. Lay*, 989 N.E.2d 591, 599–600 (Ill. 2013). Moreover, on remand, the appellate court held that the insurer was required to fund the settlement of a TCPA suit, even though the insurer did not consent to the settlement. *Standard Mut. Ins. Co. v. Lay*, 2 N.E.3d 1253, 2014 WL 272773, at *7 (Ill. App. Ct. 2014). This case may prove to have a significant impact on how courts determine whether damages under statutes with similar liquidated damages provisions can be indemnified and in determining whether an insurer's consent to settlement is required.

In this case, an Illinois real estate agent hired a marketing firm to send "blast fax" advertising to thousands of fax machines. The marketing firm represented to the agent that the recipients of the faxes had consented to receiving such messages. However, in a class action lawsuit against the agent, recipients of the faxes contended that they had not consented to receiving such advertising, such that the "blast fax" violated the TCPA. The TCPA provides for liquidated damages of $500 for each fax sent.

The agent tendered his defense to his CGL insurer, Standard Mutual Insurance Company (Standard), which agreed to provide a defense under a reservation of the right to deny coverage if the statute's liquidated damages were later held to be an uninsurable penalty. In doing so, Standard argued that, as a general principle, it was against public policy to indemnify punitive damages.

Because Standard reserved its rights, there was a conflict of interest permitting the agent to select independent counsel not controlled by the insurer. The agent's independent counsel then settled the litigation for $1,739,000 plus costs, the full amount sought in the class action complaint, but failed to obtain Standard's approval before agreeing to the settlement, as was required by the policy language at issue.

In response to the settlement, Standard filed an action in Illinois state court for a declaratory judgment that it had no duty to indemnify the TCPA damages, claiming that they were an uninsurable penalty. The trial court granted Standard's motion for summary judgment, and the appellate court affirmed, holding "the $500 in liquidated damages provided in the TCPA is a penalty and is in the nature of punitive damages. They are not insurable as a matter of Illinois law and public policy and are not recoverable from Standard." *Standard Mut.*

Ins. Co., 975 N.E.2d 1099, 975 N.E.2d 1099, 1106 (Ill. App. Ct. 2012), *rev'd*, 989 N.E.2d 591, 599–600 (Ill. 2013). The appellate court reasoned that the TCPA's damages of $500-per-fax were "far in excess of the [fax's] cost to the recipient," which would amount to no more than "the cost of a sheet of paper and some toner, as well as the brief time involved in an employee taking the unwanted fax from the fax machine." *Id.* at 1105. Thus, the appellate court concluded that the statutory damages of $500-per-violation "is a penalty to the sender." *Id.*

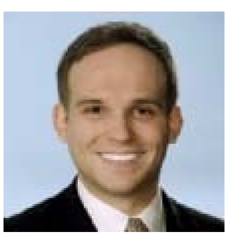
Reversing the appellate court's decision, the Illinois Supreme Court held that "[t]he manifest purpose of the TCPA is remedial and not penal." *Standard*, 989 N.E.2d 591, 599. In support, the Supreme Court cited Congressional findings that "blast faxes" impose a burden on interstate commerce involving not only "loss of paper and ink," but also significant "annoyance and inconvenience," making the damages at least partially directed towards compensating subjective, non-economic damages. *Id.* at 599–600. The Supreme Court also reasoned that "Congress intended the $500 liquidated damages available under the TCPA to be, at least in part, an incentive for private parties to enforce the statute. This added incentive is necessary because the actual losses associated with individual violations of the TCPA are small." *Id.* at 600. Besides liquidated damages, the statute included potential treble damages that were much more obviously punitive in nature, suggesting to the Supreme Court that the default liquidated damages were not intended to be penal as well. *Id.* at 600.

On remand, the appellate court held the policyholder did not breach his duty to obtain the insurer's consent to settlement. *Standard*, 2014 WL 272773, at *6. Because Standard had raised policy defenses when agreeing to provide a defense under a reservation of rights, the appellate court reasoned Standard's judgment of whether to fund the settlement was clouded by a conflict of interest. *Id.* Thus, the policyholder was relieved of his duty to obtain Standard's approval to settle. *Id.* This duty also was relieved because the settlement did not prejudice Standard's interests and was clearly reasonable: "[t]he amount was supported by simple math," *i.e.*, $500-per-violation multiplied by the number of violations alleged. *Id.* at *7.

The reasoning in this cases as to the insurability of damages under the TCPA should be applicable to claims for liquidated damages under other statutes. Policyholders should push back against insurers' contentions that they cannot indemnify statutory liquidated damages. In addition, this case demonstrates important limits to an insurer's right to insist on obtaining consent to a settlement, limits that policyholders should keep in mind.

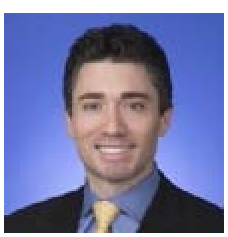
Daniel A. Johnson would like to thank Brian S. Scarbrough (Partner, Washington, DC) for his contributions to this article.

Contact Us



Daniel A. Johnson
Associate

Phone: 312 840-7411
Email: djohnson@jenner.com
Download V-Card



Brian S. Scarbrough
Partner

Phone: 202 637-6306
Email: bscarbrough@jenner.com
Download V-Card