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Protecting Your Company From Consumer Protection Claims

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Companies in virtually every sector of the economy have become targets of allegations that their business practices or products have injured consumers. These cases often arise as class actions, frequently exposing target companies to the risk of significant defense costs, liability, or a product recall. In the face of the ever-increasing risk of consumer protection claims, most companies have put into place risk management strategies that principally rely on a variety of insurance policies. All too often, though, when a company needs its insurance most, it finds that it does not get the protection that it expects. Instead, insurers frequently make every effort to evade payment under their policies.

Plaintiffs in consumer protection or class actions have asserted that companies' business practices and products cause a wide assortment of harms, such as advertising-related injuries, damage or loss of property, consumer fraud, invasion of privacy and improper trade practices. For example, one recent consumer class action alleged that department stores improperly collected telephone numbers from credit card customers for marketing purposes in violation of the consumers' privacy rights. Another recent class action asserted that a large retail chain violated various consumer laws that require pricing to be apparent on certain retail items. Increasingly, consumer claims allege improper conduct relating to technology, such as alleged misrepresentations in the advertising of the battery life of MP3 players or suits alleging consumer law violations by internet spammers and purveyors of pop-up ads and spyware.

In this legal environment, every company that designs, markets or sells products or services to the public must prepare for the possibility that it may face costly consumer protection claims.

Even as they strive to avoid circumstances that might lead to consumer protection claims, most American businesses rely on their insurance to protect against the financial consequences of consumer protection claims. Unfortunately, when a claim arises, many companies find that their insurers make every effort to minimize, or even avoid entirely, their coverage obligations.

Accordingly, companies designing and implementing risk management strategies must pay careful attention to potential pitfalls that might undercut their insurance recovery efforts. Then, when confronting consumer protection claims, companies must act quickly and effectively to protect their insurance coverage.

PROTECT YOUR COMPANY

Although the facts of each case differ, companies can more effectively protect against the financial consequences of consumer protection claims by applying three fundamental insurance lessons.

Identify All Potentially Applicable Insurance Policies

CGL Policies

Consumer protection claims can implicate a variety of insurance policies that companies commonly maintain. The type of policy that applies to any particular consumer protection action depends on the allegations asserted in that action. However, under most circumstances, companies will look first to their comprehensive general liability ("CGL") policies or their directors and officers ("D&O") policies for coverage for consumer protection allegations.

CGL policies provide broad coverage against third-party claims alleging damages resulting from a company's products or corporate behavior. Among other things, CGL policies generally cover a company for liability to claimants asserting bodily injury, property damage and damages resulting from certain specified business or advertising practices.

Some consumer protection actions fall squarely within the coverage that CGL policies provide. For example, these policies generally would cover consumer claims asserting that an unintentional misrepresentation about a company's product caused physical damage to a consumer's tangible property. Since coverage under CGL policies is broad, however, they may not always cover all of the types of allegations asserted in, or that result from, consumer protection claims. For instance, although CGL policies generally cover injuries resulting from disparaging advertising, insurers often argue that such policies do not cover advertising fraud or misrepresentation claims about a company's own products, absent some consequential property damage or bodily injury. In addition, these policies provide coverage for only limited types of economic harms, including specified advertising or business-related injuries and in some cases the loss of use of a consumer's property.

D&O Policies

Some D&O policies provide companies with coverage where CGL policies may not. D&O policies typically cover alleged "wrongful acts" of a company's directors and officers. These policies also sometimes cover the company itself for its own conduct. Although the terms of D&O policies vary substantially, some of them define organizational "wrongful acts" broadly. Under such policies, companies may have expansive coverage for economic harms that CGL policies might exclude. For example, some D&O policies cover misrepresentations in the sale of a company's own products, a category that insurers generally argue that CGL policies exclude.

Specialty Policies

In addition to CGL and D&O policies, companies occasionally purchase specialty policies to cover claims that the others may not. For instance, where CGL policies exclude coverage for the costs of a product recall, specialty product recall policies can fill in that potential gap in

a company's coverage program. Other specialty products, such as policies covering food contamination liability, are designed for the risks faced by particular lines of business.

Be Careful

Even where an insurance policy may appear at first blush to cover a particular consumer protection claim, insurers often point to ambiguous policy language or to a policy's exclusions to attempt to evade what otherwise would be their clear coverage obligation. Policyholders, though, should not be daunted by an insurer's efforts to avoid payment under its policies. There often are strong counterarguments to the insurers' positions, and many insurer arguments depend on legal positions that policyholders in other contexts already have litigated successfully. For example, courts have found that exclusions for intentional misconduct in certain D&O policies apply only if the court in the underlying case (and not in separate coverage litigation) found the existence of such intentional misconduct by final adjudication. Similarly, an actual adjudication of malicious intent or knowledge may be required for intent-related exclusions to apply under CGL coverage.

Moreover, most states place a high burden on insurers to prove that a policy excludes coverage for a particular consumer protection claim and require courts to construe such exclusions narrowly and in favor of coverage. Indeed, most states have clear case law that any ambiguities in an insurance policy must be construed in favor of coverage.

Companies also should be aware that policies from past years sometimes can pay for later-asserted consumer protection claims. Depending on the specific allegations of the claim and the policy's particular terms, companies have been able to recover under insurance policies issued in multiple years, substantially increasing the available coverage. Accordingly, it is critical for companies to maintain copies of all of their insurance policies until well after the policy periods have expired, as well as to provide notice under all policies that arguably might apply to a particular claim.

Recognize the Role of Insurance in Business and Defense Plans

Because of the variety of potentially available insurance policies and the range of potential consumer protection claims, it is critical for companies to understand how their insurance fits into a company's overarching business plan. Each company's business exposes it to a unique range of risks, some of which may not be covered by the standard policies. Accordingly, companies must evaluate the extent to which they need to spread their business risks and, in acquiring insurance coverage or other risk-spreading products, should work to meet their particular business' requirements.

In acquiring insurance coverage, companies must be aware that insurers commonly seek to include in their policies complex and ambiguous provisions. Insurers then may attempt to use those provisions to deny or limit coverage when losses occur. Often, though, insurers are willing to negotiate the particular terms of a corporate insurance policy. As a result, it is important that companies involve their counsel in the underwriting process to supplement the expertise of their risk managers and outside brokers. Including counsel at the front-end negotiations can help to ensure that a company purchases the insurance program that is the best fit for their business and can minimize problems when a claim arises. Similarly, in the days following the filing of a consumer protection claim, it is critical for companies to

consider how their insurance and defense strategies interact. Insurers might rely on positions a company takes in its defense to try to reduce the insurer's own coverage obligations. Consequently, how a company describes a claim in its defensive pleadings might have a significant impact on how much coverage is available. For example, although most CGL policies provide coverage for invasion of privacy both in advertising and in other business activities, some policies contain coverage limitations that apply only if "advertising" is at issue. A company thus inadvertently can affect its ability to obtain coverage depending on whether it characterizes the activities at issue as advertising.

The reverse also is true. Insurance policy provisions can affect how a company defends the consumer protection claim. For example, many insurance policies provide that every dollar that an insurer pays to defend the underlying claim reduces the amount available to pay any resulting liability. Similarly, some insurer defenses do not apply when a policyholder settles the underlying claim without making certain admissions (such as admissions regarding intent). These types of policy provisions can dramatically affect a company's defense strategy.

To ensure that a company's defense and insurance efforts are well coordinated, companies must fight the temptation to focus first on their defense and only later on insurance. This is particularly important because actions that a policyholder takes early in its defense can affect what coverage ultimately is available. Many insurance policies contain requirements for prompt notice and other cooperation that insurers assert act as preconditions to coverage. As a result, insurers might rely on any delay in satisfying these insurance provisions to seek to vitiate coverage.

Enforce Your Insurer's Defense and Settlement Obligations

When a company faces consumer protection allegations, it may be immediately compelled to spend substantial amounts to defend and settle the claims against it. To reap the benefit of the insurance coverage it purchased, companies must be prepared to enforce fully their insurers' obligations to pay for those amounts both for the defense and settlement of claims. Most companies' insurance policies that apply to consumer protection claims obligate the insurer either to defend the company or to pay the company's costs of defending against

consumer protection claims. Generally, an insurer's defense obligation is broader than its obligation to pay for any resulting liability. That means that a company may be entitled to a complete defense for a claim even if some or all of the allegations ultimately are determined not to be covered under the insurance policy.

Indeed, under most states' laws, insurers' defense obligations apply if any part of a claim against their policyholder is covered. Insurers might argue that they only should be required to pay for that portion of a company's defense costs attributable directly to allegations that would be covered under the policies. Companies should be skeptical of such an argument. Generally, an insurer can apportion defense obligations only if it can prove that certain defense costs are severable from the remainder of the costs and attributable only to allegations that are not covered under the policy. Under some states, even where insurers can make such a showing, they still are obligated to pay all of their policyholders' defense costs. Companies should understand, however, that some D&O policies may require the

policyholder to pay defense costs back to the insurer if it later is determined that the policy in fact did not cover the claim at issue.

Moreover, when an insurance company seeks to pay for a company's defense while concurrently reserving its right ultimately to deny coverage for the company's liability, the company's and its insurance carrier's interests might conflict. This divergence of interests can have very significant consequences.

Be aware that, where an insurer's interests in defending its policyholder can be shown to conflict with the policyholder's interests in its own defense, policyholders sometimes have the right to insist that the insurer provide the company with independent defense counsel at the insurer's expense. This right can be quite valuable because it gives a corporate defendant the comfort that its rights are being championed by a lawyer who has the corporation's, rather than the insurer's, best interests in mind.

The divergence of a company's and its insurer's interests is nowhere more evident than where a company and its insurer must consider an opportunity to settle the underlying consumer protection claim for the available insurance proceeds. In that situation, the company may want to accept the settlement, which entirely eliminates any risk that the policyholder will be required to contribute its own cash to the settlement. At the same time, the insurer has an incentive to reject the settlement and to defend the case, in effect gambling with its policyholder's money that it can reduce the liability below the amount that it would be required to pay under the proposed settlement.

In recognition of this dynamic, many states impose on insurers a fiduciary duty to consider their policyholder's interests equal to or above their own interests. This fiduciary duty can override any policy provision that requires as a condition of coverage that an insurer consent to its policyholder's settlement. As a result, particularly where an insurer denies coverage, companies generally can bind their insurers by a reasonable settlement of a consumer protection claim even absent insurer consent. By understanding and enforcing fully their insurer's defense and settlement obligations, companies facing consumer protection allegations may be able to reduce substantially the financial impact of such claims.

CONCLUSION

Consumers and their lawyers constantly explore new theories to recover from companies for alleged injuries. As the claims against businesses evolve, effective use of insurance policies to cabin the risk of these claims becomes increasingly critical to a company's business strategy. Understanding how a company's insurance coverage works before claims strike will improve the company's ability to effectively acquire and manage this valuable asset.

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