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IN PRACTICE

CONSUMER PROTECTION

Does the Consumer Fraud Act Apply to First-Party Insurance Claims?

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The N.J. Consumer Fraud Act (CFA) is a powerful statute that protects the rights of consumers in various types of commercial transactions, allowing plaintiffs to recover treble damages and attorneys' fees. A vexing question for lawyers is exactly how far it reaches. This holds true for those who practice in the field of insurance law.

While the N.J. Supreme Court has ruled that the CFA applies to the sale of insurance policies, in recent years courts have differed on whether it applies in the context of first-party insurance denials — that is, when a policyholder files a lawsuit against an insurance company due to its failure to pay insurance benefits.

Can the case law be distilled to produce an answer to this controversy? The short answer is, yes. The CFA likely applies to the failure or refusal to pay insurance benefits, and almost certainly applies to such cases that allege a widespread scheme to defraud insurance policyholders, as opposed to simply an isolated policy dispute.

At its core, the CFA provides that it is unlawful for a person to use an "unconscionable commercial practice . . . in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid." N.J.S.A. § 56:8-2. (The term *person* covers an insurance company and its agents and employees.)

The N.J. Supreme Court has observed that the CFA should be applied broadly and not be subject to a narrow textual interpretation: "Given that the fertility of human invention in devising new schemes of fraud is so great, the CFA could not possibly enumerate all, or even most, of the areas and practices that it covers without severely retarding its broad remedial power to root out fraud in its myriad, nefarious manifestations." *Lemelledo v. Beneficial Mgmt. Corp. of Am.*, 150 N.J. 255, 265 (1997) (citations and quotations omitted). As evidence of its broad application, the CFA expressly provides that its remedies are to be cumulative, or in addition to, those available to consumers under other statutes and the common law. N.J.S.A. § 56:8-2.13.

The issue, then, is whether the CFA's protections apply to the payment of insurance benefits.

In *Lemelledo*, the N.J. Supreme Court held that the CFA applied to insurance sales, but left open the question of whether it covered insurance denials. Since *Lemelledo* was decided in 1997, federal courts faced with this particular issue have reached different results. A close reading of the decisions, however, reveals that the CFA likely applies to the payment of insurance benefits, and, at the very least, almost certainly to those policyholder actions that allege anticonsumer conduct that affects the public at large, as opposed to mere isolated policy disputes.

The starting point for these federal court decisions is the Third Circuit case of *In re Van Holt*, 163 F.3d 161 (3d Cir. 1998), which held that the CFA does not apply to insurance denials. There, the plaintiffs, in separate occurrences in October 1991 and December 1992, suffered flood damage to their home. The insurer, Liberty Mutual, alleged that the plaintiffs made a fraudulent claim by including in their December 1992 claim certain property that was actually damaged in the October 1991 flood. This property damage had been denied based on a policy exclusion for items stored in the basement of the home. The Third Circuit concluded that: "New Jersey courts … have consistently held that the payment of insurance benefits is not subject

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to the Consumer Fraud Act." Not surprisingly, the facts of this case were less than ideal and did not make for a compelling cause of action under the CFA.

Eleven years later, a New Jersey federal district court in *Capogrosso v. State Farm Ins. Co.*, No. 08-cv-2229, 2009 U.S. Dist. LEXIS 97554 (D.N.J. Oct. 21, 2009), rejected a policyholder's CFA cause of action against her insurance company for failure to pay for water damage to her apartment:

> [N]otwithstanding the apparent endorsement in *Lemelledo*, the application of the CFA to insurance policies is qualified by excluding claims regarding payment of insurance benefits. Given the explicit qualification recognized by the Third Circuit Court of Appeals, this Court cannot permit Plaintiff's CFA claims to proceed insofar as they pertain to the payment of insurance benefits.

In 2007, however, in a decision that was not referenced by the district court in *Capogrosso*, the Third Circuit had again put its imprimatur on the issue, this time in favor of the policyholder. In *Weiss v. First Unum Life Ins. Co.*, 482 F.3d 254 (3d Cir. 2007), the plaintiff, an investment banker who stopped working after suffering a heart attack, had his long-term disability payments in an amount that exceeded $11,000 per month cut off by the insurance company. His complaint alleged that the insurance company had enacted a scheme to reduce expensive payouts to disability insurance policyholders with high benefit amounts, which included reaching termination decisions without ordering medical tests, reviewing medical records or consulting with physicians. Thus, the plaintiff alleged not merely an isolated insurance policy dispute, but rather a larger pattern of fraudulent activity specifically aimed at a wide swath of policyholders.

Of note, the decision in *Weiss* overruled the lower court's finding that the CFA does not apply to the failure or refusal to pay insurance benefits, stating, "We do not share the District Court's conviction that the CFA and its treble damages provision are inapplicable to schemes to defraud insureds of their benefits." *Weiss* further observed that, "The CFA covers fraud both in the initial sale (where the seller never intends to pay), and fraud in the subsequent performance (where the seller at some point elects not to fulfill its obligations)." Then, the court stated:

> We conclude that while the New Jersey Supreme Court has been silent as to this specific application of CFA, its sweeping statements regarding the application of the CFA to deter and punish deceptive insurance practices makes us question why it would not conclude that the performance in the providing of benefits, not just sales, is covered, so that treble damages would be available for this claim under the CFA.

No doubt, the case law addressing the CFA in the context of first-party insurance claims is difficult to navigate. Yet its trend, culminating in *Weiss*, which overruled *In re Van Holt* and other contrary district court decisions, shows that the CFA should apply to first-party insurance claims, and, at the very least, to those that involve allegations that go beyond isolated policy disputes and have an impact on consumers at large. The trend in the federal cases is in accord with the broad interpretation of the CFA that has been advocated by the N.J. Supreme Court. Also, as *Weiss* points out, there is no apparent reason why insurance sales, but not denials, should be covered under the CFA.

Policy arguments exist on both sides of this issue. Insurance company advocates argue that there are already more than sufficient protections available to consumers, such as the right to bring a breach-of-contract and bad-faith action — protections that are available to plaintiffs in other types of contract disputes. Insurance companies are also subject to an extensive regulatory scheme that protects against unfair and deceptive claim practices.

Policyholder advocates, of course, see things differently. The insurance regulatory scheme, such as the Unfair Claims Settlement Practices Act (N.J.S.A. 17:29B-4(9)), does not allow a private cause of action. See also *Pierzga v. Ohio Cas. Group of Ins. Companies*, 208 N.J. Super. 40 (App. Div. 1986). Given the limited resources of state agencies, they cannot possibly prosecute each and every bad-faith action, and the intent of the CFA is to enable consumers to become private attorneys general to vindicate consumer rights. Without the ability to win treble damages and attorneys' fees under the CFA, policyholder advocates fear that unscrupulous insurance companies will be permitted to improperly deny insurance claims without fear of incurring more liability than the policy amount.

Moreover, the CFA provides that its remedies are to be cumulative, or in addition to, other available legal remedies. Thus, the existence of other laws and regulations that impact the insurance industry are irrelevant to whether the CFA should cover first-party insurance claims.

Undergirding this debate is the nature of the insurance industry itself, which occupies an important role in our society. As put by Rutgers law school professor Jay Feinman in his book on the insurance industry, *Delay, Deny, Defend*: "[I]nsurance provides a social safety net for individuals and businesses, particularly for the middle class. Most Americans are only a car accident, a fire in the home, a lawsuit, or an injury away from having the wealth, the comfort, and the lifestyle accumulated over a lifetime of work wiped out."

Insurance company and policyholder advocates will have to wait to see if the N.J. Supreme Court ultimately decides the important issue of whether the CFA applies to first-party insurance claims. ■