

NORTH CAROLINA

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I. CAUSES OF ACTION

A. Bad Faith

An insurer has an implied duty to deal fairly and act in good faith with its insured. *See Robinson v. North Carolina Farm Bureau Insurance Co.*, 356 S.E.2d 392, 395 (N.C.App. 1987), *disc. rev. improvidently allowed*, 364 S.E.2d 140 (N.C. 1988) (per curiam). Good faith means honesty in fact and the observance of reasonable standards of fair dealing in the insurance industry. A violation of an insurer's duty of good faith gives rise to an action in tort for which consequential and punitive damages may be sought. *See von Hagel v. Blue Cross of North Carolina*, 370 S.E.2d 695, 698 (N.C.App. 1988). To establish liability for punitive damages, an insured must prove three elements.

First, the insured must show that the insurer (1) failed to pay a justifiable claim, *see Miller v. Nationwide Mutual Insurance Co.*, 435 S.E.2d 537, 544-45 (N.C.App. 1993), *disc. rev. denied*, 442 S.E.2d 519 (N.C. 1994), (2) failed to investigate a claim before denying a claim when presented with credible evidence supporting the claim from the insured, *see von Hagel*, 370 S.E.2d at 699, (3) failed to pay in a timely manner, *see Robinson*, at 395-96, or committed some similar act.

Second, the insured must establish that the insurer acted in "bad faith." Bad faith means conduct which is "not based on honest disagreement or innocent mistake." *Lovell v. Nationwide Mutual Insurance Company*, 424 S.E.2d 181, 185, *aff'd in part, disc. rev. improvidently allowed in part*, 435 S.E.2d 71 (N.C. 1993) (per curiam).

Third, the insured must prove that an element of aggravation accompanied the insurer's actions. Aggravated conduct may be shown by fraud, malice, or willful or wanton conduct. *See* N.C. Gen. Stat. § 1D-15(a)(1)-(3).

The insurance carrier is not liable for bad faith where the policy at issue is open to more than one reasonable interpretation and the insurance company promptly and consistently denies the insurance claim based on an interpretation of the policy "that is neither strained nor fanciful, regardless of whether it is correct." *Olive v. Great American Insurance Co.*, 333 S.E.2d 41, 46 (N.C.App.), *disc. rev. denied*, 336 S.E.2d 400 (N.C. 1985).

B. Fraud

There are five elements of actionable fraud in North Carolina. These elements are as follows:

1. That the defendant made a false representation or concealed a material fact;
2. That the false representation or concealment was reasonably calculated to deceive;
3. That the false representation was made or the concealment was done with the intent to deceive;
4. That the plaintiff was in fact deceived by the false representation or concealment and that the plaintiff's reliance was reasonable; and
5. That the plaintiff suffered damages as a result of his reliance on the defendant's false representation or concealment.

See Myers & Chapman, Inc. v. Thomas G. Evans, Inc., 374 S.E.2d 385, 391 (N.C. 1988), *reh'g denied*, 377 S.E.2d 235 (N.C. 1989).

The plaintiff has the burden of proof as to each element. A statement of opinion, belief, recommendation, future prospect or a promise is not a representation of fact. *See Johnson v. Phoenix Mutual Life Insurance Co.*, 266 S.E.2d 610, 616 (N.C. 1980), *overruled in part on other grounds by Myers & Chapman*, 374 S.E.2d at 391-92. However, a promise can be a false representation of fact if, at the time it is made, the defendant has no intention of carrying it out. *See Leake v. Sunbelt Ltd., of Raleigh*, 377 S.E.2d 285, 288-89 (N.C.App.), *disc. rev. denied*, 381 S.E.2d 774 (N.C. 1989).

C. Intentional Infliction of Emotional Distress and/or Outrage

In North Carolina, to recover on a claim for intentional infliction of serious emotional distress, the plaintiff must prove three elements by the greater weight of the

evidence: “1) extreme and outrageous conduct by the defendant 2) which is intended to and does in fact cause 3) severe emotional distress.” *Waddle v. Sparks*, 414 S.E.2d 22, 27 (N.C. 1992) (citation omitted).

As to the first element, conduct is deemed “extreme and outrageous” when it “exceeds all bounds usually tolerated by decent society.” *Stanback v. Stanback*, 254 S.E.2d 611, 622 (N.C. 1979) (citation omitted). Under the second element, plaintiff must show either that defendant intended to cause severe emotional distress or that the “defendant’s actions indicate[d] a reckless indifference to the likelihood that they [would] cause severe emotional distress.” *Dickens v. Puryear*, 276 S.E.2d 325, 335 (N.C. 1981). “Severe emotional distress” is defined for purposes of the third element as

any emotional or mental disorder, such as, for example, neurosis, psychosis, chronic depression, phobia, or any other type of *severe and disabling* emotional or mental condition which may be generally recognized and diagnosed by professionals trained to do so.

Waddle, 414 S.E.2d at 27 (citation omitted). A plaintiff is not required to show physical injury to recover for intentional infliction of emotional distress. *See Dickens*, 276 S.E.2d at 331-35. But the plaintiff must present evidence of medical documentation to substantiate alleged severe emotional distress. *Waddle*, 414 S.E.2d at 28.

D. State Consumer Protection Laws, Rules and Regulations

North Carolina’s Unfair and Deceptive Trade Practices Act prohibits “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.” N.C. Gen. Stat. § 75-1.1(a). The Act provides a private cause of action for persons injured by violations of its terms. *See* N.C. Gen. Stat. § 75-16. Claims for relief under Chapter 75 are subject to a four-year statute of limitations. *See* N.C. Gen. Stat. § 75-16.2. Damages for violations of Chapter 75 may be trebled. *See* N.C. Gen. Stat. § 75-16. A plaintiff who prevails on a claim under the Act may be entitled to attorneys’ fees if he establishes that, “[t]he party charged with the violation has willfully engaged in the act or practice, and there was an unwarranted refusal by such party to fully resolve the matter which constitutes the basis of such suit.” N.C. Gen. Stat. § 75-16.1(1). If the defendant prevails, he may be entitled to recover attorneys’ fees if he shows that “[t]he party instituting the action knew, or should have known, the action was frivolous and malicious.” N.C. Gen. Stat. § 75-16.1(2).

Chapter 58 of the North Carolina General Statutes prohibits unfair methods of competition and unfair or deceptive acts or practices in the business of insurance. *See* N.C. Gen. Stat. § 58-63-1, *et seq.* These prohibited methods, acts, and practices include, but are not limited to, making misrepresentations regarding insurance policies, false advertising, defamation, using coercion or intimidation, giving rebates, making false financial statements, and unfairly discriminating among potential insureds. *See* N.C. Gen. Stat. § 58-63-15.

Chapter 58 also prohibits certain "unfair claim settlement practices." N.C. Gen. Stat. § 58-63-15(11). These practices include, but are not limited to, making misrepresentations with respect to coverage issues, failing to act in a timely and reasonable manner when investigating, denying, or settling a claim, settling for a sum less than an amount to which a reasonable person would have believed he was entitled, not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear, and failing to provide a prompt and reasonable explanation for the denial of a claim or for the offer of a compromise settlement. *Id.* While Chapter 58 does not provide injured persons with a private cause of action, the North Carolina Supreme Court has held that a violation of Chapter 58 constitutes an unfair and deceptive practice under Chapter 75 of the North Carolina General Statutes. *See Pearce v. American Defender Life Insurance Co.*, 316 N.C. 461, 468-70, 343 S.E.2d 174, 179 (1986). Chapter 75, in turn, provides a private cause of action. *See* N.C. Gen. Stat. § 75-16. Further, while Chapter 58 only prohibits unfair claim settlement practices which occur "with such frequency as to indicate a general business practice," N.C. Gen. Stat. § 58-63-15(11), the frequency requirement is not necessary in order to state a cause of action for an unfair and deceptive act or practice under Chapter 75. *Gray v. North Carolina Insurance Underwriting Assoc.*, 352 N.C. 61, 529 S.E.2d 676 (2000).

E. State Class Actions

Class actions may be brought in North Carolina pursuant to Rule 23 of the North Carolina Rules of Civil Procedure. Rule 23 provides in relevant part that, "[i]f persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued." N.C. R. Civ. P. 23(a). The rule also provides that complaints filed in certain class actions brought by corporate shareholders must be verified. *See* N.C. R. Civ. P. 23(b).

A "class" under Rule 23 exists "when the named and unnamed members each have an interest in either the same issue of law or of fact, and that issue predominates over issues affecting only individual class members." *Faulkenbury v. Teachers & State Employees' Retirement System of North Carolina*, 345 N.C. 683, 697, 483 S.E.2d 422, 431 (1997) (citation omitted). The North Carolina Supreme Court has held that a class action may be brought only if the following additional prerequisites are also shown to exist:

- (1) the named representatives must establish that they will fairly and adequately represent the interests of all members of the class;
- (2) there must be no conflict of interest between the named representatives and members of the class;
- (3) the named representatives must have a genuine personal interest, not a mere technical interest, in the outcome of the case;
- (4) class representatives within this jurisdiction will adequately represent members outside the state;
- (5) class members are so numerous that it is

impractical to bring them all before the court; and (6) adequate notice must be given to all members of the class.

Id. The party seeking certification of a class action bears the burden of establishing the foregoing prerequisites. See *Crow v. Citicorp Acceptance Co.*, 319 N.C. 274, 282, 354 S.E.2d 459, 465 (1987).

In order to show that a class is numerous enough to qualify under Rule 23, class representatives do not need to “demonstrate the impossibility of joining class members, but they must demonstrate substantial difficulty or inconvenience in joining all members of the class.” *Id.* at 283, 354 S.E.2d at 466. In North Carolina, “[t]here . . . [is] no firm rule for determining when a class is so numerous that joinder of all members is impractical. The number is not dependent upon any arbitrary limit, but rather upon the circumstances of each case.” *Id.*

What constitutes “adequate notice” of a class action to class members is within the discretion of the trial court. *Id.* “Such notice should include individual notice to all members who can be identified through reasonable efforts, but it need not comply with the formalities of service of process.” *Id.* at 283-84, 354 S.E.2d at 466.

Once the class representatives demonstrate that the prerequisites outlined above are satisfied, the decision as to whether a class action may proceed lies within the discretion of the trial court. *Faulkenbury*, 345 N.C. at 697, 483 S.E.2d at 431. The trial court must balance “[t]he usefulness of the class action device . . . against inefficiency or other drawbacks.” *Crow*, 319 N.C. at 284, 354 S.E.2d at 466. The court may consider factors other than the aforementioned prerequisites when deciding whether to allow the lawsuit to proceed as a class action. *Id.*

Once a class action is filed, it may “not be dismissed or compromised without the approval of the judge.” N.C. R. Civ. P. 23(c). The judge also decides how class members are notified of the dismissal or settlement of such an action. See *id.*

F. State Privacy Laws, Rules and Regulations

The Insurance Information and Privacy Protection Act, NCGS §58-39-1 to §58-39-120 embodies North Carolina’s privacy law. This Act was passed in 1982 and is based on model legislation originally drafted by the National Association of Insurance Commissioners. North Carolina is one of approximately 15 states that have enacted the NAIC model act.

The Gramm-Leach-Bliley Act passed by the United States Congress (P.L. 106-102, 113 Stat. 1338, 11/12/99) has profound implications on privacy issues on both the state and federal level. In 2001, North Carolina enacted its own version of GLB by amending the Insurance Information and Privacy Protection Act in numerous ways.

II. DEFENSES

A. Preexisting Illness or Disease Clauses

North Carolina follows the general rule of insurance contract interpretation that when there is any doubt about its interpretation or meaning, an insurance policy exclusion precluding recovery for pre-existing disabilities or any other reason is strictly construed against the insurer. *See, e.g., Cantrell v. Liberty Life Insurance Co.*, 315 S.E.2d 544, 547 (N.C.App.), *disc. rev. denied*, 321 S.E.2d 897 (N.C. 1984). The North Carolina General Statutes provide that:

At the time of issuing any new policy of individual or family hospitalization insurance or individual accident and health insurance to insureds over age 65, the term "preexisting conditions," or its equivalent in said policy shall include only conditions specifically eliminated by rider.

N.C. Gen. Stat. § 58-51-60. Notably, a mere undiagnosed symptom of pain prior to the policy term does not amount to a preexisting illness. *See McDaniel v. North Carolina Mutual Life Insurance Co.*, 319 S.E.2d 676, 677 (N.C.App.), *disc. rev. denied*, 321 S.E.2d 897 (N.C. 1984).

Subject to certain exceptions, a group health insurer may exclude from coverage a pre-existing condition for a period of not more than 12 months after an insured has enrolled in the plan, or not more than 18 months in the case of a late enrollee. *See* N.C. Gen. Stat. § 58-68-30. The exclusionary period is reduced - the insured receives a credit - if the insured's condition was covered on the enrollment date under one of several other health plans listed by statute. *See id.* § 58-68-30(a) (requiring reduction of the exclusionary period by any amounts of "creditable coverage"); *see also id.* § 58-68-30(c) (listing types of policies which may provide "creditable coverage"). The North Carolina General Statutes require that if a policy includes such a provision limiting coverage for preexisting conditions, the policy also must contain a provision defining "preexisting condition," notifying the insured of the exclusionary period, and informing the insured that he may be entitled to a credit against the period for coverage under a previous health plan. *See* N.C. Gen. Stat. § 58-51-15(a)(2)b. The statute sets forth an example of such a provision and requires that insurance policies follow the model language in substance. *See id.*

Subject to certain significant exceptions, an employee covered under a group health plan is entitled under North Carolina law to obtain coverage under an individual policy upon termination of coverage under the group policy. *See* N.C. Gen. Stat. §§ 58-53-45 to 58-53-115. The new individual policy cannot exclude any preexisting condition covered under the old group policy. *See id.* § 58-53-85.

B. Misrepresentation/Rescission of Insurance Contract for Misrepresentation

The North Carolina General Statutes provide as follows with respect to misrepresentations made by insurance applicants:

All statements or descriptions in any application for a policy of insurance, or in the policy itself, shall be deemed representations and not warranties, and a representation, unless material or fraudulent, will not prevent a recovery on the policy.

N.C. Gen. Stat. § 58-3-10. Interpreting this section, one North Carolina court observed:

false statements will avoid a policy if fraudulently made, irrespective of materiality; however, absent fraud, the falsity of an applicant's answer must be material to the risk in order to warrant avoidance of the policy on that ground.

Tharrington v. Sturdivant Life Insurance Co., 443 S.E.2d 797, 799-800 (N.C.App. 1994). Further, in order to avoid a fire insurance policy on the grounds that the insured made a misrepresentation, the insurer must prove that "the insured made statements that were: 1) false, 2) material, and 3) knowingly and willfully made." *Bryant v. Nationwide Mutual Fire Insurance Co.*, 329 S.E.2d 333, 338 (N.C. 1985); see N.C. Gen. Stat. § 58-44-15.

North Carolina Pattern Jury Instruction 880.15 notes that "[a] representation is false if it is untrue. However, the law does not require that a representation literally be true and accurate in every respect. A representation is not considered under the law to be false if it is substantially true." Answers to ambiguous questions cannot be deemed false. See *Cockerham v. Pilot Life Insurance Company*, 374 S.E.2d 174, 176 (N.C.App. 1988).

A misrepresentation in an application for an insurance policy is deemed "material" if the knowledge or ignorance of it would naturally and reasonably influence the judgment of the insurance company in making the insurance contract, or estimating the degree and character of the risk, or in fixing the rate of premium. See *Tolbert v. Mutual Benefit Life Insurance Co.*, 72 S.E.2d 915, 917 (N.C. 1952). For example, in a policy of life insurance, written questions and answers relating to health are deemed material as a matter of law. See *id.*

Because an insurer need not show fraud to avoid a policy (other than a fire insurance policy) as long as the representation is false and material, the insurer can avoid the policy "even though the [insured] be innocent of fraud or an intention to deceive or to wrongfully induce the assurer to act, or whether the statement be made in ignorance or good faith, or unintentionally." *Tharrington*, 443 S.E.2d at 801 (citation omitted).

An insurer cannot attempt to rescind an insurance policy if the insurer or the agent knew at the time of the representation that it was false. See *Willets v. Integon Life Insurance Corp.*, 263 S.E.2d 300, 305 (N.C.App.), *disc. rev. denied*, 270 S.E.2d 116

(N.C. 1980). In fact, a regulation promulgated by the North Carolina Department of Insurance provides in part:

If an insurer does not promptly attempt to rescind an accident, health or disability policy upon becoming aware that the insured's application contained false statements, the insurer may not subsequently use such false statements as a basis for attempted rescission or alteration of the policy.

N.C. Admin. Code tit. 11, r. 4.0316.