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The Cigarette Rule — Up In Smoke?

Law360, New York (March 18, 2010) -- A Connecticut jury recently awarded nearly $15 million to a class of automotive body shop plaintiffs[1] based on the jury's finding that the insurance company defendant violated the Connecticut Unfair Trade Practices Act.[2]

The plaintiffs may get far more than they bargained for, however, if their lawsuit actually results in a seismic shift in the law that ultimately restricts potential plaintiffs' ability to bring similar actions in the future.

Such a shift would align Connecticut with an emerging trend and possibly influence other jurisdictions to follow suit, a development which could dramatically reduce the exposure of insurance companies and their insureds.

The shift would occur if, as expected, this becomes the case that finally forces the issue of whether the so-called "Cigarette Rule," used to determine whether an act or practice is "unfair" within the meaning of CUTPA, has been superseded by a newer, narrower federal standard.

The resolution of this issue could dramatically change the face of statutory bad faith claims in the "Insurance Capital" state and potentially, result in new law far more favorable to defendants.

In Artie's Auto Body, et al., v. Hartford Fire Ins. Co., four named plaintiffs, on behalf of a class of 1,500 Connecticut auto body shops that have performed physical auto body repairs paid for by The Hartford Fire Insurance Company ("The Hartford") under automobile insurance policies, alleged that The Hartford engaged in a pattern of unfair and deceptive acts and practices in violation of the Connecticut Unfair Trade Practices Act, or "CUTPA."[3]

CUTPA prohibits any person from engaging in unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce.[4]

The Artie's Auto Body plaintiffs alleged that The Hartford engaged in unfair trade practices by using incentives to wrongfully steer its insureds and other insurance claimants to auto body repair shops favored by The Hartford.

The plaintiffs also alleged that The Hartford used positive and negative employee incentives prevailed upon its own independent appraisers to establish an artificially low standard of hourly labor rates for auto body repair work in Connecticut.[5]

Although the plaintiffs had to establish that The Hartford engaged in unfair acts or practices to prove their CUTPA claim, oddly enough, CUTPA does not articulate what an "unfair" act or practice actually entails.

The CUTPA statute does, however, explicitly state the legislative intent that, in construing the statute, the courts of Connecticut "shall be guided by interpretations given by the Federal Trade Commission and the federal courts to ... the Federal Trade Commission Act ..., as from time to time amended."[6]

Consistent with the intent of the legislature, the Connecticut Supreme Court adopted, many years ago, the so-called "Cigarette Rule" to guide courts in their construction of what constitutes an "unfair" act or practice.[7]

The Cigarette Rule, which is a product of a 1964 Federal Trade Commission policy statement related to the requirement of warning labels on cigarette packaging,[8] is comprised of three criteria used to determine whether an act or practice is unfair to consumers:

1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statute, the common law, or otherwise — whether, in other words, it is in at least the penumbra of some common law, statutory, or other established concept of unfairness;

2) whether it is immoral, unethical, oppressive, or unscrupulous; and

3) whether it causes substantial injury to consumers, competitors or other businessmen.[9]

In Connecticut, a practice may be unfair under CUTPA because of the degree to which it meets one of the criteria, or because, to a lesser extent, it meets all three.[10]

On Nov. 17, 2009, after the completion of the Artie's Auto Body trial, the court charged the jury regarding all three prongs of the Cigarette Rule, and the jury returned a plaintiffs' verdict in the amount of $14.7 million on the first-Cigarette-prong labor rate claim.

The Hartford, however, did not acquiesce to the court giving a presumably standard three-prong Cigarette Rule charge to the jury on the CUTPA claim and, in fact, had engaged in motion practice before the trial requesting that the court deliver a different charge.[11]

The Hartford asked the court not to charge on the Cigarette Rule on the basis that the long-standing rule is now obsolete, replaced by a narrower, more recent federal standard that focuses exclusively on the third "substantial injury" prong.

More specifically: The Hartford raised, with the trial court, the issue of whether a 1980 FTC policy statement, and its subsequent codification in the Federal Trade Act, superseded the FTC's own Cigarette Rule as the go-to guide for "unfair" acts or practices.

In the 1980 policy statement (reprinted in a 1984 FTC opinion,) the FTC moved away from the first "public policy" prong, did away with the second "immoral conduct" prong, and focused almost entirely on the third "substantial injury" prong of the original Cigarette Rule.[12]

Pursuant to the new "Unjustified Injury Test," as it has been called: (1) the practice must cause a substantial injury to consumers, competitors or other businessmen; (2) the injury must not be outweighed by countervailing benefits to consumers or competition that the practice produces; and, (3) it must be an injury that consumers themselves could not reasonably have avoided.

A codification by Congress of the Unjustified Injury Test in a 1994 Amendment to the Federal Trade Act went even further and eliminated the second public policy prong as an independent basis for unfairness altogether.

The act now provides that: “The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.”[13]

Yet, despite the FTA’s revamping of its own Cigarette Rule, the codification in the Federal Trade Act of an even narrower standard than the FTC proposed, and CUTPA’s memorializing of the legislative intent that courts’ decisions “shall” be guided by the FTC and federal court interpretations of the Federal Trade Act, the Artie’s Auto Body court denied The Hartford’s request not to charge the jury on all three original Cigarette prongs.

The court explained that the “cigarette rule has consistently been used by the appellate courts and trial courts in Connecticut before and after the 1984 FTC policy statement and the Connecticut legislature has not amended CUTPA to codify that policy statement as did the U.S. Congress ... Until such time as the appellate courts or the legislature speak to the contrary this court will be bound to apply the ‘cigarette rule’ as the test of an unfair trade practice.”[14]

The verdict against The Hartford, based on the jury’s finding that a first-prong public policy violation of CUTPA had occurred,[15] would not have presented a viable CUTPA claim under the standard of unfairness adopted in the Federal Trade Act.

Notably, The Hartford did not present a novel idea, but rather, one which the Connecticut Supreme Court appears somewhat eager to decide. In 2005, the court acknowledged awareness of the FTC Policy Statement, and the uncertain continued application of the Cigarette Rule, when it made an unsolicited statement that:

“Although we have consistently followed the cigarette rule in CUTPA cases, we also note that, when interpreting ‘unfairness’ under CUTPA, our decisions are to be guided, pursuant to General Statutes § 42-110b(c), by the federal trade commission and federal court interpretations of the Federal Trade Act. Under those authorities, a serious question exists concerning whether the cigarette rule remains the guiding rule utilized by the federal trade commission. ... Nevertheless, because neither party in the present case has raised or briefed this issue or asked us to reconsider our law in this area, it is appropriate that we wait until the issue has been squarely presented to us for determination.”[16]

Even Connecticut’s federal courts appear to be waiting for the state courts to shed light on the issue.[17] Oddly enough, however, despite the fact that Connecticut courts have thus far been unwilling to acknowledge that the Unjustified Injury Test supersedes the Cigarette Rule, the courts do include it as a subset of the existing three-prong Cigarette Rule, creating a sort of hybrid law, where all three original prongs are still valid but, the third substantial injury prong is governed by the new rule.[18]

Not surprisingly, there is no uniformity among the other states with similar unfair trade practices statutes and who, at one time, adopted the original Cigarette Rule.

A few states, like Maine, have viewed the enactment of the Unjustified Injury Test in the same manor that The Hartford does, and have altogether replaced the Cigarette Rule with the new, more narrow test.[19] Other states, like Massachusetts, have yet to move at all and are still applying the Cigarette Rule.[20]

And still others, like Illinois (and, thus far, Connecticut), are going with the hybrid method. In those states, the courts still consider all three Cigarette prongs to be valid, but apply the Unjustified Injury Test to the third “substantial injury” prong.[21]

Finally, other states, like Iowa, have outright codified the new federal definition of "unfairness" right into their own state statutes.[22]

So what does this all mean for insurers? For starters, since the November verdict in the Artie's Auto Body case, the parties to that lawsuit have been briefing their post-trial motions[23] and, it has been reported, "[i]f those are unsuccessful, the insurer plans to appeal" and, "[o]n appeal, the continued vitality of the three-prong Cigarette Rule is expected to be highly contested."[24]

Thus, an appellate-level determination may finally be made, in Connecticut, as to the continued viability of the Cigarette Rule.

Additionally, statutory bad faith claims against insurers in Connecticut could potentially change if the Cigarette Rule is abandoned and the Unjustified Injury Test is adopted.

In Connecticut, a private cause of action exists under CUTPA to enforce alleged violations of the Connecticut Unfair Insurance Practices Act, or "CUIPA."[25] This is largely how statutory bad faith claims are made against insurers by individual consumers.

Not only are CUIPA claims permitted under CUTPA but, where a lawsuit involving a CUTPA claim also involves the insurance industry, the CUTPA claim must be based on a violation of CUIPA.[26] In those CUTPA/CUIPA insurance cases, the Connecticut courts have established that, when a CUTPA claim is based on public policy, "it is the CUIPA violation that is the equivalent of CUTPA's 'cigarette rule.'"[27]

Hence, if Connecticut adopts the new definition of unfairness, which eliminates the first and second prongs of the Cigarette Rule, including the public policy prong upon which all CUIPA/CUTPA actions are based, will such a cause of action survive the modification?

Moreover, even if Connecticut abandons the traditional Cigarette Rule while somehow preserving the public policy-based CUIPA/CUTPA action, insurers will still be affected because Connecticut courts have allowed CUTPA claims to independently stand even when a CUIPA count has been stricken, provided that the plaintiff has pleaded sufficient facts to establish unfair and deceptive trade practices.[28]

Thus, in those instances, claimants would lose the ability to bring CUTPA claims against insurers based on public policy grounds or on the basis that the conduct was immoral, unethical, oppressive, or unscrupulous.

Only those actions alleging a CUTPA violation based on an unfair practice that caused substantial injury, and passed the three-part Unjustified Injury Test, would present a valid cause of action.

Insurers are currently faced with a unique opportunity to try to reshape statutory bad faith laws, both in Connecticut and in all those states still applying the original Cigarette prongs without yet evaluating their continuing viability. This important issue should be followed in the industry.

Additionally, motivated insurers may consider filing amicus briefs should the opportunity arise in Artie's Auto Body or similar appeals in other states.

Alternatively, insurers may consider blazing the trail and setting up their own Artie's-esque claim with a pending CUTPA lawsuit to force the issue to the forefront in those jurisdictions that have not yet determined whether the time has come to stomp out the Cigarette Rule.

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[1] Artie's Auto Body et al. v. Hartford Fire Ins. Co., FST-CV03-0196141-S, 2009 WL 3737931 (Conn. Super., Sept. 22, 2009).

[2] Conn. Gen. Stat. §42-110a et seq.

[3] Artie's Auto Body, supra.

[4] Conn. Gen. Stat. §42-110b(a).

[5] Artie's Auto Body, supra.

[6] Conn. Gen. Stat. §42-110b(c).

[7] Conaway v. Prestia, 191 Conn. 492-93 (1984); McLaughlin Ford Inc. v. Ford Motor Company, 192 Conn. 558, 568 (1984).

[8] Federal Trade Commission in Statement of Basis and Purpose of Trade Regulation Rule 408, "Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking," 29 Fed. Reg. 8355 (1964).

[9] Artie's Auto Body, supra, citing McLaughlin Ford Inc. v. Ford Motor Company, 192 Conn. 558, 568 (1984).

[10] Ramirez v. Health Net of the Northeast Inc., 285 Conn. 1, 18-19, 938 A.2d 576 (2008).

[11] Artie's Auto Body, supra.

[12] Artie's Auto Body, supra, citing Commission Statement of Policy on the Scope of the Consumer Unfairness Jurisdiction (Dec. 17, 1980) reprinted in In Re Int'l Harverster Company, 104 FTC 949, 979 app. (1984).

[13] 15 U.S.C. § 45(n).

[14] Artie's Auto Body, supra.

[15] Scheffey, Thomas B., "Getting Hammered," The Connecticut Law Tribune, Nov. 23, 2009.

[16] American Car Rental Inc. v. Commissioner of Consumer Protection, 273 Conn. 296, 305, n. 6, (2005); see also Votto v. American Car Rental Inc., 273 Conn. 478, 484, n. 3 (2005) ("We note that we recently have recognized that a question exists as to whether the cigarette rule remains the guiding rule utilized by the Federal Trade Commission. ... In the present case, however, neither party has raised or briefed this issue or asked us to reconsider our law in this area, and, accordingly, we will wait to consider this question until it has been presented to us for determination.")

[17] A&R Body Specialty v. Progressive Casualty Insurance Co., No. 3:07-cv-0929, 2008 WL 2229888 (2008) ("Defendants contend that the issue on which certification is sought is one that the Connecticut Supreme Court has indicated that the state of the law is in flux. Specifically, the Supreme Court has recently remarked that the 'cigarette rule,' ... may be of limited continuing vitality. The current state of the law ... is that the cigarette rule governs this issue. Until such time as the Supreme Court abandons the rule, it remains the guiding principle for this Court to follow as state and federal courts in Connecticut still follow and apply it. ... As the Connecticut appellate courts and this Court are in agreement as to what test to apply at this point in time, the Court will deny defendants' request for certification.")

[18] "The cigarette rule contains three factors: (1) [w]hether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise ... (2) whether it is immoral, unethical, oppressive, or unscrupulous; [and] (3) whether it causes substantial injury to consumers, [competitors, or other business persons] ... The third factor of 'substantial injury' is itself subject to a three-part test: (1) the injury must be substantial; (2) the injury must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and (3) it must be an injury that consumers themselves could not reasonably have avoided." Health Communications Inc. v. Chicken Soup for the Soul Publishing LLC, 2009 WL 579227, 25 (Conn. Super. 2009).

[19] Searles v. Fleetwood Homes Of Pennsylvania Inc., 878 A.2d 509, 519 (Me. 2005).

[20] Bodycote IMT Inc. v. NALCO Chemical Company Inc., 2005 WL 6190785 (Mass. Super. 2005).

[21] Robinson v. Toyota Motor Credit Corp., 201 Ill.2d 403, 416 (2002); Case v. Ameritech Services, 2004 WL 73524, 5 (Ill.Cir. 2004).

[22] The Iowa Code explicitly defines unfair practice as "an act or practice which causes substantial, unavoidable injury to consumers that is not outweighed by any consumer or competitive benefits which the practice produces." Iowa Code, § 714.16(1)(n).

[23] civilinquiry.jud.ct.gov/CaseDetail/PublicCaseDetail.aspx?DocketNo=FSTCV030196141S

[24] Scheffey, Thomas B., "Getting Hammered," The Connecticut Law Tribune, Nov. 23, 2009.

[25] Conn. Gen. Stat. §38a-. 815 et seq.; Mead v. Burns, 199 Conn. 651, 663 (1986).

[26] Mead v. Burns, 199 Conn. 651 (1986); Thomas v. Biller Associates Tri-State Inc., 2009 WL 3086547, 1 (Conn.Super. 2009).

[27] Engelman v. Connecticut General Life Ins. Co., Superior Court, judicial district of New Haven, Docket No. 337028 (Aug. 12, 1997) (Barnett, J.) (20 Conn.L.Rptr. 331).

[28] Palmieri v. Nationwide Mutual Ins. Co., Superior Court, judicial district of Fairfield, Docket No. CV 07 5012326 (Jan. 29, 2009, Tobin, J.); Don Beach Movers, Inc. v. Transguard Ins. Co. of America, Inc., Superior Court, judicial district of New London, Docket No. CV 05 4002395 (Conn. Super. 2006); Pusztay v. Allstate Ins. Co., 2009 WL 2357958, *9 (Conn. Super. 2009).