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IN PRACTICE

INSURANCE LAW

False Reporting of Fraud Can Lead to Bad-Faith Liability

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There is a strong public policy in the state of New Jersey to prevent insurance fraud. All insurers are susceptible to claim and application fraud. However, if an insurer suspects fraud, it must be sure to strictly comply with the mandates of New Jersey's Fraud Prevention Act, N.J.S.A. 17:33A-3 et seq., and the administrative regulations promulgated there under, N.J.A.C. 11:16-1.2 et seq. The reporting of suspected insurance fraud must be made to the Office of Insurance Fraud Prosecutor (OIFP) in the Division of Criminal Justice, which is part of the Department of Law and Public Safety. The OIFP has jurisdiction over all civil, criminal and administrative prosecutions for insurance fraud.

While a referral of suspected insurance fraud made in good faith may shield an insurer from civil liability for libel, violation of privacy or otherwise (N.J.S.A. 17:33A-9), a referral made in bad faith or with malice can expose an entity or individual to civil damages and even criminal prosecution pursuant to N.J.S.A. 2C:28-4, "False Reports to Law Enforcement Authorities." Insurers owe a duty of good faith and fair dealing in the investigation and adjustment of a claim. If the insurer acts in bad faith, and if its actions are malicious or outrageous in nature, the policyholder may be entitled to his foreseeable economic losses in addition to punitive damages. *Pickett v. Lloyds*, 131 N.J. 457 (1993). See also *Miglicio v. HCM Claim Mgt. Corp.*, 288 N.J. Super. 331 (Law Div. 1995). On a tort theory, the insured can recover an amount above his policy limits, when the conduct of the insurance company is in bad faith.

In a case where the insurance company has either refused to pay benefits, underpaid benefits or delayed the adjustment of a claim, the critical issue is whether the company had a good-faith basis for its decision. The substance of any investigations conducted by the insurer, the information available to the insurer at the time of its decision and the manner by which the company arrived at its decision are all relevant avenues of inquiry.

When the insurance company refers an insured's claim to the OIFP, this is fertile ground for discovery into the insurance company's files to discover potentially important evidence of whether the insurer acted reasonably and in good faith. Such discovery may prove that the insurance company acted with malice and failed to conduct an appropriate investigation before taking the step to enlist law enforcement. The discovery might also show that the referral was a pretense to intimidate the insured to accept less than what he was entitled to under the insurance policy. High value claims are susceptible to abuse by some insurers who may routinely misdirect their standard claims adjustment practices toward building a fraud case instead of adjusting the claim in good faith and paying the insured what he is justly entitled to. This conduct is inimical to a sense of fair play and justice and should be scrutinized by courts and litigants.

New Jersey's Statutory Framework

All insurers licensed in New Jersey are required to: (1) maintain a fraud detection and prevention plan; (2) establish a full-time Special Investigations Unit (SIU) separate from claims and underwriting; (3) have a training program and manual for the prevention and detection of fraud; and (4) ensure that its SIU keeps written records of its findings and that SIU employees are suitably trained and qualified. The functions of an SIU may be performed by external vendors who must also be in compliance. All referrals to the OIFP must be submitted on forms approved by the OIFP, which are included on the OIFP website. In addition, N.J.A.C. 11:6-1, which regulates the reporting of insurance fraud, includes the forms in its appendix. The statute governing referrals

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to the OIFP, N.J.A.C. 11:6-6.7, explicitly directs that an insurer's SIU "shall refer cases on form OIFP 1, OIFP 2, OIFP 3 or OIFP 4."

Fraud Prevention and Detection Plan

Insurers are required to file a "fraud prevention and detection plan" (plan) for approval in accordance with N.J.S.A. 17:33A-15 and N.J.A.C. 11:16-6.1. No insurer is to use or implement a plan that is not filed and approved. The plan can provide that the functions of the SIU may be assigned to an outside vendor or third-party administrator. If so assigned, the plan shall provide that the outside vendor or third-party administrator will also be responsible, together with the insurer, for compliance with N.J.A.C. 11:16-6. The plan must provide that an application or claim will be referred to OIFP for further investigation or other appropriate action, on the prescribed Referral Form — OIFP-1 for claim fraud, OIFP-2 for application fraud, OIFP-3 for health claim fraud and OIFP-4 for health application fraud — with all other information required by the form.

When the insurer's investigation complies with the requirements set forth in N.J.A.C. 11:16–6.7, the matter shall be referred to OIFP by the SIU as soon as practicable, but not later than 30 days after completion of the investigation. The plan must provide that all referrals and notifications to OIFP are to be made by personnel in the insurer's SIU or other personnel designated in the plan, so long as records are kept of all referrals and notification and the appropriate form is used. Where the insurer outsources any of its SIU functions to an outside vendor or third-party administrator in accordance with N.J.A.C.11:16-6.4(e), the plan must provide the name and address of the outside party along with a copy of the contract between it and the insurer.

SIU Duties, Qualifications and Composition

The functions of the insurers' SIU include: (1) conducting investigations of claims referred by the claim personnel, or applications referred by underwriting personnel, whenever specific facts or circumstances are identified that may lead to a reasonable conclusion that a violation of N.J.S.A. 17:33A-4 has occurred; (2) providing liaison with OIFP and other law enforcement personnel; (3) providing in-service training to adjusters and claims and underwriting personnel in accordance with N.J.A.C. 11:16-6.5; (4) identifying persons and organizations that are involved in suspicious claim activity and application fraud; (5) referring matters to OIFP in accordance with N.J.A.C.11:16-6.6(b) and 6.7, and providing notice of suspicious claims in accordance with N.J.A.C.11:16-6.6(c); and (6) ensuring that all evidence on matters referred to the SIU are identified, collected and preserved so that they may be turned over to OIFP upon request.

SIU investigators and specialists must exist in a separate unit from the claims or underwriting unit. Claims personnel should be walled off from any fraud investigations, otherwise a good-faith and objective claims adjustment process can be compromised by an unproven suspicion of fraud that is being investigated by the SIU.

Manual for the Prevention and Detection of Fraud

An insurer's Fraud Prevention and Detection Procedures Manual is expected to include, at a minimum, information regarding: general investigation guidelines, unfair claims practices, conducting interviews, writing reports, information disclosure, law enforcement relations and the New Jersey Insurance Fraud Prevention Act. The manual must cover the process to be employed for reporting to OIFP when specific facts and circumstances have been identified, and further investigation has led to a reasonable conclusion that a violation of N.J.A.C. 17.33A-4 has occurred. With regard to the SIU, the manual should set out its duties and functions, the procedure for referral of a claim or application to the SIU and the post-referral procedure for communication between the claims unit and/or the underwriting unit and the SIU. Finally, the manual must contain a page indicating that the manual has been updated and kept current.

Referrals to OIFP

A case should be referred to OIFP only where the SIU demonstrates that an application or claim contains facts and circumstances that create a reasonable suspicion that a violation of N.J.S.A. 17:33 A-4 has occurred. There must be sufficient independent evidence corroborating the reasonable suspicion described above, such as a statement from a witness, an expert report or other documentary evidence that negates a material element of the claim.

An SIU-led investigation is complete for purposes of referral to OIFP when reasonable and appropriate investigative leads and opportunities have been exhausted. It is crucial for insurers to thoroughly investigate and document any suspicions of insurance fraud prior to referring a matter to OIFP. The absence of strict adherence to the mandates of N.J.S.A. 17:33A-4 and N.J.A.C. 11:16-1.2 could expose an insurance company to damages for a bad-faith referral of an insurance claim.■