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Roundtable 3: Thursday, April 10, 2014 (3:30 pm – 4:30 pm)

To Declare Or Not To Declare: Effectiveness Of Declaratory Judgment Actions In The Fight Against Fraud

I How to Cost Effectively Identify and Litigate Declaratory Judgment Actions in Cases Under Suspicion of Insurance Fraud.

According to the Coalition Against Insurance Fraud, approximately $80 Billion in fraudulent insurance claims are made in the United States every year. http://goo.gl/nU1Tyx. Therefore, early detection of claims under suspicion of fraud begins at claim inception, and in most cases, begins with a suspicious fact pattern and/or scarcity of facts.

a. Red Flags and Smoking Guns

A suggested practice is to have a checklist of suspicious things to look for when evaluating a new claim. The checklist is not only useful in detecting fraud, but should facilitate identification of fraudulent claims on a consistent basis. Because most state insurance companies audit insurers every three years, it is important that the claim file be properly documented and good cause shown before disclaiming and possibly pursuing a declaratory judgment action (DJA). If and when a DJA is filed, it may later be reviewed by regulators who will want to know why that course of action was taken. Therefore, the claims checklist should detail the information needed in evaluating the claim, and what to do if that information is not provided or otherwise remains unaccounted for.

In an automobile context, a few red flags to look for in determining if an SIU referral should be made include, but are not limited to, a motor vehicle accident involving an unknown driver and not the named insured, a claim that is reported by a passenger in the named insured's vehicle and/or injured person's attorney and not by the insured, and a claim that is reported several weeks to months after the date of loss. Other telltale signs are refusing medical attention at the scene of the accident and presenting for treatment later with inflated injuries, using the same vehicle in multiple accidents, use of known

medical mills, staging an accident shortly after policy inception, facing an overly aggressive insured who pushes for a quick settlement, dealing with an insured who has too much knowledge of the claims process, and documents which show signs of alteration. Additionally, a fraudulent claimant will usually not use the same lawyers or doctors in successive claims, which is another red flag.

Once some indicia of fraud has been made, it's time for an SIU referral and/or referral to outside counsel.

b. Investigative Tools and Resources

Critical to quick and early detection of fraudulent claims is a preliminary interview of the claimant or insured. It is good to have the claimant tell his/her story backwards. The fraudulent claimant usually has the "story" memorized a certain way, and can rarely tell the story in reverse chronological order.

Equally important is internet research of the claimants and all participants in the accident. With an automobile claim, one of the primary indicators of fraud is a relationship between one or more people involved in the accident. The tech savvy and cost conscious claims professional will check Facebook, Twitter, Instagram and even LinkedIn to learn more about the claimants and their connections. Why? Because Facebook has over 1 Billion users, Twitter – more than 500 million, LinkedIn – more than 200 million and Instagram – more than 150 million users. See, http://goo.gl/hbcy06. And, with over 500 million users, Google Plus should also be on one's radar as an up and coming research tool. http://goo.gl/v7K2Nf

Pipl.com is another great resource because it shows the names of a person's purported relatives. Whitepages.com can also be useful in identifying the names of people residing at the same address. Last, but not least, an ISO Claimsearch will usually prove invaluable in obtaining background information on claimants, and the history of vehicles used in the accident. Although the ISO database is not free, subscriptions to the service are available, so there should be no added cost per claim in using it.

c. The Reservation of Rights Letter

Once the available evidence suggests that the claim is fraudulent in some respect, the reservation of rights letter should be issued as soon as possible. The ultimate usefulness of the reservation of rights letter is debatable, but it does at a minimum put the claimant on notice that the claim may be denied. The reservation of rights letter is also supposed to give insurers a reasonable time to complete its investigation, and serves as a means of requesting additional information from the claimant in furtherance of that investigation.

d. Advantages in Employing the Examination Under Oath

The Examination Under Oath (EUO) is another useful, but not always necessary tool when conducting fraud investigations. The purpose of the EUO was defined in the case of *Claflin v. Commonwealth Insurance Company*, 110 U.S. 81, 3 S.Ct. 507, 20 L. Ed. 76 (188), where the court explained that the EUO (1) enables fair and proper claim evaluation, (2) helps an insurance company determine its own policy obligations, and (3) enables the insurer to protect itself from fraudulent claims. Generally, the insurer's right to an EUO is founded in a first party property context. However, an insurer may ask a third-party claimant or other witness to voluntarily submit to an EUO. In New York, especially, EUO's are very effective in fighting No-Fault fraud.

In short, if additional facts are necessary for a disclaimer letter and/or declaratory judgment action, then an EUO should be conducted. The EUO is best served when the accompanying demands in the EUO Notice are detailed to the subject claim. Used properly, it can provide a limitless amount of

information and documents that the insurer can use to clarify ambiguities in the claim, inconsistencies, and red flags. Secondarily, the mere noticing of the EUO alone may deter the claimant from proceeding further with the fraudulent claim.

The examination, however, is not a prerequisite to the filing of a declaratory judgment action. If there is enough indicia of fraud for the DJA, the EUO becomes an unnecessary expense. Used improperly, it can not only waste money, but cause the potential inability to deny a claim that should otherwise be denied.

II The Declaratory Judgment Action

At minimal cost to the insurer, the SIU investigator should be able to go into the field and interview witnesses, obtain photos, collect police accident reports involving the same claimants and/or same vehicles, and report the suspected activity to a local insurance frauds bureau.

a. The Disclaimer Letter

Armed with indicia of fraud, it's time to disclaim or DJ the claim away. Although disclaimers should generally be issued as soon as possible (*Zappone v. Home Ins. Co*., 55 N.Y.2d 131 (1982), New York courts have held that no disclaimer letter is required under Insurance Law § 3420(d) when the denial of coverage is based on lack of coverage for the incident in the first instance, and not an exclusion under the policy. *See, State Farm Mutual Automobile Insurance Company v. Laguerre*, 305 A.D.2d 490, 759 N.Y.S.2d 531 (2nd Dept. 2003).

b. Advantages of Filing the Declaratory Judgment Action

The disclaimer, of course, does not bring finality to a claim the way a declaratory judgment action does. And, when a claim is denied, there is always a chance for a suit against the insurer for coverage. As such, an SIU investigation should be as complete and thorough as possible in order to avoid claims of bad faith. *See, e.g. State Farm Fire & Cas. Co. v. Simmons*, 857 S.W.2d 126 (Tex. App.-Beaumont 1993) [jury awarded actual and punitive damages to insureds whose fire loss claim was denied on the basis of fraud; because the SIU investigation was less than objective and outcome oriented the verdict was affirmed].

The benefit of filing the DJA is that it resolves questions of coverage, and is usually resolved quicker and in advance of an underlying personal injury action. Additionally, DJA's are often resolved on motion, thus avoiding the expense of trial. In many cases, the fraudulent actors get scared and will not answer the complaint once served with the DJA, allowing the insurance company to prevail on default. In other cases, their attorneys, ignorant of the fraud, move to be relieved as counsel in the underlying personal injury suit upon the filing of an artfully drafted complaint for declaratory relief.

In order to prevail on a DJA based on a fraudulent auto claim in NY, the insurer need only establish by a preponderance of the evidence that no coverage ever existed. *See, V.S Medical Services, PC. v. Allstate Ins. Co.,* 25 Misc. 3d 39 889 N.Y.S.2d 360 (N.Y. App. Term 2009) ["while an insurer may put forth evidence of a fraudulent scheme in order to prove that a collision was not an accident, the insurer need not prove fraud"]. *See also*, *State Farm Mutual Automobile Insurance Company v. Laguerre, supra* ["a deliberate collision caused in furtherance of an insurance fraud scheme is not a covered accident"]. Because insurance policies are not meant to cover intentional acts, no coverage is available for the intentionally caused "accident".

c. Considerations Before Filing the Declaratory Judgment Action

The DJA won't always scare fraudulent actors away and insurers don't always win. Accordingly, there are a few things to consider before proceeding with a DJA.

Of primary concern is the cost-benefit analysis. Indeed, insurers are subject to fines from state insurance departments if it loses a DJA. A fine may be issued if regulators think the DJA was improper. Therefore, the insurer must carefully evaluate venue and the likelihood of success before filing the DJA.

Upon careful review of the claim, the insurer must be sure that it wants to proceed with the DJA on the facts known. The point is to try to mitigate the risk of creating bad law.

Where applicable, the insurer should also be fairly certain that under the facts it should have no duty to defend its insured. Because there is often an underlying action for personal injuries, the careful insurer should try to avoid a situation where it not only pays litigation costs in the DJA, but is also found liable for defense costs in the underlying personal injury action and indemnity as well. Additionally, if the insured is being sued and/or innocent people have been injured as a result of the insured's fraudulent scheme, the insurer should be comfortable in its decision to put the insured in a position where it will be stuck without coverage.

Timing and jurisdiction can also play a critical role here. In Texas, for example, insurers can not recover defense costs from an insured following determination in a DJA of no coverage. *See, TX Ass'n Counties Cty Gov't Risk Mgmt v. Matagorda Cty*, 52 S.W.3d 128, 44 Tex. Sup. Ct. J. 215 (Tex., 1999). Therefore, it may not be prudent to file the DJA if it can not be resolved before the underlying action.

The value of the claim and the likelihood of resolving the DJA on motion are also a factor. If projected litigation costs significantly outweigh the value of the claim, then it may be more cost effective to settle the claim in the short term. In the long term, everyone pays when insurance fraud is rewarded, and the DJA has a deterrence value which should not be overlooked.

III Ethical Considerations in Mining the Internet for Public Data About Participants in Fraudulent Schemes

a. "Friending" the Claimant

During an investigation, it is generally acceptable for police officers and investigators to "friend" a claimant or witness online – either with real or fake profiles so long as the friending is not done at the direction of a lawyer. *See Philadelphia Bar Association Opinion 2009-02 and* and *Model Rule of Professional Conduct 5.3*, which makes lawyers responsible for nonlawyers they supervise. *See also, Michigan Ethics Opinion ri-153* (an investigator hired by the insurance company may friend the plaintiff so long as the attorney is not involved; it does not matter if pretexts are used).

A claims professional, however, should not friend a claimant because an adjuster should not communicate with a represented claimant/plaintiff. Friending the person would be such a communication. It is also unethical for a claims adjuster to use subterfuge to friend a claimant. *See, Cal. Ins. Code § 791.03* [No insurance institution, agent or insurance-support organization shall use or authorize the use of pretext interviews to obtain information in connection with an insurance transaction]. As defined by the Connecticut Insurance Information and Privacy Protection Act, G.G.S.C. 38a-976(v), a pretext interview, is "an interview where a person, in an attempt to obtain information about an individual, performs one or more of the following acts: (1) pretends to be someone he is not, (2) pretends to represent a person he is not in fact representing, (3) misrepresents the true purpose of the interview, or (4) refuses to identify himself upon request."

b. Lawyer Do's and Don'ts

A lawyer may not friend a represented party because this would violate Rule 4.2 of the Model Rules of Professional Conduct. It would also be improper for a lawyer to friend directly or indirectly an unrepresented party through deceptive means. See Philadelphia Bar Association Opinion 2009-02. A lawyer may not ask a legal assistant or friend or investigator or any third party to do the friending. See, Model Rules of Professional Conduct 8.4(a) (maintaining the integrity of the profession) and Rule 5.3(c) (responsibilities regarding non lawyer assistants).

However, there would be no violation of the rules of professional conduct if an attorney or her agent used her real name and profile to send a "friend request" to obtain information from an unrepresented person's social networking website without also disclosing the reasons for making the request. Nevertheless, a "lawyer may not attempt to gain access to a social networking website under false pretenses, either directly or through an agent." See, Association of the Bar of the City Of New York Committee on Professional and Judicial Ethics - Opinion 2010-2 (Sept. 2010).

And, according to New York State Bar Assoc. Ethics Opinion 843 (Sept. 10, 2010), a lawyer representing a client in pending litigation may access the public pages of another party's social networking website (such as Facebook or MySpace) for the purpose of obtaining possible impeachment material for use in the litigation. However, if a litigant's public profile does not reveal any evidence that contradicts the alleged injuries or claimed damages, a court will likely not permit discovery of all of the account information. *See, e.g. Tomkins v. Detroit Metropolitan Airport,* 2012 WL 179320 (E.D. Mich. Jan. 18, 2012) (where public photos did not show plaintiff engaged in activities contrary to the claims made in her lawsuit). In a litigation context, private social media information is generally only discoverable if there is evidence from the publicly available information of additional relevant evidence. No fishing expeditions are allowed.

IV Collection, Organization and Presentation of SIU Information

a. Preserving Information

In preparation of a contested DJA, social media evidence collected by SIU must be saved before the claimant deletes the information and/or modifies his/her privacy settings. The SIU Investigator or individual discovering and storing the information will need to sign an affidavit and possibly testify at trial after printing and/or saving information collected from the internet. Additionally, an e-discovery expert should be retained to preserve the metadata (aka digital fingerprint) in this electronically stored information. Private companies such as X1 Discovery (x1discovery.com) help law enforcement, prosecutors and insurers capture metadata and follow a chain of custody so cases have a better chance of holding up in court.

Once litigation ensues, subpoenas can be served on Facebook and other social media giants. Because of the Stored Communications Act 18 U.S.C. 2701, however, actual user data like comments, wall posts, status updates, tweets, etc. is rarely provided. The Facebook website even states that it is prohibited from providing user data. See, http://goo.gl/iDpqk3. And, courts have interpreted the Stored Communications Act as prohibiting sites from disclosing nonpublic content without the user's consent.

b. Authentication

Another concern is proper authentication of social media evidence. Indeed, social media evidence has to be authenticated; otherwise, there is no conclusive evidence that a status update, comment, tweet or post is actually came from the individual in question. In the federal case of *Lorraine v. Markel Am. Ins.,* 241 F.R.D. 534 (D.Md. 2007), the court suggested that evidence be authenticated by (a) having the alleged author authenticate his/her own online postings, (b) retain a computer forensic firm and (c) proffer testimony from a representative of the social media website linking the profile to the

posting. *See also, Griffin v. State of Maryland*, 419 Md. 343,19 A.3d 415 (Md. 2011) and *People v. Clevenstine*, 68 A.D.3d 1448, 891 N.Y.S.2d 511 (2009).