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The Basics of Insurance Fraud

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The specter of fraud has haunted commerce since long before the creative salesmanship of the snake oil salesmen of the old west. Its fundamental character, however, has remained a constant. The architect of the fraud makes a representation he or she knows to be false with the intention that the recipient will rely upon it, and does so to his or her detriment. The motivation is usually quite simple—money.

Among the most fertile fields for fraud today is the area of insurance coverage and claims. Insurance fraud victimizes not only insurers, but the public at large, which ultimately pays a price in the form of larger premiums and limitations in coverage. As a consequence, the New Jersey courts and the state Legislature have fashioned powerful remedies to combat fraud both in applying for insurance and in the claims process.

The New Jersey Insurance Fraud Prevention Act

Traditional common law contractual remedies available to combat fraud have been buttressed by statutory causes of action such as the New Jersey Insurance Fraud Prevention Act (IFPA).¹ The IFPA not only provides insurers with a vehicle to recover costs and fees expended in investigating and challenging false claims, it also provides a penal aspect, allowing for treble damages where multiple instances of fraud are proven. The act further demonstrates the seriousness with which the Legislature views the problem by requiring that any action



brought under its auspices must be noticed to the attorney general, who may intervene and seek sanctions on behalf of the state.

The IFPA provides a list of practices that are deemed to be fraudulent, including: presenting or preparing false written or oral statements to an insurance company for the purpose of obtaining a benefit, and concealing or knowingly failing to disclose an event that impacts a person's entitlement to insurance benefits. Those aiding and abetting a violation are equally culpable.² The intent of the act is clearly to provide a framework within which any type of insurance fraud is actionable.

The attorney general may seek civil penalties under the IFPA for each false statement made by a claimant, irrespective of whether multiple statements were made in support of a single fraudulent claim.⁷ Despite the potentially severe penalties that may be meted out under IFPA, a party does not have a right to a jury trial.⁸ Moreover, although New Jersey has a public policy favoring arbitration, the courts have held that fraud claims in personal injury protection (PIP) actions need not proceed to arbitration under N.J.S.A. 39:6A-5.1.⁹

In interpreting the IFPA, the Supreme Court has held that the burden of proof required to prove a violation is by a mere preponderance of the evidence rather than the common law fraud standard of clear and convincing evidence.¹⁰

standard, the Supreme Court reversed. The Court held that a lesser burden of proof was appropriate in view of the Legislature's stated purpose in enacting the legislation of aggressively confronting the problem of insurance fraud. In reaching its conclusion, the Court discussed a number of other state and federal statutes governing false claims that were satisfied by a preponderance standard. The Court noted that other New Jersey statutes providing for substantial monetary penalties, such as the New Jersey Law Against Discrimination, employ a preponderance standard. The Court also found it incongruous to require the higher standard considering that an insurer asserting an affirmative defense of fraud, such as arson, need only prove it by a preponderance of the evidence. Finally, it

action is that the misrepresentation was *material* to a legitimate interest of the carrier at the time the false statement was made.

The definition of materiality will depend upon the context. A misrepresentation on an insurance application will be deemed material if it naturally and reasonably influenced the judgment of the underwriter in making the contract at all, or in estimating the degree or character of the risk, or in fixing the premium.¹¹ New Jersey courts differentiate between subjective and objective questions in analyzing whether to void a policy. An objective question calls for information within the applicant's knowledge, such as whether the applicant has been examined or treated by a physician.¹² Subjective questions,

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In *Liberty Mutual v. Land*, Liberty Mutual provided a homeowner's policy to Frank and Rose Land.⁷ The Lands sought coverage for damage to their home, allegedly caused by a fallen tree. Unbeknownst to them, a neighbor videotaped the Lands' nephew and two other men slamming a portion of the tree against the roof of the house. Based on this evidence, Liberty Mutual filed suit alleging a violation of the IFPA.

The jury found in favor of Liberty Mutual, holding that it had established fraud by clear and convincing evidence. The Appellate Division reversed on a number of grounds, but affirmed the trial court's decision that the proper burden of proof under the act is clear and convincing evidence.

Limiting its review to the evidentiary

reasoned that if the Legislature considered the clear and convincing standard appropriate, it would have included it in the statutory language, since it represents a departure from the customary standard of proof in civil cases.⁸

Common Law Remedies

In addition to a cause of action under IFPA, insurance carriers may seek the traditional common law contractual remedies. Where an insured has made false statements on an application for insurance, the carrier may pursue a claim for rescission. Where the insured makes a post-loss misrepresentation in support of a claim, the carrier may also avoid coverage pursuant to the standard "concealment-fraud" language of the policy. The touchstone for each cause of

on the other hand, concern the applicant's state of mind.¹¹

Importantly, the applicant's knowledge of the falsity of his or her representations must only be proven in response to subjective questions.¹² Nevertheless, the Appellate Division has held that summary judgment is appropriate where a false answer provided to a subjective question on an application was so blatantly dishonest that no reasonable fact-finder could conclude that the applicant's answer truly reflected his or her actual opinion.¹⁴

In a post-loss misrepresentation, an insured's misstatement is material if, when made, a reasonable insurer would have considered the misrepresented fact relevant to its concerns and important in determining its course of action.¹⁴

Prejudice from a post-loss misrepresentation is unnecessary to relieve the insurer of the obligation to cover the loss.¹⁵ Where a post-loss misrepresentation is promptly corrected, however, the action may defeat a carrier's claim that the misstatement was material.¹⁶

False Statements in the Application

In *Massachusetts Mut. v. Manzo*, the New Jersey Supreme Court held that a life insurer could void a policy for equitable fraud, even where the insured lied about a physical condition that did not cause his death.¹⁷ In *Manzo*, the insured, Albert Manzo, lied on his life insurance application when he denied ever having been treated for diabetes. After the policy was issued, but within the period of contestability, Manzo was found shot to death and left in the trunk of his car. Manzo's wife made a claim under the policy. Massachusetts Mutual discovered that Manzo had been treated for diabetes, and denied the claim. The trial court held that Massachusetts Mutual was entitled to rescind the policy, but the Appellate Division reversed, holding that the carrier had failed to prove that Manzo's diabetes rendered him either uninsurable or contributed to his death.

The Supreme Court reversed, and held that even equitable fraud—an innocent material misrepresentation—may be used to rescind a life insurance policy. The Court explained that N.J.S.A. 17B:24-3(d), which governs the falsity of statements on applications for life and disability policies, does not require the insurer prove the insured lied with intent to defraud. The Court further held that the insurer does not have to prove the misrepresented disability rendered the insured uninsurable or was causally related to his or her death in order to rescind the policy.

Most notably, the Court held that a material misrepresentation is one that affects the insurer's acceptance of the risk. The Court viewed the testimony of

an insurance underwriter asserting that Manzo's lie affected the company's estimation of the degree of risk and its calculation of the premium as sufficient to satisfy this burden.

The simplicity of this concept grows complex when viewed in the context of an automobile policy where the loss of coverage affects not the insured or his beneficiaries, but rather the innocent victim of the insured's tortious conduct. While an insured and his or her beneficiaries are appropriately denied the benefits of a fraudulently obtained policy, persons injured in auto accidents through the negligence of the insured, and potentially left without a way to pay for medical bills if a policy is voided, present a competing variable. The courts have thus drawn a distinction between persons who may be charged with the knowledge of the named insured's application fraud, and those who fall into the category of "innocent beneficiaries" of a policy voidable for fraud. This rubric, however, does not end the discussion.

In *Palisades Safety and Insurance Ass'n v. Bastien*, the Court upheld rescission of the policy to a resident spouse injured in an automobile accident who was not a named insured on the policy and had not engaged in fraudulent conduct.¹⁸ Leonel Bastien applied for auto insurance and falsely represented that he was single and the sole driver of the two vehicles he sought to insure. Bastien actually was married, and the lie was calculated to secure lower premiums on the two vehicles. There was no evidence, however, that his wife knew of the misrepresentation.

Mrs. Bastien was involved in an accident while driving one of the insured vehicles. She filed a claim for PIP benefits under the policy and the insurer denied coverage. The Supreme Court affirmed the lower courts' rulings that the wife was not an innocent third party and voided the policy. Noting that as a

spouse residing in the household, Mrs. Bastien should have been aware of household insurance matters, the Court saw a bright line distinction, grounded in the strong policy against insurance fraud, between resident spouses and innocent third parties.

Recently, the Supreme Court further refined the distinctions to be considered when courts address how a fraudulent application impacts claims by members of the insured's household.¹⁹ In *Rutgers Cas. Ins. Co. v. LaCroix*, Chrissy LaCroix, the resident daughter of Robert LaCroix, was injured in an auto accident while operating her father's car.²⁰ She filed a claim with Rutgers Casualty for PIP benefits that was denied when her father admitted he had omitted her name from his insurance application in an attempt to secure lower premiums. The Court held that the daughter was entitled to coverage because she was a young, newly licensed driver who had placed trust in her father for ensuring that the vehicles he allowed her to drive were properly insured.

The distinction between *Palisades Safety* and *LaCroix* is the status of the "innocent beneficiary." In *Palisades Safety*, the Court noted that the wife's status as a resident adult charged her with the knowledge of the on-goings in the household and the ability to change the information on the policy. In contrast, in *LaCroix* the innocent beneficiary is a daughter who had no authority to alter the information on the application for insurance submitted by her father. Based upon the daughter's status as an innocent third party, the Court extended to her the protection of the policy.

Where auto policies are declared void *ab initio* and coverage is extended only to innocent third parties, it is limited to the \$15,000 statutory minimum.²¹ The courts strike a balance between the two parties victimized by the fraud, the insurance carrier and the innocent third party. While the policy is judicially

extended to protect the innocent third party, the carrier is protected from an excessive loss by application of the statutory minimums.

Post-Loss Misrepresentations

The law governing post-loss misrepresentations presents fewer permutations since it involves, for the most part, only the insurer and its insured. For an insurer to void a policy because of a post-loss misrepresentation, the misrepresentation must be knowing and material. A mere oversight or an honest mistake will not cost an insured his or her coverage.²²

In *Longobardi v. Chubb*, the insured, Longobardi, owned a valuable art collection, insured with the defendant, Chubb Insurance.²³ Claiming his home was burglarized and the collection stolen, Longobardi filed a claim for its value. The policy contained a standard "concealment or fraud" provision that Chubb would not provide coverage to any insured who intentionally concealed or misrepresented any fact material to the claims process. Following the loss, Chubb conducted an examination of Longobardi under oath, where he denied knowing two individuals whom Chubb had reason to believe were involved in insurance fraud schemes and had had contact with Longobardi. Chubb was able to establish that Longobardi lied in this regard, and denied coverage for the claim.

The case was tried, and a jury found that Longobardi had indeed been burglarized and had not conspired to defraud the insurance company. The jury also found that he had made a material false statement during the examination under oath in an effort to mislead Chubb in its investigative process. The trial court dismissed Longobardi's complaint for coverage.

The Appellate Division reversed, entered a judgment on liability for Longobardi and remanded for a trial on damages. The court found that the con-

cealment or fraud clause was ambiguous, and determined that Longobardi's misstatements were neither material nor prejudicial.

The Supreme Court reversed, and held that the concealment or fraud clause was not ambiguous and applies when an insured misrepresents facts to the insurer during a post-loss investigation. The Court recognized that Longobardi's misstatements ultimately did not prejudice Chubb, but it discounted this fact as irrelevant, since Chubb's inquiry was material when the misstatement was made.

Stressing that the right rule of law is one that provides insureds with an incentive to tell the truth, the Court held that an insured's misstatement is material if, when made, a reasonable insurer would have considered the misrepresented fact relevant to its concerns and important in determining its course of action. The carrier need not demonstrate that it ultimately suffered prejudice in order to void coverage.

Conclusion

The law governing insurance fraud may be distilled into a simple credo: Tell the truth. New Jersey courts have struck a balance between fraudulent insureds on the one hand, and their insurers and innocent parties on the other. Although a carrier may be obligated to extend some level of protection to an innocent party, it will not be excessive and the perpetrator of the fraud will not benefit from his or her dishonesty. When competing interests have to be addressed, the solution is rarely perfect; however, in terms of insurance fraud, this is probably the most equitable possible. ☺

Endnotes

1. N.J.S.A. 17:33A(1)-14.
2. N.J.S.A. 17:33A-4.
3. *Marin v. Maglaki*, 126 N.J. 430 (1992).
4. *State v. Sailor*, 355 N.J. Super. 315 (App. Div. 2002).

5. *Nationwide Mut. Fire v. Fioris*, 395 N.J. Super. 156 (App. Div. 2007).
6. *Liberty Mutual v. Land*, 186 N.J. 163 (2006).
7. *Id.*
8. *Id.* at 179.
9. *Kerpchuk v. John Hancock Mut. Life Ins. Co.*, 97 N.J.L. 196, 198 (E&A 1922).
10. *Formosa v. Equitable Life Assur. Soc. of US*, 166 N.J. Super. 8 (App. Div. 1979).
11. *Ledley v. William Penn Life Ins. Co.*, 138 N.J. 627 (1995).
12. *Id.*
13. *Leibling v. Garden State Indemnity*, 337 N.J. Super. 447 (App. Div.), *certif. den.*, 169 N.J. 606 (2001).
14. *Longobardi v. Chubb Ins. Co. of NJ*, 121 N.J. 530 (1990).
15. *Id.* at 542.
16. *Mariani v. Bender*, 85 N.J. Super. 490 (App. Div. 1964), *certif. den.*, 44 N.J. 409 (1965).
17. *Massachusetts Mut. v. Manzo*, 122 N.J. 104 (1991).
18. *Palisades Safety and Insurance Ass'n v. Bastien*, 175 N.J. 144 (2003).
19. *Rutgers Cas. Ins. Co. v. LaCroix*, 194 N.J. 515 (2008).
20. *Id.*
21. *Marotta v. NJ Auto*, 280 N.J. Super. 525 (App. Div. 1995), *aff'd o.b.*, 144 N.J. 325 (1996) and *Dillard v. Hertz, supra*. The *LaCroix* court remanded the case to the Trial Division for a determination as to whether the daughter's extensive injuries qualified her for enhanced benefits under N.J.S.A. 39:6A-4.3.
22. *Longobardi, supra*, 121 N.J. at 540.
23. *Id.*

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