

COURT OF APPEALS OF THE STATE OF NEW YORK

State Farm Mutual Automobile Insurance Co. v. Mallela

State Farm Mut. Auto. Ins. Co. v. Mallela, 4 N.Y.3d 313, 827 N.E.2d 758, 794 N.Y.S.2d 700 (2005) · Decided March 29, 2005

SUMMARY

The New York Court of Appeals held that no-fault insurers may withhold reimbursement for medical services provided by fraudulently incorporated medical corporations. It upheld an insurance regulation excluding providers that fail to satisfy applicable licensing requirements, while distinguishing willful and material fraud from technical corporate violations. The court answered a certified question from the United States Court of Appeals for the Second Circuit in the negative and declined to resolve related fraud or unjust-enrichment claims.

CASE DETAILS

COURT	Court of Appeals of the State of New York
WRITING FOR THE COURT	Rosenblatt, J.; Kaye, C.J.; G.B. Smith, J.; Ciparick, J.; Graffeo, J.; Read, J.; R.S. Smith, J.
JURISDICTION	New York
DECIDED	March 29, 2005
DISPOSITION	other
PROCEDURAL POSTURE	The New York Court of Appeals decided a question certified by the United States Court of Appeals for the Second Circuit concerning whether fraudulently incorporated medical corporations are entitled to reimbursement under New York's no-fault insurance laws.
STANDARD OF REVIEW	The court reviewed the validity and application of the Superintendent of Insurance's regulation under the principle that an agency interpretation is upheld if it is not irrational or unreasonable and does not conflict with clear statutory language.
PRECEDENTIAL VALUE	binding precedent
PARTIES	State Farm Mutual Automobile Insurance Co. v. Robert Mallela et al., Astoria Physical Medicine and Rehabilitation, P.C. and another, Valley Physical Medicine and Rehabilitation, P.C. and others, Yonkers Medical Services, P.C. and others, Dr. Dipak Nandi and others

TOPICS

insurance coverage

administrative law

statutory interpretation

corporate law

declaratory relief insurance

PRACTICE AREAS

insurance law

administrative law

health law

corporate law

statutory interpretation

QUESTIONS PRESENTED

1. Whether a medical corporation fraudulently incorporated in violation of New York's professional-corporation and licensing laws is entitled to reimbursement from no-fault insurers for medical services rendered by licensed practitioners.
2. Whether the Superintendent of Insurance's regulation excluding unlicensed or fraudulently licensed providers from reimbursement is valid and enforceable.
3. Whether the court should decide State Farm's potential fraud and unjust-enrichment claims for payments made before or after the regulation's effective date.

HOLDINGS

1. A medical corporation fraudulently incorporated through willful and materially false filings is not entitled to reimbursement from no-fault insurers, even when the actual medical care was rendered by licensed practitioners within the scope of their licenses.
2. The Superintendent of Insurance acted within his authority in promulgating the regulation excluding fraudulently licensed medical corporations from no-fault reimbursement.
3. No-fault insurers may look beyond facially valid licensing documents to investigate willful and material violations of licensing and ownership requirements, but may delay payment for investigation only upon good cause; technical violations alone are insufficient.
4. The court declined to decide whether State Farm had pleaded sufficient facts to support fraud or unjust-enrichment claims, and held that no such claim would lie for payments made before the regulation became effective on April 4, 2002.

KEY QUOTATIONS

"We hold that on the strength of this regulation, carriers may look beyond the face of licensing documents to identify willful and material failure to abide by state and local law." (321)

"Technical violations will not do." (322)

"certified question answered in the negative." (323)

FACTUAL BACKGROUND

State Farm alleged that nonphysicians evaded New York's prohibition on lay ownership of medical service corporations by paying physicians to serve as nominal owners. The nonphysicians allegedly operated the corporations through management companies that received inflated fees, thereby diverting the corporations'

profits. State Farm did not allege that patients received unnecessary or improper medical care; the alleged fraud concerned the corporations' ownership and licensing structure.

PROCEDURAL HISTORY

State Farm filed an action in the United States District Court for the Eastern District of New York seeking declaratory, equitable, fraud, and unjust-enrichment relief against medical corporations and individuals. The District Court dismissed the complaint, concluding that licensing and incorporation violations did not extinguish State Farm's payment obligation where licensed practitioners had provided care. The Second Circuit certified the reimbursement question to the New York Court of Appeals, which accepted the certification and answered it in the negative.

DISPOSITION

other

CASES CITED

- Matter of New York Pub. Interest Research Group v. New York State Department of Insurance, 66 N.Y.2d 444, 448 (1985)
- Matter of Medical Society of State of New York v. Serio, 100 N.Y.2d 854, 866 (2003)
- State Farm Mutual Automobile Insurance Co. v. Mallela, 372 F.3d 500, 510 (2d Cir. 2004)

OPINION

ROSENBLATT, J.

4 N.Y.3d 313 (2005) 827 N.E.2d 758 794 N.Y.S.2d 700 STATE FARM MUTUAL AUTOMOBILE INSURANCE Co., Appellant, v. ROBERT MALLELA et al., Respondents. Court of Appeals of the State of New York. Argued February 8, 2005. Decided March 29, 2005. *314 Rivkin Radler LLP, Uniondale (Evan H. Krinick, Cheryl F. Korman and Stuart M. Bodoff of counsel), and KMZ Rosenman LLP, Chicago, Illinois (Ross O. Silverman and Gil M. Soffer of counsel), for appellant.

Law Office of Joseph J. LaBarbera, P.C., Brooklyn (Joseph J. *315 LaBarbera of counsel), for Astoria Physical Medicine and Rehabilitation, P.C. and another, respondents. Friedman Harfenist Langer & Kraut, Lake Success (Steven J. Harfenist and Neil Torczyner of counsel), for Valley Physical *316 Medicine and Rehabilitation, P.C. and others, respondents. Hoffman, Einiger & Polland, PLLC, New York City (Mark L. Furman of counsel), and Israel, Israel & Purdy, LLP, Great Neck (Veronica Renta Irwin, Stuart M. Israel and William M. Purdy of counsel), for Yonkers Medical Services, P.C. and others, respondents. *317 Goodwin Proctor LLP, New York City (Jeffrey A. Simes and Richard M. Strassberg of counsel), and La Sorsa & Beneventano, White Plains (Gregory M. La Sorsa of counsel), for Dr. Dipak Nandi and others, respondents.

Eliot Spitzer, Attorney General, New York City (Daniel Smirlock and Robert H. Easton of counsel), for Gregory V. Serio, amicus curiae. *318 Locks Law Firm, PLLC, New York City (Seth R. Lesser and Andrew P. Bell of counsel), Thomas W. Alfano and Belesi & Donovan, P.C., Garden City (John Belesi of counsel), for Meridian Acupuncture Care, amicus curiae. Cadwalader, Wickersham & Taft LLP, New York City (Francis J. Serbaroli and William J. Natbony of counsel), and Short & Billy, P.C.

(Skip Short of counsel), for Allstate Insurance Company and others, amici curiae. Pastel & Rosen, LLP, Albany (Robert Pastel of counsel), for New York Insurance Association, Inc., amicus curiae. *319 perintendent of Insurance's prohibition against reimbursing fraudulently incorporated medical providers is not unreasonable. Chief Judge KAYE and Judges G.B. SMITH, CIPARICK, GRAFFEO, READ and R.S.

SMITH concur. OPINION OF THE COURT ROSENBLATT, J. On this certified question from the United States Court of Appeals for the Second Circuit, we are asked whether, under our "no-fault" insurance laws (see Insurance Law § 5101 et seq. and implementing regulations), insurance carriers may withhold payment for medical services provided by fraudulently incorporated enterprises to which patients have assigned their claims.

We conclude that they may. Patients covered by no-fault insurance often assign their claims to their health care providers rather than seek reimbursement from insurance carriers directly (see 11 NYCRR 65-3.11). Regulations require the carriers to make prompt decisions on claims once the provider has furnished adequate factual support (see 11 NYCRR 65.15). This case began when State Farm filed a complaint in the United States District Court for the Eastern District of New York seeking a judgment declaring that it need not reimburse defendants' fraudulently incorporated medical corporations for assigned claims submitted under no-fault.

The complaint also sought equitable relief and damages against defendant companies and individuals for unjust enrichment and fraud. State Farm alleged, in essence, that to obtain payments from the carriers under the requirements of no-fault insurance, defendants willfully evaded New York law prohibiting nonphysicians from sharing ownership in medical service corporations.[1] According to the complaint, the unlicensed defendants paid physicians to use their names on paperwork filed with the State to establish medical service corporations.

Once the medical service corporations were established under the facially valid cover of the nominal physician-owners, the nonphysicians actually operated the companies. To maintain the appearance that the physicians owned the entities, the nonphysicians caused the corporations to hire management companies (owned by the nonphysicians), which billed the medical corporations inflated rates *320 for routine services.

In this manner, the actual profits did not go to the nominal owners but were channeled to the nonphysicians who owned the management companies. Notably, State Farm never alleged that the actual care received by patients was unnecessary or improper.

The patients insured by State Farm presumably received appropriate care from a health professional qualified to give that care. State Farm's complaint centers on fraud in the corporate form rather than on the quality of care provided.

The Federal District Court dismissed State Farm's complaint, holding that defendants' noncompliance with the licensing and incorporation statutes did not extinguish State Farm's duty to pay, so long as the actual providers acted within the scope of their licenses in rendering care.

The Second Circuit then certified to this Court the question whether "a medical corporation that was fraudulently incorporated under N.Y. Business Corporation Law §§ 1507, 1508, and N.Y. Education Law § 6507(4)(c) [is] entitled to be reimbursed by insurers, under New York Insurance Law §§ 5101 et seq., and its implementing regulations, for medical services rendered by licensed medical practitioners" (372 F3d 500, 510 [2004]).

We accepted the certification and now answer that such corporations are not entitled to reimbursement. Insurance Law § 5102 et seq. requires no-fault carriers to reimburse patients (or, as in this case, their medical provider assignees) for "basic economic loss." Interpreting the statute, the Superintendent of Insurance promulgated 11 NYCRR 65-3.16 (a) (12) (effective April 4, 2002) and excluded from the meaning of "basic economic loss" payments made to unlicensed or fraudulently licensed providers, thus rendering them ineligible for reimbursement.[2] If State Farm's allegations are true, as we must construe them to be at this stage, the defendant companies undisputedly fail to meet the applicable state licensing requirements, which *321 prohibit nonphysicians from owning or controlling medical service corporations.

Furthermore, a fraudulently incorporated medical company is "[a] provider of health care services" within the meaning of the regulation. Defendants contend they are entitled to reimbursement even if fraudulently licensed. They first argue that the actual care that patients received was within the scope of the licenses of those who treated the patients. Defendants posit that this licensing compliance brings them within the regulatory framework for reimbursement.

We disagree. The fact remains that the reimbursement goes to the medical service corporation that exists to receive payment only because of its willfully and materially false filings with state regulators. Defendants also argue that the quoted regulation conflicts with the prompt payment goals of the no-fault statutes.

The Second Circuit treated this issue as a difficult policy balance: on the one hand, there is our State's prohibition against lay ownership of shares in medical corporations (and the accompanying

potential for fraud), and on the other, our encouragement of prompt payment of insurance claims, as reflected in the statutes.

The regulation is valid. We are guided by the well-established principle of administrative law that the Superintendent's "interpretation, if not irrational or unreasonable, will be upheld in deference to his special competence and expertise with respect to the insurance industry, unless it runs counter to the clear wording of a statutory provision" (Matter of New York Pub.

Interest Research Group v New York State Dept. of Ins., 66 NY2d 444, 448 [1985]). Where, as here, the Superintendent has properly crafted a rule within the scope of his authority, that rule has the force of law and represents the policy choice of this State.[3] The Superintendent's regulation allowing carriers to withhold reimbursement from fraudulently licensed medical corporations governs this case.

We hold that on the strength of this regulation, carriers may look beyond the face of licensing documents to identify willful and material failure to abide by state and local law. Defendants argue that the carriers will *322 turn this investigatory privilege into a vehicle for delay and recalcitrance.

The regulatory scheme, however, does not permit abuse of the truth-seeking opportunity that 11 NYCRR 65-3.16 (a) (12) authorizes. Indeed, the Superintendent's regulations themselves provide for agency oversight of carriers, and demand that carriers delay the payment of claims to pursue investigations solely for good cause (see 11 NYCRR 65-3.2 [c]).

In the licensing context, carriers will be unable to show "good cause" unless they can demonstrate behavior tantamount to fraud. Technical violations will not do. For example, a failure to hold an annual meeting, pay corporate filing fees or submit otherwise acceptable paperwork on time will not rise to the level of fraud.

We expect, and the Legislature surely intended, vigorous enforcement action by the Superintendent against any carrier that uses the licensing-requirement regulation to withhold or obstruct reimbursements to nonfraudulent health care providers.

The Second Circuit questioned whether, if the fraudulent corporations were not entitled to reimbursement, State Farm could recover money already paid out under theories of fraud or unjust enrichment. Because we rest our holding on the Superintendent's amended regulation declaring fraudulently licensed corporations ineligible for reimbursement, no cause of action for fraud or unjust enrichment would lie for any payments made by the carriers before that regulation's effective date of April 4, 2002.

State Farm's complaint does not clearly indicate, one way or the other, whether it has paid money to defendants after the amended regulation took effect. We therefore answer only the certified

question and decline to consider whether State Farm has alleged sufficient facts to support causes of action for fraud or unjust enrichment. Based on the foregoing, the certified question should be answered in the negative.

Following certification of a question by the United States Court of Appeals for the Second Circuit and acceptance of the question by this Court pursuant to section 500.17 of the Rules *323 of Practice of the Court of Appeals (22 NYCRR 500.17), and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified question answered in the negative.

NOTES [1] See e.g. Business Corporation Law § 1507 ("A professional service corporation may issue shares only to individuals who are authorized by law to practice in this state a profession which such corporation is authorized to practice...").

[2] See 11 NYCRR 65-3.16 (a) (12) ("A provider of health care services is not eligible for reimbursement under section 5102 (a) (1) of the Insurance Law if the provider fails to meet any applicable New York State or local licensing requirement...").

In his amicus brief, the Superintendent asserts that he promulgated this rule to combat rapidly growing incidences of fraud in the no-fault regime, fraud that he has identified as correlative with the corporate practice of medicine by nonphysicians.

[3] We have already unanimously concluded that the regulation is within the Superintendent's authority to issue and will not disturb that result (see *Matter of Medical Socy. of State of N.Y. v Serio*, 100 NY2d 854, 866 [2003] ["Here, however, the challenged regulations create not a new category of exclusion, but rather merely a condition precedent with which all claimants must comply in order to receive benefits under the statute."]).