USCOA,2 No. 29

State Farm Mutual Automobile Insurance Co.,

Appellant,

v.

Robert Mallela, et al.,

Respondents.

Evan H. Krinick, for appellant.

Steven J. Harfenist, for respondents Valley Physical Medicine and Rehabilitation, P.C., et al.

Mark L. Furman, for respondents Yonkers Medical Services, P.C., et al.

Joseph J. LaBarbera, for respondents Astoria Physical Medicine and Rehabilitation, P.C., et al.

Gregory V. Serio, Superintendent of Insurance of the State of New York; Meridian Acupuncture Care; Allstate Insurance Company, et al.; New York Insurance Association, Inc., amici curiae.

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 non-physicians from sharing ownership in medical service corporations.[1]

According to the complaint, the unlicensed defendants

[1]See e.g. Business Corporations 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. . . .").

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 non-physicians actually operated the companies. To maintain the appearance that the physicians owned the entities, the non-physicians caused the corporations to hire management companies owned by the non-physicians, which billed the medical corporations inflated rates for routine services. In this manner, the actual profits did not go to the nominal owners but were channeled to the non-physicians 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' non-compliance 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 NY Business Corporation Law §§ 1507, 1508, and NY 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."

We accepted the certification and now answer that such corporations are not entitled to reimbursement.

Insurance Law § 5102 (a) 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 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 prohibit non-physicians 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 that they are entitled to

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[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 non-physicians.

reimbursement even if they are 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" (NY Pub Interest Research Group, Inc v NYS Dep't 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 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

[3]We have already unanimously concluded that the regulation is within the Superintendent's authority to issue and will not disturb that result (see Medical Soc'y of New York, Inc 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."]).

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 non-fraudulent healthcare 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 unlicensed 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.

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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 of Practice of the New York State Court of Appeals, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified question answered in the negative. Opinion by Judge Rosenblatt. Chief Judge Kaye and Judges G.B. Smith, Ciparick, Graffeo, Read and R.S. Smith concur.

Decided March 29, 2005