

Like Client, Like Attorney: Partners in Organized Crime

by: Robert A. Stern, Stern & Montana, LLP; Thomas H. Cellilli, III, Locher, Cellilli, Pavelka & Dostal, P.C; Lawrence K. Spitz, M.D., Penn Diagnostic Center, Inc.

Attorneys have always had a prominent role in facilitating the insurance fraud on behalf of their clients who engaged in such practices. In recent years, though, the extent of the attorney's involvement has shifted from merely creating the corporate structure through which a client could fraudulently bill for medical services through the use of a series of legal documents designed to divert and mask the profits from the illegal enterprise. Rather, recent trends suggests that some attorneys are shedding their arguably passive role, to a more active one in which they participate in the secretion of their client's assets and the concealment of their identity.

Moreover, in some instances, these same attorneys who form or advise their clients to form professional corporations that fraudulently bill insurance companies, simultaneously engage in self-dealings by creating their own factoring companies that purchase the accounts receivables from their clients professional corporations.¹

Indeed, although the insurance industry and law enforcement, even in the wake of the horrific and tragic events of Sept. 11th, have continued to commit unprecedented resources to combat insurance fraud, the organized fraud rings have become more brazen, with the attorney and client walking side-by-side. The corporate structures are created, with the principals concealed, making it virtually impossible to distinguish the attorney from the criminals that the special investigative units (SIU) are investigating. In fact, in the schemes that will be discussed during the workshop, there is no distinction. The attorneys knowingly form the ring ostensibly on their clients behalf, and in time become the ones responsible for sheltering the illegal activities from detection by insurers and law enforcement. From setting up the sham corporate structure, to collecting an inventory of doctors who are willing to sell their names and licenses for a fee, to providing back office systems to fraudulently bill and collect money from insurers and ultimately laundering the money to a location where the spoils obtained from their illegal operations may be disbursed to various other illicit enterprises.

Corporate Practice of Medicine

Many states restrict who may own shares of a professional corporation (PC) or professional association (PA). Due to this restriction, the emergence of the "doc-in-the-box" scam has widely emerged as the primary means to circumvent the restrictive

corporate practice of medicine or other licensed healthcare professions. For example, under section 1503 of the New York State Business Corporation Law (BCL) of New York State, a corporation is not permitted to practice a profession, such as medicine, physical therapy, chiropractic, acupuncture, psychology, and audiology², unless it incorporates as a professional corporation. To qualify as a professional corporation it must first obtain the consent of the licensing authority certifying that the shareholders, officers and directors named in its certificate of incorporation are authorized to practice in the profession in which the corporation is being organized. A corporation, owned by a non-professional, that practices medicine without incorporating as a professional corporation is engaged in the illegal corporate practice of medicine and its principals may be subject to criminal prosecution for the unlawful practice of medicine, injunctive relief and lawsuits by those victimized by its deceit. See BCL § 1507.

The New York State BCL plainly provides that if a corporation is to practice a profession it must do so in accordance with Article 15.³ Article 15 requires a professional corporation to disclose the names of all shareholders, officers and directors. A doctor that is listed in a PC's certificate of incorporation as its owner but in fact is merely its paper or nominal owner violates the provisions of the BCL. Any professional corporation that is owned by a layperson or a non-disclosed professional is engaged in the illegal corporate practice of medicine and is not entitled to reimbursement under the no-fault law.

By way of another example, Florida law similarly proscribes the unlicensed practice of a profession.⁴ Under Florida law, only licensed professionals authorized to practice the specific profession of the professional association may be shareholders of that corporation. While, unlike New York, Florida does not appear to prohibit a lay person from being an officer or director of a Florida PA (only a shareholder), such a distinction is of no meaningful consequence, since in the doc-in-the-box scheme the central issue is one of undisclosed control and ownership. On that score, Florida law seems to prohibit a lay person from being a shareholder of a PA and therefore any such corporation engaged in the illegal corporate practice of medicine should be subject to the same licensing issues in Florida as they are in New York.⁵ Of course, consultation with an attorney admitted in Florida is required to definitively answer this question and evaluate the merits of pursuing such a defense to no-fault claims submitted by unlicensed corporations.

Moreover, while all states have statutes regulating the practice of medicine, local counsel should be consulted to determine whether any providers are in violation of your particular state's laws.

The Doc-in-the-Box Scam

As noted above, to circumvent the corporate practice of medicine and to allow chiropractors and lay individuals to bill insurance companies at the generally high fee schedule rates afforded medical doctors under various state no-fault provisions, billing management companies (BMCs) have been used as a vehicle to allow these individuals to bill insurance companies indirectly for what they cannot bill directly. In the typical doc-in-the-box scam, a lay person or chiropractor purchases the name and licensing number of a medical doctor, who for a nominal fee, agrees to appear as the owner/doctor of a new professional corporation (PC) opened under his or her license of name. Simultaneous with the incorporation of the new PC, the doctor/owner enters into a series of agreements with the BMC, typically owned by the lay person or chiropractor, that is intended to sweep virtually all of the revenue generated by the PC to the BMC.

Generally, the agreements entered into between the BMC and the PC include the following:

- A. Premises Lease Agreement;

- B. Equipment Lease Agreement;
- C. Billing Management Agreement; and
- D. Escrow Agreement

Premises Lease Agreement

The typical BMC will either be the owner or primary leaseholder of the property where the clinic purportedly renders its services. If the BMC is the owner, it will enter into a lease agreement with the PC that charges the PC rent in excess of 70 percent of the fair market value. If the BMC is leasing the premises from a landlord, the BMC will enter into a sublease that will typically charge the PC in excess of 70 percent of the rent it is charged by the landlord under the primary lease. Regardless of the type, the lease will usually include restrictions on the ability of the PC to sublease and will grant security interests to the BMC of all property within the premises. Like all of the agreements entered into between the BMC and PC, the principal purpose of the premises lease is to provide a means to ensure that the revenue generated by the PC is funneled to the BMC.

Equipment Lease Agreement

Similar to the premises lease agreement, the PC "rents" its office equipment from the BMC at an exorbitant fee that is typically in excess of 70 percent beyond fair market value.

Billing Management Agreement

Next, there is the billing management or consultant agreement that ensures that all money not previously paid to BMC in the form of "rent" is paid by the PC under the "management agreement." The billing management agreement may be based on an excessive flat fee arrangement or it may have a variable rate component that ties the management service fee to the number of bills it generates. Under either scenario, at the end of each month, the PC will have all of its money swept to the BMC, leaving virtually in its bank accounts after allowing for payment of the PC's payroll. It should be noted that a billing management agreement that ties its fee to the number of bills generated may reflect an illegal fee splitting scheme, which on its face would subject the doctor to disciplinary proceedings and the billing management company to potential allegations of the unauthorized practice of medicine. Accordingly, if you learn of such an agreement, you should consult with local counsel to determine whether the agreement is illegal on its own, thereby allowing your company to immediately deny the claims and to refer the matter to appropriate law enforcement and professional misconduct boards.

Stock Certificate

To ensure the smooth, uninterrupted activities of the BMC, at the time the PC incorporates the nominal owner/doctor signs the reverse side of the stock certificate in blank. In doing so, the owner/doctor provides for his resignation from the PC at anytime the BMC determines it is no longer in its interest to have that doctor as the named owner and elects to substitute a new one in his or her place. The signing of the stock certificate in blank further vests total control in the BMC, as the owner/doctor can be ousted from the PC at the BMC's discretion.

Escrow Agreement

The final piece to the puzzle is an escrow agreement, which is also signed at the time the PC is incorporated. Generally, pursuant to the terms of the typical BMC/PC escrow agreement, the stock certificate that the owner/doctor signed in blank may be released to the BMC by a designated escrowee (typically the BMC's attorney) in the event of occurrences:

1. The owner/doctor directs an insurance company to remit payments to someplace other than that designated by the BMC, or
2. the owner/doctor withdraws funds from the PC's bank accounts, which, of course, the owner of the BMC is also named as a signatory.

The totality of the agreements described above are designed for the dual purpose of

funneling all revenue generated by the PC to the BMC and ensuring that all control is vested with the owner of the BMC. The owner/doctor involved in these types of arrangements is the nominal owner, at best, and the true owner of the PC is the owner of the BMC, who cannot by law own a PC or bill insurance companies at a medical doctor's rates. Accordingly, as indicated above, the overly simplified "doc-in-the-box" scam depicted above is an attempt to allow the owner of the BMC to bill insurance companies at rates that it otherwise could not do without the benefit of this structure.

In carrying out the doc-in-the-box scheme, the intended consequence is generally to sweep the money from the PC to a billing management company and ultimately to the true owner of the PC. At the end of each month, after paying basic support staff and administrative expenses, the PC's bank account is left with a near zero balance and the process begins anew each successive month. Equally important to funneling the money to the true owner, is the need to conceal his or her identity.

In elaborate schemes to defraud, the ringleaders often commit their crimes with the foreknowledge that they might be arrested. As such, the efforts to conceal the identity and secrete assets begin from the outset. With the assistance of their attorneys, the clients establish sham corporations to shelter their illicit proceeds. The entities created to hide the money are sham, close corporations, which, in turn, funnel money to other corporations that they either control or own or that they use to launder money. The corporations generally have no purpose other than to be additional receptacles for receiving cash and creating another layer of corporate insulation, further removing the true owner from the fraudulent PCs and the scheme to defraud. As the additional entities are closed corporations, scant public information about the owners of the corporations is generally available. The foregoing sometimes is accomplished with the assistance of the same attorneys who incorporated the PCs and BMCs, drafted the corporate structure documents and might have even brokered or located the doctor who allowed his or her name and license to be used to form the sham PC on their clients behalf.

As their clients hide behind complex, multi-layered corporate structures, trust agreements, payments to dummy corporations and offshore accounts that the attorneys created, drafted or established, an important body of case law is developing that allows fraud victims to attach assets that might otherwise seem out of reach. In particular, as noted above, the criminal mind appreciates the wrong it is committing and does so with the knowledge that it will eventually be caught. It is for this reason that complex schemes to defraud are not only accompanied by the act of fraud, but of creating an equally complex labyrinth in which to receive and protect the money from law enforcement and their victims who would seek to attach their assets when they are caught.

To attach someone's assets, one must show, among a number of other things, that the defendant is seeking to secrete or dissipate assets with the intent to frustrate a potential judgment that might be rendered against him or her. To make such a showing, the victims of the crime often lack direct proof and therefore must rely on circumstantial evidence. See *Bank Leumi Trust Co. of New York v. Istim, Inc.*, 892 F. Supp. 478 (S.D.N.Y. 1995). In doing so, the Court, in *United States Fidelity and Guaranty Company v. United Electrical Contracting Corp.*, 1999 U.S. Dist. Lexis 12504 (E.D.N.Y. 1999), noted that it is important to look to the defendant's "badges of fraud." *Id.* (*Emphasis added.*)

In *United States Fidelity supra*, the defendant at an attachment hearing sought to infer fraudulent intent from the plaintiff-corporation sole-shareholder's transfer of certain property to his wife. The court allowed evidence of this transfer over objection as a "badge of fraud." The Fidelity Court went on to set forth a non-exhaustive list of the "badges of fraud," including

1. close relationships between the parties of a transaction
2. secret and unusual transfers
3. lack of consideration

4. transferor's knowledge of creditor's claim and his inability to pay for it
5. dummy corporations
6. retention of control by the transferor after the conveyance.

In addition, in *In re Kaiser*, 722 F.2d 1574, 1583 (1983 2nd Cir.) a seminal case on "badges of fraud," the court noted that it was "insignificant" as to when certain transfers were made because "fraudulent acts are as varied as the fish in the sea." Based on the foregoing, insurers will be able to show fraudulent intent by satisfying the criteria set forth in *Fidelity*. And thus significant money transfers and the secretion and dissipation of assets made by the ringleaders to dummy corporations and other entities that might be considered as secret and unusual transfer can form the basis for attaching their assets.

Consequently, once necessary bank documents are subpoenaed and insurers are able to follow the money, the ringleaders and their attorneys might ultimately be done in by the very same complex structure they created to protect the assets and, in the process, find their assets subject to an order of pre-judgment attachment.

Other Forms of Attorney Involvement

In addition to providing their clients with the means to carry out insurance fraud, some attorneys provide additional services, such as collection services that mask a factoring arrangement with their clients. In such instances, the attorneys will appear as counsel for medical providers, say, in a no-fault arbitration or no-fault suit (in no-fault insurance states) where they ostensibly are representing the provider who under most no-fault laws may seek payment for their services directly from the insurer.

Unbeknownst to the carrier, where such a factoring arrangement exists, the law firm is the real party in interest in the no-fault suit or arbitration, since it purchased the accounts receivables from its client, with the right to pursue and retain any proceeds recovered in the no-fault action. Of course, the law firm does not have standing to initiate its own suit to recover payment under the no-fault laws of most states. Therefore, it creates the fiction of suing in the name of the provider that billed the insurer for the services, but in reality will be the party that keeps any money awarded in the suit or arbitration. The provider, whose accounts receivable were purchased by the law firm, has no interest in the outcome of the litigation. If an insurer learns of such a relationship, it can be argued that the law firm is the true party in an interest in the no-fault dispute and as such lacks standing to recover no-fault benefits.

Organized Schemes to Defraud

As noted above, attorneys not only create the corporate structures from which their clients perpetrate their schemes to defraud, they are sometimes involved in their finances, including arranging for financing through factoring companies that they own. In addition to factoring arrangements, some attorneys supply important contacts to runners and people with access to police accidents. The runners, in turn, either pay individuals to participate in staged accidents that they orchestrate or to allow their names to be used in paper accidents in which the runners pay police officers or police aids for supplying blank police reports. Similarly, the attorneys often work in tandem with medical brokers, who are paid a fee for referring patients to a particular clinic or MRI facility, after being involved in a staged or paper accident. It should be noted that as part of its omnibus anti-insurance fraud legislation enacted last year, Florida recently outlawed MRI brokering services. See Fla. Stat. 627.732

A depiction of a typical scheme was detailed in connection with a press release issued by the United States Attorney Office for the Eastern District of New York on November 16,

2000 wherein it announced the arrests of 53 people who allegedly participated in a staged accident ring. A particular medical clinic and office clerk were accused of paying runners for staging accidents and billing insurance companies for services that by definition were medically unnecessary and/or that were never rendered. The press release contained the following chart of how the scheme operated, which reflects the typical flow of activity and money for this type of ring. Source: New York State Department of Insurance Press Release, November 16, 2000.

As attorneys, however, become a more intricate part of their clients scheme to defraud, future press releases and charts are likely to include the attorneys who provide the means and ability for their clients to execute their schemes to defraud.

Side-by-Side

As the lines between client and attorney continue to blur, the willingness of attorneys to become active participants in the fraud, or to make misrepresentations on behalf of their clients has proportionately increased as well. In doing so, in many instances, they now walk side-by-side, shoulder-to-shoulder, with their interests perfectly joined in their pursuit of insurance fraud.

Conclusion

The use of attorneys willing to actively participate in insurance fraud is on the rise. Insurance fraud is big business, costing the insurance industry billions of dollars each year. As such, an increasing number of attorneys are not merely creating the illegal corporate structure documents to circumvent professional corporate practice laws, but are also providing the financing and means to allow their clients to hide their money and identity from insurers. As such, insurers must add a new component to their investigative models, which now must include the ability to identify those law firms that do not merely represent suspect providers, but have joined the criminal enterprise. Once these firms are identified, it will easier to discover additional suspect providers and uncover potential leads involving integrated medical mills.

Endnotes

1. In some instances, the relationship between client and attorney can be so incestuous that, in addition to illegally owning a particular group of professional corporations, the client may also possess an interest in the factoring company that is owned by the attorney who established the client's illegally formed professional corporation.
2. See Title VIII of Education Law, enumerating the 38 professions licensed under New York State law.
3. Although, in *State Farm v. Mallela, et al.*, a recent decision by a federal district court judge in the Eastern District of New York, held, among other things, that an insurer did not have the right to deny claims based on violations of Article 15 of the BCL, for the reasons noted herein, many do not believe it is consistent with New York law or that it will ultimately be followed by the state courts of New York. Indeed, opinions issued by the New York State Department of Insurance and New York case law provides that when a corporation seeks to bill under its no-fault laws, it must be

licensed as a professional corporation; it is insufficient that the corporation employ licensed providers. To name but a few cases, in *Southern Medical Devices v. GEICO*, there was an arbitration award by a 3-arbitrator panel, affirmance by a master arbitrator and confirmation by the Supreme Court, New York County on this precise issue. See also *In the Matter of the Arb. Between Josephine McCarthy and Healthcare Recoveries, Inc. v. Allstate* (holding that the fact that services were provided by licensed professionals was irrelevant, since "it was not medical providers who sought reimbursement-but an unlicensed, non-professional out of state "Inc.," which sought payment" for the performance of professional services.) It has been consistently applied to no-fault health providers. See *Great South Bay v. Allstate* (EDNY), *Great South Bay v. State Farm* (EDNY), *North Bronx Medical v. State Farm* (Sup.Ct. NY County); *Advanced Care of New York, Inc. v. Friscoia* (Sup.Ct. Kings County); *Paramount Medical v. GEICO* (Civ.Ct. Queens County); *Progressive Northeastern Ins. Co., et al. v. Advanced Diagnostic and Treatment Medical P.C., et al.* (Sup. Ct. New York County); *Fordham v. State Farm* (Sup.Ct. NY County) and *Millennium Med. Diagnostics v. Nat'l Grange Ins. Co.*

Recently, in *State Farm v. North Bronx Medical Services, P.C.*, a New York State court judge rejected the federal decision in *State Farm v. Mallela*, as being in conflict with New York State law and affirmed an arbitration award against a professional corporation that was not incorporated in accordance with Article 15 of the BCL. Similarly, as noted above, in *Progressive Northeastern Insurance Company, et al. v. Advanced Diagnostic and Treatment Medical, P.C., et al.*, a New York State Supreme Court judge recently found that attempts to conceal noncompliance with Article 15 of the BCL supported a RICO and common law fraud action. In another recent decision, *Universal Acupuncture Pain Services, P.C. v. State Farm Mutual Automobile Insurance Company*, a federal judge similarly recognized there are many decisions holding that "an insurer has no obligation to pay no fault benefits for services performed by an unlawfully incorporated health care provider." Importantly, this decision was issued subsequent to *State Farm v. Mallela*. As indicated by the cases referred to herein, it is noted that the federal decision in *State Farm v. Mallela* is anomalous to the great body of New York case law and arbitration decisions holding that a corporation billing for professional services is not entitled to recover No-fault benefits if it is not incorporated in accordance with Article 15 of the BCL. Moreover, there have been at least 18 arbitration decisions and three decisions by federal judges and one decision by a federal magistrate that have similarly found contrary to the federal decision in *State Farm v. Mallela*, and in accordance with the well-established principles of New York State law that a corporation must be in compliance with Article 15 of the BCL to recover No-fault benefits. Accordingly, notwithstanding the decision in *State Farm v. Mallela*, it is our view that New York State law requires, as a matter of standing, that an entity billing for professional services be in compliance with the laws of New York State governing its profession before being entitled to recover No-fault benefits.

4. See Fla. Stat. 621.01, *et seq.*
5. Importantly, it should be noted that Florida Gov. Jeb Bush signed into law omnibus legislation designed to combat insurance fraud, which went into effect on October 1, 2001. The omnibus provisions included a clinic registration law, codified in Fla. Stat. 456.0375, which specifically allows laypersons and non-professionals to own registered professional clinics. As such, the statute allowing for registered clinic ownership by laypersons seems to conflict with the plain meaning and purpose of Florida's own laws governing the corporate practice of medicine. In doing so, the Florida Legislature appears to have created fertile ground for the proliferation of the doc-in-the-box scheme to take root in Florida.