New York Law Journal

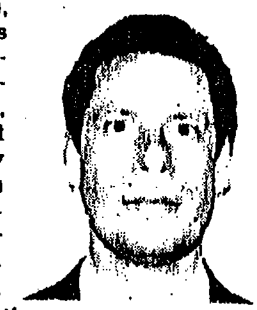
SERVING THE BENCH AND BAR SINCE 1888

VOLUME 214 - NO. 19 NEW YORK, FRIDAY, JULY 28, 1995 ©1995 New York Law Publishing Co. PRICE $2.50

OUTSIDE COUNSEL

By Robert A. Stern

What Insurers Need to Know About Investigating Claims



IN processing a claim, insurance companies routinely request information from a consumer reporting agency, which, if they are not careful, may inadvertently trigger the notification and disclosure requirements mandated under the federal Fair Credit Reporting Act (FCRA).[1] As the panoply of civil sanctions available to a successful consumer under the FCRA include actual damages, costs, attorneys fees and in some cases, punitive damages[2], in-house and outside counsel to insurers need to be aware of its potential application to their clients.

This article will review when communications between a consumer reporting agency and an insurance company are governed by the FCRA as well as suggest guidelines for counsel to follow in advising their clients on how to avoid liability under the Act.

Any analysis involving the application of the FCRA to the investigation of insurance claims must start with the intent and purpose behind its enactment, together with a review of the applicable definitional sections.

The legislative history accompanying the passage of the FCRA in 1970 indicates that Congress intended it to serve the dual purpose of ensuring the use of reliable and accurate credit reporting practices by consumer reporting agencies while simultaneously securing the confidentiality of the consumer reports they generate by limiting access to those having a specific, limited and legitimate purpose for its use.[3]

The FCRA "focuses on the rights of consumers by regulating the practices of credit [reporting] agencies and the recipients of their reports."[4] Generally, the strictures of the FCRA are invoked whenever a person[5] receives a consumer report or consumer investigative report in connection with eval-

Continued on page 4, column 4

Robert A. Stern, *a member of Aborn & Anesi, concentrates in insurance fraud and defense.* **Tracy Dennis**, *a student at New York Law School, assisted in the preparation of this article.*

OUTSIDE COUNSEL

What Insurers Need to Know About Investigating Claims

OUTSIDE COUNSEL

Continued from page 1, column 2

uating a consumer's[6] eligibility for credit, employment or insurance.

The FCRA defines a consumer report as any communication expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing a consumer's eligibility for "(1) credit or insurance to be used primarily for personal, family or household purposes, or (2) employment purposes, or (3) purposes authorized under 81681b."[7]

As noted below, the courts have consistently interpreted the inclusion of insurance in the definition of a consumer report to concern only the underwriting of insurance.[8] Accordingly, communications received by an insurance company that are not requested to determine a consumer's eligibility for insurance are generally regarded outside the scope of the Act.

A consumer investigative report, considered to be a species of the consumer report, is created whenever all or a portion of the report relating to the consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with others with whom the consumer is acquainted or may have knowledge of such information.[9]

To further confidentiality, the reasons for which consumer reporting

Continued on page 12, column 4

Continued from page 4, column 4

agencies are permitted to release consumer reports are circumscribed under the Act. Generally, such reports may be released to a person it has reason to believe intends to use the information to determine a consumer's eligibility for credit, insurance or employment.[10]

Under the Act, the recipient of a report is required to notify the consumer that it has obtained a report in two instances. First, when a consumer's application for credit, insurance or employment is denied based, in whole or in part, on the information contained in the report. Second, the recipient has requested a consumer investigative report in which case it must notify the consumer within three days of requesting such a report and disclose the same upon request.[11]

With respect to the former, the recipient who extends credit, employment or insurance to a consumer based on its review of a consumer report is not required to notify the consumer that it reviewed such a report in making its determination. The recipient's duty to notify is triggered only when it takes adverse action concerning a consumer's application for credit, employment or insurance.[12]

Moreover, while the recipient is responsible for notifying the consumer of the report in the situations noted above, its duty to disclose the actual report is restricted to cases where it has ordered a consumer investigative report. By contrast, in situations involving the denial of credit, employment or insurance to a consumer based on a consumer report, the recipient is not required to disclose the report to the consumer. Rather, the extent of its obligation is to inform the consumer of the name and address of the consumer reporting agency providing the information upon which it relied.[13]

Investigation of Claims

While reports from consumer reporting agencies are useful in helping insurance claims personnel evaluate the legitimacy of a particular claim, an emerging dichotomization within the federal judiciary requires insurance companies to examine the method in which they obtain these reports to avoid liability under the FCRA.

Generally, anytime an insurance company obtains a communication from a consumer reporting agency, the potential for liability arises under the Act. The threshold question becomes whether the communication qualified as either a consumer report or consumer investigative report. If a court determines that it was either, and the insurance company failed to comply with the notice or disclosure provisions, the insurer may be held liable for its noncompliance with the act.[14]

In *Houghton v. New Jersey Mfrs. Ins. Co.*[15], the court addressed the issue of when a communication between a consumer reporting agency and an insurance company investigating a claim is subject to the FCRA.

There the insurance company requested Equifax Services Inc. to conduct an investigation and prepare a written report to assist in evaluating a personal injury claim made against its insured.[16] Equifax submitted a three page report that was prepared based on interviews with neighbors, an examination of the claimant's available credit files and other relevant information.[17] Four years after the case was settled, the plaintiff learned of the report[18] and commenced an action based on the defendant's alleged violations of the notice and disclosure requirements set forth under the Act[19].

The district court held that the insurance company violated the Act since the communications between it and the consumer reporting agency qualified as a consumer investigative report. In so holding, the court relied primarily on two facts: First, part of the report was originally collected for evaluating a consumer's eligibility for credit, employment or insurance. Second, portions of the report were obtained through interviews, a method specifically referred to in the definition of a consumer investigative report.[20]

In reversing the district court's holding, the Third Circuit examined the definitional language of a consumer report and consumer investigative report and concluded that "nothing in the [insurance company's] request indicated that [it] desired a report on the [plaintiff] for a purpose encompassed within the statutory definition of an investigative report."

Furthermore, the court noted, the "request concerned only the genuineness of [plaintiff's] claim and not her eligibility for . . . credit, or insurance or employment . . . ." Importantly, the *Houghton* court's decision reflects the well-established interpretation that the inclusion of insurance in the definition of a consumer report relates exclusively to the underwriting of insurance and not the investigation of a claim for benefits under an existing policy.[21]

The *Houghton* court's opinion has been followed by Eleventh Circuit as well. In *Hovater v. Equifax Inc.*[22], an insurance company requested an investigative report from Equifax to use in evaluating a home fire loss claim

OUTSIDE COUNSEL

What Insurers Need to Know About Investigating Claims

E

that it believed may have been caused by the claimant. When the claimant Hovater learned of the report, he sued Equifax for negligently[23] releasing a consumer report for a purpose not authorized under the Act.[24]

The issue framed by the court was "whether the FCRA governs information given by a consumer reporting agency to an insurance company for the insurer's use in considering an insured's claim for benefits under an existing policy."[25]

Thus, the issue was identical to that before the *Houghton* court. Similarly, the court held that since the insurance company procured the report from Equifax solely for use in evaluating the insured's claim for benefits under an existing policy the report was not governed by the FCRA.

For insurance companies' investigating claims within the jurisdiction of the Third Circuit and Eleventh Circuit, the courts' holdings mean that they can do so with impunity under the FCRA, provided that the request is made solely with respect to the investigation of a claim.

Furthermore, while the *Houghton* and *Hovater* decisions provide significant security for insurance companies, they also create the potentially anomalous situation where a person or consumer reporting agency could conceivably never be held liable under the Act.

For example, under *Houghton* and *Hovater*, an insurance company that requests a report in connection with its investigation of a claim would be beyond the reach of the Act because it did not obtain the information for a purpose enumerated thereunder, i.e., credit, employment or insurance. Moreover, an insurance company that obtains a report for a permissible reason would likewise be protected because it met the definition of a consumer report.

Believing that Congress did not intend such an illogical result, other circuit courts have attempted to distance themselves from *Houghton* and *Hovater*.[26] In *St. Paul Guardian Ins. Co. v. Johnson*[27], for instance, the insurance company's investigators obtained a copy of their insured's preexisting credit report to assist in evaluating a property theft claim that it suspected was based on fraud. When the plaintiff insured learned of the report, he sued the insurance company for negligence[28] failing to comply with the requirements imposed under the Act.[29]

Although, as was the case in *Houghton* and *Hovater*, the insurance company specifically sought the report for use solely in evaluating a claim for benefits under a pre-existing policy, the Fifth Circuit found that was not determinative of whether the communication was governed by the Act.

Rather, relying on the definition of a consumer report, the court held that it was the purpose for which the report was originally prepared that dictates whether a communication is a consumer report under the FCRA.

Since the insurance company simply obtained a copy of a report that was originally collected to determine the insured's eligibility for credit, employment or insurance, the court concluded that the insurance company was bound by the FCRA with respect to the insured's credit report.[30]

In reconciling its holding with *Houghton* and *Hovater*, the court noted that those cases involved the generation of reports that were prepared solely for evaluating a specific claim under a specific insurance policy. In other words, unlike the insurance company in *Johnson*, the insurers in *Houghton* and *Hovater* did not rely on preexisting reports that were originally collected for a purpose set forth in the definition of a consumer report.[31]

The *Johnson* court's emphasis on the purpose for which the report is originally collected rather than on how it is ultimately used clearly represents the court's attempt to avoid the incongruous consequences that may flow from *Houghton* and *Hovater*. Indeed, it is apparent the court was cognizant that its holding was necessary to avoid making consumer reports releasable under all circumstances, a result that it clearly believed would obliterate the confidentiality safeguards built into the Act by Congress.

Based on the *Johnson* court's holding, a subtle dichotomy between the circuit courts has emerged. Whereas a court following *Houghton* will focus predominantly on the use of a particular report, one electing to observe *Johnson* will look to the original purpose for which the report was collected to determine whether a given communication received from a consumer reporting agency fits the definition of a consumer report. Both courts have their following.

In fact, while the only reported case in New York relating to the definition of the consumer report was decided well prior to the decisions noted above, its decision falls squarely within the *Johnson* rubric.

In *Boothe v. TRW Credit Data*[32], the court was asked to decide whether the release of information by a consumer reporting agency to a company to use against another business was governed by the act. The court ruled that the determinative factor was whether "the information in question was collected for one of the purposes provided in the Act."[33]

In searching the record, the court found that the report was originally collected for a purpose listed under §1681(d), the definition of a consumer report, and held that the communication was subject to the provisions of the FCRA. 6

While not involving an insurance company, the district court's decision may be indicative of how the Second Circuit will treat such cases in the future. Indeed, if it is adopted, insurance companies will have to be guided by the lessons of *Boothe* and *Johnson*.

Conclusion

Counsel to insurance companies that regularly request and receive communications from consumer reporting agencies in connection with evaluating a claim, would be well advised to err on the side of caution and instruct their clients to follow the court's holding in *Johnson*.

That is, first only obtain consumer reports or consumer investigative reports in connection with a review of a claim submitted for benefits under a preexisting policy.

Second, insurers should be counseled to order reports that are generated solely for their evaluation of a specific claim. Third, since a preexisting report may have been originally collected for a FCRA purpose, insurers should never ask for or use copies of previously prepared reports in reviewing a party's claim.

Finally, if an insurer has reason to believe that it has come into possession of a consumer investigative report, it should be advised that it is subject to the FCRA and is therefore required to comply with the same.

OUTSIDE COUNSEL

What Insurers Need to Know About Investigating Claims

H

(1) 15 U.S.C.A. 1681, et seq. In addition, most states have adopted complimentary statutes to provide a consumer with state remedies as well. See, e.g., N.Y. GEN. BUS. LAW sect. 380, et seq.

(2) See 15 U.S.C.A. 1681n (subjecting consumer reporting agencies and users of consumer reports to, inter alia, punitive damages for their willful failure to comply with the requirements of the FCRA); 15 U.S.C.A. 1681o (imposing civil liability upon consumer reporting agencies and users of consumer reports who negligently fail to comply with the requirements of the FCRA); 15 U.S.C.A. 1681q (providing for penal sanctions against any person who knowingly and willfully obtains a consumer report or consumer investigative report under false pretenses.)

(3) See 1970 U.S. CODE CONG. & ADMIN. NEWS, P. 4394. See also St. Paul Guardian Ins. Co. v. Johnson (5th Cor. 1989); Hovater v. Equifax, Inc., 823 F.2d. 413 (11th Cir. 1987).

(4) Hovater, 823 F.2d. at 417

(5) Section 1681a(b) defines a "person" as "any individual , partnership, corporation . . . . or other entity. "

(6) Section 1681a(c) defines a "consumer" as an individual.

(7) 15 U.S.C.A. 1681a(d).

(8) See Cochran v. Metropolitan Life Ins. Co. 472 F.Supp. 827, 831 (N.D. Ga. 1979) (concluding that the "term 'consumer report' as defined . . . includes only those reports prepared to determine an applicant's eligibility for 'insurance to be used primarily for personal, family, or household purposes . . . .' 15 U.S.C. sect. 1681(d)(1). or furnished in connection with the underwriting of insurance involving the consumer . . . sect. 1681b(3)(c)."); Hovater, 823 F.2d. at 418; St. Paul Guardian Ins. Co. v. Johnson, 884 F2d 881, 885.(5th Cir. 1989); Ippolito v. WNS, Inc., 864 F.2d 440, 451 (7th Cir. 1988).

(9) 15 U.S.C.A. 1681a(e).

(10) 15 U.S.C.A.1681b. This section also permits the release of consumer reports in "(1) . . . response to the order of a court having jurisdiction to issue such an order[,] [2] in accordance with the written instruction of the consumer to whom it relates[,] [and] [3] to a person which [the consumer reporting agency] has reason to believe [E] . . . has a legitimate business need for the information in connection with a business transaction involving the consumer." The issue of what qualifies as a legitimate business need has been the subject of much litigation. Due to space limitations, this issue is not addressed, save for noting that most courts have limited the application of the business transaction language of section 1681b(3)(E) to the definition of a consumer report. See Houghton v. New Jersey Mfrs. Ins. Co., 795 F.2d 1144, 1147 (3rd Cir. 1986) (following Cochran v. Metropolitan Life Ins. Co. 472 F.Supp. 827, 831 (N.D. Ga. 1979). See also Hovater v. Equifax, Inc., 823 F.2d. 413 (11th Cir. 1987); Ippolito v. WNS, Inc., 864 F.2d 440, 451 (7th Cir. 1988). But cf. Beresh v. Retail Credit Co., 358 F.Supp. 260 (C.D. Cal. 1973) (adopting an expansive interpretation of a business transaction, 1681b(3)(E), and holding that insurance claims reports are governed by the FCRA.)

(11) 15 U.S.C.A. 1681d. See also Houghton v. New Jersey Mfrs. Ins. Co., 795 F.2d 1144, 1147 (3rd Cir. 1986) (explaining notification requirements under the FCRA).

(12) Houghton 795 F2d at 1147.

(13) See 15 U.S.C.A. 1681m. See also Houghton 795 F2d at 1147.

(14) See generally Houghton v. New Jersey Mfrs. Ins. Co., 795 F.2d 1144, 1147 (3rd Cir. 1986); Hovater v. Equifax, Inc., 823 F.2d. 413 (11th Cir. 1987); St. Paul Guardian Ins. Co. v. Johnson, 884 F2d 881, 885.(5th Cir. 1989); Ippolito v. WNS, Inc., 864 F.2d 440, 451 (7th Cir. 1988).

(15) 795 F.2d 1144.

(16) Id. at 1146.

(17) Id.

(18) See 15 U.S.C.A. 1681g(a)(3) (requiring consumer reporting agencies to identify all recipients of consumer reports upon a consumer's request). See also Houghton 795 F.2d at 1147, n.4.

(19) Houghton 795 F.2d at 1146.

(20) See Houghton 795 F.2d 1149.

(21) See Hovater, 823 F.2d at 416 (11th Cir. 1987).

(22) 823 F.2d 413 (11th Cir. 1987).

(23) Consumer reporting agencies that negligently fail to comply with the requirements of the FCRA are subject to civil liability. See 15 U.S.C.A. 1681(o).

(24) See Hovater, 823 F.2d at 416. (citing 15 U.S.C.A. 1681b).

(25) Id. at 417

(26) See St. Paul Guardian Ins. Co. v. Johnson, 884 F2d 881, 885.(5th Cir. 1989); Ippolito v. WNS, Inc., 864 F 2d 440, 451 (7th Cir. 1988); Heath v. Credit Bureau of Sheridan, Inc., 681 F.2d 693 (10th Cir. 1980); Hansen v. Morgan, 582 F.2d 1214 (9th Cir. 1978).

(27) 884 F.2d 881.

(28) Users of information that negligently fail to comply with the requirements of the FCRA are subj[illegible] liability. See 15 U.S.C.A. 1681(o).

(29) See St. Paul Guardian Ins. Co., 884 F.2d at 885.

(30) Id.

(31) Id.

(32) [illegible] F.Supp. 631 (S.D.N.Y. 1981).

(33) Id. at 634.